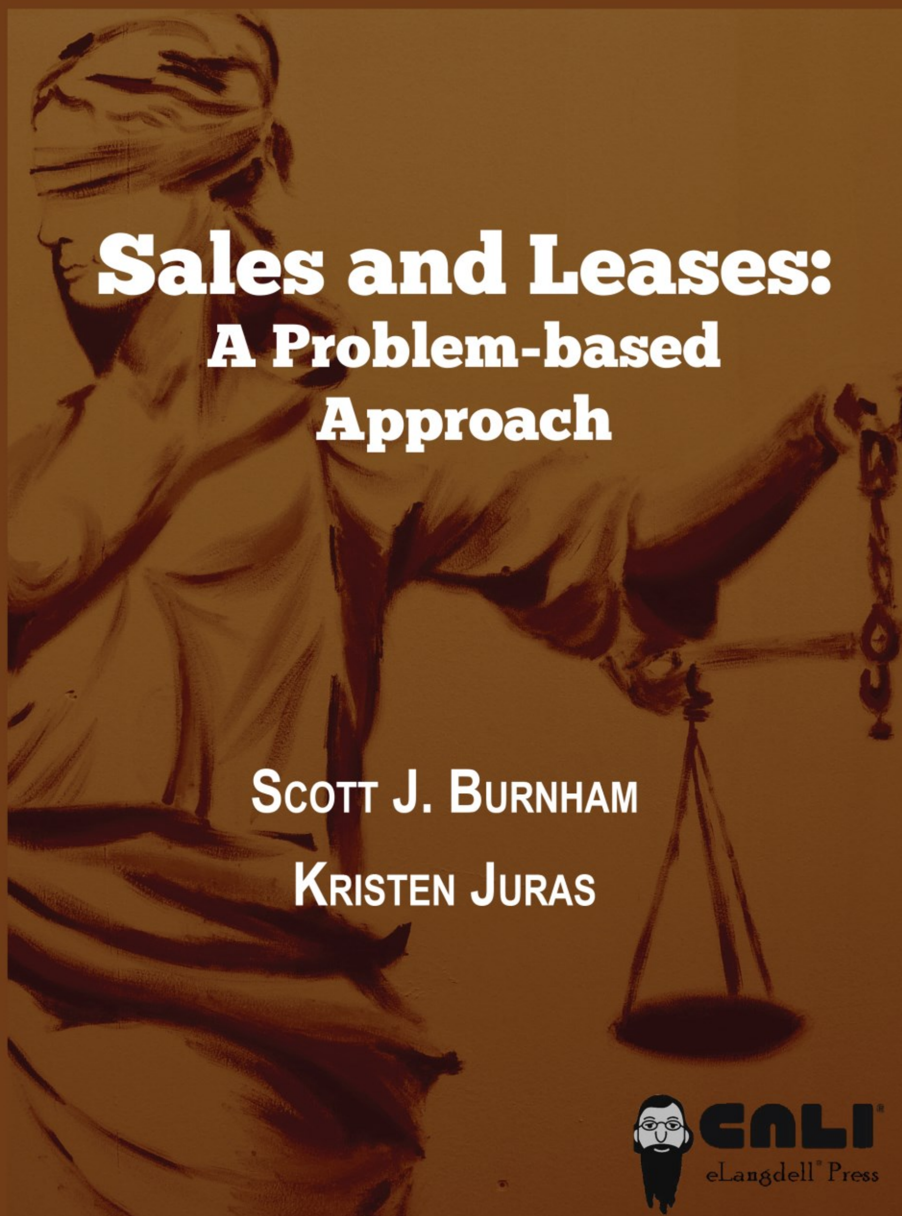


Sales and Leases:
A Problem-based Approach

Scott J. Burnham

Kristen Juras

CALI
eLangdell® Press

SALES AND LEASES: A Problem-based Approach

Scott J. Burnham
Curley Professor of Law
Gonzaga University School of Law

Kristen Juras
Professor of Law
The University of Montana School of Law

CALI eLangdell Press 2016

About the Authors

Professor Scott J. Burnham teaches in the areas of contracts, commercial law, and intellectual property. Professor Burnham received his J.D. and LL.M. degrees from New York University School of Law in 1974 and 1981. Between degrees, he practiced in New York City with London, Buttenweiser, Bonem & Valente, and then as a sole practitioner. He has been a visiting professor at Santa Clara, Tennessee, Western New England, Memphis, UNLV, Hawaii, Ohio State, Cardozo, Montevideo (Uruguay), and Vytautas Magnus (Lithuania). He is the author of numerous law review articles in the fields of contracts, consumer law and legal education, and two books on drafting published by The Michie Company: The Contract Drafting Guidebook, which is written for practitioners, and Drafting Contracts, 2nd ed., which is written for law students. He is a member of the ALI.

Professor Kristen Juras has taught contracts, UCC Article 2, property, business, international law and other classes at the University of Montana School of Law since 2000. She is the coauthor of the Law of the Sea in a Nutshell (West 2009) and Cases and Materials on the Law of the Sea (Brill 2015). Prior to teaching, Professor Juras practiced transactional and commercial law for more than twenty years, including serving as general counsel for a publicly traded corporation.

About CALI eLangdell Press

The Center for Computer-Assisted Legal Instruction (CALI®) is: a nonprofit organization with over 200 member US law schools, an innovative force pushing legal education toward change for the better. There are benefits to CALI membership for your school, firm, or organization. ELangdell® is our electronic press with a mission to publish more open books for legal education.

How do we define "open?"

- Compatibility with devices like smartphones, tablets, and e-readers; as well as print.
- The right for educators to remix the materials through more lenient copyright policies.
- The ability for educators and students to adopt the materials for free.

Find available and upcoming eLangdell titles at elangdell.cali.org. Show support for CALI by following us on Facebook and Twitter, and by telling your friends and colleagues where you received your free book.

Notices

This is the first edition of this casebook, updated March, 2016. Visit http://elangdell.cali.org/ for the latest version and for revision history.

Table of Contents

Chapter 1. Introduction to the Uniform Commercial Code and Article 1

1.1. History of the UCC. As interstate commerce grew, so did the need for national uniformity in laws applicable to commercial transactions. Under the leadership of Professor Karl Llewellyn, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) (which is now known as the Uniform Law Commission or ULC) promulgated the Uniform Commercial Code (UCC or Code), which was first enacted by a state in 1953. Today, all states have enacted most parts of the UCC, although there are some variations. Louisiana is the only state that has not enacted Article 2.

> 1.1.1. Article 1 of the UCC contains general provisions that, according to Revised § 1-102, apply when a transaction is governed by another article of the UCC. For example, statements of purpose, rules of construction, and general definitions are contained in Article 1. In 2001, the ULC promulgated changes to Article 1; these changes are known as Revised Article 1. Most states have adopted Revised Article 1, although none has enacted it in its uniform version. For a tally of adopting states, see the web site of the Uniform Law Commission at http://www.uniformlaws.org.
>
> Note the three significant changes that Revised Article 1 made to former Article 1. It (1) clarifies that Article 1 applies only to Code transactions, (2) clarifies that the concept of course of performance applies throughout the Code, and (3) redefines good faith. When a jurisdiction enacts Revised Article 1, it also makes a few changes to Article 2 to coordinate with the changes in Article 1.
>
> 1.1.2. In 1999, the ALI voted to support a draft Revised Article 2, but the ULC did not support it, probably because of the perceived difficulty of enacting such a substantial revision in the states. In 2003, the ULC drafted a less radical version known as Amended Article 2. In May 2011, the ULC and the ALI agreed to withdraw Amended Article 2 from consideration by the states. No state has enacted either Revised Article 2 or Amended Article 2. Nevertheless, reference to the proposed revisions may be valuable for seeing the clarifications that were made to the existing text.
>
> The bottom line is that a statute more than 50 years old governs modern commercial transactions. As we will see, the Code has a great deal of flexibility in the joints to accommodate change, but there will be many strains put on it.
>
> 1.1.3. Unless otherwise indicated, when these materials cite sections from Article 1 and Article 2, this refers to the sections as found in Revised Article 1 and the pre-2003 version of Article 2 as amended to reflect Revised Article 1. When researching the law of a particular jurisdiction, you will have to determine (1) whether that jurisdiction has

enacted Revised Article 1, and (2) whether that jurisdiction adopted any nonuniform provisions when it enacted the Code.

These materials sometimes include a **Research Assignment** that invites you to determine or apply the rule adopted in a particular jurisdiction.

1.1.4. Most of the Code sections are followed by Official Comments (which we often simply refer to as "Comment" throughout these materials). In most jurisdictions, these have not been enacted by the legislature. Therefore, they are only persuasive authority. However, because they are promulgated by the drafters of the statute, they are highly persuasive. The Official Comments can be useful for (1) putting the section in context, (2) elaborating on the principles involved in the section, and (3) guiding interpretation to preserve uniformity.

1.2. Purposes of the UCC. Always keep in mind the general *purposes* of the UCC, as set forth at § 1-103:

(1) To *simplify, clarify, and modernize* the law governing commercial transactions;

(2) To permit the continued expansion of commercial practices through *custom, usage, and agreement* of the parties; and

(3) To *make uniform* the law among various jurisdictions.

Regarding this last purpose, consider this analysis by Judge Posner in *Northrop Corp. v. Litronic Industries*, 29 F.3d 1173, 1175, 1178 (7th Cir. 1994):

> Unfortunately, the Illinois courts – whose understanding of Article 2 of the UCC is binding on us because this is a diversity suit governed, all agree, by Illinois law – have had no occasion to choose among the different positions on the consequences of an acceptance that contains "different" terms from the offer. We shall have to choose....
>
> The Uniform Commercial Code, as we have said, does not say what the terms of the contract are if the offer and acceptance contain different terms, as distinct from cases in which the acceptance merely contains additional terms to those in the offer. The majority view is that the discrepant terms fall out and are replaced by a suitable UCC gap-filler.… The leading minority view is that the discrepant terms *in the acceptance* are to be ignored.… Our own preferred view – the view that assimilates "different" to "additional," so that the terms in the offer prevail over the different terms in the acceptance only if the latter are materially different, has as yet been adopted by only one state, California….
>
> Because Illinois in other UCC cases has tended to adopt majority rules …, and because the interest in the uniform nationwide application of the Code – an interest

> asserted in the Code itself (see [§ 1-103(a)(3)]) – argues for nudging majority views, even if imperfect (but not downright bad), toward unanimity, we start with a presumption that Illinois, whose position we are trying to predict, would adopt the majority view.…

Problem 1-1. You are litigating a case in the state of Washington involving a particular section of UCC Article 2 which has not been addressed by the Washington Supreme Court, but has been addressed by courts in other jurisdictions. What weight should the Washington Supreme Court give to the decisions of other jurisdictions? Mandatory, persuasive, or something in-between?

1.3. Variation of UCC Provisions by Agreement. Although some provisions of the UCC are mandatory and cannot be varied (discussed below), most provisions are intended to be "default" provisions that govern in the absence of a differing agreement by the parties. See Scott J. Burnham, *Is UCC Article 2 Facilitatory or Regulatory?* 68 Ohio St. L. J. 57 (2007).

1.3.1. The principle of *freedom of contract* (which you should always be prepared to argue to a court) is alive and well under the UCC. Section 1-302(a) provides:

> Except as otherwise provided in subsection (b) or elsewhere in the UCC, the effect of provisions of the UCC *may be varied by agreement*. (emphasis added)

After they finished, the Code drafters realized that sometimes they stated that a provision governed "unless otherwise agreed" and sometimes they didn't. They then included § 1-302(c) to make clear that when they failed to say it, they did not mean that the parties cannot otherwise agree.

Query: Do parties have the freedom of contract to opt out of the UCC when it would otherwise apply? To opt into the UCC when it would not otherwise apply? See § 1-302, Official Comment 2.

Problem 1-2. Although the UCC allows a *buyer* to recover reasonably foreseeable consequential damages arising from a breach, the UCC does not provide for a *seller* to recover consequential damages. See §§ 2-708, 2-713. In a transaction involving goods, the parties agree to the following provision: "In the event of a breach, both Seller and Buyer may recover from the breaching party all damages arising from the breach, including reasonably foreseeable consequential damages." If all the elements of are established, will the seller be entitled to recover consequential damages? See also § 1-305.

What difference does it make that Amended Article 2 provides in § 2-708 that "the measure of [seller's] damages for nonacceptance by the buyer is the difference between the contract price and the market price at the time and place for tender together with any incidental or consequential damages provided in Section 2-710"?

1.3.2. Although § 1-302(a) provides the general rule that the parties may vary the UCC default rules by agreement, under § 1-302(b) the parties *may not* disclaim any of the following obligations prescribed by the UCC:

(1) *good faith* (see § 1-304);
(2) *diligence* (see, for example, the use of *"due diligence"* in the context of notice at § 1-202(f) and "*reasonable diligence*" in the context of notice of dishonor at § 3-504);
(3) *reasonableness* (see, for example, the requirement of reasonable notice of termination at § 2-309(3)); and
(4) *care* (see, for example, buyer's duty to hold rejected goods with reasonable care at § 2-602(b)).

Although these obligations cannot be disclaimed by agreement of the parties, standards of performance intended to satisfy these requirements may be specified, as long as such standards are not manifestly unreasonable. See Scott J. Burnham, *Setting Standards under Sections 1-302 and 9-603*, 1 The Transactional Lawyer 3 (Aug. 2011), available at http://www.law.gonzaga.edu/files/Transactional-Lawyer-Aug2011.pdf.

Problem 1-3. In defining when a buyer's acceptance of goods occurs, § 2-606 refers to a "reasonable opportunity to inspect." Your client has recently opened a retail computer store, and he wants you to draft a standard purchase agreement governing the sale of personal computers to his customers.

(1) Can the agreement provide that the buyer waives the reasonable opportunity to inspect?

(2) Can the agreement provide that the purchaser has a certain minimum time to inspect? What factors would you consider in coming up with this time frame?

1.3.3. In addition to providing that the obligations of good faith, diligence, reasonableness and care prescribed by the UCC may not be disclaimed, § 1-302(a) contains a second limitation on the parties' freedom to contract: "except as otherwise provided ... *elsewhere* in the UCC." (emphasis added) In other words, throughout the UCC there are mandatory provisions which may not be modified by contract. Some provisions expressly state that they may not be varied by contract. However, others may not be so labeled.

Problem 1-4. Determine whether the following provisions of Article 2 may be varied by agreement of the parties:

(1) The statute of limitations in § 2-725(1).
(2) The statute of frauds in § 2-201(1).
(3) The requirement in § 2-309(3) that a terminating party provide notice of termination of a contract.

(4) The requirement in § 2-511 that tender of payment is a condition to seller's duty to deliver the goods.
(5) The requirement in § 2-602 that a buyer seasonably notify the seller of rejection.

1.4. Good Faith. Section 1-304 states that the obligation of good faith applies throughout the Code, and § 1-201(b)(20) defines it. Recall that § 1-302(b) states that this obligation cannot be disclaimed by the parties.

> 1.4.1. *Good faith* is defined at § 1-201(b)(20) as "honesty in fact and the observance of reasonable commercial standards of fair dealing." The pre-2001 version of Article 1 applied the subjective standard of "honesty in fact" to all parties. However, for purposes of Article 2, former § 2-103(1)(b) applied the additional objective requirement of "observance of reasonable commercial standards of fair dealing" to merchants (the definition of which is discussed in Chapter 2). Thus, it is very important in applying this concept to ascertain what version of Article 1 has been adopted in the jurisdiction involved. Before applying precedent, determine whether the case you are citing applies the old standard or the new standard. For non-merchants, if there was not good faith under the old standard, then there would not be good faith under the new standard; but if there was good faith under the old standard, then there is not necessarily good faith under the new standard.

Research Assignment 1-1. Which version of the definition of "good faith" applies in your chosen jurisdiction?

Problem 1-5. Aunt Martha is not a merchant. She recently sold her car to her nephew, a law student. The written purchase agreement provides that the purchase price of $10,000 shall be paid in 36 monthly installments. However, there is a provision that gives Aunt Martha the option to accelerate the payment date and declare the entire amount due "at will." See § 1-309. When Aunt Martha learned that her nephew failed his Sales and Leases Class in his second year of law school, Aunt Martha declared the entire unpaid balance of the purchase price due. The nephew had insufficient funds to pay her back in full. The nephew sued Aunt Martha for breach of the duty of good faith.

(1) Under the old definition of good faith, what would the nephew have to prove? How could he prove it?

(2) Under the new definition of good faith, what would the nephew have to prove? How could he prove it?

1.5. Unconscionability. Section 2-302 addresses *unconscionability* in contracts for the sale of goods. Although unconscionability is expressly found in the Code only in Article 2 and in Article 2A (Leases) at § 2A-108, as explained in the *Williams* case discussed below, it is a common law concept and probably supplements all Code transactions under § 1-103(b). Curiously, California did not enact § 2-302. This seems shocking until your realize that the provision was codified with the general Contracts statutes at Civil Code § 1670.5 to make clear that it applies to *all* contracts and not just to those involving transactions in goods.

1.5.1. The statute does not define "unconscionability," probably because defining it might limit it and the concept is intended to be applied in many different circumstances. However, Official Comment 1 states:

> The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.

It is not exactly helpful to say that a term is unconscionable if it is unconscionable.

The case of *Williams v. Walker-Thomas Furniture Co*., 350 F.2d 445, 449 (D.C. Cir. 1965) laid out the two elements courts usually look for when confronted with an issue of unconscionability:

> Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.

The element of "absence of meaningful choice" is sometimes referred to as ***procedural unconscionability***. The inquiry is into how the parties came to enter into the transaction. The element of "unreasonably favorable terms" is sometimes referred to as ***substantive unconscionability***. As the *Williams* court went on to say, the inquiry is "whether the terms of the contract are so unfair that enforcement should be withheld." *Id*. at 450. Many, but not all, courts require both elements to be present to support a finding of unconscionability. See, e.g., *Arrowhead School Dist. No. 75, Park Co., Montana v. Klyap*, 79 P.3d 250, ¶ 48 (Mont. 2003).

1.5.1.1. *Procedural unconscionability*: Generally, courts find unconscionability only when there is a "contract of adhesion," a contract that is prepared in advance of the transaction by a stronger party who offers it to a weaker party who has no alternative but to agree to the terms. Of course, one alternative is to walk away, so some courts are less willing to find unconscionability when the market offers a choice.

1.5.1.2. *Substantive unconscionability*: A claim of unconscionability usually arises when the party with all the bargaining power uses that power to include unfair terms in a contract with which the other party must agree. What makes a term so unfair that a court refuses enforcement? Obviously, the standard is subjective and flexible. However, § 2-302(2) provides some guidance:

> When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

1.5.2. Most cases of unconscionability involve a consumer who agreed to a contract of adhesion. This makes sense, for if a party were able to negotiate the terms of a contract, it should not later be heard to complain that it agreed to unfair terms. Although business owners may have a more difficult time establishing procedural unconscionability because they are often viewed by courts as possessing "a greater degree of commercial understanding and substantially more economic muscle than the ordinary consumer …, generalizations are always subject to exceptions and categorization is rarely an adequate substitute for analysis." Several courts have recognized that "experienced but legally unsophisticated businessmen may be unfairly surprised by unconscionable contract terms." *A & M Produce Co. v. FMC Corp*., 135 Cal. App. 3d 473, 489 (1982). See also *Bridge Fund Capital Corp. v. Fastbucks Franchise Corp.*, 622 F.3d 996, 1004 (9th Cir. 2010), in which the court found certain terms in a franchise agreement between two businesses to be unconscionable, noting that "California courts have long recognized that franchise agreements have some characteristics of contracts of adhesion because of the 'vastly superior bargaining strength' of the franchisor."

1.5.3. Several courts employ a sliding scale between the two elements of unconscionability. If there is a great deal of procedural unconscionability, then less substantive unconscionability is needed to support the finding of unconscionability. On the other hand, if there is little procedural unconscionability, then a great deal of substantive unconscionability is needed to support the finding. See, for example, *Donovan v. RRL Corporation*, 27 P.3d 702, 723 (Cal. 2001), in which the court refused to enforce a contract for the sale of a car advertised at a mistaken purchase price because of substantive unconscionability , even though there was little evidence of procedural unconscionability.

1.5.4. Note that the determination of whether a contract or a term is unconscionable is to be made as of "the time [the contract] was made." § 2-302(1). If the effect of a term turns out to be unfair later, it is probably not unconscionable. For example, in *J.L. McEntire & Sons, Inc. v. Hart Cotton Co., Inc*., 511 S.W.2d 179 (Ark. 1974), cotton growers agreed to sell their crop at a certain price when the crop was delivered at harvest time. When that time came, the market price had doubled. The sellers claimed that the contract was unconscionable, but the court held that it was fair at the time, and "prices could have fallen as easily as they could have risen." *Id.* at 183.

1.5.5. What can a court do if it determines that a clause is unconscionable? The alternatives set forth in § 2-302(1) are:

> (1) refuse to enforce the contract in its entirety;
> (2) enforce the contract without the unconscionable clause; or
> (3) limit the application of an unconscionable clause (*i.e.*, partial enforcement in a way which is not unconscionable).

1.5.6. Unconscionability is one of the provisions in the Code that the parties are not free to disclaim.

Practice Tip: If a drafter is concerned that a term may appear to be unfair, the drafter may wish to include some recitals that explain why it is reasonable in light of commercial practices or the circumstances of the parties.

Problem 1-6. Educational Materials Company sells a package of educational materials entitled "Junior Institute," which is advertised to prepare toddlers for elementary school. Company employees solicit sales door-to-door in areas that the company has identified as having high numbers of residents with limited education and economic means. The purchase price of $600 is three to four times higher than comparable educational products. Ninety-nine percent of purchasers elect to pay the purchase price in 36 monthly installments (rather than cash); interest is charged at the highest rate allowed by law. The salesman allows the consumer to examine the materials at the time of solicitation, and immediately delivers a complete set of materials to the purchaser if a sale is concluded. At the time of sale, the consumer is presented with a contract containing three pages of fine print. Salesmen are not authorized to make any changes to the contract. In compliance with federal consumer protection laws, the contract allows the consumer to cancel the contract within three business days after the purchase for a full return of the purchase price. The contract provides that the contract may not be terminated after this three-day cancellation period for any reason, and disclaims in bold print in the middle of the contract any express or implied warranties.

After making three of her monthly installment payments, a 22-year old purchaser terminated the contract, after reading a review rating the Junior Institute program at 1.5 on a scale of 1 (poor) to 10 (superior). She also discovered, while reading the review, that several similar but more highly rated toddler packages could be purchased for prices ranging between $150 and $200. Educational Materials Company filed a judicial proceeding to collect the balance owing on the contract, plus all of its attorney's fees and expenses, pursuant to a clause requiring the consumer to pay any attorney's fees and expenses incurred by the company in any legal proceeding arising under the contract (and which does not contain a reciprocal attorneys fee clause in favor of the consumer). The mother raised the argument that the contract should not be enforced against her because it is unconscionable.

(1) What factors should the consumer's attorney rely upon to support an argument that the contract is procedurally unconscionable?

(2) What factors should the consumer's attorney rely upon to support an argument that the contract is substantively unconscionable?

(3) If you determine that the contract or portions thereof are unconscionable, what would be the appropriate remedy?

1.6. Hierarchy of Construction. The UCC provides rules of construction in interpreting the terms of the parties' contract.

> 1.6.1. First, you need to understand the definition of both *contract* and *agreement* under the UCC. Let's start with the term *agreement*, which is defined at § 1-201(b)(3) as comprising the following elements:
>
> > (1) the bargain of the parties in fact as determined from their language and the circumstances;
> > (2) course of performance;
> > (3) course of dealing; and
> > (4) usage of trade.
>
> 1.6.2. Under § 1-201(b)(12), a *contract*, as distinguished from an *agreement*, means the total legal obligation that results from the agreement as determined by the UCC (such as gap-fillers) and supplemental laws. For example, if I say that I will sell you ten grams of cocaine for $1,000 and you agree, we have made an agreement on those terms and you have probably impliedly agreed to pay cash on delivery, but we have not made a contract.
>
> 1.6.3. Note that the definitions in § 1-201 apply throughout the UCC, including, for example, Article 2A (Leases), Article 3 (Commercial Paper), and Article 9 (Secured Transactions). A separate list of definitions also appears within each Article. See, for example, §§ 2-103 through 2-106. If you run across an unfamiliar term, *always* check for a definition provided elsewhere in the UCC. You should even check for definitions of familiar terms. You might assume, for example, what constitutes a writing or what the term "signed" means. Now look at how those terms are defined at § 1-201. Look also at the Official Comment for the term "signed" for further insight. Note, however, that § 1-201(a) provides that the definition applies "unless the context requires otherwise."
>
> 1.6.4. Now, let's go back to the term "agreement." In addition to the "bargain of the parties," (*i.e.*, terms specifically agreed upon by language, conduct, or other circumstances), the UCC incorporates three important other sources of terms into the parties' agreement: *course of performance, course of dealing*, and *usage of trade.* These terms are defined at § 1-303:

1.6.4.1. *Course of performance* arises when there are repeated occasions for performance of *this particular contract* by the parties, and the repeated performance by one party is accepted by or acquiesced in by the other. For example, an installment contract would give rise to course of performance. See § 1-303(a).

1.6.4.2. *Course of dealing* is a sequence of conduct concerning *previous transactions* between the parties that is fairly to be regarded as establishing a common basis of understanding for interpreting a future agreement. See § 1-303(b).

1.6.4.3. *Usage of trade* is any practice or method of dealing having such regularity of observation in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. See § 1-303(c).

Query: Are you bound by a trade usage if you are not in the trade? See § 1-303, Official Comments 3 and 4.

Problem 1-7. Identify each of the following as course of performance, course of dealing, or usage of trade:

(1) On several previous occasions, a law firm has ordered stationery from a local paper company. The orders are less than $500 each, and the offer and acceptance are completed orally over the phone each time. On each prior sale, the law firm paid within 30 days of delivery. When the company delivered the next order, it insisted on payment upon delivery. When is payment due?

(2) An agreement provides for monthly delivery of books by Caselaw Publishing Group to Cheapbooks.com for resale. The agreement is silent as to the delivery date. The publisher delivered between the 5th and the 10th day of each month for the first three months of the agreement, and Cheapbooks.com accepted the deliveries without complaint. In the 4th month, Cheapbooks.com complained that a delivery made on the 10th is late. Is it?

(3) Poulsen's Hardware Store ordered 1,000 feet of 2"x4" lumber boards from Seeley Swan Mill. A recognized industry publication allows a variance of up to 10% in the number of feet delivered. Seeley Swan Mill delivered 950 feet. Is the mill in breach?

1.6.5. Now read § 1-303(e). What happens if there is a conflict between the terms of the parties' agreement, and, for example, usage of trade? What if there is a conflict between, for example, the parties' course of performance and any mandatory provisions of the UCC?

Problem 1-8. Number from 1 through 6 the priority of the following sources of terms of the parties' contract:

___Course of dealing	___Course of performance	___Express terms
___Usage of trade	___Mandatory UCC provisions	___UCC default provisions

Problem 1-9. Apply the § 1-303 hierarchy to the following situations:

(1) You sell me a machine. The contract provides you will service it "every week." You find out that in the trade, these machines are serviced monthly, so you want to switch to monthly service. Can you?

(2) You sell me a machine. The contract provides you will service it "regularly." For a year, you service it every week. You find out that in the trade, these machines are serviced monthly, so you want to switch to monthly service. Can you?

(3) You sell me a machine every year for three years. Each contract provides you will service it "regularly." During each of these three years, you have serviced the machine every week. In the fourth year, you sell me another machine. The contract provides you will service it "regularly." When you don't show up the first week, I call and ask you to come service the machine. You say you only have to service it monthly, because that is the trade practice. Are you right?

(4) In the fifth year, you sell me a machine. The contract provides you will service it "regularly." You service it monthly for the first six months, and I don't object until the seventh month, when I claim you are in breach because you serviced the previous machines every week. Are you in breach?

> 1.6.6. In the hierarchy, the express terms of the parties' agreement trumps course of performance. However, under § 1-303(f), if the parties' course of performing a particular agreement varies from the express terms of the agreement, the conduct may constitute a waiver or modification of the term. We discuss waiver and modification in Chapter 9.

Problem 1-10. An agreement provides for monthly delivery of books by Caselaw Publishing Group to Cheapbooks.com for resale. The agreement provides for delivery on the 1st day of each month. The publisher delivered between the 5th and the 10th day of each month for the first three months of the agreement, and Cheapbooks.com accepted the deliveries without complaint. In the 4th month, Cheapbooks.com complained that a delivery made on the 10th is late. Is it? Does Cheapbooks.com have any recourse?

1.7. Supplementation by Other Law. Section 1-103(b) provides that *unless displaced* by a particular provision of the UCC, the principles of law and equity supplement the provisions of the UCC. Specific examples given of such supplementing laws and equitable principles include:

> (1) the law merchant (what the heck is that?);
> (2) capacity to contract, duress, coercion, mistake (issues going to the validity of a contract);
> (3) estoppel;
> (4) fraud and misrepresentation;
> (5) bankruptcy;
> (6) principal and agency relationships; and
> (7) "other validating or invalidating cause" (huh?).

For example, in *Daniels-Sheridan Federal Credit Union v. Bellanger*, 36 P.3d 397 (Mont. 2001), Smith, a seller of cattle on credit who did not secure his interest under Article 9, claimed that he had an "equitable" interest in the cattle that was superior to the interest of a creditor who had a perfected security interest in the cattle pursuant to Article 9, and that the secured creditor would be "unjustly enriched" if Smith's prior equitable interest were not recognized. In rejecting his arguments, the court stated:

> ¶40 In *Northwest Potato Sales, Inc. v. Beck* (1984), 208 Mont. 310, 678 P.2d 1138, a potato dealer appealed a district court's dismissal of its breach of contract claim which was based on Charles Beck's failure to honor a contract to sell it seed potatoes. Beck asserted a statute of frauds defense on the basis he had never signed the written contract signed by the potato dealer and forwarded to him. The potato dealer raised estoppel as a bar to the defense. We reversed, holding that Beck had both actively and passively led the potato dealer to believe the written contract would be honored and, as a result, Beck was estopped from asserting a statute of frauds defense to the contract action. In doing so, we rejected Beck's argument that estoppel cannot apply to a UCC statute of frauds transaction, noting that § 30-1-103, MCA, expressly mentions estoppel as one of the general principles of law that supplements the UCC, absent an express displacement of the principle elsewhere. We ultimately determined that no provision of the UCC precludes application of estoppel to defeat a statute of frauds defense.…
>
> ¶41 Smith attempts to apply our recognition in *Northwest* that equitable remedies can supplement the UCC to the present case, but *Northwest* is readily distinguishable. *Northwest* did not address the priority of secured interests and, indeed, did not relate to secured interests in any way. Moreover, unlike in *Northwest*, the equitable principle of unjust enrichment urged by Smith – and adopted by the District Court – is not mentioned in the UCC as one of the general principles of law which can supplement the UCC's specific hierarchy of priorities for security interests at issue here.

Was the court correct to distinguish the two cases as it did? Are the principles of law and equity that are enumerated in § 1-103(b) exclusive? See Official Comment 4. Could a court apply the equitable principle of unjust enrichment in a Code case? Is there a better reason why the court should not have applied the principle in *Daniels-Sheridan*?

1.8. Choice of Law. Prior to its revision in 2001, former § 1-105 allowed the parties to designate a jurisdiction whose law governs the contract if the transaction bears a "reasonable relation" to that jurisdiction. As noted in Official Comment 1, any jurisdiction in which "a significant enough portion of the making or performance of the contract is to occur" is appropriate. For example, if a seller of goods enters into a contract at its headquarters in Delaware, has a California warehouse from which goods are to be shipped under the contract, the goods are manufactured in South Dakota, the buyer is located in Montana, and the goods are to be shipped to Texas, any one of those jurisdictions would have a "reasonable relation" to the contract, and the parties could choose to apply the law of any of those jurisdictions.

Revised Article 1 proposed a regime in which parties to a transaction that did not involve a consumer were free to choose the applicable law without limitation. After this proposal was rejected by every jurisdiction that enacted Revised Article 1, the Uniform Law Commission gave in and revised § 1-301 to restore the original regime.

> 1.8.1. Section 1-301(c) sets forth a narrow list of limitations on the parties' right to designate their choice of governing law. For example, under § 2A-106(1), a consumer lease may only designate the law of the jurisdiction where the consumer resides or in which the goods are to be used.
>
> 1.8.2. In the absence of an effective choice of law, § 1-301(b) directs the courts to apply the UCC to transactions having an "appropriate relationship" to that jurisdiction. Official Comment 1 notes that it would not be appropriate to apply the UCC if, for example, the parties have "clearly contracted on the basis of some other law." Due to the uniformity and widespread adoption of the UCC, its application by the forum state should not present difficulties, unless the forum state has adopted a non-uniform version of the applicable UCC provisions that may affect the outcome of the case.
>
> 1.8.3. Note that choice of law differs from choice of forum. *Choice of forum* resolves the issue of where the case will be heard. Once that is determined, either by the parties or by the rules of civil procedure, then *choice of law* determines the law that the court will apply to the transaction. If the parties have not exercised their freedom of contract to determine the applicable law, then the courts will use principles of conflict of laws to make the determination.
>
> 1.8.4. Recall that § 1-103(b) provides that principles of law and equity supplement the UCC, unless displaced. *Restatement (Second) of Conflict of Laws* § 187(2) sets forth a widely accepted principle:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied …, unless either
>
> > (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
> >
> > (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which … would be the state of the applicable law in the absence of an effective choice of law by the parties.

Problem 1-11. The parties have chosen the law of a jurisdiction that has a reasonable relation to the transaction. The forum state (which is a different state than the jurisdiction whose law governs) also has a reasonable relation to the transaction. The forum court has determined that the law of the chosen jurisdiction applicable to certain non-UCC elements of the claim is contrary to an important public policy of the forum state. Under § 1-301, must the court honor the choice of law clause? Applying §187 of the Restatement, under what circumstances would the court be allowed to disregard the parties' choice of law provision and apply the law of the forum state?

Chapter 1 Additional Sources.

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 2

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Introduction

Chapter 2. Introduction to UCC Article 2

2.1. Scope of Article 2: Transactions in Goods. Article 2 of the Uniform Commercial Code applies to *transactions in goods*. § 2-102.

> 2.1.1. One of the purposes of this class is to teach you how to read and use statutes. In some areas of law, such as torts, you rely more heavily on case law than on statutes in giving advice and coming to conclusions. "Sales of goods" is an area of law where you must learn to *begin with the statute* and the *Official Comments*. Note that while the Official Comments are extremely valuable for purposes of interpretation, in most jurisdictions they have not been enacted by the legislature and are only persuasive authority. Cases become important when a particular UCC provision is subject to more than one interpretation.
>
> 2.1.2. You can seldom rely on a single statute when applying the UCC. In applying a particular provision of Article 2, you often have to refer to other provisions of Article 2, or to the general provisions of Article 1. Always look at any applicable *definitions*, which may be in Article 1 or Article 2, and at the *cross-references* to other UCC sections that are contained in or immediately follow the provision you are reading.
>
> 2.1.3. Article 2 applies to "transactions in goods." § 2-102. Article 2 does not apply to transactions involving real property or services. Our first step is to determine what constitutes a "good" under Article 2. For a comprehensive compilation of federal and state cases, see Sonja A. Soehnel, Annotation, W*hat Constitutes "goods" Within the Scope of UCC Article 2*, 4 A.L.R.4th 912 (1981).

Problem 2-1. Where are "goods" defined for purposes of Article 2? Identify the statutory requirements that must be met before an item can fall within the definition of "goods."

Problem 2-2. Seller is in the business of creating neon signs. Buyer offers seller $1,000 to create a neon sign that says "Stockman's Bar" and seller promises to create the sign within 30 days. Is this a contract for the sale of goods?

Problem 2-3. What three items are specifically *excluded* from the definition of goods?

Problem 2-4. In general, are things firmly affixed to the land at the time of the contract for sale subject to Article 2? Under § 2-107, what categories of things attached to realty fall within the definition of "goods"?

Problem 2-5. Now that you've mastered the definition of "goods," let's apply it. Do the following items fall within the definition of "goods" for purposes of Article 2:

(1) the sale of cookies by a girl scout?
(2) the sale of television programming?
(3) the sale of a yellow page ad?
(4) the sale of electricity by a utility company?
(5) the sale of a debt owed to you?
(6) the sale of a mobile home located on blocks on a dealer's lot?
(7) the sale of a mobile home embedded in a cement foundation on land, which the buyer subsequently intends to move?
(8) the sale by a farmer in December of wheat which he will plant next May?
(9) the sale of Confederate money?
(10) the sale of tickets to the Final Four basketball play-offs?
(11) the sale of the answer sheet to the Sales and Leases final exam?
(12) the sale of water by an owner of land on which an artesian well is located to a bottler who will pump 100,000 gallons per month from the spring?

Research Assignment 2-1. Does the sale of blood by a law student to a blood bank fall within the definition of "goods" for purposes of Article 2? Many jurisdictions have a statute on point that you may wish to research. See, e.g., California Health and Safety Code § 1606, which provides:

> **Blood, etc.; processing, distribution; service, not sale**
>
> The procurement, processing, distribution, or use of whole blood, plasma, blood products, and blood derivatives for the purpose of injecting or transfusing the same, or any of them, into the human body shall be construed to be, and is declared to be, for all purposes whatsoever, the rendition of a service by each and every person, firm, or corporation participating therein, and shall not be construed to be, and is declared not to be, a sale of such whole blood, plasma, blood products, or blood derivatives, for any purpose or purposes whatsoever.

What reasons do you believe the California legislature considered in enacting this "blood shield" statute?

2.1.4. Section 2-102 specifies that Article 2 applies to "transactions in goods." *Transaction* is not defined, but is undoubtedly a broader concept than a "sale." Clearly, sales of goods are governed by Article 2, but what about gifts of goods? Leases of goods? Barter transactions? See § 2-304.

2.1.4.1. Most operative provisions of Article 2 apply only to *sales* of goods. For example, the definition of "contract" and "agreement" under § 2-106 are limited to those relating to the *present* or *future sale* of goods. Thus, wherever the term "contract" or "agreement" is used in Article 2, leases of goods are by definition excluded. Similarly, most Article 2 provisions specifically refer to a contract for the sale of goods, such as the statute of frauds found at § 2-201 which states "a contract *for the sale of goods* ... is not enforceable ... unless there is some writing."

2.1.4.2. A few sections, such as § 2-403 regarding title, apply not only to sales of goods, but to gifts of goods (see § 1-201(b)(29) that defines a "purchase" to include gifts and the corresponding definition of "purchaser" at § 1-201(b)(30)), and to "entrusting" of goods.

2.1.4.3. Transactions intended to operate as a security transaction are specifically excluded from the scope of Article 2. § 2-102.

2.1.4.4. **Warning**: Some "leases" are actually sales in substance, especially those that give ownership to the lessee at the end of the term of the lease for little or no additional consideration. Sometimes what the parties call a "lease" is actually a sale, where the seller retains a security interest in the goods. See § 1-203 if you ever face this issue. We will go into more depth on this issue in Chapter 20.

2.1.4.5. For a compilation of relevant cases, see Sonja A. Soehnel, Annotation, *What Constitutes a Transaction, a Contract for Sale, or a Sale Within the Scope of UCC Article 2*, 4 A.L.R.4th 85 (1981).

2.2. Mixed Transactions. Article 2 does not apply to contracts for services or contracts for land, intangibles, or other items that are not "goods." Often a contract involves either both goods and services (such as the sale and installation of carpet), or both UCC goods (cattle) and non-UCC property (ranch land). In a mixed transaction, the courts have developed two different tests to determine whether or not the transaction is within the scope of Article 2.

2.2.1. The majority of jurisdictions have applied the ***predominant factor*** test. A well-known case, *Bonebrake v. Cox*, 499 F.2d 951 (8th Cir. 1974) enunciated this test as follows:

> The test for inclusion or exclusion is ... whether their predominant factor, their thrust, their purposes reasonably stated, is the rendition of service with goods incidentally involved (e.g., contract with artist for painting) or is it a transaction of sale, with labor incidentally involved (e.g., installation of a water heater in a bathroom).

2.2.2. In *Pass v. Shelby Aviation, Inc*., 2000 Tenn. App. LEXIS 247, an airplane was brought in for a required inspection. The mechanics failed to install some bolts, resulting in an accident. Having missed the statute of limitations for negligence, which is 3 years, the plaintiffs sought to bring a claim for breach of express and implied warranties under the UCC, which has 4 year statute of limitations. The court enunciated four factors to look at in determining whether the contract was predominantly for goods, or predominantly for services:

- the language of the parties' contract (*i.e.*, whether it focused on goods versus services);
- the nature of the business of the supplier (is this a person who regularly sells goods, or rather provides services);
- the reason the parties entered into the contract (what was bargained for B goods or services); and
- the respective amounts charged under the contract for goods and for services.

No one factor alone is conclusive. For example, even where the cost of goods exceeds the cost of services, the predominant purpose may still be deemed the provision of services where the other factors support such a finding. Applying these factors, the appellate court determined that the predominant purpose of this particular contract was the provision of services rather than the sale of goods, and thus plaintiff could not assert breach of warranty claims under Article 2.

2.2.3. Not all courts apply the same factors. See, for example, *Colorado Carpet Installation, Inc. v. Palermo*, 668 P.2d 1384, 1388-89 (Colo. 1983), which defined the factors as: (1) the contractual language used by the parties; (2) whether the agreement involves one overall price that includes both goods and labor or, instead, calls for separate and discrete billings for goods on the one hand and labor on the other; (3) the ratio that the cost of goods bears to the overall contract price; and (4) the nature and reasonableness of the purchaser's contractual expectations of acquiring a property interest in goods.

2.2.4. A minority of courts apply the ***gravamen*** test in determining whether a particular transaction is subject to Article 2. This test focuses on whether the gravamen of the action involves goods or services. A well-known case applying this test involved a lady who sued a beauty salon where she had received a permanent. The permanent solution was defective, and caused considerable damage to her hair and scalp. Under the predominant factor test, most courts would find (as the trial court did) that the predominant purpose of the contract was services, and thus not subject to Article 2. But the New Jersey Supreme Court concluded that because the gravamen of her claim was the defective goods, Article 2 applied. *Newmark v. Gimbel's Inc*., 258 A.2d 697 (N.J. 1969). Other courts which have applied the gravamen test include: *Anthony Pools v. Sheehan*, 455 A.2d 434 (Md. 1983) (plaintiff slipped on pool diving board; court held UCC applied to predominantly services contract for installation of diving board because gravamen of action was alleged defect in diving board); *H. Hirschfield Sons, Co. v. Colt Industries Operating Corp*., 309 N.W.2d

714 (Mich. App. 1981) (court held that UCC does not apply to contract for sale of railroad and truck scale because action alleged defects in the installation of scale, not in the scale itself); *Providence Hospital v. Truly*, 611 S.W.2d 127 (Tex. Civ. App. 1980) (contaminated drug was injected into plaintiff's eye during cataract surgery; court held UCC applies in action alleging breach of warranty of fitness of goods sold for particular purpose).

Under the gravamen test, a single contract could be subject to two different bodies of law: UCC law for any claim involving the goods, and non-UCC law for any claim relating to the services. Is this troublesome? Not if you would get to the same result regardless of the law implied. But where the laws differ (and they often do regarding important issues such as the statute of limitations, the statute of frauds, warranties, and other areas of law), this may be troublesome to a court.

2.2.5. Most "mixed transactions" involve goods and services. In other contracts the "mixture" relates to goods and real property or intangibles, such as intellectual property. What body of law would govern in the event of a breach? Once again, courts will apply either the "predominant factor" test or "gravamen" test, even though those tests were developed in the context of goods/services contracts. Some of the factors of the "predominant factor" test don't easily apply, leaving the cost of the items involved as the most influential factor. Compare *Cianbro Corp. v. Curran-Lavoie, Inc.*, 814 F.2d 7, 13-14 (1st Cir. 1987), which held that Article 2 governed the sale of a construction company's equipment, inventory, and uncompleted construction contracts where "most of the significant terms" and 98% of the purchase price related to the sale of goods; and *Fink v. DeClassis*, 745 F. Supp. 509, 515-16 (N.D. Ill. 1990), finding that Article 2 did not govern the sale of a company's beauty care product lines where the goods (machinery, equipment, and inventory) constituted only 17% of the purchase price, which also included such intangible assets as "tradenames, trademarks, logos, advertising, artwork, customer lists, sales records, unfulfilled sales orders, goodwill, and licensing agreements."

2.2.6. Drafting Point: Under the principle of freedom of contract, and subject to the choice of law provisions of § 1-301, the parties can agree to choose the law applicable to the contract. For example, if you draft a "mixed transaction" contract, you can avoid the "predominant factor" test by specifying that UCC law applies to all claims relating to the goods, and non-UCC law to all other claims. Query: can you choose the UCC to govern all claims arising under the "mixed transaction" contract, including, for example, claims relating to services or to intellectual property? What danger might there be in attempting to apply the UCC to all potential claims arising under a contract?

Problem 2-6. Belva needed dentures. When she visited her dentist, he measured her mouth and ordered the dentures. The invoice stated that the dentist's services were valued at $2,000 and the dentures at $1,000. The dentures were defective and she developed severe mouth sores. Applying the predominant factor test, does she have a claim against the dentist for breach of warranty under Article 2? What factors would you consider? Would there be a different result under the gravamen test? Would the result be different if the dentist's services were valued at $1,000 and the dentures at $2,000?

Problem 2-7. A farmer contracts with an aerial spraying service to have his crops sprayed for weeds with a herbicide. The cost of the herbicide is separately stated in the contract, and represents 90% of the total invoice. The herbicide fails to control the weeds, and the farmer brings a claim for breach of warranty under Article 2. Will the farmer be able to do so under the predominant factor test? What factors should you consider? See *Moeller v. Huntting Elevator Co.*, 38 U.C.C. Rep. Serv. 2d (Callaghan) 1122 (Minn. App. 1999).

2.3. Application of Article 2 to Sales of Computer Software. Does the term "goods" include computer software? As noted by the American Law Institute in its *Introduction to the Principles of the Law of Software Contracts*, "perhaps no other commercial subject matter is in need of greater harmonization or clarification."

Advent Systems Ltd. v. Unisys Corp.
925 F.2d 670 (3d Cir. 1991)

WEIS, Circuit Judge

In this diversity case we conclude that computer software is a good within the Uniform Commercial Code.…

Plaintiff, Advent Systems Limited, is engaged primarily in the production of software for computers. As a result of its research and development efforts, by 1986 the company had developed an electronic document management system (EDMS), a process for transforming engineering drawings and similar documents into a computer data base.

Unisys Corporation manufactures a variety of computers.... In June 1987 Advent and Unisys signed two documents.…

In these documents, Advent agreed to provide the software and hardware making up the document systems to be sold by Unisys in the United States. Advent was obligated to provide sales and marketing material and manpower as well as technical personnel to work with Unisys employees in building and installing the document systems. The agreement was to continue for two years, subject to automatic renewal or termination on notice.…

The relationship, however, soon came to an end. Unisys, in the throes of restructuring, decided it would be better served by developing its own document system and in December 1987 told Advent their arrangement had ended....

Advent filed a complaint in the district court alleging, *inter alia*, breach of contract, fraud, and tortious interference with contractual relations. The district court ruled at pretrial that the Uniform Commercial Code did not apply because although goods were to be sold, the services aspect of the contract predominated.

On appeal ... Unisys contends that the relationship between it and Advent was one for the sale of goods and hence subject to the terms of statute of frauds in the Uniform Commercial Code. Because the agreements lacked an express provision on quantity, Unisys insists that the statute of frauds bans enforcement....

The district court ruled that as a matter of law the arrangement between the two parties was not within the Uniform Commercial Code and, consequently, the [UCC] statute of frauds was not applicable. As the district court appraised the transaction, provisions for services outweighed those for products and, consequently, the arrangement was not predominantly one for the sale of goods....

The Distribution Agreement begins with the statement, "Unisys desires to purchase, and Advent desires to sell, on a non-exclusive basis, certain of Advent hardware products and software licenses for resale worldwide."… Schedule A lists twenty products, such as computer cards, plotters, imagers, scanners and designer systems.…

In support of the district court's ruling that the U.C.C. did not apply, Advent contends that the agreement's requirement of furnishing services did not come within the Code. Moreover, the argument continues, the "software" referred to in the agreement as a "product" was not a "good" but intellectual property outside the ambit of the Uniform Commercial Code.

Because software was a major portion of the "products" described in the agreement, this matter requires some discussion. Computer systems consist of "hardware" and "software." Hardware is the computer machinery, its electronic circuitry and peripheral items such as keyboards, readers, scanners and printers. Software is a more elusive concept. Generally speaking, "software" refers to the medium that stores input and output data as well as computer programs. The medium includes hard disks, floppy disks, and magnetic tapes.

In simplistic terms, programs are codes prepared by a programmer that instruct the computer to perform certain functions. When the program is transposed onto a medium compatible with the computer's needs, it becomes software. The process of preparing a program is discussed in some detail in *Whelan Associates, Inc. v. Jaslow Dental Laboratory, Inc.*, 797 F.2d 1222, 1229 (3d Cir. 1986), *cert. denied*, 479 U.S. 1031, 107 S. Ct. 877, 93 L. Ed. 2d 831 (1987) and *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240 (3d Cir. 1983), *cert. dismissed*, 464 U.S. 1033, 104 S. Ct. 690, 79 L. Ed. 2d 158 (1984). *See also* Rodau, *Computer Software: Does Article 2 of the Uniform Commercial Code Apply*?, 35 Emory L.J. 853, 864-74 (1986).

The increasing frequency of computer products as subjects of commercial litigation has led to controversy over whether software is a "good" or intellectual property. The Code does not specifically mention software.

In the absence of express legislative guidance, courts interpret the Code in light of commercial and technological developments. The Code is designed "to simplify, clarify and modernize the law governing commercial transactions" and "to permit the continued expansion of commercial practices." 13 Pa. Cons. Stat. Ann. § 1102 (Purdon 1984). As the Official Commentary makes clear:

> "This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices."

Id. comment 1.

The Code "applies to transactions in goods." 13 Pa. Cons. Stat. Ann. § 2102 (Purdon 1984). Goods are defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale." *Id.* at § 2105. The Pennsylvania courts have recognized that "'goods' has a very extensive meaning" under the U.C.C." [cites omitted]

Our Court has addressed computer package sales in other cases, but has not been required to consider whether the U.C.C. applied to software per se. *See Chatlos Systems, Inc. v. National Cash Register Corp.*, 635 F.2d 1081 (3d Cir. 1980) (parties conceded that furnishing the plaintiff with hardware, software and associated services was governed by the U.C.C.); *see also Carl Beasley Ford, Inc. v. Burroughs Corporation*, 361 F. Supp. 325 (E.D. Pa. 1973) (U.C.C. applied without discussion), *aff'd* 493 F.2d 1400 (3d Cir. 1974). Other Courts of Appeals have also discussed transactions of this nature. *RRX Industries, Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985) (goods aspects of transaction predominated in a sale of a software system); *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604 F.2d 737, 742-43 (2d Cir. 1979) (in sale of computer hardware, software, and customized software goods aspects predominated; services were incidental).

Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser-readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.

That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace. The fact that some programs may be tailored for specific purposes need not alter their status as "goods" because the Code definition includes "specially manufactured goods."

The topic has stimulated academic commentary with the majority espousing the view that software fits within the definition of a "good" in the U.C.C. Applying the U.C.C. to computer software transactions offers substantial benefits to litigants and the courts. The Code offers a uniform body of law on a wide range of questions likely to arise in computer software disputes: implied warranties, consequential damages, disclaimers of liability, the statute of limitations, to name a few.

The importance of software to the commercial world and the advantages to be gained by the uniformity inherent in the U.C.C. are strong policy arguments favoring inclusion. The contrary arguments are not persuasive, and we hold that software is a "good" within the definition in the Code.

The relationship at issue here is a typical mixed goods and services arrangement. The services are not substantially different from those generally accompanying package sales of computer systems consisting of hardware and software. *See Chatlos Systems, Inc. v. National Cash Register Corp.*, 479 F. Supp. 738, 741 (D.N.J. 1979); *Beasley Ford*, 361 F. Supp. at 328.

Although determining the applicability of the U.C.C. to a contract by examining the predominance of goods or services has been criticized, we see no reason to depart from that practice here. As we pointed out in *De Filippo v. Ford Motor Co.*, 516 F.2d 1313, 1323 (3d Cir.), *cert. denied*, 423 U.S. 912, 96 S. Ct. 216, 46 L. Ed. 2d 141 (1975), segregating goods from non-goods and insisting "that the Statute of Frauds apply only to a portion of the contract, would be to make the contract divisible and impossible of performance within the intention of the parties."

We consider the purpose or essence of the contract. Comparing the relative costs of the materials supplied with the costs of the labor may be helpful in this analysis, but not dispositive. *Compare RRX*, 772 F.2d at 546 ("essence" of the agreement) *with Triangle*, 604 F.2d at 743 ("compensation" structure of the contract).

In this case the contract's main objective was to transfer "products." The specific provisions for training of Unisys personnel by Advent were but a small part of the parties' contemplated relationship.

The compensation structure of the agreement also focuses on "goods." The projected sales figures introduced during the trial demonstrate that in the contemplation of the parties the sale of goods clearly predominated. The payment provision of $ 150,000 for developmental work which Advent had previously completed, was to be made through individual purchases of software and hardware rather than through the fees for services and is further evidence that the intellectual work was to be subsumed into tangible items for sale.

We are persuaded that the transaction at issue here was within the scope of the Uniform Commercial Code and, therefore, the judgment in favor of the plaintiff must be reversed.

Case Notes:

> 1. A subsidiary issue that the *Advent* court failed to discuss was whether the software, which it classified as a good, was sold to Unisys, and thus subject to Article 2, or licensed, and thus not within the scope of Article 2. Some courts have ruled that because a software user is not required to return the software to the vendor, it is a sale and not a license. *Softman Products Co. v. Adobe Systems, Inc*. 171 F. Supp. 2d 1075 (C.D. Cal. 2001). Other courts have held that the "sale" of software is a license, because the end-user does not obtain all rights to the program (such as the right to copy it), but only a limited right to use it. *Adobe Systems v. Stargate Software*, 216 F. Supp. 2d 1051 (N.D. Cal. 2002).
>
> 2. Not all courts have followed the *Advent* decision. See *Triple Point Technology, Inc. v. D.N.L. Risk Management, Inc*., 2000 U.S. Dist. LEXIS 22327 (noting that "merely because the program had to be contained on a floppy disk or CD-ROM for transfer does not bring this agreement under the purview of the U.C.C."). Several commentators have also criticized the decision, including the following comments of Lorin Brennan from *Why Article 2 Cannot Apply to Software Transactions*, 38 Duq. L. Rev. 459, 466-67 (2000):
>
>> As the court in *Advent Systems v. Unisys Corp*. blithely put it:
>>
>>> That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable, and available in the marketplace.
>>
>> In other words, a computer program may start off as intangible intellectual property, but once it is copied onto a floppy disc it merges into the disc and becomes a tangible, physical "good." Under this view all software transactions fit neatly into the, if you will, Ptolemic world view of Article 2, where everything circles around the fixed notion of a sale in goods.
>>
>> It is a tidy and comforting notion - and spectacularly wrong.…
>>
>> The mere fact that [a software retailer downloads and redistributes a copy of a Linux program] does not make Linux the computer program "tangible, moveable

> and available in the marketplace." Linux, the computer program, still remains an intangible, copyrighted work. Linux, the computer program, has not moved from the Linux Web page even though it was copied. If the copy made by [the user] does not conform to the requirements of the GNU Public License, then that copy is unauthorized, its distribution infringing, and the copy is definitely not available in the marketplace.
>
> This difference is profound. The goods-centric image sees a software transaction as a delivery of a particular CD. It makes the medium the message; the container the content; the CD the computer program. The information-centric view sees just the opposite. The essence of the transaction is the legal authorization to use the program; the CD is just the means to enable that use. One needs a jar to carry caviar, but that does not make the jar the essence of the meal.…

For additional articles discussing whether software should constitute a "good," see Jean Braucher, *Contracting out of Article 2 Using a "License" Label: A Strategy That Should Not Work for Software Products*, 40 Loy. L.A. L. Rev. 261 (2006) (advocating that Article 2 should apply to the sale or license of software) and Holly K. Towle, *Enough Already: It Is Time to Acknowledge That UCC Article 2 Does Not Apply to Software and Other Information*, 52 S. Tex. L. Rev. 531 (2011) (advocating that Article 2 should not apply to the sale or license of software).

3. Applying the reasoning of the *Advent* court, would you characterize as an Article 2 "good" software that is not sold on a diskette, but which is obtained via the internet through a download from a software vendor's website? In *Specht v. Netscape Communications Corp.*, 306 F.3d 17, n.13 (2nd Cir. 2002), the court stated that downloadable software "is scarcely a 'tangible' good," but did not decide whether the UCC should apply to the downloaded program in question, because the application of the UCC (versus common law) would not affect the outcome with regard to the issues raised in the case (including the issue of whether an arbitration clause was enforceable).

4. What law should apply when customized (rather than "shrink-wrapped") software is involved?

5. In 1999, the Uniform Law Commission promulgated the Uniform Computer Information Transactions Act (UCITA) to apply to "computer information transactions" such as the purchase or license of shrink-wrapped software. It has been adopted in only two states (Maryland and Virginia), and in those states it is clear that UCITA governs sales or licenses of software rather than Article 2. The American Bar Association and several other groups have come out against UCITA, virtually stopping its enactment. Several states have adopted anti-UCITA laws, in an attempt to prevent choice of law clauses from making UCITA applicable to their residents. For more information on UCITA, see Carlyle C. Ring, Jr., *Uniform Rules for Internet Information Transactions:*

An Overview of Proposed UCITA, 38 Duq. L. Rev. 319 (2000); Henry Deeb Gabriel, *The 2003 Amendments of Article Two of the Uniform Commercial Code: Eight Years or a Lifetime After Completion*, 52 S. Tex. L. Rev. 487 (2011).

6. In May 2009, the American Law Institute approved its *Principles on the Law of the Law of Software Contracts*. This publication contains valuable notes that summarize the case law applying UCC provisions to software. For a discussion of the Principles, see Maureen A. O'Rourke, *An Essay on the Challenges of Drafting a Uniform Law of Software Contracting*, 10 Lewis & Clark L. Rev. 925 (2006); Juliet M. Moringiello, *What's Software Got To Do with It? The ALI Principles of the Law of Software Contracts*, 84 Tul. L. Rev. 1541 (2010).

7. We will later compare the terms, especially the warranty terms, of a contract for the sale or licensing of software and a contract for the sale of goods. Based on your personal experience, how different is a warranty on a good that you have recently purchased compared to warranty terms contained in a licensing agreement for software that you have recently downloaded? What do these differences tell us about the expectations of the software companies?

2.4. The Article 2 "Merchant" Rules. As we have seen, Article 2 applies to transactions in goods. If a sale of goods is within Article 2, in general it doesn't matter whether the transaction is between sophisticated or unsophisticated parties. Article 2 covers Bic's sale of 2 million pens to Wal-Mart, Wal-Mart's sale of a package of six Bic pens to me, and my sale of one pen to you. See Scott J. Burnham, *Why Do Law Students Insist that Article 2 Applies Only to Merchants and What Can We Do About It?*, 63 Brook. L. Rev. 1271 (1997).

However, there are a few occasions (thirteen to be exact), where Article 2 contains a rule that applies only to merchants or only "between merchants." If the rule applies to a merchant, then only that party has to be a merchant, but if the rule applies "between merchants," then both parties have to be merchants for the rule to kick in. See § 2-104(3).

2.4.1. What does it mean to be a merchant? As you can imagine, when a rule applies to a merchant, it is generally because the merchant is more sophisticated in business matters and may be held to a higher standard of diligence. How does the merchant obtain that sophistication? Let's turn to the definition of merchant at § 2-104(1). The UCC distinguishes between *merchants as to goods* and *merchants as to practices*.

2.4.2. Under § 2-104(1), a merchant falls into the class of a merchant *as to goods* in one of three ways:

- A person who *deals in goods of the kind*;

- A person who, *by his occupation* (and not by hobby) holds himself out as having knowledge or skill peculiar to the goods involved (for example, an automobile parts dealer, although he doesn't deal in cars, may nonetheless be a merchant as to cars because *by his occupation* he has special knowledge of car parts and car maintenance (see *Fay v. O'Connell,* 1990 Mass. App. Div. 141);

- A person who employs an agent who, *by the agent's occupation*, holds himself out as having knowledge or skill peculiar to the goods involved (see *Swift Freedom Aviation, LLC v. R.H. Aero*, 2005 U.S. Dist. LEXIS 37261 (E.D. Tenn. 2005)).

2.4.3. There are three important Article 2 sections which apply only to *merchants as to goods*:

2.4.3.1. The most important by far relates to the *implied warranty of merchantability* under § 2-314, which applies only to "merchants with respect to goods of that kind."

2.4.3.2. The power to transfer title in an *entrustment* situation applies only to a "merchant who deals in goods of that kind." § 2-403(2). For example, if you entrust your snowboard to a ski shop for waxing, and the shop (which sells skis) mistakenly sells the snowboard, a buyer in the ordinary course of business will obtain good title.

2.4.3.3. Under § 2-312(3), a merchant dealing in goods of the kind gives a warranty that the goods are free of infringement claims.

Problem 2-8. To reduce its operating deficit, the nonprofit Nordic Sports Association sponsored a fund-raising luncheon, where it sold Swedish meatballs. A patron's tooth was cracked when the patron bit into a big chunk of bone contained in the meatball. Does the patron have a claim for breach of the implied warranty of merchantability against the Association?

Problem 2-9. Kathleen, a law professor, collects quilts as a hobby. In 2010 she began to sell some of her quilts on eBay; her transactions steadily increased to more than 100 transactions per year and more than $5,000 in annual sales. In 2014, eBay invited Kathleen to become a "Power Seller." Does the implied warranty of merchantability apply to Kathleen's sales of quilts on eBay?

Problem 2-10. Bob owns and operates a retail furniture store. As a hobby, he collects antique phonographs. If he sells one of the antique phonographs to a friend, does the warranty of merchantability apply? What if Bob consigns his collection of antique phonographs to an auction agency that specializes in the sale of antiques (including antique phonographs)?

2.4.4. Section 2.4.3 notes certain Article 2 "merchant" provisions that apply only to merchants in goods. Other merchant rules apply to both merchants in goods and merchants as to practices. It is much easier to fall into the class of *merchants as to practices*. This definition focuses on a person's familiarity with general business practices, and according to § 2-104, Comment 2, would include "*almost every person in business*." (emphasis added) A person falls into this class by one of two means:

2.4.4.1. A person who, *by his occupation* (and not by hobby) holds herself out as having knowledge or skill peculiar to the practices involved; or

2.4.4.2. A person who employs an agent who, *by the agent's occupation*, holds herself out as having knowledge or skill peculiar to the practices involved (such as a university that hires a purchasing agent familiar with general business practices to acquire equipment and supplies for the university).

2.4.4.3. ***Important exclusion***: Comment 2 states that the Article 2 sections providing special rules for merchants as to practices *only applies* to a merchant in his mercantile capacity; the special rules *do not apply* when a merchant is buying goods for his *personal use*.

Problem 2-11. Ann, a car dealer, purchases a copy machine for her office. For purposes of determining whether the written confirmation rules of § 2-201(2) apply, is the car dealer a merchant?

Problem 2-12. Jack owns a pet shop. He orders a computer for his personal use from Dell by phone. Will Jack be considered a merchant in determining what rules to apply under § 2-207(2) regarding any additional terms proposed by Dell contained in the shipment?

2.4.5. You need to carefully read each Article 2 provision to determine to whom it applies. Although most Article 2 rules apply regardless of whether either party is a merchant, several Article 2 rules are limited in their application, depending upon one or both parties' status as a merchant as to goods or practices. In addition to the three rules that apply only if a party is a merchant as to goods as noted at Section 2.4.3, following are examples of rules whose application depends upon the merchant status of one or both parties.

2.4.5.1. The § 2-201(2) written confirmation exception to the statute of frauds applies when *both* parties are merchants, as indicated by the language "[b]etween merchants."

2.4.5.2. Section 2-207(2) regarding the "battle of the forms" allows additional terms to become a part of the contract when both parties are merchants, if certain requirements are met.

2.4.5.3. Section 2-209(2) requires a "no oral modification clause" on a form supplied by a merchant to be separately signed or initialed, *unless* both parties are merchants (in which case the "no oral modification clause" does not need to be separately signed or initialed).

2.4.5.4. Section 2-205 provides that an offer by a merchant to *buy or sell* goods may become irrevocable without consideration if certain requirements are met. Only the offeror needs to be a merchant.

2.4.5.5. As discussed in Chapter 1, Section 1.4, the obligation of "good faith" applies to merchants and nonmerchants alike, but the pre-2001 version of UCC Articles 1 and 2 (which still exists in several jurisdictions) applies a higher standard to merchants versus nonmerchants.

2.4.5.6 Under § 2-509, if the seller is a *merchant as to goods or practices*, the risk of loss passes to the buyer when the buyer receives the good. If the seller is a nonmerchant, the risk of loss passes to buyer on tender of delivery.

2.5. Special Cases Regarding "Merchant" Status.

2.5.1. Can a government be a merchant as to goods or practices? When presented with this question, the Montana Supreme Court in *Western Sign v. State*, 590 P.2d 141, 144 (Mont. 1979), conceded that "it may well be that a state may be a merchant in some circumstances," but ruled that the burden of proof to support such classification rests upon the opposing party.

If a government entity makes purchases through a purchasing division, and the purchasing division has knowledge regarding general purchasing practices, the government should be a merchant as to practices under the "agency" rules of § 2-104. See, for example, *County of Milwaukee v. Northrop Data Systems, Inc*., 602 F.2d 767 (7th Cir. 1979), in which the court ruled that a county that purchased a sophisticated computer system was a merchant, because the purchase was made through its purchasing division, which had extensive experience in business practices.

2.5.2. Is a farmer a merchant for purposes of § 2-201(2)? This issue has been frequently litigated. See David B. Harrison, Annotation, *Farmers as "merchants" Within Provisions of UCC Article 2, Dealing with Sales*, 95 A.L.R.3d 484 (1979).

Chapter 2 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapters 3, 4.A, 4.B

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 1-1

Chapter 3. Formation of a Contract under the UCC

3.1. Common Law Principles of Contract Formation. Common law has developed principles governing formation of a contract, including the requirement of mutual assent between the parties manifested through an offer and acceptance. Early in its development, the common law was strict, making it difficult at times to form a contract.

3.1.1. Under the early *mirror image rule*, the terms of the acceptance had to exactly mirror the terms of the offer in order for a contract to be formed. Furthermore, the manner of acceptance (promise or performance) had to be the same, as did the medium of acceptance (letter, telegraph, etc.). For example, if an offer to sell a horse was delivered to a potential buyer in a telegram, the buyer could accept the offer only by telegram, and not by letter and not by performance. However, even before the UCC was adopted, these strict rules of contract formation were being relaxed by the courts and legislatures. See, for example, *Hammersberg v. Nelson*, 224 Wis. 403 (1937) (oral acceptance of a written offer was sufficient to form a contract). Reflecting current common law, the *Restatement (Second) of Contracts* § 30 (1981) provides: "Unless otherwise indicated by the language or the circumstances, an offer invites acceptance in any manner and by any medium reasonable in the circumstances."

3.1.1.1. Even though common law has relaxed the rules of offer and acceptance, many courts require a "mirror image" acceptance of the terms proposed. In other words, a purported acceptance is not effective if it adds new or differing terms from those proposed; instead, it is a counter-offer. See *Restatement (Second) of Contracts* § 59 (1981): "A reply to an offer which purports to accept it but is conditional on the offeror's assent to terms additional to or different from those offered is not an acceptance but is a counter-offer." If a seller offers to sell a horse for $2,000, and the buyer replies, "It's a deal if you include the bridle," then there is no acceptance. The buyer's response is a counter-offer.

3.1.2. At common law, a contract cannot be formed if ***essential terms are missing***. In *Drug Fair Northwest v. Hooper Enterprises, Inc*., 733 P.2d 1285 (Mont. 1987), the court determined that a letter regarding the lease of property did not form a contract. Although the letter referenced the lease of a specific property and the rental amount, it did not specify the commencement date of the lease or the responsibility of the parties for taxes, insurance, repairs, maintenance and utilities. In addition, the letter provided for renewal terms, but failed to specify the rental amount for the renewal periods.

3.2. Relaxed Formation Rules under the UCC. As noted by the Montana Supreme Court in *Conagra, Inc. v. Nierenberg*, 7 P.3d 369, ¶ 28 (Mont. 2000), "the UCC rules governing sales agreements are far more permissive in this respect than the general common law rules governing contract formation." The party trying to avoid a contract for the sale of grain argued that there was no mutual assent as to all material terms of the contract. The court cited § 2-204 to support its finding that a contract had been formed, emphasizing that:

3.2.1. Under § 2-204(1), a contract for the sale of goods may be made in *any manner sufficient to show agreement*, including conduct by both parties which recognizes the existence of a contract.

3.2.2. Under § 2-204(2), a contract may be found *even though the moment of its making is undetermined.*

3.2.3. Under § 2-204(3), even though *one or more terms are left open* a sales contract does not fail for indefiniteness if the parties have *intended* to make a contract and there is a reasonably certain basis for giving an appropriate remedy. The court also noted the gap-filler provisions upon which it could rely under Part 3 of Article 2. The gap fillers are summarized commencing at Section 3.2.4.1 below.

3.2.3.1. The court noted that the *only* term generally required is a *quantity term*, citing Comment 1 of § 2-201 (statute of frauds).

3.2.3.2. ***Warning:*** The Official Comment to § 2-204 states: "The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions." Although the UCC is more flexible, it still must be established that there was an intent to agree on the part of both parties.

3.2.4 If a seller agrees to sell a particular widget, and the buyer agrees to buy it, it looks like they made an agreement, but the terms are certainly indefinite. As discussed above, the Code wants to facilitate the making of the agreement, and if the parties intended an agreement, it will attempt to supply the missing terms. The Official Comment to § 2-204 states:

> Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies, and the like.

Let's look at some of those "gap-fillers" or "default rules."

3.2.4.1. *Price*. In the absence of a stated price, the price is a reasonable price. The usual measure of a reasonable price is some objective source such as the seller's catalog or the market price. If the price is to be set by one of the parties, then that party is constrained by "good faith" as discussed in Chapter 1.

3.2.4.2. *Quantity*. Section § 2-204(3) states that a contract does not fail for indefiniteness if "there is a reasonably certain basis for giving an appropriate remedy." Failure to state a quantity can be fatal because without a quantity, it is difficult to determine the remedy. For example, if I sue you for your failure to deliver "widgets," how many did you promise me? Failure to state a quantity is not fatal, however, if there is a reasonable basis for supplying the quantity term. It might be supplied by course of dealing. If each month a law firm has purchased 10 reams of paper from a seller and in April it orders "paper," the quantity can probably be supplied by the past measure. According to § 2-306, if the quantity is measured either by the output of the seller or the requirements of the buyer, that is sufficient to establish a quantity. The amount supplied or demanded is constrained by good faith and by prior output or requirements.

3.2.4.3. *Delivery*. Section 2-307 provides the default rule that all the goods ordered must be tendered in a single delivery. If the parties contract around that rule, they have created an "installment contract" under § 2-612. According to § 2-308, in the absence of a specified place for delivery, the place of delivery is at the seller's place of business or residence if the seller does not have a place of business. As we will see, this concept becomes important when we discuss delivery terms in Chapter 10. The starting point is that the seller has no obligation to deliver the goods to the buyer.

3.2.4.4. *Time*. It will not surprise you that § 2-309 provides that when the contract does not specify a time, the default rule is a reasonable time.

3.2.4.5. *Payment*. Sections 2-307 and 2-310 provide that payment is due on tender of delivery. According to § 2-511, payment must be made in the manner current in the ordinary course of business. So if it is customary to pay by check, the seller must accept a check. However, if the seller demands legal tender, the seller must give the buyer an extension of time to come up with the cash.

3.2.4.6. *Quality*. The quality of the goods promised by the seller is a matter of warranty law, which is discussed in Chapters 6-8.

Problem 3-1. A buyer agrees in writing to buy a widget from a seller for $1,000. The buyer then finds out that the market price of that widget at the time of sale was $800. Does the buyer have a claim against the seller that the price was not reasonable under § 2-305?

3.3. Offer and Acceptance. The UCC has not done away with the concepts of offer and acceptance. Although not expressly stated in such terms in § 2-204, both must still be present in order to form a contract under the UCC. We turn to the common law for basic principles of offer and acceptance, except to the extent they are revised by the UCC (which modifications we'll discuss in a moment). See § 1-103(b).

3.3.1. An "offer" is defined by *Restatement (Second) of Contracts* § 24 (1981) as "the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it." A "bargain" is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances. Id., § 3.

Problem 3-2. Are the following transactions offers? Why or why not?

(1) Professor Burnham asks Professor Juras if she is interested in buying his bicycle.

(2) You receive a catalog from Outdoor Adventureware offering certain goods at certain prices.

(3) A regional online auction site contains an item that states: "2008 Subaru Outback for sale; 115,000 miles; $5,500 firm. Call 253-0000."

3.3.2. At common law an offer can be revoked (that is, taken back) at any time prior to acceptance, unless consideration is paid to hold the offer open (referred to as an option contract). According to *Restatement (Second) of Contracts* § 36 (1981), in addition to revocation, the power of an offeree to accept is terminated by:

- Rejection or counter-offer by the offeree;
- Lapse of time; or
- Death or incapacity of the offeror or offeree.

3.3.3. Section 2-205 alters the common law rule on revocation of an offer. Under common law, an offeror can withdraw an offer at any time prior to acceptance, *unless* the offeror has specifically agreed to hold the offer open, which agreement must be supported by *additional consideration*, resulting in an option contract. See *Restatement (Second) of Contracts* § 25 (1981). For example, if on March 1 Gabe offers to sell his house to Dell for $100,000, offer open until April 1, he can withdraw his offer at any time prior to acceptance *unless* Dell pays consideration to Gabe for the promise to hold the offer open until April 1.

3.3.3.1. Take a look at § 2-205, which provides that an offer will be irrevocable, or firm, *without payment of any additional consideration* (*i.e.*, a departure from common law). The provision probably reflects prevailing commercial practice, and is available only in the following circumstances:

- the offeror must be a *merchant*;
- there must be a *writing signed* by the merchant offering to hold the offer open;
- the period of irrevocability must be for a *reasonable time*, which *cannot exceed three months* (and if longer than three months, will be enforced up to three months); and
- if the writing containing the firm offer is provided by the offeree, the firm offer portion of the writing must be separately signed by the offeror.

This fourth requirement is a good example of "reasonable expectations," a concept found frequently in the Code, though that name for it is never used. The concept recognizes the reality that the parties do not read their contracts carefully, and puts the burden on the party offering an unusual or unexpected term to reasonably call it to the attention of the other party. See Scott J. Burnham, *Incorporating the Doctrine of Reasonable Expectations in Article 2*, 11 Duq. Bus. L.J. 217 (2009).

Problem 3-3. A seller offers to sell a widget to a buyer for $1,000. The buyer sends the seller a draft agreement containing standard terms of sale. In addition, the buyer includes this term in the middle of the contract:

> 17. Seller hereby offers to sell Buyer 100 additional widgets for $1,000 each on the same terms. This offer will be held open until May 15.

On May 1, the seller signs the form on the signature line at the end and sends it to the buyer, who also signs it. A week later, the buyer informs the seller that he accepts the offer in paragraph 17. Is there a binding contract for the 100 additional widgets?

3.3.3.2. If consideration is paid by the offeree to the offeror to hold the offer open, the terms of § 2-205 do not apply. Read the last two sentences of Comment 3 to § 2-205.

Problem 3-4. A seller offers to sell a widget to a buyer for $1,000. The buyer wants more time to think about it, and asks the seller if he will accept $25 to keep the offer open for six months. The seller agrees and the buyer pays the $25. Four months later, the buyer accepts the offer. Is the offer still open at the time the buyer accepted it?

Problem 3-5. Raymond, who raises, trains, and sells quarter horses, sends the following letter to Ed, who has been looking for a roping horse to buy:

January 13, 2014
Dear Ed: I offer you the opportunity to buy an outstanding 8 year old roping horse, Pokey, for $20,000. This offer remains open until May 30, 2014.
Sincerely yours, Raymond

Ed arrives on February 26, 2014 at Raymond's stables, $20,000 check in hand, to pick up Pokey. Raymond advises Ed that he sold Pokey for $25,000 to his neighbor yesterday. Ed comes to see you to ask if he has a claim for breach of contract against Raymond. What do you tell him?

3.3.4. Once an offer is made, a contract is formed when the offer is accepted. Acceptance is the manifestation by the offeree of assent to the terms of the offer. *Restatement (Second) of Contracts* § 50. In other words, if the offeree does not clearly express assent to the terms that have been offered, there is no acceptance.

3.3.4.1. Under the common law, if an expression of "acceptance" contains any differing terms or additional terms than those contained in the original offer, this is a "counter-offer," and not an acceptance. Example: Sue offers to sell John her car for $10,000. John replies that he'll accept her offer, provided that she throws in a new set of tires. At common law, this is not an acceptance, but a counter-offer.

3.3.5. The UCC has modified the common law rule regarding "mirror acceptance," most notably under § 2-207, commonly referred to as the "battle of the forms." But let's start with § 2-206. We will dedicate Chapter 4 to the intricacies of § 2-207.

3.3.5.1. As the common law developed, there was a departure from the mirror image rule regarding the *manner* of acceptance. Today, most jurisdictions allow acceptance in any reasonable manner and by any reasonable medium *unless* the offeror prescribes a specific manner or medium of acceptance. ***Note***: At common law, the offeror is still master of the offer, and can still insist on a specific manner or medium of acceptance.

3.3.5.2. Consistent with the development under common law, § 2-206(1)(a) allows an offeree to accept "in *any manner* and *by any medium reasonable* in the circumstances," *unless* otherwise unambiguously indicated by the language or circumstances.

Problem 3-6. Joe offers to sell his car to Bob for $1,000, but the offer specifically states that Bob can accept only by coming to Joe's house on February 15 between the hours of 5:00 p.m. and 8:00 p.m. to pick up the car, along with a certified check for $1,000. Can Bob accept by writing a letter to Joe accepting his offer? What if he shows up at the specified time and place, but brings a personal check instead of a certified check?

3.3.5.3. Section 2-206(1)(b) provides that if an offer to buy goods seeks "prompt or current shipment," the seller can accept by *either* a prompt promise to ship or by prompt performance. In other words, a reference to a prompt shipment is not to be construed as limiting the manner of acceptance to shipment, but also allows acceptance by promise.

3.3.5.4. Under § 2-206(1)(b), if there is an offer to buy goods for prompt or current shipment, and a seller responds by promptly sending a shipment, *but* the shipment is *non-conforming*, the shipment will nonetheless operate as an acceptance even though it does not mirror the terms of the offer. In other words, the seller accepts and breaches at the same time. However, if the seller does not want to breach, it can notify the buyer that the shipment is only an accommodation, in which event it becomes a counter-offer that the buyer can accept or reject.

Problem 3-7. Two Medicine Ranch sends the following fax to several of its neighbors: "In urgent need of 30 head of registered Black Angus cows. Must be bred and between 3 and 4 year years of age; will pay $1500 per head. If you have this quantity to sell, ship immediately to Two Medicine Ranch." Two neighbors respond that day. First, Bob calls and says "I'll deliver 30 head of cattle as you described tomorrow." About one hour after that phone call, Alice drives up with 28 head of registered cows as described in the offer.

(1) Is a contract formed between Bob and Two Medicine Ranch, although the offer requested acceptance by shipment?

(2) Is a contract formed between Alice and Two Medicine Ranch when she delivers 28 head of cattle as described in the offer?

Problem 3-8. Office Supplies offers to sell a specific model of a copy machine to Mega Law Firm for $16,000. Mega Law firm responds: "We accept but will pay $15,000 for the copy machine." Has there been acceptance under § 2-206?

Problem 3-9. Toyland, a retail toy store, places a written order asking Dollmaker to ship 10,000 of its popular Cutie-Pie dolls at $1.00 per unit. Dollmaker responds by shipping 9000 Cutie-Pie dolls, with an invoice showing a price of $1.00 per unit. Has there been acceptance by Dollmaker under § 2-206?

3.3.6. Under § 2-206(2), if an offeree accepts by beginning performance, and performance is a reasonable mode of acceptance, the offeree must also provide notice within a reasonable time of beginning performance. Failure to do so will allow the offeror to treat the offer as having lapsed before acceptance. Read Comment 3.

ProCD, Inc. v. Zeidenberg
86 F.3d 1447 (7th Cir. 1996)

EASTERBROOK, Circuit Judge

Must buyers of computer software obey the terms of shrinkwrap licenses? The district court held not, for two reasons: first, they are not contracts because the licenses are inside the box rather than printed on the outside; second, federal law forbids enforcement even if the licenses are contracts. 908 F. Supp. 640 (W.D. Wis. 1996). The parties and numerous amici curiae have briefed many other issues, but these are the only two that matter--and we disagree with the district judge's conclusion on each. Shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable). Because no one argues that the terms of the license at issue here are troublesome, we remand with instructions to enter judgment for the plaintiff.

ProCD, the plaintiff, has compiled information from more than 3,000 telephone directories into a computer database....

The database in SelectPhone cost more than $ 10 million to compile and is expensive to keep current. It is much more valuable to some users than to others. The combination of names, addresses, and sic codes enables manufacturers to compile lists of potential customers.... Every box containing its consumer product declares that the software comes with restrictions stated in an enclosed license. This license, which is encoded on the CD-ROM disks as well as printed in the manual, and which appears on a user's screen every time the software runs, limits use of the application program and listings to non-commercial purposes.

Matthew Zeidenberg bought a consumer package of SelectPhone in 1994 from a retail outlet in Madison, Wisconsin, but decided to ignore the license. He formed Silken Mountain Web Services, Inc., to resell the information in the SelectPhone database. The corporation makes the database available on the Internet to anyone willing to pay its price -- which, needless to say, is less than ProCD charges its commercial customers. Zeidenberg has purchased two additional SelectPhone packages, each with an updated version of the database, and made the latest information available over the World Wide Web, for a price, through his corporation. ProCD filed this suit seeking an injunction against further dissemination that exceeds the rights specified in the licenses (identical in each of the three packages Zeidenberg purchased). The district court held the licenses ineffectual because their terms do not appear on the outside of the packages. The court added that the second and third licenses stand no different from the first, even though they are identical, because they *might* have been different, and a purchaser does not agree to -- and cannot be bound by -- terms that were secret at the time of purchase. 908 F. Supp. at 654.

Following the district court, we treat the licenses as ordinary contracts accompanying the sale of products, and therefore as governed by the common law of contracts and the Uniform

Commercial Code. Whether there are legal differences between "contracts" and "licenses" (which may matter under the copyright doctrine of first sale) is a subject for another day.... Zeidenberg does argue, and the district court held, that placing the package of software on the shelf is an "offer," which the customer "accepts" by paying the asking price and leaving the store with the goods.... In Wisconsin, as elsewhere, a contract includes only the terms on which the parties have agreed. One cannot agree to hidden terms, the judge concluded. So far, so good -- but one of the terms to which Zeidenberg agreed by purchasing the software is that the transaction was subject to a license. Zeidenberg's position therefore must be that the printed terms on the outside of a box are the parties' contract -- except for printed terms that refer to or incorporate other terms. But why would Wisconsin fetter the parties' choice in this way? Vendors can put the entire terms of a contract on the outside of a box only by using microscopic type, removing other information that buyers might find more useful (such as what the software does, and on which computers it works), or both. The "Read Me" file included with most software, describing system requirements and potential incompatibilities, may be equivalent to ten pages of type; warranties and license restrictions take still more space. Notice on the outside, terms on the inside, and a right to return the software for a refund if the terms are unacceptable (a right that the license expressly extends), may be a means of doing business valuable to buyers and sellers alike. See E. Allan Farnsworth, 1 *Farnsworth on Contracts* § 4.26 (1990); *Restatement (2d) of Contracts* § 211 comment a (1981) ("Standardization of agreements serves many of the same functions as standardization of goods and services; both are essential to a system of mass production and distribution. Scarce and costly time and skill can be devoted to a class of transactions rather than the details of individual transactions."). Doubtless a state could forbid the use of standard contracts in the software business, but we do not think that Wisconsin has done so.

Transactions in which the exchange of money precedes the communication of detailed terms are common. Consider the purchase of insurance. The buyer goes to an agent, who explains the essentials (amount of coverage, number of years) and remits the premium to the home office, which sends back a policy. On the district judge's understanding, the terms of the policy are irrelevant because the insured paid before receiving them. Yet the device of payment, often with a "binder" (so that the insurance takes effect immediately even though the home office reserves the right to withdraw coverage later), in advance of the policy, serves buyers' interests by accelerating effectiveness and reducing transactions costs. Or consider the purchase of an airline ticket. The traveler calls the carrier or an agent, is quoted a price, reserves a seat, pays, and gets a ticket, in that order. The ticket contains elaborate terms, which the traveler can reject by canceling the reservation. To use the ticket is to accept the terms, even terms that in retrospect are disadvantageous.... Just so with a ticket to a concert. The back of the ticket states that the patron promises not to record the concert; to attend is to agree. A theater that detects a violation will confiscate the tape and escort the violator to the exit. One *could* arrange things so that every concertgoer signs this promise before forking over the money, but that cumbersome way of doing things not only would lengthen queues and raise prices but also would scotch the sale of tickets by phone or electronic data service.

Consumer goods work the same way. Someone who wants to buy a radio set visits a store, pays, and walks out with a box. Inside the box is a leaflet containing some terms, the most important of which usually is the warranty, read for the first time in the comfort of home. By Zeidenberg's lights, the warranty in the box is irrelevant; every consumer gets the standard warranty implied by the UCC in the event the contract is silent; yet so far as we are aware no state disregards warranties furnished with consumer products. Drugs come with a list of ingredients on the outside and an elaborate package insert on the inside. The package insert describes drug interactions, contraindications, and other vital information -- but, if Zeidenberg is right, the purchaser need not read the package insert, because it is not part of the contract.

Next consider the software industry itself. Only a minority of sales take place over the counter, where there are boxes to peruse. A customer may place an order by phone in response to a line item in a catalog or a review in a magazine. Much software is ordered over the Internet by purchasers who have never seen a box. Increasingly software arrives by wire. There is no box; there is only a stream of electrons, a collection of information that includes data, an application program, instructions, many limitations ("MegaPixel 3.14159 cannot be used with Byte-Pusher 2.718"), and the terms of sale. The user purchases a serial number, which activates the software's features. On Zeidenberg's arguments, these unboxed sales are unfettered by terms -- so the seller has made a broad warranty and must pay consequential damages for any shortfalls in performance, two "promises" that if taken seriously would drive prices through the ceiling or return transactions to the horse-and-buggy age....

What then does the current version of the UCC have to say? We think that the place to start is § 2-204(1): "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance. And that is what happened. ProCD proposed a contract that a buyer would accept by *using* the software after having an opportunity to read the license at leisure. This Zeidenberg did. He had no choice, because the software splashed the license on the screen and would not let him proceed without indicating acceptance. So although the district judge was right to say that a contract can be, and often is, formed simply by paying the price and walking out of the store, the UCC permits contracts to be formed in other ways. ProCD proposed such a different way, and without protest Zeidenberg agreed. Ours is not a case in which a consumer opens a package to find an insert saying "you owe us an extra $ 10,000" and the seller files suit to collect. Any buyer finding such a demand can prevent formation of the contract by returning the package, as can any consumer who concludes that the terms of the license make the software worth less than the purchase price. Nothing in the UCC requires a seller to maximize the buyer's net gains....

REVERSED AND REMANDED.

Case Notes:

1. Although UCC § 2-204(2) permits formation of a contract "even though the moment of its making is undetermined," the timing of the formation of the contract in the *Pro CD* case was an important issue. The district court ruled that the placement of the software program on the store shelf was an offer, and the contract was formed when Mr. Zeidenberg accepted the offer by paying the purchase price to the sales clerk. 908 F. Supp. 640, 652 (W.D. Wis. 1996). At that point in time, the court reasoned, Mr. Zeidenberg had neither read nor considered the terms contained in the license enclosed in the box; he could not possibly have assented to them; and thus those terms were not a part of the contract. *Id.* at 654-55. Does the appellate court agree that Mr. Zeidenberg accepted the offer (and a contract was formed) when he paid the purchase price? What constituted acceptance, according to the appellate court?

2. The type of contract involved in this case has been referred to as a "terms later," "rolling," or "layered" contract. Can you recall a purchase that you have recently made in which you became aware of additional terms after you ordered and paid for a good? When you ordered or paid for the good, were you aware that additional terms would be coming? Did you actually read the terms once they did arrive? Did you have the opportunity to return the good if the terms were, in fact, unacceptable to you? If there had not been notice on the outside of the box that additional terms were contained within the box, or if Mr. Zeidenberg had not been provided the option to return the software after reading those terms, would the court have reached a different result? What if there had been notice on the box and the option to return, but Mr. Zeidenberg had simply neglected to read the terms after he opened the box and for that reason was unaware of the limitations imposed? For further discussion of these types of contracts and the difficult issues they raise, see Eric A. Posner, *ProCD v Zeidenberg and Cognitive Overload in Contractual Bargaining*, 77 U. Chi. L. Rev. 1181 (2010); John E. Murray, Jr., *The Dubious Status of the Rolling Contract Formation Theory*, 50 Duq. L. Rev. 35 (2012).

3.4. Uniform Electronic Transactions Act. Most states have adopted the Uniform Electronic Transactions Act promulgated by the Uniform Law Commission in 1999. E-sign is the federal statute governing the enforceability of electronic contracts and signatures. Like UETA, it does not attempt to provide substantive law. E-sign does not preempt state law if a state uniformly enacts sections one to sixteen of UETA. 15 U.S.C. §§ 7001-7006.

As noted by the ULC, "the primary objective of this act is to establish the legal equivalence of electronic records and signatures with paper writings and manually-signed signatures, removing barriers to electronic commerce." UETA is not intended to be a source of substantive law regarding contracts; it relies upon other applicable laws for matters such as contract formation and enforceability. See § 7.

3.4.1. Section 5(b) of UETA specifically requires that a party assent to conduct a transaction electronically in order for UETA to apply. It does not force parties to use electronic records, electronic signatures, or other electronic processes.

Problem 3-10. Jane gives out a business card with an e-mail address on it. Has she consented to conduct transactions electronically with those customers who receive her card and place an order with her by e-mail?

3.4.2. Where it applies, UETA allows offers and acceptances to be communicated electronically. The formation of a contract may not be denied solely because there is not a pen and ink "writing" or "signature." UETA § 7. However, substantive law applies to the electronic communications. For example, if Susan sends an e-mail to Bill stating "I offer to sell you my collection of baseball cards for $1,000," and Bill replies by e-mail stating "I'll buy them for $900," the substantive laws of offer and acceptance apply and Bill's e-mail will be construed as a counter-offer rather than an acceptance.

Problem 3-11. Nancy, a law student, orders a computer from Superfast Computer Co. for $750 on its website, and provides an electronic signature. The signature and other details of the transaction, including the quantity, purchase price, and delivery terms, are recorded and stored electronically at Superfast's website. A few hours later she finds a better deal on a better computer. Can Nancy successfully argue that her electronic signature is not valid, and thus she is not obligated to purchase the computer from Superfast? That the statute of frauds (§ 2-201) has not been satisfied? What if Nancy had engaged in the electronic deal by purchasing a used computer from another student on Craigslist? Does UETA apply to transactions where neither party is a merchant?

3.4.3. Section 14 of UETA allows contracts to be formed by machines functioning as electronic agents for parties to a transaction, *without action or review by a human being.* An electronic agent is defined at § 2(6) to include, for example, an automated computer program. This is referred to as an *automated transaction* (defined at §2(2)). See also § 2, Official Comment 2.

Problem 3-12. A pharmacy has a computerized inventory program which, without human review or input, automatically places an order by e-mail to a drug company when it determines that the supply of a particular drug is low. The drug company, through use of its own computer program that has access to the e-mail, accepts the offer. Has mutual assent to form a contract occurred, even though no human is aware of this particular transaction at the time it is made?

3.4.4. Under UETA § 14(2), special rules apply to the formation of a contract in an automated transaction occurring between an *electronic agent*, on one end, and an *individual*, on the other. Not all transactions between an individual and, for example, a website result in a contract. For example, an agreement is not necessarily formed when you get onto the ULC website to look at the text of UETA. However, what if you get onto a website and a little box pops up and provides you with the terms of usage, and states conspicuously **"If you proceed further you consent to the above terms"**? Or if the website does not allow you to proceed further unless you click "yes, I agree" (a clickwrap agreement). A contract may be formed if the individual performs actions that (i) the individual is free to refuse to perform and (ii) the individual knows or has reason to know will cause the electronic agent on the other end to complete the transaction or performance. Keep that in mind next time you click "yes" to access a company's website.

3.4.5. What happens, in an automated transaction, if an individual makes a mistake? For example, you are in the process of ordering a shirt from the Stuffed Shirts website, and you inadvertently type in "10" when requested to state the quantity of shirts, instead of "1"? Have you just formed a contract for ten shirts, when you really only wanted one? (By the way, is this a "unilateral" or a "mutual" mistake, and what would the result be at common law?)

Problem 3-13. Read UETA §§ 14(2) and 10 before responding to the following questions, which are based upon the above mistake while ordering from the Stuffed Shirts website.

(1) What if the Stuffed Shirts website provides you with an opportunity to correct the error? For example, at the end it provides a summary of your order, clearly showing the quantity as "10" and asks you to confirm the order, and you zone out and hit "confirm"?

(2) What if the Stuffed Shirts website provides no opportunity to correct the error? What, if anything, can you do to "avoid" the effect of the error?

Chapter 3 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 5

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 1-2, 1-4, 1-5

Chapter 4. Battle of the Forms

4.1. Introduction.

4.1.1. In today's business world, buyers and sellers have developed standardized forms to use when offering to sell goods and when accepting an offer to buy goods. These forms typically have blank spaces to fill in for "material" or "dickered" terms, such as the type of good, quantity, price, and delivery date. These standardized forms also contain many paragraphs, even pages, of "fine print" or "boilerplate" terms, such as warranties, exclusions of warranties, payment terms, remedies (or limitations of remedies), choice of law, choice of forum, arbitration clauses, etc. UCC § 2-207 was designed to resolve the issue of what terms govern when these forms contain terms that either contradict each other (*i.e.*, "different" terms), or when one form contains terms not addressed in the other form (*i.e.*, "additional" terms).

4.1.2. Another fairly common situation today is an oral agreement followed up by written confirmations. For example, a law student calls Computer Warehouse to order a new computer, specifying the model, quantity, and price. Computer Warehouse accepts the order over the phone. When Computer Warehouse ships the computer, it sends along a nine-page "written confirmation" of its acceptance that contains numerous terms, such as warranties and choice of law clauses, none of which were discussed when the contract was originally formed on the phone. UCC § 2-207 provides the framework for determining whether the additional terms govern the transaction.

4.1.3. UCC § 2-207 is not a model of clarity. One commentator has this to say:

> Section 2-207, if not the most complex section in the Code, is certainly among the strong contenders. It is beset with awesome difficulties in its application and few, if any Code commentators would presume to know all there is to know about this troublesome section.

Thomas Quinn, *Quinn's Uniform Commercial Code Commentary and Law Digest* §2-207[A][1] (West 2d ed., 2002).

4.2. First Step: Work through Section 2-207(1) before the Comma. As discussed in Chapter 3, formation of a contract at common law requires "mirror" acceptance of the terms offered. An acceptance cannot contradict terms contained in the original offer, nor add terms to those originally proposed. Such an acceptance becomes a counter-offer, which the original offeror is now free to accept or reject. The purpose of § 2-207 is to allow, in some circumstances, a response to an offer that adds or varies terms of the original offer to nonetheless *operate* as an acceptance, whereas under common law it would be construed as a counter-offer.

4.2.1. Section 2-207(1) requires a communication that is either (i) a "definite and seasonable expression of acceptance" or (ii) a "written confirmation" following an oral agreement. Let's start by analyzing what constitutes a "definite and seasonable expression of acceptance."

Problem 4-1. Office Supplies and MegaLawFirm have been talking about MegaLawFirm's purchase of a new Beerox 1000 copy machine. Office Supplies writes to MegaLawFirm. "We offer to sell the Beerox 1000 copy machine to you upon the terms contained in the enclosed purchase order form." That form is reproduced below:

Date: January 10, 2014
Purchaser: MegaLawFirm
Description of Product: Beerox 1000 copy machine
Quantity: 1
Purchase Price: $16,000.00
Delivery Date: February 1, 2014

(1) MegaLawFirm responds to this offer as follows: "We acknowledge receipt of your offer, and agree to enter into a contract upon the terms enclosed." MegaLawFirm encloses the following:

Date: January 11, 2014
Purchaser: MegaLawFirm
Description of Product: Beerox 1000 copy machine
Quantity: 1
Purchase Price: $15,000.00
Delivery Date: February 1, 2014

Is MegaLawFirm's response a "definite and seasonable expression of acceptance" under the UCC? Why or why not?

(2) What if MegaLawFirm had responded: "We accept your offer, upon the terms enclosed." MegaLawFirm encloses the following:

Date: January 11, 2014
Purchaser: MegaLawFirm
Description of Product: Beerox 1000 copy machine
Quantity: 1
Purchase Price: $16,000.00
Delivery: To be delivered by Office Supplies at its expense to the offices of MegaLawFirm located at 100 Main Street, Missoula, Montana on February 1, 2014.

Is MegaLawFirm's response a "definite and seasonable expression of acceptance" under the UCC? Why or why not?

4.2.2. In determining whether there has been "a definite and seasonable expression of acceptance," what factors should you look at?

> 4.2.2.1. Look for words of acceptance. In the two problems above, MegaLawFirm responds in the first letter with "we *agree to enter into a contract* upon the terms enclosed"; the other response indicates "we *accept your offer* upon the terms enclosed." Which presents a better case for arguing that MegaLawFirm's response is a "definite and seasonable expression of acceptance"? Is usage of the word "accept" in a response to an offer conclusive?
>
> 4.2.2.2. Second, look at whether a purported acceptance manifests assent by the offeree to the offeror's proposed ***"dickered"*** or ***material*** terms. In the first problem above, did MegaLawFirm express consent to the ***material*** terms? If in its response to an offer the offeree does not manifest assent to the material terms proposed by offeror, for example, by proposing a different price, quantity, type of good, delivery date or something inconsistent with any other important, dickered term, then you have good grounds to argue that the response is not an acceptance, but a counter-offer. On the other hand, a response containing a contradictory non-dickered term, or adding non-material terms not discussed, should not preclude acceptance.
>
> To put it another way, § 2-207 is concerned with reasonable expectations. Parties usually read the material terms in the acceptance to be sure they conform to the terms of the offer. But they don't read all the fine print. The intent of § 2-207 is to allow formation of a contract even if the fine print differs.

4.2.3. Now let's look at the ***written confirmation*** portion of § 2-207(1). Note first that the written confirmation must follow "within a reasonable time." Section 1-205 tells us that ***reasonable*** depends on the "nature, purpose and circumstances of the action," so it will be determined on a case by case basis.

> 4.2.3.1. Comment 1 gives two examples in which the "written confirmation" provision could apply. The first is a written confirmation following an agreement reached orally. The second is a written confirmation following an agreement reached by "informal correspondence." In other words, key terms, such as the description of the good, quantity, and purchase price, are agreed to in an exchange of faxes, and then one or both of the parties follows up with its five-page standard purchase agreement that includes numerous other terms not discussed in the exchange of correspondence, such as warranties and choice of law clauses.

4.3. Second Step: Look for Language Sufficient to Satisfy Section 2-207(1) after the Comma. Let's assume you have concluded that so far § 2-207(1) applies because there exists either a "definite and seasonable expression of acceptance" of an offer or a "written confirmation" of an oral or informal agreement. Normally, either of these will operate as an acceptance even though they propose "additional" or "different" terms (the effect of which we discuss at Section 4.4). But there is an exception found after the comma in § 2-207(1): is the acceptance "expressly made conditional on assent to the additional or different terms"?

Problem 4-2. In preparation for spring sales of its potted herbs, HerbPots submits a purchase order to TerraGreen for 10,000 4" x 4" plant containers made from recycled materials, at $.25/pot, to be delivered by February 1. In its "fine print," the purchase order states that HerbPots will pay within thirty days of receipt of the goods. TerraGreen responds with its standard form entitled "acknowledgement of order," the first clause of which states (in large italicized font): *"TerraGreen's acceptance of your purchase order is conditioned upon your assent to all of the following terms and conditions."* As part of the standard terms printed on back, TerraGreen provides that payment must be made within twenty days of receipt of the goods, and that a late payment fee of 5% will be assessed against any payment made after the twenty-day period.

> (1) Does TerraGreen's acknowledgement operate as an acceptance of HerbPots' order?
>
> (2) What would your conclusion be if, instead of the italicized language above, TerraGreen's acknowledgement had commenced with the following phrase: *"The printed terms contained in this form shall become a part of the contract between the parties."*
>
> 4.3.1. Language making an offeree's acceptance conditional upon assent to its proposed additional or different terms may not trigger the exception if that language is buried in fine print somewhere in its written acceptance form. In *Daitom, Inc. v. Pennwalt Corp*., 741 F.2d 1569 (10th Cir. 1984), Pennwalt offered to sell commercial vacuum dryers to Daitom. Daitom's response expressed its consent to the "dickered" material terms; however Daitom's response also contained language -- in fine print on the back -- that Daitom's "acceptance is *expressly limited to [Daitom's] terms and conditions, unless each deviation is mutually recognized therefore in writing*." The court found that in order to constitute a "conditional acceptance," the offeree "***must explicitly communicate*** his or her unwillingness to proceed with the transaction unless the additional or different terms in its response are accepted by the offeror." *Id*. at 1577 (emphasis supplied). The court found that Daitom did not adequately bring its conditional acceptance to the attention of Pennwalt, and thus the exception did not apply.
>
> 4.3.2. If a party has used language sufficient to satisfy the language of exception after the comma in § 2-207(1), then there is no acceptance. If there is no acceptance, at this point there is no contract. There are three possibilities as to what will happen next:
>
> - the parties will refuse to agree on terms;

• the parties will agree on terms; or
• the parties will go ahead and ship the goods and pay for them, moving the parties into § 2-207(3).

4.3.3. Section 2-207(3), which was added in 1966, is intended to apply when the writings of the parties do not establish a contract, but they act as if they have reached an agreement. Recall that if acceptance is expressly made conditional on assent, the response is not an acceptance but a counter-offer. If there is no acceptance then there is no contract established by the writings. But a contract might nevertheless be established by conduct. In the case of *Uniroyal, Inc. v. Chambers Gasket and Manufacturing Company*, 380 N.E.2d 571 (Ind. App. 1978) the court concluded that the writings exchanged between Chambers and Uniroyal did not create a contract, because Uniroyal's acceptance of Chambers' offer to purchase goods was expressly conditioned on Chambers' assent to the new terms and the record revealed no manifestation of Chambers' assent to those terms. Because Uniroyal shipped the goods ordered by Chambers, and Chambers accepted the shipment, the parties' conduct was "sufficient to establish a contract." In such a situation, § 2-207(3) provides that the terms of the contract are those on which the writings agree, as supplemented by applicable Code provisions. In other words, the additional or different terms are subject to a "knock-out" rule, the application of which is discussed in more detail at Section 4.4.4.

4.4. Third Step: Determine the Effect of Different or Additional Terms. Now let's back up. Assume that we have concluded that the requirements of § 2-207(1) before the comma are satisfied, and there is not sufficient language to invoke the exception after the comma. We now know that an acceptance has occurred even though the acceptance proposes additional or different terms from those offered. The problem now is to find out which terms govern – those in the offer or those in the acceptance. Section 2-207(2) provides the framework for answering that question.

4.4.1. Introduction. Section 2-207(2) tells us what to do with "***additional***" terms, but does not mention "***different***" terms. However, Comment 3 states that subsection (2) determines whether or not either "additional" or "different" terms will become part of the contract. The dilemma of "different" terms is discussed at Section 4.4.4 below. With regard to additional terms, one set of rules applies to contracts between merchants (Section 4.4.2) and another set of rules applies to contracts in which one or both parties are non-merchants (Section 4.4.3).

4.4.2. Additional Terms Between Merchants. Subsection (2) states that any ***additional*** terms "are to be construed as proposals." Where both parties are ***merchants***, a proposed additional term becomes a part of the agreement ***unless***:

(1) the ***offer expressly limits acceptance*** to the terms of the offer;

(2) the additional term ***materially alters*** the contract (Comment 4 explains that a term which would "materially alter" the contract is one that would result in *surprise* or *hardship* if incorporated into the contract; Comment 5 gives examples of terms that would not result in surprise); or

(3) the ***offeror gives notice of its objection*** to the additional term, which can be done either at the time the contract is made by appropriate language in the offer (*i.e.*, limiting acceptance to the terms of the offer or otherwise making it clear that no additional terms will be considered part of the contract) or within a reasonable time after receipt of notice of the additional terms.

If any one of these three possibilities occur, the terms of the offer control *unless* the offeree assents to the additional terms. Several courts have ruled that in contracts between merchants, it is *presumed* that any additional terms proposed by the offeree become a part of the agreement, and the offeror bears the burden of proof as to the existence of one of the exceptions. See, for example, *Avedon Engineering, Inc. v. Seatex*, 126 F.3d 1279, 1284 (10th Cir. 1997); *Bayway Refining Co. v. Oxygenated Marketing & Trading A.G.*, 215 F.3d 219, 223-224 (2nd Cir. 2000).

Problem 4-3. On January 15, LePooch, a dog grooming and boarding business, submits a purchase order to Animal Treats, a manufacturer of pet supplies, for $10,000 worth of dog food, specifying the quantity and price of a variety of types of dog foods, to be delivered by February 1. The purchase order is silent as to when the purchase price will be paid. Animal Treats responds with its standard form entitled "acknowledgement of order," which does not contain any "conditional assent" language. As part of the standard terms printed on back, Animal Treats provides that payment must be made within thirty days of receipt of the goods, and that any payments made after such date will incur interest at the rate of 6% per annum. Is Animal Treats entitled to collect interest if LePooch does not pay within thirty days of its receipt of the goods? Why or why not?

Problem 4-4. In addition to the 6% interest clause, Animal Treats' standard "acknowledgment of order" form includes the following term:

> "Purchaser may return any defective goods for refund of the purchase price or for replacement within sixty days of knowledge of the defect. Except for a refund of the purchase price or replacement of the defective good, Purchaser shall have no other remedies, including, without limitation, a claim for consequential damages."

Assume that LePooch's order form is silent as to remedies. Does Animal Treats' additional term limiting damages become a part of the contract?

4.4.3. Additional Terms *Not* Between Merchants. Whereas UCC § 2-207(2) specifically states what happens to proposed additional terms as between merchants, it does not say what to do when either party to the agreement is a ***non-merchant***.

Problem 4-5. A law student orders a new computer over the phone from Computer BigBox, specifying the model, quantity, and price, which order is accepted by an agent of Computer BigBox over the phone. When Computer BigBox ships the computer, it sends along a "written confirmation" of its acceptance, which is a nine-page document containing numerous terms, such as warranties and choice of law clauses, which were never discussed when the contract was originally formed on the phone. Do these terms become part of the contract under § 2-207?

Problem 4-6. Assume that the nine-page document delivered by Computer BigBox with the computer states in bold print at the very top: "By keeping your computer beyond ten days after the date of delivery, you assent to these Terms and Conditions."

1. Does the law student's conduct of keeping the computer constitute acceptance of the additional terms?

2. Is there anything the law student can do, if she keeps the computer, to prevent the additional terms and conditions from becoming a part of the contract?

Klocek v. Gateway, Inc.
104 F. Supp. 2d 1332 (D. Kan. 2000)

[Klocek and other individuals purchased computers from Gateway. Plaintiff brought individual and class action law suits against Gateway for breach of contract. Gateway sought to dismiss the actions, and requested enforcement of an arbitration clause contained in the Standard Terms included with the computers when they were delivered to the plaintiffs.]

VRATIL, District Judge

….

The Uniform Commercial Code ("UCC") governs the parties' transaction under both Kansas and Missouri law.... Thus the issue is whether the contract of sale includes the Standard Terms as part of the agreement.

State courts in Kansas and Missouri apparently have not decided whether terms received with a product become part of the parties' agreement. Authority from other courts is split. Compare *Step-Saver*, 939 F.2d 91 (printed terms on computer software package not part of agreement); *Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759 (D. Ariz. 1993) (license agreement shipped with computer software not part of agreement); and *U.S. Surgical Corp. v. Orris, Inc.*, 5 F. Supp. 2d 1201 (D. Kan. 1998) (single use restriction on product package not binding agreement); with *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir.), cert. denied, 522 U.S. 808 (1997) (arbitration provision shipped with computer binding on buyer); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (shrinkwrap license binding on buyer); and *M.A. Mortenson Co., Inc. v. Timberline Software Corp*., 140 Wn.2d 568, 998 P.2d 305 (Wash. 2000) (following *Hill* and *ProCD* on license agreement supplied with software). It appears that at least in part, the cases turn on whether the court finds that the parties formed their contract *before* or *after* the vendor communicated its terms to the purchaser. Compare *Step-Saver*, 939 F.2d at 98 (parties' conduct in shipping, receiving and paying for product demonstrates existence of contract; box top license constitutes proposal for additional terms under § 2-207 which requires express agreement by purchaser); *Arizona Retail*, 831 F. Supp. at 765 (vendor entered into contract by agreeing to ship goods, or at latest by shipping goods to buyer; license agreement constitutes proposal to modify agreement under § 2-209 which requires express assent by buyer); and *Orris*, 5 F. Supp. 2d at 1206 (sales contract concluded when vendor received consumer orders; single-use language on product's label was proposed modification under § 2-209 which requires express assent by purchaser); with *ProCD*, 86 F.3d at 1452 (under § 2-204 vendor, as master of offer, may propose limitations on kind of conduct that constitutes acceptance; § 2-207 does not apply in case with only one form); *Hill*, 105 F.3d at 1148-49 (same); and *Mortenson*, 998 P.2d at 311-314 (where vendor and purchaser utilized license agreement in prior course of dealing, shrinkwrap license agreement constituted issue of contract formation under § 2-204, not contract alteration under § 2-207).

Gateway urges the Court to follow the Seventh Circuit decision in *Hill*. That case involved the shipment of a Gateway computer with terms similar to the Standard Terms in this case, except that Gateway gave the customer 30 days -- instead of 5 days -- to return the computer. In enforcing the arbitration clause, the Seventh Circuit relied on its decision in *ProCD*, where it enforced a software license which was contained inside a product box. See *Hill*, 105 F.3d at 1148-50. In *ProCD*, the Seventh Circuit noted that the exchange of money frequently precedes the communication of detailed terms in a commercial transaction. See *ProCD*, 86 F.3d at 1451. Citing UCC § 2-204, the court reasoned that by including the license with the software, the vendor proposed a contract that the buyer could accept by using the software after having an opportunity to read the license.[8]*ProCD*, 86 F.3d at 1452. Specifically, the court stated:

> A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance.

ProCD, 86 F.3d at 1452. The Hill court followed the *ProCD* analysis, noting that "practical

8.Section 2-204 provides: "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such contract."

considerations support allowing vendors to enclose the full legal terms with their products." *Hill,* 105 F.3d at 1149.[9]

The Court is not persuaded that Kansas or Missouri courts would follow the Seventh Circuit reasoning in *Hill* and *ProCD*. In each case the Seventh Circuit concluded without support that UCC § 2-207 was irrelevant because the cases involved only one written form. See *ProCD*, 86 F.3d at 1452 (citing no authority); *Hill*, 105 F.3d at 1150 (citing *ProCD*). This conclusion is not supported by the statute or by Kansas or Missouri law. Disputes under § 2-207 often arise in the context of a "battle of forms," see, e.g., *Daitom, Inc. v. Pennwalt Corp*., 741 F.2d 1569, 1574 (10th Cir. 1984), but nothing in its language precludes application in a case which involves only one form. The statute provides:

> 2-207 Additional terms in acceptance or confirmation.
>
> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
>
> (2) The additional terms are to be construed as proposals for addition to the contract [if the contract is not between merchants]. . . .

By its terms, § 2-207 applies to an acceptance or written confirmation. It states nothing which requires another form before the provision becomes effective. In fact, the official comment to the section specifically provides that § 2-207(1) and (2) apply "where an agreement has been

---

9 Legal commentators have criticized the reasoning of the Seventh Circuit in this regard. See, e.g., Jean R. Sternlight, Gateway Widens Doorway to Imposing Unfair Binding Arbitration on Consumers, Fla. Bar J., Nov. 1997, at 8, 10-12 (outcome in *Gateway* is questionable on federal statutory, common law and constitutional grounds and as a matter of contract law and is unwise as a matter of policy because it unreasonably shifts to consumers search cost of ascertaining existence of arbitration clause and return cost to avoid such clause); Thomas J. McCarthy et al., Survey: Uniform Commercial Code, 53 Bus. Law. 1461, 1465-66 (Seventh Circuit finding that UCC § 2-207 did not apply is inconsistent with official comment); Batya Goodman, Honey, I Shrink-Wrapped the Consumer: the Shrinkwrap Agreement as an Adhesion Contract, 21 Cardozo L. Rev. 319, 344-352 (Seventh Circuit failed to consider principles of adhesion contracts); Jeremy Senderowicz, Consumer Arbitration and Freedom of Contract: A Proposal to Facilitate Consumers' Informed Consent to Arbitration Clauses in Form Contracts, 32 Colum. J.L. & Soc. Probs. 275, 296-299 (judiciary (in multiple decisions, including *Hill*) has ignored issue of consumer consent to an arbitration clause). Nonetheless, several courts have followed the Seventh Circuit decisions in *Hill* and *ProCD*. See, e.g., *Mortenson*, 2000 WL 550845 (license agreement supplied with software); *Rinaldi v. Iomega Corp*., 1999 Del. Super. LEXIS 563, 1999 WL 1442014, Case No. 98C-09-064-RRC (Del. Sept. 3, 1999) (warranty disclaimer included inside computer Zip drive packaging); *Westendorf v. Gateway 2000, Inc*., 2000 Del. Ch. LEXIS 54, 2000 WL 307369, Case No. 16913 (Del. Ch. March 16, 2000) (arbitration provision shipped with computer); *Brower v. Gateway 2000, Inc*., 246 A.D.2d 246, 676 N.Y.S.2d 569 (N.Y. App. Div. 1998) (same); *Levy v. Gateway 2000, Inc.,* 1997 WL 823611, 33 U.C.C. Rep. Serv. 2d (Callaghan) 1060 (N.Y. Sup. Ct. August 12, 1997) (same).

reached orally . . . and is followed by one or both of the parties sending formal memoranda embodying the terms so far agreed and adding terms not discussed." Official Comment 1 of UCC § 2-207. Kansas and Missouri courts have followed this analysis. See *Southwest Engineering Co. v. Martin Tractor Co*., 205 Kan. 684, 695, 473 P.2d 18, 26 (1970) (stating in dicta that § 2-207 applies where open offer is accepted by expression of acceptance in writing or where oral agreement is later confirmed in writing); *Central Bag Co. v. W. Scott and Co*., 647 S.W.2d 828, 830 (Mo. App. 1983) (§ 2-207(1) and (2) govern cases where one or both parties send written confirmation after oral contract). Thus, the Court concludes that Kansas and Missouri courts would apply § 2-207 to the facts in this case. Accord *Avedon*, 126 F.3d at 1283 (parties agree that § 2-207 controls whether arbitration clause in sales confirmation is part of contract).

In addition, the Seventh Circuit provided no explanation for its conclusion that "the vendor is the master of the offer." See *ProCD*, 86 F.3d at 1452 (citing nothing in support of proposition); *Hill*, 105 F.3d at 1149 (citing *ProCD*). In typical consumer transactions, the purchaser is the offeror, and the vendor is the offeree. See *Brown Mach., Div. of John Brown, Inc. v. Hercules, Inc*., 770 S.W.2d 416, 419 (Mo. App. 1989) (as general rule orders are considered offers to purchase); *Rich Prods. Corp. v. Kemutec Inc*., 66 F. Supp. 2d 937, 956 (E.D. Wis. 1999) (generally price quotation is invitation to make offer and purchase order is offer). While it is possible for the vendor to be the offeror, see *Brown Machine*, 770 S.W.2d at 419 (price quote can amount to offer if it reasonably appears from quote that assent to quote is all that is needed to ripen offer into contract), Gateway provides no factual evidence which would support such a finding in this case. The Court therefore assumes for purposes of the motion to dismiss that plaintiff offered to purchase the computer (either in person or through catalog order) and that Gateway accepted plaintiff's offer (either by completing the sales transaction in person or by agreeing to ship and/or shipping the computer to plaintiff).[11] Accord *Arizona Retail*, 831 F. Supp. at 765 (vendor entered into contract by agreeing to ship goods, or at latest, by shipping goods).

Under § 2-207, the Standard Terms constitute either an expression of acceptance or written confirmation. As an expression of acceptance, the Standard Terms would constitute a counter-offer only if Gateway expressly made its acceptance conditional on plaintiff's assent to the additional or different terms. "The conditional nature of the acceptance must be clearly expressed in a manner sufficient to notify the offeror that the offeree is unwilling to proceed with the transaction unless the additional or different terms are included in the contract." *Brown Machine*, 770 S.W.2d at 420.[12] Gateway provides no evidence that at the time of the sales

11 UCC § 2-206(b) provides that "an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment . . ." The official comment states that "either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment." UCC § 2-206, Official Comment 2.

12 Courts are split on the standard for a conditional acceptance under § 2-207. See *Daitom*, 741 F.2d at 1576 (finding that Pennsylvania would most likely adopt "better" view that offeree must explicitly communicate unwillingness to proceed with transaction unless additional terms in response are accepted by offeror). On one extreme of the spectrum, courts hold that the offeree's response stating a materially different term solely to the

transaction, it informed plaintiff that the transaction was conditioned on plaintiff's acceptance of the Standard Terms. Moreover, the mere fact that Gateway shipped the goods with the terms attached did not communicate to plaintiff any unwillingness to proceed without plaintiff's agreement to the Standard Terms. See, e.g., *Arizona Retail*, 831 F. Supp. at 765 (conditional acceptance analysis rarely appropriate where contract formed by performance but goods arrive with conditions attached); *Lighton Indus., Inc. v. Callier Steel Pipe & Tube, Inc*., 1991 WL 18413, Case No. 89-C-8235 (N.D. Ill. Feb. 6, 1991) (applying Missouri law) (preprinted forms insufficient to notify offeror of conditional nature of acceptance, particularly where form arrives after delivery of goods).

Because plaintiff is not a merchant, additional or different terms contained in the Standard Terms did not become part of the parties' agreement unless plaintiff expressly agreed to them. See K.S.A. § 84-2-207, Kansas Comment 2 (if either party is not a merchant, additional terms are proposals for addition to the contract that do not become part of the contract unless the original offeror expressly agrees). Gateway argues that plaintiff demonstrated acceptance of the arbitration provision by keeping the computer more than five days after the date of delivery. Although the Standard Terms purport to work that result, Gateway has not presented evidence that plaintiff expressly agreed to those Standard Terms. Gateway states only that it enclosed the Standard Terms inside the computer box for plaintiff to read afterwards. It provides no evidence that it informed plaintiff of the five-day review-and-return period as a condition of the sales transaction, or that the parties contemplated additional terms to the agreement.[14] See *Step-Saver*, 939 F.2d at 99 (during negotiations leading to purchase, vendor never mentioned box-top license or obtained buyer's express assent thereto). The Court finds that the act of keeping the computer past five days was not sufficient to demonstrate that plaintiff expressly agreed to the Standard

---

disadvantage of the offeror constitutes a conditional acceptance. See *Daitom*, 741 F.2d at 1569 (citing *Roto-Lith. Ltd v. F.P. Bartlett & Co.*, 297 F.2d 497 (1st Cir. 1962)). At the other end of the spectrum courts hold that the conditional nature of the acceptance should be so clearly expressed in a manner sufficient to notify the offeror that the offeree is unwilling to proceed without the additional or different terms. See *Daitom*, 741 F.2d at 1569 (citing *Dorton v. Collins & Aikman Corp*., 453 F.2d 1161 (6th Cir. 1972)). The middle approach requires that the response predicate acceptance on clarification, addition or modification. See *Daitom,* 741 F.2d at 1569 (citing *Construction Aggregates Corp. v. Hewitt-Robins, Inc*., 404 F.2d 505 (7th Cir. 1968)). The First Circuit has since overruled its decision in *Roto-Lith*, see *Ionics, Inc. v. Elmwood Sensors, Inc.,* 110 F.3d 184, and the Court finds that neither Kansas nor Missouri would apply the standard set forth therein. See *Boese-Hilburn Co. v. Dean Machinery Co*., 616 S.W.2d 520, (Mo. App. 1981) (rejecting *Roto-Lith* standard); *Owens-Corning Fiberglas Corp. v. Sonic Dev. Corp*., 546 F. Supp. 533, 538 (D. Kan. 1982) (acceptance is not counteroffer under Kansas law unless it is made conditional on assent to additional or different terms (citing *Roto-Lith* as comparison)); *Daitom*, 741 F.2d at 1569 (finding that *Dorton* is "better" view). Because Gateway does not satisfy the standard for conditional acceptance under either of the remaining standards (*Dorton* or *Construction Aggregates*), the Court does not decide which of the remaining two standards would apply in Kansas and/or Missouri.

14 The Court is mindful of the practical considerations which are involved in commercial transactions, but it is not unreasonable for a vendor to clearly communicate to a buyer -- at the time of sale -- either the complete terms of the sale or the fact that the vendor will propose additional terms as a condition of sale, if that be the case.

Terms. Accord *Brown Machine*, 770 S.W.2d at 421 (express assent cannot be presumed by silence or mere failure to object). Thus, because Gateway has not provided evidence sufficient to support a finding under Kansas or Missouri law that plaintiff agreed to the arbitration provision contained in Gateway's Standard Terms, the Court overrules Gateway's motion to dismiss....

> 4.4.4. Different Terms. Now let's discuss what happens to "different" terms contained in offeree's acceptance if, under § 2-207(1), you have concluded that there is in fact an operative acceptance. Section 2-207(2), on its face, applies only to "additional" terms. What happens if the terms contained in the acceptance are "different" rather than additional?

Daitom, Inc. v. Pennwalt Corp.
741 F.2d 1569 (10th Cir. 1984)

[Daitom invited bids from manufacturers of commercial vacuum dryers to supply it with machinery to be incorporated into a chemical manufacturing plant being built by Daitom. Pennwalt submitted a proposal specifying the equipment to be sold, the price, and delivery and payment terms. Several pages of pre-printed terms and conditions were attached and incorporated into the offer, including a clause providing for a one-year statute of limitations and a clause providing certain express warranties and disclaiming all other warranties. Daitom accepted the offer by issuing its own "purchase order" containing 17 pages of fine print terms and conditions. When the machinery failed to work properly, Daitom brought a proceeding against Pennwalt alleging, among other things, breach of implied warranties that had been disclaimed by Pennwalt in its offer. The District Court dismissed Daitom's breach of warranty claims, ruling that the claims were barred by the one-year statute of limitations specified in Pennwalt's offer.]

William E. Doyle, Circuit Judge delivered the opinion of the 10th Circuit Court of Appeals:

….

The trial court concluded that the parties' exchanged writings formed a contract. Thus, there was not a formal single document. Pennwalt's September 7, 1976 proposal constituted the offer and Daitom's October 5, 1976 purchase order constituted the acceptance....

Having found an offer and an acceptance which was not made expressly conditional on assent to additional or different terms, we must now decide the effect of those additional or different terms on the resulting contract and what terms became part of it. The district court simply resolved this dispute by focusing solely on the period of limitations specified in Pennwalt's offer of September 7, 1976. Thus, the court held that while the offer explicitly specified a one-year period of limitations in accordance with § 2-725(1) allowing such a reduction, Daitom's acceptance of October 5, 1976 was silent as to the limitations period. Consequently, the court held that § 2-207(2) was inapplicable and the one-year limitations period controlled, effectively barring Daitom's action for breach of warranties.

While the district court's analysis undertook to resolve the issue without considering the question of the application of § 2-207(2) to additional or different terms, we cannot accept its approach or its conclusion. We are unable to ignore the plain implication of Daitom's reservation in its boilerplate warranties provision of all its rights and remedies available at law. Such an explicit reservation impliedly reserves the statutory period of limitations; without such a reservation, all other reservations of actions and remedies are without effect.

The statutory period of limitations under the U.C.C. is four years after the cause of action has accrued. U.C.C. § 2-725(1). Were we to determine that this four-year period became a part of the contract rather than the shorter one-year period, Daitom's actions on breach of warranties were timely brought and summary judgment against Daitom was error.

We realize that our conclusion requires an inference to be drawn from a construction of Daitom's terms; however, such an inference and construction are consistent with the judicial reluctance to grant summary judgment where there is some reasonable doubt over the existence of a genuine material fact. *See Williams v. Borden, Inc.*, 637 F.2d 731, 738 (10th Cir. 1980). When taking into account the circumstances surrounding the application of the one-year limitations period, we have little hesitation in adopting the U.C.C.'s four-year limitations reservation, the application of which permits a trial on the merits. Thus, this court must recognize that certain terms in Daitom's acceptance differed from terms in Pennwalt's offer and decide which become part of the contract. The district court certainly erred in refusing to recognize such a conflict.

The difficulty in determining the effect of different terms in the acceptance is the imprecision of drafting evident in § 2-207. The language of the provision is silent on how different terms in the acceptance are to be treated once a contract is formed pursuant to § 2-207(1). That section provides that a contract may be formed by exchanged writings despite the existence of additional or different terms in the acceptance. Therefore, an offeree's response is treated as an acceptance while it may differ substantially from the offer. This section of the provision, then, reformed the mirror-image rule; that common law legal formality that prohibited the formation of a contract if the exchanged writings of offer and acceptance differed in any term.

Once a contract is recognized pursuant to § 2-207(1), § 2-207(2) provides the standard for determining if the additional terms stated in the acceptance become a part of the contract. Between merchants, such *additional* terms become part of the resulting contract *unless* 1) the offer expressly limited acceptance to its terms, 2) the additional terms materially alter the contract obligations, or 3) the offeror gives notice of his or her objection to the additional terms within a reasonable time. Should any one of these three possibilities occur, the *additional* terms are treated merely as proposals for incorporation in the contract and absent assent by the offeror the terms of the offer control. In any event, the existence of the additional terms does not prevent a contract from being formed.

Section 2-207(2) is silent on the treatment of terms stated in the acceptance that are *different*, rather than merely additional, from those stated in the offer. It is unclear whether "different" terms in the acceptance are intended to be included under the aegis of "additional" terms in § 2-207(2) and, therefore, fail to become part of the agreement if they materially alter the contract. Comment 3 suggests just such an inclusion.[7] However, Comment 6 suggests that different terms in exchanged writings must be assumed to constitute mutual objections by each party to the other's conflicting terms and result in a mutual "knockout" of both parties' conflicting terms; the missing terms to be supplied by the U.C.C.'s "gap-filler" provisions.[8] At least one commentator, in support of this view, has suggested that the drafting history of the provision indicates that the word "different" was intentionally deleted from the final draft of § 2-207(2) to preclude its treatment under that subsection. The plain language, comments, and drafting history of the provision, therefore, provide little helpful guidance in resolving the disagreement over the treatment of different terms pursuant to § 2-207.

Despite all this, the cases and commentators have suggested three possible approaches. The first of these is to treat "different" terms as included under the aegis of "additional" terms in § 2-207(2). Consequently, different terms in the acceptance would never become part of the contract, because, by definition, they would materially alter the contract (*i.e.*, the offeror's terms). Several courts have adopted this approach. [citations omitted.]

The second approach, which leads to the same result as the first, is that the offeror's terms control because the offeree's different terms merely fall out; § 2-207(2) cannot rescue the different terms since that subsection applies only to *additional* terms. Under this approach, Comment 6 (apparently supporting a mutual rather than a single term knockout) is not applicable because it refers only to conflicting terms in confirmation forms following *oral* agreement, not conflicting terms in the *writings* that form the agreement. This approach is supported by Professor Summers. J. J. White & R. S. Summers, *Uniform Commercial Code*, § 1-2, at 29 (2d ed. 1980).

The third, and preferable approach, which is commonly called the "knock-out" rule, is

---

7 Comment 3 states (emphasis added): "Whether or not *additional or different* terms will become part of the agreement depends upon the provision of subsection (2)." It must be remembered that even official comments to enacted statutory text do not have the force of law and are only guidance in the interpretation of that text. *In re Bristol Associates, Inc.*, 505 F.2d 1056 (3rd Cir. 1974) (while the comments to the Pennsylvania U.C.C. are not binding, the Pennsylvania Supreme Court gives substantial weight to the comments as evidencing application of the Code).

8 Comment 6 states, in part: "Where clauses on confirming forms sent by both parties conflict each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself …. The contract then consists of the terms expressly agreed to, terms on which the confirmations agree, and terms supplied by the Act, including subsection (2)."

that the conflicting terms cancel one another. Under this view the offeree's form is treated only as an acceptance of the terms in the offeror's form which did not conflict. The ultimate contract, then, includes those non-conflicting terms and any other terms supplied by the U.C.C., including terms incorporated by course of performance (§ 2-208), course of dealing (§ 1-205), usage of trade (§ 1-205), and other "gap fillers" or "off-the-rack" terms (e.g., implied warranty of fitness for particular purpose, § 2-315). As stated previously, this approach finds some support in Comment 6. Professor White supports this approach as the most fair and consistent with the purposes of § 2-207. *White & Summers, supra*, at 29. Further, several courts have adopted or recognized the approach. [citations omitted.]

We are of the opinion that this is the more reasonable approach, particularly when dealing with a case such as this where from the beginning the offeror's specified period of limitations would expire before the equipment was even installed. The approaches other than the "knock-out" approach would be inequitable and unjust because they invited the very kind of treatment which the defendant attempted to provide.

Thus, we are of the conclusion that if faced with this issue the Pennsylvania Supreme Court would adopt the "knock-out" rule and hold here that the conflicting terms in Pennwalt's offer and Daitom's acceptance regarding the period of limitations and applicable warranties cancel one another out. Consequently, the other provisions of the U.C.C. must be used to provide the missing terms.

This particular approach and result are supported persuasively by the underlying rationale and purpose behind the adoption of § 2-207. As stated previously, that provision was drafted to reform the infamous common law mirror-image rule and associated last-shot doctrine that enshrined the fortuitous positions of senders of forms and accorded undue advantages based on such fortuitous positions. *White & Summers, supra* at 25. To refuse to adopt the "knock-out" rule and instead adopt one of the remaining two approaches would serve to re-enshrine the undue advantages derived solely from the fortuitous positions of when a party sent a form. Cf., 3 Duesenberg & King at 93 (1983 Supp.). This is because either approach other than the knock-out rule for different terms results in the offeror and his or her terms always prevailing solely because he or she sent the first form. Professor Summers argues that this advantage is not wholly unearned, because the offeree has an opportunity to review the offer, identify the conflicting terms and make his or her acceptance conditional. But this joinder misses the fundamental purpose of the U.C.C. in general and § 2-207 in particular, which is to preserve a contract and fill in any gaps if the parties intended to make a contract and there is a reasonable basis for giving an appropriate remedy. U.C.C. § 2-204(3); § 2-207(1); § 2-207(3). Thus, this approach gives the offeree some protection. While it is laudable for business persons to read the fine print and boilerplate provisions in exchanged forms, there is nothing in § 2-207 mandating such careful consideration. The provision seems drafted with a recognition of the reality that merchants seldom review exchanged forms with the scrutiny of lawyers. The "knock-out" rule is therefore the best approach. Even if a term eliminated by operation of the "knock-out" rule is reintroduced by operation of the U.C.C.'s gap-filler provisions, such a result does not indicate a weakness of the approach. On the contrary, at least the reintroduced term has the merit of being a term that the U.C.C. draftpersons regarded as fair.

[The appellate court remanded the matter to the district court for application of the "knock-out" rule.]

Case Notes:

1. The original offer by Pennwalt contained a one-year statute of limitations. Daitom's acceptance was silent as to the applicable statute of limitations. How, then, did the Tenth Circuit conclude that Daitom's acceptance contained a "different" four-year statute of limitations?

2. The Tenth Circuit, in discussing the first approach of treating "different" terms in the same manner as "additional" terms was not acceptable, stating that "different terms in the acceptance would never become part of the contract, because by definition, they would materially alter the contract." Do you agree that different terms would always "materially alter" a contract? For example, if an offer, in fine print, provided for delivery by UPS, and the acceptance, in fine print, provided for delivery by the USPO, and this was not a "dickered" term, would this be a material alteration as defined by Comment 4?

3. The second approach discussed by the court is to apply § 2-207(2) to "additional" terms only, because § 2-207(2) fails to mention "different" terms. Under this approach, the different terms would be disregarded, giving deference to the offeror's terms. Is this approach more consistent with common law than the "knock-out" rule adopted by the court?

4. Several commentators feel the *Daitom* approach is supported by Comment 6. Do you agree that Comment 6 implements a "knock-out" rule?

5. The "knock-out" rule has been adopted by a majority of jurisdictions.

Problem 4-7. HerbPots' purchase order form states in fine print on the back that HerbPots will pay within thirty days of receipt of the goods. TerraGreen's acknowledgement form (which does not make its acceptance conditional on assent to any additional or different terms) provides that payment must be made within ten days of receipt of the goods. After the exchange of forms, TerraGreen ships an order of pots to HerbPots. Applying § 2-207(2), when is payment due:

(1) under the first approach cited in Daitom?

(2) under the second approach cited in Daitom?

(3) under the knock-out rule?

(4) would the result vary if HerbPots' order form was silent as to date of payment?

Research Assignment 4-1. Several states have modified § 2-207; for example, Mont. Code Ann. §30-2-207(2) provides that "additional *or different* terms are to be construed as proposals for addition to the contract." Considering any modifications that may have been made to § 2-207 in your chosen jurisdiction, which of the three approaches discussed in *Daitom* applies in your jurisdiction?

4.5. Conclusion.

4.5.1 In recognition of the problems that have arisen in the interpretation and application of § 2-207, it was entirely rewritten in Amended Article 2. The revised version provided:

§ 2-207. Terms of Contract; Effect of Confirmation.

If (i) conduct by both parties recognizes the existence of a contract although their records do not otherwise establish a contract, (ii) a contract is formed by an offer and acceptance, or (iii) a contract formed in any manner is confirmed by a record that contains terms additional to or different from those in the contract being confirmed, the terms of the contract, subject to Section 2-202, are:

(a) terms that appear in the records of both parties;
(b) terms, whether in a record or not, to which both parties agree; and
(c) terms supplied or incorporated under any provision of this Act.

Recall that the Amendments have been withdrawn, but it is nevertheless instructive to see how the drafters proposed to solve the problems created by the original version. Under the Amendment, what rule applies to different terms? What rule applies to non-merchants?

4.5.2. As parties increasingly enter into transactions through the internet, the importance of § 2-207 is subsiding. Unless one of the parties has leverage, it may have to agree to the offered terms. And if there is negotiation, the parties will only have one document that constitutes the agreement.

If one party has agreed to the other's non-negotiable terms in an internet-based transaction, what basis is there for challenging those terms after the transaction has been concluded?

Chapter 4 Additional Sources.

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 5.E

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 1-3

Chapter 5. Statute of Frauds

5.1. Statute of Frauds – the General Rule. The general rule is that oral contracts are perfectly good. The exception is the collection of statutes referred to as the Statute of Frauds. These statutes require certain transactions to be evidenced by a writing. Although you may have an offer and an acceptance that form a contract for the sale of goods, under UCC § 2-201, the contract may not be judicially enforceable *unless* it is evidenced by a writing. The writing requirement only applies to sales of goods for $500 or more.

5.1.1. Section 2-201(1) sets forth the following requirements for enforcement of a contract for the sale of goods of $500 or more:

- some ***writing***;
- sufficient to ***indicate a contract*** for sale has been made between the parties;
- ***signed*** by the party ***against whom*** enforcement is sought, or by the party's authorized agent; and
- indicating the ***quantity***.

5.1.1.1. Official Comment 1 notes that the writing "need not contain all the material terms" and any terms stated "need not be precisely stated." Comment 1 emphasizes that the only term that must appear is the quantity term, but even that does not need to be accurately stated. However, recovery is limited to the amount stated, whether accurate or not.

5.1.2. "Writing" is defined at UCC § 1-201(b)(43) as "printing, typewriting, or any other intentional reduction to tangible form." Under Section 7(c) of the Uniform Electronic Transactions Act, if a law, such as § 2-201, requires a record to be in writing, an electronic record satisfies the law.

5.1.3. Any terms not supplied by the writing will be supplied by other permissible evidence and by the gap-filler sections of the UCC.

5.1.4. The statute of frauds does not require the writing to be in one document. Two or more writings may be pieced together, provided that they relate to the same transaction (which may be established by the documents themselves, or by other evidence showing the connection). Thus, one signed payroll card and one unsigned payroll card could be read together to determine the terms of the agreement. *Crabtree v. Elizabeth Arden Corp.*, 110 N.E.2d 551 (N.Y. 1953).

Problem 5-1. Would the following constitute a "writing" for purposes of UCC § 2-201(focus on the writing requirement; we'll get to content requirements later):

(1) A sales receipt from Wal-Mart?

(2) An internal memorandum prepared by a manufacturing company addressed to one of its sales employees authorizing a sale?

(3) Notations of the terms of a sale made on a napkin at lunch?

(4) A digital recording?

5.1.5. There must be *some indication* that a contract has been made. For example, a check with a notation on the memo line such as "purchase of briefcase" would constitute language indicating a contract for sale has been made. A check with nothing written on it but the payee's name and the amount of the check would not sufficiently indicate the existence of a contract.

5.1.6. The writing need not necessarily be signed by both parties. The important signature is the signature of the party *against whom enforcement is sought*. So, for example, a letter signed by the purchaser, would be sufficient against the purchaser, *but not* against the seller, whose signature is not on the letter. Under § 7(d) of the Uniform Electronic Transactions Act (UETA), if a law requires a signature, an electronic signature satisfies the law.

Problem 5-2. Read the definition of "signed" at § 1-201(b)(37). Which of the following likely constitutes a signature:

(1) Handwritten initials?

(2) A typed name?

(3) A seller's letterhead?

Southwest Engineering Co. v. Martin Tractor Co.
473 P.2d 18 (Kan. 1970)

Fontron, J.

This is an action to recover damages for breach of contract. Trial was had to the court which entered judgment in favor of the plaintiff. The defendant has appealed.

Southwest Engineering Company, Inc., the plaintiff, is a Missouri corporation engaged in general contracting work, while the defendant, Martin Tractor Company, Inc., is a Kansas corporation. The two parties will be referred to hereafter either as plaintiff, or Southwest, on the one hand and defendant, or Martin, on the other.

We glean from the record that in April, 1966, the plaintiff was interested in submitting a bid to the United States Corps of Engineers for the construction of certain runway lighting facilities at McConnell Air Force Base at Wichita. However, before submitting a bid, and on April 11, 1966, the plaintiff's construction superintendent, Mr. R. E. Cloepfil, called the manager of Martin's engine department, Mr. Ken Hurt, who at the time was at Colby, asking for a price on a standby generator and accessory equipment. Mr. Hurt replied that he would phone him back from Topeka, which he did the next day, quoting a price of $18,500. This quotation was re-confirmed by Hurt over the phone on April 13. Southwest submitted its bid on April 14, 1966, using Hurt's figure of $18,500 for the generating equipment, and its bid was accepted. On April 20, Southwest notified Martin that its bid had been accepted. Hurt and Cloepfil thereafter agreed over the phone to meet in Springfield on April 28. On that date Hurt flew to Springfield, where the two men conferred at the airfield restaurant for about an hour. Hurt took to the meeting a copy of the job specifications which the government had supplied Martin prior to the letting.

At the Springfield meeting it developed that Martin had upped its price for the generator and accessory equipment from $18,500 to $21,500. Despite this change of position by Martin, concerning which Cloepfil was understandably amazed, the two men continued their conversation and, according to Cloepfil, they arrived at an agreement for the sale of a D353 generator and accessories for the sum of $21,500. In addition it was agreed that if the Corps of Engineers would accept a less expensive generator, a D343, the aggregate price to Southwest would be $15,000. The possibility of providing alternate equipment, the D343, was suggested by Mr. Hurt, apparently in an attempt to mollify Mr. Cloepfil when the latter learned that Martin had reneged on its price quotation of April 12. It later developed that the Corps of Engineers would not approve the cheaper generator and that Southwest eventually had to supply the more expensive D353 generator.

At the conference, Mr. Hurt separately listed the component parts of each of the two generators on the top half of a sheet of paper and set out the price after each item. The prices were then totaled. On the bottom half of the sheet Hurt set down the accessories common to both generators and their cost. This handwritten memorandum, as it was referred to during the trial, noted a 10 per cent discount on the aggregate cost of each generator, while the accessories were listed at Martin's cost. The price of the D353 was rounded off at $21,500 and the D343 at $15,000. The memorandum was handed to Cloepfil while the two men were still at the airport. We will refer to this memorandum further during the course of this opinion.

On May 2, 1966, Cloepfil addressed a letter to the Martin Tractor Company, directing Martin to proceed with shop drawings and submittal documents for the McConnell lighting job and calling attention to the fact that applicable government regulations were required to be followed. Further reference to this communication will be made when necessary.

Some three weeks thereafter, on May 24, 1966, Hurt wrote Cloepfil the following letter:

MARTIN TRACTOR COMPANY, INC.
Topeka Chanute Concordia Colby
CATERPILLAR

P.O. Box 1698
Topeka, Kansas
May 24, 1966

Mr. R. E. Cloepfil
Southwest Engineering Co., Inc.
P.O. Box 3314, Glenstone Station
Springfield, Missouri 65804

Dear Sir:

Due to restrictions placed on Caterpillar products, accessory suppliers, and other stipulations by the district governing agency, we cannot accept your letter to proceed dated May 2, 1966, and hereby withdraw all verbal quotations.

Regretfully,

/s/ Ken Hurt
Ken Hurt,
Manager Engine Division

On receipt of this unwelcome missive, Cloepfil telephoned Mr. Hurt who stated they had some work underway for the Corps of Engineers in both the Kansas City and Tulsa districts and did not want to take on any other work for the Corps at that time. Hurt assured Cloepfil he could buy the equipment from anybody at the price Martin could sell it for. Later investigation showed, however, that such was not the case. In August of 1966, Mr. Cloepfil and Mr. Anderson, the president of Southwest, traveled to Topeka in an effort to persuade Martin to fulfill its contract.

Hurt met them at the company office where harsh words were bandied about. Tempers eventually cooled off and at the conclusion of the verbal melee, hands were shaken all around and Hurt went so far as to say that if Southwest still wanted to buy the equipment from them to submit another order and he would get it handled. On this promising note the protagonists parted.

After returning to Springfield, Mr. Cloepfil, on September 6, wrote Mr. Hurt placing an order for a D353 generator (the expensive one) and asking that the order be given prompt attention, as their completion date was in early December. This communication was returned unopened.

A final effort to communicate with Martin was attempted by Mr. Anderson when the unopened letter was returned. A phone call was placed for Mr. Martin, himself, and Mr. Anderson was informed by the girl on the switchboard that Martin was in Colorado Springs on a vacation. Anderson then placed a call to the motel where he was told Mr. Martin could be reached. Martin refused to talk on the call, on learning the caller's name, and Anderson was told he would have to contact his office.

Mr. Anderson then replaced his call to Topeka and reached either the company comptroller or the company treasurer who responded by cussing him and saying "Who in the hell do you think you are? We don't have to sell you a damn thing." Southwest eventually secured the generator equipment from Foley Tractor Co. of Wichita, a company which Mr. Hurt had one time suggested, at a price of $27,541. The present action was then filed, seeking damages of $6,041 for breach of the contract and $9,000 for loss resulting from the delay caused by the breach. The trial court awarded damages of $6,041 for the breach but rejected damages allegedly due to delay. The defendant, only, has appealed; there is no cross-appeal by plaintiff.

The basic disagreement centers on whether the meeting between Hurt and Cloepfil at Springfield resulted in an agreement which was enforceable under the provisions of the Uniform Commercial Code § 2-201 (1) . . . .

Southwest takes the position that the memorandum prepared by Hurt at Springfield supplies the essential elements of a contract required by the foregoing statute, *i.e.,* that it is (1) a writing signed by the party sought to be charged, (2) that it is for the sale of goods and (3) that quantity is shown. In addition, the reader will have noted that the memorandum sets forth the prices of the several items listed.

It cannot be gainsaid that the Uniform Commercial Code has effected a somewhat radical change in the law relating to the formation of enforceable contracts as such has been expounded by this and other courts. In the Kansas Comment to 84-2-201, which closely parallels the Official U.C.C. Comment, the following explanation is given:

> Subsection (1) relaxes the interpretations of many courts in providing that the required writing need not contain all the material terms and that they need not be stated precisely.

> All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. Only three definite and invariable requirements as to the writing are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be signed, a word which includes any authentication which identifies the party to be charged; and third, it must specify quantity. Terms relating to price, time, and place of payment or delivery, the general quality of goods, or any particular warranties may all be omitted. . . .

The defendant does not seriously question the interpretation accorded the statute by eminent scriveners and scholars, but maintains, nonetheless, that the writing in question does not measure up to the stature of a signed memorandum within the purview of the Code; that the instrument simply sets forth verbal quotations for future consideration in continuing negotiations.

But on this point the trial court found there was an agreement reached between Hurt and Cloepfil at Springfield; that the formal requirements of K.S.A. 84-2-201 *were* satisfied; and that the memorandum prepared by Hurt contains the three essentials of the statute in that it evidences a sale of goods, was authenticated by Hurt and specifies quantity. Beyond that, the court specifically found that Hurt had apparent authority to make the agreement; that both Southwest and Martin were "merchants" as defined in K.S.A. 84-2-104; that the agreement reached at Springfield included additional terms not noted in the writing: (1) Southwest was to install the equipment; (2) Martin was to deliver the equipment to Wichita and (3) Martin was to assemble and supply submittal documents within three weeks; and that Martin's letter of May 24, 1966, constituted an anticipatory breach of the contract.

We believe the record supports all the above findings.

We digress at this point to note Martin's contention that the memorandum is not signed within the meaning of 84-2-201. The sole authentication appears in handprinted form at the top lefthand corner in these words: "Ken Hurt, Martin Tractor, Topeka, Caterpillar." The court found this sufficient, and we believe correctly so.

K.S.A. 84-1-201 (39) provides as follows:

> "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

The official U.C.C. comment states in part:

> The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; ... It may be on any part of the document and in appropriate

> cases may be found in a billhead or letterhead. . . . The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

Hurt admittedly prepared the memorandum and has not denied affixing his name thereto. We believe the authentication sufficiently complies with the statute. . . . It is quite true, as the trial court found, that terms of payment were not agreed upon at the Springfield meeting. . . . However, a failure on the part of Messrs. Hurt and Cloepfil to agree on terms of payment would not, of itself, defeat an otherwise valid agreement reached by them. K.S.A. 84-2-204(3) reads:

> Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

The official U.C.C. Comment is enlightening:

> Subsection (3) states the principle as to "open terms" underlying later sections of the Article. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions. . . .

So far as the present case is concerned, K.S.A. 84-2-310 supplies the omitted term. This statute provides in pertinent part:

> Unless otherwise agreed
> (a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery;

In our view, the language of the two Code provisions is clear and positive. Considered together, we take the two sections to mean that where parties have reached an enforceable agreement for the sale of goods, but omit therefrom the terms of payment, the law will imply, as part of the agreement, that payment is to be made at time of delivery. In this respect the law does not greatly differ from the rule this court laid down years ago. . . .

We do not mean to [imply] that terms of payment are not of importance under many circumstances, or that parties may not condition an agreement on their being included. However, the facts before us hardly indicate that Hurt and Cloepfil considered the terms of payment to be significant, or of more than passing interest. Hurt testified that while he stated his terms he did not recall Cloepfil's response, while Cloepfil stated that as the two were on the point of leaving, each stated their usual terms and that was as far as it went. The trial court found that only a brief and casual conversation ensued as to payment, and we think that is a valid summation of what took place. Moreover, it is worthy of note that Martin first mentioned the omission of the terms of payment, as justifying its breach, in a letter written by counsel on September 15, 1966, more than four months after the memorandum was prepared by Hurt. On prior occasions Martin attributed its cancellation of the Springfield understanding to other causes. In its May 24 letter, Martin ascribed its withdrawal of "all verbal quotations" to "restrictions placed on Caterpillar products, accessory suppliers, and other stipulations by the district governing agency." In explaining the meaning of the letter to Cloepfil, Hurt said that Martin was doing work for the Corps of Engineers in the Kansas City and Tulsa districts and did not want to take on additional work with them at this time.

The entire circumstances may well give rise to a suspicion that Martin's present insistence that future negotiations were contemplated concerning terms of payment, is primarily an afterthought, for use as an escape hatch. Doubtless the trial court so considered the excuse in arriving at its findings. . . .

Neither confirmation nor acceptance by Southwest was needed on May 2 to breathe life into the agreement previously concluded at Springfield, for it was memorialized in writing at the time of making. In an article entitled The Law of Sales Under the Uniform Commercial Code, 17 Rutgers Law Review 14, Professor Calvin W. Corman writes:

> The Code Provision merely requires that the writing be sufficient to indicate that a contract for sale has been made between the parties. (p. 20.)

In our opinion the instant memorandum amply satisfies that requirement, affording a substantial basis for the belief that it rests on a real transaction.

We find no error in this case and the judgment of the trial court is affirmed.

Authors' Note: The definitions of "signed" and "writing" are now found at §§ 1-201(37) and (43) respectively.

5.2. The Confirmation between Merchants Exception. Section 2-201(1) having set forth the general requirements imposed by the statute of frauds, subsection (2) provides an ***exception*** for agreements ***between merchants***:

IF

- a written confirmation is sent within a ***reasonable time*** after an agreement is made,
- the writing is "***sufficient against the sender***,"
- the writing is ***received*** by the other party, and the other party ***has reason to know*** of its contents

AND

- the recipient ***does not object*** to the writing's contents ***within 10 days*** of receipt

THEN the writing satisfies the statute of frauds, and is enforceable against the recipient, even though not signed by the recipient.

5.2.1. See UCC § 1-205 which states that "reasonable" time depends on "the nature, purpose and circumstances of the action."

5.2.2. What does it mean to be "sufficient against the sender?" The writing must meet the elements of subsection (1) (*i.e.*, a writing, indication of contract, at least a quantity term, signed by the sender).

5.2.3. The written confirmation must be *received*. See § 1-202(e), which states that a person "receives" a notice when:

- it comes to that person's attention, or
- it is duly delivered in a form reasonable under the circumstances at the place of business through which the contract was made OR at another location held out by that person as the place for receipt of such communications.

Section 15(b) of UETA states that an electronic record is received when it enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record, in a form capable of being processed by that system.

5.2.4. Note the distinctions between notice, receipt, and knowledge. See § 1-202. What does it mean in § 2-201(2) that the writing must be "received" and the recipient must have "reason to know" its contents? What if it said that one party must "notify" the other party of the confirmation? What if it said that the recipient must "know" its contents?

5.2.5. Note that if a recipient *objects* within 10 days to the written confirmation, then the written confirmation does not satisfy the statute of frauds.

Problem 5-3. On July 10, 2014, Jack, a farmer, made a contract over the phone to sell all of his winter wheat to be harvested in August to General Milling for $7.50/bushel. On July 25, 2014, General Milling sent an e-mail to the e-mail address provided to it by Jack, stating "per phone conversation, confirm purchase of all your 2014 winter wheat at $7.50/bushel." Jack saw the e-mail from General Milling, but he thought it was probably just an advertisement for some products, so he never opened it nor read its contents. On August 25, 2014, after the harvest, Jack received an offer of $7.95/bushel from AgraBroker, and Jack sold the winter wheat to AgraBroker. When General Milling brings a breach of contract claim against Jack, Jack raises the statute of frauds defense, noting that he had not signed a contract with General Milling. Apply each element of § 2-201(2). Will Jack prevail?

5.3. Exceptions Applicable to Merchants and Non-Merchants. Subsection (3) of § 2-201 provides three additional exceptions to the statute of frauds that apply to all contracts (and not just contracts involving merchants):

> 5.3.1. *The specially manufactured goods exception:* If the contract is for *specially manufactured* goods which *are not suitable for sale to others in the ordinary course of business*, UCC § 2-201(3)(a) provides that the contract *will be enforced* in the absence of a writing if:
>
> - the manufacturer makes a substantial beginning of their manufacture OR commitments for their procurement
> - before any notice of repudiation AND under circumstances which reasonably indicate that the goods are for the buyer (*i.e.*, some sort of identification to the contract).

Problem 5-4. TheaterCo places an order with DesignCo over the phone for 100 custom made outfits to be used in an upcoming theatrical production. DesignCo accepts the order over the phone and the parties agree upon a price of $10,000. The outfits are to be made with lots of glitter, feathers, and neon green fabric. Before a written agreement is entered into, TheaterCo calls DesignCo and cancels the order.

> (1) DesignCo has taken no steps to begin making the outfits. Is there an enforceable contract under UCC § 2-201(3)(a)?
>
> (2) DesignCo has not started making any of the outfits, but in reliance on the oral agreement DesignCo has paid for and ordered 1,000 yards of neon green fabric. Is there an enforceable contract?

5.3.2. *The admission exception*: If a party to an agreement that does not satisfy the statute of fraud *admits* the existence of a contract in its pleadings, testimony, or other court proceedings, the contract is enforceable under UCC § 2-201(3)(b) up to the quantity of goods admitted.

Problem 5-5. On October 1, Bonnie, a student, orally agreed to purchase her roommate Stephanie's car for $6,000. When Stephanie tendered the car, Bonnie refused to pay, saying that her boyfriend, a law student, told her that the contract was not enforceable because it was not in writing.

(1) Stephanie sued Bonnie, alleging:

A. On October 1, plaintiff offered to sell her car to defendant.
B. On October 1, defendant accepted the offer and promised to pay plaintiff $6,000 for the car.
C. On October 3, plaintiff tendered the car and defendant refused to pay for it.
D. The market value of the car is $5,600.
E. Wherefore plaintiff is damaged in the amount of $400.

How should Bonnie answer the complaint?

(2) Alternatively, suppose Bonnie was questioned in a deposition as follows:

Q: Did you and Stephanie talk about purchasing her car on October 1?
A: Yes.
Q: And she offered to sell it to you for $6,000?
A: Yes.
Q: And you accepted that offer?
A: Yes.

Will Bonnie prevail in her statute of frauds defense?

5.3.3. *The performance exception*: Under UCC § 2-201(3)(c), an agreement for the sale of goods for $500 or more not otherwise satisfying the statute of frauds will nonetheless be enforced if there has been performance, either in the form of ***payment for goods*** or ***acceptance of goods***. Many other defenses to contract formation make the contract voidable, so that a party can assert the defense even if they have performed. But if you accept the goods or pay for them, you lose your right to later assert the statute as a defense. This makes sense, for if the purpose of the statute is to prevent fraud, a person should not be able to in effect admit they made a contract by performing it, and then deny it.

A more difficult question is whether a partial payment, such as a deposit, will constitute sufficient payment to enforce the contract. Several courts have held that a deposit is sufficient. See, e.g*., Morris v. Perkins Chevrolet*, 663 S.W.2d 785 (Mo. Ct. App. 1984), where the court enforced an oral agreement for the purchase of an "Indy 500 Pace Car" because purchaser had paid a $100 deposit by check (which was cashed by the seller). On the other hand, in *Jones v. Wide World of Cars, Inc*., 820 F. Supp. 132 (S.D.N.Y. 1993), the court held that a buyer's deposit towards the purchase of a car was insufficient to establish an enforceable contract absent additional conduct or a writing. This court noted that courts are more inclined to find a deposit sufficient when enforcement is sought against the seller rather than the buyer.

5.4. Estoppel. If all else fails, and the contract does not meet the requirements of the statute of frauds, and no exceptions apply, is there any other argument you can present to avoid the statute of frauds defense? Recall § 1-103(b), discussed in Section 1.7 of Chapter 1, which allows principles of law and equity to supplement the UCC, specifically including "estoppel."

5.4.1. In *Northwest Potato Sales, Inc. v. Beck*, 678 P.2d 1138 (Mont. 1984), a farmer agreed to sell seed potatoes to a merchant. In reliance on that oral agreement, the merchant re-sold the potatoes in the market (before they were delivered). Seed potato prices quickly escalated, and when it came time for delivery, the farmer refused, and sold his seed potatoes to another merchant at double the price. When the first merchant brought a breach of contract claim, the farmer raised the statute of frauds defense. The court estopped the farmer from denying the existence of the contract. The court noted previous dealings between the parties which gave rise to the farmer's knowledge that the merchant would re-sell the seed potatoes into the market in reliance on the contract. Another factor noted by the court were phone conversations between the parties after the original contract was formed, in which the farmer failed to deny the existence of the contract when the merchant brought it up, and even promised to send back a written contract.

5.4.2. Is UCC § 2-201 the exclusive statement of the statute of frauds applicable to sales of goods, or should it be supplemented by the non-UCC statute of frauds? For example, assume that on October 1, 2017, John orally agreed with Mary to sell his Ted Williams autographed baseball to her for $400 on November 1, 2018. This agreement does not fall within UCC § 2-201, because the price is under $500. If John refuses to perform on November 1, 2018, and Mary subsequently brings a breach of contract claim against him, can he assert as a defense the non-UCC statute of frauds which, in most jurisdictions, prevents enforcement of an oral contract that cannot be performed within one year? One argument is that the UCC § 2-201 is the exclusive source of the statute of frauds for the sale of goods, in which case the one-year rule would not apply. This is the approach used in Amended § 2-201, which specifically addressed the issue in a new subsection (4):

> (4) A contract that is enforceable under this section is not unenforceable merely because it is not capable of being performed within one year or any other period after its making.

However, since the Amended Code has not been enacted in any jurisdiction and has been withdrawn, this question remains one where there is a split of authority.

5.5. Writings Signed by Agents. Is a writing otherwise sufficient to meet the statute of frauds enforceable when signed by an agent? Yes. However, under the ***equal dignities rule***, if the contract signed by the agent must be in writing, then the agent's authority to enter into the contract must also be in writing.

Problem 5-6. Buffalo Bill orally authorizes his ranch manager to sell 10 head of buffalo for $1,000 each. The ranch manager, in turn, enters into a written agreement with a local restaurant for the sale of ten buffalo at $1,000 each. Is the contract enforceable against Buffalo Bill?

Chapter 5 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 8

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 2-1 to 2-8

Randy R. Koenders, Annotation, *Sales: Construction of Statute of Frauds Exception under UCC § 2-201(2) for Confirmatory Writing Between Merchants*, 82 A.L.R.4th 709 (1990)

Chapter 6. Warranties Implied by Law

6.1. Introduction to Warranties

6.1.1 What is a warranty? Black's Law Dictionary includes the following definition in a commercial context: "an assurance or guaranty, either express in the form of a statement by a seller of goods, or implied by law, having reference to and ensuring the character, quality or fitness of purpose of the goods." Black's Law Dictionary (West 6th ed. 1991).

6.1.2 When a buyer purchases goods from the seller, the buyer generally has certain expectations about the goods he or she is purchasing. Absent an agreement to the contrary, the buyer will expect that the seller is transferring ownership of the goods; that no other party has a rightful claim to the goods; that the goods do not infringe the rights (generally, patent, trademark or copyright) of any third party; and that the goods meet certain standards of quality. Each of these expectations is specifically addressed by one or more provisions of Article 2. In Chapter 6 we consider warranties that arise or are implied by operation of law. Chapter 7 addresses express warranties.

6.1.3 Warranty liability is a kind of strict liability -- if the goods do not conform to the warranties made, either express or implied, the seller is liable regardless of fault. The buyer need only prove that the goods did not conform to the warranty. This concept was described in *Vlases v. Montgomery Ward & Co., Inc.,* 377 F.2d 846, 850 (3d Cir. 1967), a case in which the buyer of diseased chickens sued to recover for the breach of the implied warranty of merchantability:

> The entire purpose behind the implied warranty sections of the Code is to hold the seller responsible when inferior goods are passed along to the unsuspecting buyer. What the Code requires is not evidence that the defects could or should have been uncovered by the seller but only that the goods upon delivery were not of merchantable quality. If those requisite proofs are established the only exculpatory relief afforded by the Code is a showing that the implied warranties were modified or excluded…. Lack of skill or foresight on the part of the seller in discovering the product's flaw was never meant to bar liability. The gravamen here is not so much with what precautions were taken by the seller but rather with the quality of the goods contracted for by the seller.

6.1.4 It is not surprising, of course, that sellers and buyers often have different interests and expectations with respect to the warranties made by a seller of goods and the remedies available to buyers when the goods do not conform to those warranties. Chapters 6 and 7 discuss the default rules – the warranties that are given in the absence of limitation or disclaimer; Chapters 8 we will consider the ways that a seller may limit the or disclaim those warranties.

6.2 Warranties of Title

Under § 2-312, with *every* contract for sale of a good, the seller (whether merchant or non-merchant) warrants that:

6.2.1 The title conveyed is *good*, and the transfer is *rightful*. This warranty applies regardless of whether or not the seller had actual knowledge of a title problem. For example, even if seller is unaware that the watch he purchased from a friend is stolen, the seller will nonetheless breach this warranty of title when he subsequently sells the stolen watch.

6.2.2 The goods are delivered *free from any security interest or other lien*, except for those security interests or liens *known by the buyer* at the time of contracting. In order to fall into this exception, the buyer must have *actual* knowledge of a lien or other encumbrance at the time of contracting. The seller cannot argue that the buyer "should have known." For example, where a security interest had been perfected by the filing of a UCC financing statement, but the buyer did not have actual knowledge of it, the seller breached this warranty (even though the buyer could have, and probably should have, done a lien search). *Elias v. Dobrowolski*, 412 A.2d 1035 (N.H. 1980).

Problem 6-1. ABC Co. buys a machine from XYZ Co. Shortly thereafter, the repo man arrives and tells ABC that he is there to repossess the machine on behalf of a bank, which has a security interest in the machine. It turns out the repo man is right. Does ABC have any recourse?

6.3. Warranty Against Infringement. Section 2-312(3) adds an additional warranty that the goods shall be delivered "free of the rightful claim of any third person by way of infringement or the like." Official Comment 3 indicates that this warranty relates to intellectual property infringement claims. Note that this warranty is given *only by merchants dealing in goods of the kind*. Suppose, for example, that you bought a Blackberry from Best Buy. Then a patent infringement claim is brought against Blackberry. If the plaintiff obtains an injunction that prevents Blackberry from using the technology and causes your Blackberry not to work, you would have a claim for breach of this warranty. Note that according to the statute, the claim for breach is against the *seller*, in this case Best Buy, who is of course an innocent party. Does it make sense that this warranty is given by the seller rather than the manufacturer?

6.3.1 If a buyer provides specifications to the seller, the buyer must hold the seller harmless against any infringement claim that arises out of compliance with the specifications. "There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered." Official Comment 3.

6.4. Implied Warranty of Merchantability. There are ***two implied warranties of quality*** that arise by operation of law: the implied warranty of ***merchantability*** (§ 2-314) and the implied warranty of ***fitness for a particular purpose*** (§ 2-315). By far, the most important warranty implied by operation of law is the warranty of merchantability. Read § 2-314. Note that the warranty is not only given only by a merchant seller, but only by a "merchant with respect to goods of that kind." You might want to review § 2.4 on the different categories of merchant in Article 2.

Problem 6-2. Fill in the conditions that must be present to give rise to an implied warranty of merchantability:

(1) There is a contract involving ____;

(2) The seller is a ____; and

(3) There is no valid ______________________ of the implied warranty of merchantability.

Problem 6-3. Jay Celebrity, a city boy, recently bought a ranch in Nevada. Jay enters a farm supply store, and asks the salesman for his recommendation as to which herbicide would control a knapweed infestation that has started in one of his pastures. The farm supply store carries several lines of herbicides; Jay buys the product recommended by the salesman. It kills not only the knapweed, but every green thing in sight (which, it turns out, is what the product is designed to do).

(1) Is there an implied warranty of merchantability?

(2) What if, unbeknownst to Jay, the sales clerk was new, and had little knowledge of herbicides. Does that fact affect the existence of the warranty?

Problem 6-4. Joan, a hairdresser by profession, sells her Labrador retriever's first litter of puppies. One of the purchasers asks for Joan's advice in selecting a puppy which would be suitable for show, and the purchaser relies on Joan's recommendations. It turns out that the puppy has hip dysplasia, making it unfit for show purposes. Further, because of the hip dysplasia, the puppy is not suitable for breeding, which is an ordinary purpose for which female puppies are purchased. Is there an implied warranty of merchantability?

Problem 6-5. Marilyn enters a grocery store to purchase a bottle of bleach, wearing a very expensive coat. Due to poor packaging, the bleach spills all over her coat and ruins it on her way to the checkout stand. When she brings a claim for breach of the implied warranty of merchantability for inadequate packaging, the store argues that because it had not yet sold her the bleach, there was no contract, there was no seller, and she has no claim. Will the store prevail? See *Barker v. Allied Supermarket*, 596 P.2d 870 (Okla. 1979).

6.5. Merchantability Standards. In order to comply with the warranty of merchantability, the goods sold must, ***at a minimum***, meet ***all six*** of the standards set forth at UCC § 2-314(2), to the extent those standards apply. For example, the standard requiring a good to conform to an affirmation of fact on a label would not apply if there is no label. The goods must:

(a) pass without objection in the trade under the contract description;

(b) in the case of fungible goods, such as wheat in a bin, be of fair average quality within the description;

(c) be fit for the ordinary purposes for which such goods are used;

(d) run, within the variations permitted by the agreement (including any standards allowed by usage of trade) of even kind, quality and quantity within each unit and among all units involved;

(e) be adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promise or affirmations of fact made on the container or label, if any.

Note: these are minimum standards; additional or higher standards can be established by usage of trade or course of dealing.

6.5.1. The price paid by a consumer may establish a higher standard of merchantability. See the last sentence of Comment 7 to § 2-314, which states:

> In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

For example, a purchaser will expect longer wear and higher quality from a $1,000 coat versus a $100 coat.

6.5.2. A breach of either the implied warranty of merchantability or the implied warranty of fitness for a particular purpose occurs ***at the time of sale***. However, how long a particular good should last is a component of the standard of merchantability. If a particular model of toaster would be objectionable in the trade if it did not work for at least three years, a purchaser can show that the warranty of merchantability was breached at the time of sale if the seller sells a toaster that works only six months.

Problem 6-6. For each situation listed below, indicate which (if any) of the six minimum standards above have not been met (more than one may apply):

(1) Ann purchases wine at Liquid Planet. When she uncorks the bottle one week later, there is mold in the wine.

(2) Ann, instead of opening the wine, uses it to prop a door open. The bottle breaks under the door's weight, and the spilled wine damages Ann's carpet.

(3) Carl buys a bag of salt for his water softener. On the way out the door, the bag splits open, causing Carl to slip and fall.

(4) Dan buys three cans of eggshell paint to paint his living room. After he's finished, he notices that the paint from the third can has left the walls slightly (but noticeably) different than the walls painted with the first two cans.

(5) General Milling orders one ton of hard red spring wheat, with a minimum protein content of 15%. When the shipment arrives, a sample testing shows that on average, the protein content is 15%, but some grain has a higher protein content, and some has a lower protein content.

6.6 Merchantability of Used Goods. The implied warranty of merchantability applies to the sale of ***used goods*** by a merchant who sells goods of that kind. See Comment 3 to § 2-314. However, the standard of merchantability will be less for used goods than for new goods. Even among used goods, a "newer" or "more expensive" used good will have different standards than an "older," "less expensive" used good, as expressed by the court in *Dale v. King Lincoln-Mercury*, 676 P.2d 744, 748 (Kan. 1984):

> A late model, low mileage car, sold at a premium price, is expected to be in far better condition and to last longer than an old, high mileage, "rough" car that is sold for little above scrap value.

Nonetheless, a used car, in order to be merchantable, must be fit for its ordinary purpose of driving, *i.e.*, be in reasonably safe condition and operable.

Problem 6-7. Evan buys a used Nintendo game from a local pawn shop for $10. He goes home and puts the game in his Nintendo; it doesn't work. Has the implied warranty of merchantability been breached?

6.7. Special Standards of Merchantability for Food. Is the warranty of merchantability breached when a restaurant patron has ordered a bowl of fish chowder, and is seriously injured by a fishbone? Or a patron breaks a tooth on a cherry pit in a cherry pie? How about a patron who breaks a tooth on a bolt contained in an order of mashed potatoes? The early line of cases distinguished between "natural substances" and "foreign substances," but today a majority of courts apply a "reasonable expectations" test, which considers whether the consumer reasonably should have expected to find the injury-causing substance in the object, whether natural or foreign.

Webster v. Blue Ship Tea Room, Inc.
198 N.E.2d 309 (Mass. 1964)

REARDON, Justice.

This is a case which by its nature evokes earnest study not only of the law but also of the culinary traditions of the Commonwealth which bear so heavily upon its outcome. It is an action to recover damages for personal injuries sustained by reason of a breach of implied warranty of food served by the defendant in its restaurant. An auditor, whose findings of fact were not to be final, found for the plaintiff. On a retrial in the Superior Court before a judge and jury, in which the plaintiff testified, the jury returned a verdict for her. The defendant is here on exceptions to the refusal of the judge (1) to strike certain portions of the auditor's report, (2) to direct a verdict for the defendant, and (3) to allow the defendant's motion for the entry of a verdict in its favor under leave reserved.

The jury could have found the following facts: On Saturday, April 25, 1959, about 1 P. M., the plaintiff, accompanied by her sister and her aunt, entered the Blue Ship Tea Room operated by the defendant. The group was seated at a table and supplied with menus.

This restaurant, which the plaintiff characterized as 'quaint,' was located in Boston 'on the third floor of an old building on T Wharf which overlooks the ocean.'

The plaintiff, who had been born and brought up in New England (a fact of some consequence), ordered clam chowder and crabmeat salad. Within a few minutes she received tidings to the effect that 'there was no more clam chowder,' whereupon she ordered a cup of fish chowder. Presently, there was set before her 'a small bowl of fish chowder.' She had previously enjoyed a breakfast about 9 A. M. which had given her no difficulty. 'The fish chowder contained haddock, potatoes, milk, water and seasoning. The chowder was milky in color and not clear. The haddock and potatoes were in chunks' (also a fact of consequence). 'She agitated it a little with the spoon and observed that it was a fairly full bowl * * *. It was hot when she got it, but she did not tip it with her spoon because it was hot * * * but stirred it in an up and under motion. She denied that she did this because she was looking for something, but it was rather because she wanted an even distribution of fish and potatoes.' 'She started to eat it, alternating between the chowder and crackers which were on the table with * * * [some] rolls. She ate about 3 or 4 spoonfuls then stopped. She looked at the spoonfuls as she was eating. She saw equal parts of liquid, potato and fish as she spooned it into her mouth. She did not see anything unusual about it. After 3 or 4 spoonfuls she was aware that something had lodged in her throat because she couldn't swallow and couldn't clear her throat by gulping and she could feel it.' This misadventure led to two esophagoscopies at the Massachusetts General Hospital, in the second of which, on April 27, 1959, a fish bone was found and removed. The sequence of events produced injury to the plaintiff which was not insubstantial.

We must decide whether a fish bone lurking in a fish chowder, about the ingredients of which there is no other complaint, constitutes a breach of implied warranty under applicable provisions of the Uniform Commercial Code, the annotations to which are not helpful on this point. As the judge put it in his charge, 'Was the fish chowder fit to be eaten and wholesome? * * * [N]obody is claiming that the fish itself wasn't wholesome. * * * But the bone of contention here-I don't mean that for a pun-but was this fish bone a foreign substance that made the fish chowder unwholesome or not fit to be eaten?'

The plaintiff has vigorously reminded us of the high standards imposed by this court where the sale of food is involved (see *Flynn v. First Natl. Stores Inc*., 296 Mass. 521, 523, 6 N.E.2d 814) and has made reference to cases involving stones in beans (*Friend v. Childs Dining Hall Co.*, 231 Mass. 65, 120 N.E. 407, 5 A.L.R. 1100), trichinae in pork (*Holt v. Mann*, 294 Mass. 21, 22, 200 N.E. 403), and to certain other cases, here and elsewhere, serving to bolster her contention of breach of warranty.

The defendant asserts that here was a native New Englander eating fish chowder in a 'quaint' Boston dining place where she had been before; that '[f]ish chowder, as it is served and enjoyed by New Englanders, is a hearty dish, originally designed to satisfy the appetites of our seamen and fishermen'; that '[t]his court knows well that we are not talking of some insipid broth as is customarily served to convalescents.' We are asked to rule in such fashion that no chef is forced 'to reduce the pieces of fish in the chowder to miniscule size in an effort to ascertain if they contained any pieces of bone.' 'In so ruling,' we are told (in the defendant's brief), 'the court will not only uphold its reputation for legal knowledge and acumen, but will, as loyal sons of Massachusetts, save our world-renowned fish chowder from degenerating into an insipid broth containing the mere essence of its former stature as a culinary masterpiece.' Notwithstanding these passionate entreaties we are bound to examine with detachment the nature of fish chowder and what might happen to it under varying interpretations of the Uniform Commercial Code.

Chowder is an ancient dish preëxisting even 'the appetites of our seamen and fishermen.' It was perhaps the common ancestor of the 'more refined cream soups, purées, and bisques.' Berolzheimer, The American Woman's Cook Book (Publisher's Guild Inc., New York, 1941) p. 176. The word 'chowder' comes from the French 'chaudière,' meaning a 'cauldron' or 'pot.' 'In the fishing villages of Brittany * * * 'faire la chaudière' means to supply a cauldron in which is cooked a mess of fish and biscuit with some savoury condiments, a hodge-podge contributed by the fishermen themselves, each of whom in return receives his share of the prepared dish. The Breton fishermen probably carried the custom to Newfoundland, long famous for its chowder, whence it has spread to Nova Scotia, New Brunswick, and New England.' A New English Dictionary (MacMillan and Co., 1893) p. 386. Our literature over the years abounds in references not only to the delights of chowder but also to its manufacture. A namesake of the plaintiff, Daniel Webster, had a recipe for fish chowder which has survived into a number of modern cookbooks[2] and in which the removal of fish bones is not mentioned at all. One old time recipe recited in the New English Dictionary study defines chowder as 'A dish made of fresh fish (esp. cod) or clams, stewed with slices of pork or bacon, onions, and biscuit. 'Cider and champagne are sometimes added.'' Hawthorne, in The House of the Seven Gables (Allyn and Bacon, Boston, 1957) p. 8, speaks of '[a] codfish of sixty pounds, caught in the bay, [which] had been dissolved into the rich liquid of a chowder.' A chowder variant, cod 'Muddle,' was made in Plymouth in the 1890s by taking 'a three or four pound codfish, head added. Season with salt and pepper and boil in just enough water to keep from burning. When cooked, add milk and piece of butter.'[3] The recitation of these ancient formulae suffices to indicate that in the construction of chowders in these parts in other years, worries about fish bones played no role whatsoever. This broad outlook on chowders has persisted in more modern cookbooks. 'The chowder of today is much the same as the old chowder * * *.' The American Woman's Cook Book, supra, p. 176. The all embracing Fannie Farmer states in a portion of her recipe, fish chowder is made with a 'fish skinned, but head and tail left on. Cut off head and tail and remove fish from backbone. Cut fish in 2-inch pieces and set aside. Put head, tail, and backbone broken in pieces, in stewpan; add 2 cups cold water and bring slowly to boiling point * * *.' The liquor thus produced from the bones is added to the balance of the chowder. Farmer, The Boston Cooking School Cook Book (Little Brown Co., 1937) p. 166.

Thus, we consider a dish which for many long years, if well made, has been made generally as outlined above. It is not too much to say that a person sitting down in New England to consume a good New England fish chowder embarks on a gustatory adventure which may entail the removal of some fish bones from his bowl as he proceeds. We are not inclined to tamper with age old recipes by any amendment reflecting the plaintiff's view of the effect of the Uniform Commercial Code upon them. We are aware of the heavy body of case law involving foreign substances in food, but we sense a strong distinction between them and those relative to

---

2 'Take a cod of ten pounds, well cleaned, leaving on the skin. Cut into pieces one and a half pounds thick, preserving the head whole. Take one and a half pounds of clear, fat salt pork, cut in thin slices. Do the same with twelve potatoes. Take the largest pot you have. Fry out the pork first, then take out the pieces of pork, leaving in the drippings. Add to that three parts of water, a layer of fish, so as to cover the bottom of the pot; next a layer of potatoes, then two tablespoons of salt, 1 teaspoon of pepper, then the pork, another layer of fish, and the remainder of the potatoes. Fill the pot with water to cover the ingredients. Put over a good fire. Let the chowder boil twenty-five minutes. When this is done have a quart of boiling milk ready, and ten hard crackers split and dipped in cold water. Add milk and crackers. Let the whole boil five minutes. The chowder is then ready to be first-rate if you have followed the directions. An onion may be added if you like the flavor.' 'This chowder,' he adds, 'is suitable for a large fishing party.' Wolcott, The Yankee Cook Book (Coward-McCann, Inc., New York City, 1939) p. 9.

3 Atwood, Receipts for Cooking Fish (Avery & Doten, Plymouth, 1896) p. 8.

unwholesomeness of the food itself, e. g., tainted mackerel (*Smith v. Gerrish*, 256 Mass. 183, 152 N.E. 318), and a fish bone in a fish chowder. Certain Massachusetts cooks might cavil at the ingredients contained in the chowder in this case in that it lacked the heartening lift of salt pork. In any event, we consider that the joys of life in New England include the ready availability of fresh fish chowder. We should be prepared to cope with the hazards of fish bones, the occasional presence of which in chowders is, it seems to us, to be anticipated, and which, in the light of a hallowed tradition, do not impair their fitness or merchantability. While we are bouyed up in this conclusion by *Shapiro v. Hotel Statler Corp*., 132 F. Supp. 891 (S.D. Cal.), in which the bone which afflicted the plaintiff appeared in 'Hot Barquette of Seafood Mornay,' we know that the United States District Court of Southern California, situated as are we upon a coast, might be expected to share our views. We are most impressed, however, by *Allen v. Grafton*, 170 Ohio St. 249, 164 N.E.2d 167, where in Ohio, the Midwest, in a case where the plaintiff was injured by a piece of oyster shell in an order of fried oysters, Mr. Justice Taft (now Chief Justice) in a majority opinion held that 'the possible presence of a piece of oyster shell in or attached to an oyster is so well known to anyone who eats oysters that we can say as a matter of law that one who eats oysters can reasonably anticipate and guard against eating such a piece of shell * * *.' (P. 259 of 170 Ohio St., p. 174 of 164 N.E.2d.)

Thus, while we sympathize with the plaintiff who has suffered a peculiarly New England injury, the order must be

Exceptions sustained.

Judgment for the defendant.

In *Schafer v. JLC Food Systems, Inc*., 695 N.W. 2d 570, 574-75 (Minn. 2005), the court stated:

> The bright-line rule set out in the foreign-natural test, which assumes that all substances that are natural to the food in one stage or another of preparation are in fact anticipated by the ordinary consumer in the final product served, has been called into question. For example, in *Betehia v. Cape Cod Corp.,* 10 Wis.2d 323, 103 N.W.2d 64 (1960), a restaurant patron was injured by a chicken bone in a chicken sandwich and sued the restaurant for breach of implied warranty of fitness and for negligence. *Id.* at 65. The court concluded that it did not logically follow that consumers should expect that every product containing some chicken must as a matter of law occasionally or frequently contain chicken bones or chicken-bone slivers simply because chicken bones were natural to chicken meat. *Id.* at 67. Thus, the court concluded that categorizing a substance as foreign or natural might have some importance in determining the degree of negligence of the processor of food, but it was not determinative of what was unfit or harmful for human consumption. *Id.* The court further concluded that the naturalness of a substance to a food served was important only in determining whether the consumer might reasonably expect to find such substance in the particular type of food served. *Id.*; *see also Ex Parte Morrison's Cafeteria of Montgomery, Inc.,* 431 So.2d 975, 978 (Ala.1983)

(“The undesirability of the foreign substance test lies in the artificial application at the initial stage of processing the food without consideration of the expectation of the consumer in the final product served.”); *Jackson,* 168 Ill. Dec. 147, 589 N.E.2d at 548-49 (stating that the foreign-natural test was “unsound and should be abandoned”); *Phillips v. Town of West Springfield,* 405 Mass. 411, 540 N.E.2d 1331, 1332-33 (1989) (stating that the foreign-natural test's focus on the product in its natural form failed to recognize that sellers might fairly be held responsible in some instances for natural substances in food that caused injury).

Comparatively, the reasonable expectation test focuses on what is reasonably expected by the consumer in the food product as served, not what might be foreign or natural to the ingredients of that product before preparation. *See Betehia,* 103 N.W.2d at 69. As applied to common-law negligence, the reasonable expectation test is related to the foreseeability of harm on the part of the defendant; that is, the defendant has the duty of ordinary care to eliminate or remove in the preparation of the food served such harmful substance as the consumer of the food, as served, would not ordinarily anticipate and guard against. *Id.* The majority of jurisdictions that have dealt with the defective food products issue have adopted some formulation of the reasonable expectation test. *See* Restatement (Third) of Torts: Products Liability § 7 rep. n. 1 to cmt. b (1998).

Problem 6-8. Clark orders a chicken pot pie at his favorite restaurant. He sustains throat injuries when he swallows a one-inch chicken bone contained in the pie. Has the restaurant breached the implied warranty of merchantability

(1) under the natural substances theory?

(2) under the “reasonable expectations” theory?

6.8. Merchantability of Inherently Dangerous Goods. Goods that are inherently dangerous, such as knives and strychnine, are nonetheless merchantable as long as they are “fit for the ordinary purposes” for which they are used and otherwise meet the standards of UCC § 2-314. If a hunter injures herself when the handle of a knife falls off while she is using it, she may successfully assert a breach of the implied warranty of merchantability.

6.8.1. Let’s pause and talk about the overlap between tort law and contract law as they apply to “inherently dangerous” goods. When the UCC was promulgated in the 1950s, the law of strict liability in tort was developing. In 1964, the American Law Institute adopted the influential Section 402A of the *Restatement (Second) of Torts*, which imposes strict liability on sellers of “defective” goods that are “inherently dangerous.” *Comment i* states that “[m]any products cannot possibly be made entirely safe for all consumption,” noting that “sugar is a deadly poison to diabetics” and that “good whiskey” is “especially dangerous to alcoholics.” Nonetheless, neither sugar nor whiskey are “unreasonably dangerous.” In order to be “unreasonably dangerous,” a good “must be dangerous to an extent beyond that which would be contemplated by the ordinary consumer who purchases it."

6.8.1.1 Frequently, consumers who are injured by a good will bring a contractual breach of warranty claim, as well as negligence and/or strict liability claims under tort law. Recall that a breach of warranty claim is akin to a strict liability claim, in that a showing of fault or negligence is not required in order to prevail.

6.8.1.2 Is a claim for the breach of the implied warranty of merchantability identical to a strict liability claim in tort? This question was certified by the Second Circuit Court of Appeals to the highest court of New York in a case in which the plaintiff sustained injuries resulting from the rollover of her Ford Bronco when she slammed on the brakes to avoid a deer. The jury had determined that the Ford Bronco was not defective, because its narrow track width and high center of gravity were necessary to the vehicle's off-road capabilities, and thus Ford was not liable on plaintiff's strict liability tort claim. However, the jury found that Ford was liable for breach of the implied warranty of merchantability, because the Bronco was not fit for its ordinary purpose of driving on paved roads. The New York court determined that the two claims are not identical and that the jury's finding of no product defect was reconcilable with its finding of a breach of warranty. *Denny v. Ford Motor Co*., 662 N.E.2d 730 (N.Y. 1995).

Research Assignment 6-1. Identify at least three differences between the procedural or substantive requirements of a contractual breach of warranty claim and a claim for strict liability arising in tort.

6.8.2. What about a product which causes an adverse reaction in a small group of purchasers, such as an after-shave that causes an allergic skin reaction in ten percent of those who use it, or milk that causes an upset stomach to those who are lactose intolerant? The implied warranty will not be breached if only a small number of people relative to the total number of persons using the product suffer an allergic reaction. *Hafner v. Guerlain*, 34 A.D.2d 162 (1970) (less than one percent of purchasers of Shalimar perfume suffered an allergic reaction). With regards to the milk issue, a factor to consider is that milk is a natural product; it is not anything added by the manufacturer which causes the reaction.

6.9. Implied Warranty of Fitness for a Particular Purpose. UCC § 2-315 provides that certain circumstances may give rise, by operation of law, to a warranty that a good is fit for a particular purpose. Unlike the warranty of merchantability, which applies only to sellers of goods of the kind involved, the warranty of fitness for a particular purpose can arise whether the seller is a merchant or a non-merchant. Read § 2-315.

Problem 6-9. Fill in the conditions that must be present to give rise to an implied warranty of fitness for a particular purpose:

(1) There is a contract involving ____;

(2) At the time of contract, seller has reason to know:

a. ____; and

b. ____.

(3) There is no valid __________________ of the implied warranty of fitness for a particular purpose.

6.9.1. A "particular purpose" envisages a specific use by the buyer which is "peculiar" and not the ordinary purpose for which the goods are used. For example, shoes are generally used for walking on ordinary ground, but a seller may know that a particular pair is selected for climbing mountains. Comment 2 to § 2-315.

6.9.2. The test is whether the seller "should have known" of the particular purpose, not whether the seller *actually* knew of the particular purpose.

6.9.3. The buyer must, in fact, *rely upon* the seller's skill or judgment. Comment 1 to § 2-315.

6.9.4. A breach of the implied warranty of fitness for a particular purpose occurs ***at the time of sale***.

Problem 6-10. Let's now revisit the problems relating to the warranty of merchantability and ask whether there is a breach of the implied warranty of fitness for a particular purpose in either case:

(1) Jay Celebrity, a city boy, recently bought a ranch in Nevada. Jay enters a farm supply store, and asks the salesman for his recommendation as to which herbicide would control a knapweed infestation that has started in one of his pastures. The farm supply store carries several lines of herbicides; Jay buys the product recommended by the salesman. It kills not only the knapweed, but every green thing in sight (which, it turns out, is what the product is designed to do). Is there an implied warranty of fitness for a particular purpose?

(2) What if, unbeknownst to Jay, the sales clerk was new, and had little knowledge of herbicides. Does that fact affect the existence of the warranty?

(3) Joan, a hairdresser by profession, sells her Labrador Retriever's first litter of puppies.

One of the purchasers asks for Joan's advice in selecting a puppy which would be suitable for show, and the purchaser relies on Joan's recommendations. It turns out that the puppy has hip dysplasia, making it unfit for show purposes. Further, because of the hip dysplasia, the puppy is not suitable for breeding, which is an ordinary purpose for which female puppies are purchased. Is there an implied warranty of fitness for a particular purpose?

Problem 6-11. Albert informs a clerk at Sullivan's Appliance Store that he needs an air conditioner for his office. The clerk asks for information concerning the space Albert wants to cool. Albert replies, "I don't have time for that. Just give me a good one." The clerk sells Albert a model which would cool an average office (15' by 15'). A few weeks later, Albert returns the model, complaining that it didn't cool the office sufficiently. When he returns the air conditioner, Albert explains that his office is 25' by 25' with high ceilings and the entire southern wall is made of glass.

(1) Is there a breach of the implied warranty of fitness for a particular purpose?

(2) Change the facts. Albert does not tell the clerk about the specifics of his office, but the clerk was in Albert's office a few months ago when he made a delivery, and he is aware of the general size and nature of the office. Is there a breach?

(3) Change the facts again. Albert tells the clerk of the specifics of his office, and the clerk recommends a particular air conditioner. Albert talks to his father, a mechanical engineer, and based on that conversation decides to buy the air conditioner recommended by the clerk (which, it turns out, doesn't adequately cool the office). Is there a breach?

6.10. Other Implied Warranties

Section 2-314(3) refers to other implied warranties that may arise from course of dealing or usage of trade.

Problem 6-12. In a particular agricultural area, it is the custom and usage of farm implement dealers in connection with the sale of used equipment to pay for one-half the cost of repairs arising within a few months of sale. Does this practice give rise to an implied warranty under § 2-314(3)?

The issue of implied warranties given by "remote sellers" such as manufacturers will be addressed in the next chapter.

Chapter 6 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 9

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 9

Chapter 7. Express Warranties and Warranties Given by Remote Sellers

7.1. Creation of Express Warranties. In contrast to the implied warranties, which arise automatically by operation of law when the required elements set forth in UCC § 2-314 (merchantability) or § 2-315 (fitness for a particular purpose) exist, an express warranty is *created by the seller*. Both merchant and non-merchant sellers can create an express warranty. The following chart summarizes how a seller can create an express warranty under § 2-313:

Any (*i.e.*, oral, written, conduct) - affirmation of fact or - promise made by seller to buyer relating to goods		Creates a warranty: goods shall conform to the affirmation or promise
	which becomes part of the basis of the bargain	
Any description of the goods (see comment 5 for "description" – needs not be by words)		Creates a warranty: goods shall conform to the description
Any sample or model		Creates a warranty: goods shall conform to the sample or model

7.1.1 UCC § 2-313(2) notes that a seller does not need to use formal words such as "warrant" or "guarantee" to give rise to an express warranty, nor is the seller required to have specific intent to make a warranty. In other words, if you advertise your car for sale in the classified ads with the description "2012 Honda Fit; single owner," you are making a warranty whether you intend to or not.

7.1.2. UCC § 2-313(2) provides that "an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty." In other words, affirmations of fact give rise to a warranty, whereas a mere affirmation of the value or a seller's opinion does not. It is not always easy to distinguish between the two.

7.1.2.1. A number of factors may help distinguish the line between puffing and affirmations of fact. In *Federal Signal Corp. v. Safety Factors, Inc*., 886 P.2d 172, 178-79 (Wash. 1994), the court considered whether the statements were:

- oral rather than written,
- general rather than specific,
- "hedged" in some way,
- phrased in terms of opinion rather than fact, or
- capable of objective measurement.

7.1.3. Express warranties may be created in a number of contexts, both oral and written, including negotiations, promotional materials, offers, packaging, and contracts. For examples of each, see the following series of annotations by Gary D. Spivey: *Statement in Contract Proposals, Contract Correspondence, or Contract Itself as Constituting "Affirmation of Fact" Giving Rise to Express Warranty Under U.C.C. § 2-313(1)(a)*, 94 A.L.R.6th 1 (2014); *Oral Statement as Constituting "Affirmation of Fact" Giving Rise to Express Warranty Under UCC § 2-313(1)(a),* 88 A.L.R.6th 1 (2013); *Statement in Product Packaging, User Manuals, or Other Product Documentation as Constituting "Affirmation of Fact" Giving Rise to Express Warranty Under UCC § 2-313(1)(a)*, 84 A.L.R.6th 1 (2013); *Statement in Advertisements, Product Brochures or Other Promotional Materials as Constituting "Affirmation of Fact" Giving Rise to Express Warranty Under UCC § 2-313(1)(a)*, 83 A.L.R.6th 1 (2013).

Problem 7-1. Characterize the following in accordance with one or more sources of warranty in § 2-313:

a. Affirmation of fact
b. Promise
c. Affirmation of value, opinion, or commendation (*i.e.*, "puffing")
d. Description
e. Sample
f. Model

1. A tag on a necklace chain in a jewelry store states: "solid 14-karat gold."

2. You walk into a jewelry store and tell the clerk "I'm looking for a 14-karat gold chain." The clerk pulls out a chain and shows it to you.

3. A jewelry store clerk tells you "this chain is the finest that we sell."

4. A diamond ring bears a tag which states "V.V.S. quality," which is a trade term indicating a quality classification used by gemologists.

5. A picture of a watch with a face that glows in the dark is on the outside of the box in which the watch is packaged.

6. In a newspaper advertisement, the jewelry store states: "lifetime guarantee of internal parts of all watches sold by us." This ad is not visible in the store itself.

7. You point to a particular watch on display and tell the clerk that is the watch you want; the clerk doesn't sell you the display watch, but reaches into a cupboard with a supply of watches and hands you a box, saying, "here it is."

8. You're looking for loose artificial gems to incorporate into jewelry you are making. You walk into a store and see a barrel full of loose gems. The clerk pulls a handful of them out for you to look at, and after examining them, you ask for two pounds of gems from the barrel.

9. A jewelry clerk scratches a glass with a gem to demonstrate its hardness.

Problem 7-2. Are the following statements contained in an ad for a used car affirmations of fact or opinion? What criteria are you using to make the distinction?

(1) best in its class	(6) new tires
(2) A-1 condition	(7) good rubber
(3) superb handling	(8) single owner
(4) runs and drives good	(9) clean as your mom's car
(5) top quality	(10) 30,000 miles

7.2. Basis of the Bargain. Not only must there be an express warranty by affirmation of fact, promise, description, sample or model, but according to UCC § 2-313(1), the warranty must be part of the ***basis of the bargain***. To what extent does a buyer have to be aware of the warranty prior to the purchase? If you buy a watch because you like it, and you're not even aware of a description that it is "14-karat gold," can you later sue for a breach of this warranty if you discover that the watch is not made of 14-karat gold? Does the buyer have to establish that she would not have purchased the product in the absence of the warranty?

7.2.1. Official Comment 1 to § 2-313 states that "'express' warranties rest on 'dickered' aspects of the individual bargain," giving rise to the argument that the buyer must have ***some knowledge*** of the warranties in order for them to become a part of the basis of the bargain.

7.2.1.1. Many courts have stated that the buyer does not have to have actual knowledge of the specific terms of the express warranty. However, usually in these cases the buyer was generally aware that some sort of warranty was offered. See, for example, *Murphy v. Mallard Coach Co*., 179 A.D.2d 187, 193 (N.Y. App. Div. 1992), where the court stated "[to require knowledge of the terms of the warranty at the time of sale] is to ignore the practical realities of consumer transactions wherein the warranty card generally comes with the goods, packed in the box of boxed items or handed over after purchase of larger, non-boxed goods and, accordingly, not available to be read by the consumer until after the item is actually purchased and brought home. Indeed, such interpretation would, in effect, render almost all consumer warranties an absolute nullity."

7.2.2. Official Comment 3 to § 2-313 provides that "no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such [express warranties], once made, out of the agreement requires clear affirmative proof."

7.2.2.1. Some courts have relied on Official Comment 3 to conclude that no ***specific*** reliance is required of a purchaser. See, for example, *Massey-Ferguson, Inc. v. Laird*, 432 So. 2d 1259 (Ala. 1983), where a farmer purchased a combine but was not given the specific terms of a warranty until after the sale, and thus could not have relied specifically upon those terms in forming his decision to purchase the combine. However, the court noted that he was generally familiar with the types of warranties provided by combine manufacturers, and had expected some form of warranty.

7.2.2.2. Some courts, relying on Comment 3 and in particular the last sentence thereof, have held that an express warranty made during the bargain is ***presumed*** to be part of the basis of the bargain unless clear, affirmative proof otherwise is shown. *Weng v. Allison*, 678 N.E.2d 1254 (Ill. App. Ct. 1997). Thus, the burden shifts to the seller to establish by clear, affirmative proof that the warranty did not become a part of the basis of the bargain.

7.2.2.3. Several courts (some commentators believe a majority of courts) have ruled that in order to become a "part of the basis of the bargain," the buyer must have relied upon the express warranty.

7.2.2.4. See Frank J. Wozniak, Annotation, *Purchaser's Disbelief in, or Nonreliance Upon, Express Warranties Made by Seller in Contract for Sale of Business as Precluding Action for Breach of Express Warranties*, 7 A.L.R.5th 841 (1992).

Schmaltz v. Nissen
431 N.W.2d 657 (S.D. 1988)

[Crown Quality Seed Company processes and markets sorghum seed under the name of "Big Red #1." Crown sold its seed through a chain of distributors. Farmers Schmaltz and Nible bought bags of Big Red #1 sorghum seed from one of these distributors. The farmers planted the sorghum seed, but it didn't grow. The bags of seed were labeled, and contained several warranties, including: "This quality seed is protected by Heptachlor insecticide treatment to help ensure stronger stands, superior quality and increased yields." The farmers sued Crown and its distributor for breach of its express warranties. The district court ruled in favor of the farmers. The Supreme Court reversed based upon its finding that the warranty had not become a part of the basis of the bargain, because Schmaltz was unaware of it at the time he bought the bags of seed. Following is the court's discussion of this issue.]

In this case the trial court need not determine whether the language on the seed bags constitutes an express warranty, since it is clear that such language did not in any way become the basis of the bargain. Both Nible and Schmaltz admit that they purchased the seed prior to seeing the bag containing the seed. Neither read the language supposedly creating the express warranty until after the sale was completed. Without having read or even known of this language, it is impossible to say this language was part of the basis of the bargain. For similar rulings by other courts, *see Agricultural Services Association v. Ferry-Morse Seed Co*., 551 F.2d 1057 (6th Cir. 1977) (purchase on basis of prior satisfactory experience with product, not description, does not make description part of the basis of the bargain); *Chemco Industrial Applicators Co. v. E. I. duPont de Nemours & Co*., 366 F. Supp. 278 (E.D. Mo. 1973) (new label not used until after decision on purchase, could not have been part of the bargain); *Jones v. Clark*, 36 N.C. App. 327, 244 S.E.2d 183 (1978) (seal of approval, attached to product after contract had been made, did not become a part of the basis of the bargain).

Nible also claims that an express warranty was created when an employee of Farmers Feed told him that Big Red #1 was "good seed." An affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty. [UCC § 2-313(2)]. General statements to the effect that goods are "the best" or are "of good quality," or will "last a lifetime" and be "in perfect condition," are generally regarded as expressions of the seller's opinion or "the puffing of his wares" and do not create an express warranty. *Royal Business Machines v. Lorraine Corp*., 633 F.2d 34, 42 (7th Cir. 1980). However, words of this type may create express warranties when given in response to specific questions or when given in the context of a specific averment of fact. The words "good seed" in the context in which they were used do not create an express warranty.

The trial court's holding of breach of express warranty is hereby reversed.

Case Notes:

1. White and Summers offer a succinct and compelling challenge to those who advocate abandoning reliance: "Why should one who has not relied on the seller's statement have the right to sue? That plaintiff is asking for greater protection than one would get under the warranty of merchantability, far more than bargained for. We would send this party to the implied warranties." James J. White & Robert S. Summers, Handbook of the Law under the Uniform Commercial Code § 10-6, 463 (West 6th ed. 2010). Note: "sending

this party to the implied warranties" may not provide relief if implied warranties have been disclaimed, which we'll study in the next chapter.

2. Another UCC scholar offers a different answer: "One can answer White and Summers' final rhetorical question with another question: Why should a seller be permitted to deny the validity of statements he has made in a sale context, whether or not the buyer has relied on them at the time of negotiation? To do so surely does not promote commercial honesty." Charles A. Heckman, *"Reliance" or "Common Honesty of Speech": The History and Interpretation of Section 2-313 of the Uniform Commercial Code*, 38 Case W. Res. 1, 29 (1988).

3. In the South Dakota seed case, the court did allow the farmers to bring a claim for breach of implied warranties of merchantability and fitness for a particular purpose, so the farmers did recover damages. The court refused to enforce disclaimers of these warranties, finding the disclaimers to be unconscionable. The farmers had no bargaining power, and would be left without an effective remedy if the disclaimers were enforced.

4. Some courts find that "basis of the bargain" refers to the *time* when the warranties are given. When an express warranty is given *after* the contract for sale has been formed, the following approaches have been taken by the courts:

a. Many (but not all) courts have ruled that such warranties do not become a part of the basis of the bargain. See, for example, *Global Truck & Equipment Co., Inc. v. Palmer Mach. Works, Inc.*, 628 F. Supp. 641 (N.D. Miss. 1986).

b. If a purchaser knows generally that some form of express warranty will be provided (such as in a sale of a new car, where by usage of trade warranties are typically given), but does not receive the actual terms of the express warranty until after the sale, the warranties are a part of the basis of the bargain. *Harris v. Ford Motor Co.*, 845 F. Supp. 1511 (M.D. Ala. 1994).

c. An express warranty given after the sale may be deemed a modification of the contract if the elements of UCC § 2-209 regarding contract modification are satisfied. *Moldex, Inc. v. Ogden Engineering Corp.*, 652 F. Supp. 584 (D. Conn. 1987).

d. See Russell G. Donaldson, Annotation, *Affirmations or Representations Made After the Sale is Closed as Basis of Warranty Under UCC § 2-313(1)(a)*, 47 A.L.R.4th 200 (1986).

Problem 7-3. Martha goes to BigMart to purchase a new DVR. While in the store, she reads the box containing a BigMart brand DVR which states on the outside: "Limited Warranty – see inside." She purchases the DVR, but does not read the terms of the limited warranty when she gets home. When the DVR breaks ten weeks later, she pulls out the warranty, and reads about a one-year replacement guarantee. Did the limited warranty become a part of the basis of the bargain? List arguments in favor of ***both*** Martha and BigMart.

7.3. Warranties Given by Remote Sellers

7.3.1. Express Warranties of Remote Sellers. Official Comment 2 to § 2-313 states that the express warranties provided for in that section are limited to those express warranties "made *by the seller* to the buyer." In today's world, products are often made by the manufacturer, distributed throughout the country by one or more distributors, and sold to the end-user by a retail store. Warranties may be given by those parties as well. You need to analyze:

- whether a warranty is given at each step of the transaction,
- the type of warranty (express or implied), and
- whether anyone else in the chain of distribution is responsible for that particular warranty.

Problem 7-4. KitchenwareCo. manufactures toasters. It provides a limited express warranty with each toaster, and disclaims all other warranties. BeauMart stocks and sells KitchenwareCo. toasters.

(1) Can the customer sue BeauMart for a breach of the limited express warranty given by Kitchenware Co., the manufacturer?

(2) Can the customer sue the manufacturer for its limited express warranty, even though he did not directly purchase the toaster from the manufacturer?

(3) Does BeauMart give an implied warranty of merchantability when it sells the toaster to the customer, or is the only available warranty the express warranty of the manufacturer?

7.3.1.1. Official Comment 2 to § 2-313 states that express warranties "need not be confined either to sales contracts or to the *direct parties* to such a contract. They may arise in other appropriate circumstances.... [T]he matter is left to the case law."

7.3.1.2. Most jurisdictions allow a claim by a remote purchaser against the manufacturer for any express warranties made by the manufacturer. In *Whitaker v. Farmhand, Inc.*, 567 P.2d 916, 921 (Mont. 1977), the court stated "a remote manufacturer without privity with the purchaser is liable for breach of warranty by advertising on radio and television, in newspapers and magazines, and in brochures made available to prospective purchasers, if the purchaser relies on them to his detriment."

7.3.1.3. Is a remote manufacturer responsible for any express warranties made by the dealer? For example, what if an appliance manufacturer provides a limited one-year warranty for a particular model of washing machine, and the retail store provides a three-year warranty for all brands sold by it? If the dealer adds to or changes the express warranties of the manufacturer, the manufacturer is not responsible for the additional or modified express warranties, unless adopted by the manufacturer as its own. *Gross v. Systems Engineering Corp*., 36 U.C.C. Rep. Serv. (Callaghan) 42 (E.D. Pa. 1983).

7.3.1.4. Note that the "basis of the bargain" element of § 2-313 applies to claims against remote manufacturers (though the courts diverge as to when an express warranty becomes a part of the basis of the bargain, as discussed above). In other words, if a manufacturer provides a warranty through brochures or other advertising, such warranty must become the basis of the bargain.

> 7.3.1.4.1. In *Cipollone v. Liggett Group, Inc.*, 893 F.2d 541, 567–68 (3rd Cir. 1990), plaintiffs claimed that Liggett had breached an express warranty given in its advertisements that "smoking is healthy." Liggett argued that the smoker had not proved that this advertisement was a part of the basis of the bargain. The court adopted a ***presumption of reliance*** as follows:
>
>> [A] plaintiff effectuates the "basis of the bargain" requirement of section 2-313 by proving that she read, heard, saw or knew of the advertisement containing the affirmation of fact or promise. Such proof will suffice "to weave" the affirmation of fact or promise "into the fabric of the agreement," U.C.C. Comment 3, and thus make it part of the basis of the bargain. We hold that once the buyer has become aware of the affirmation of fact or promise, the statements are presumed to be part of the "basis of the bargain" unless the defendant, by "clear affirmative proof," shows that the buyer knew that the affirmation of fact or promise was untrue. (footnotes omitted)

7.3.1.5. Is a direct seller responsible for breach of any express warranties made by the manufacturer? If an express warranty is made by an appliance manufacturer as to a specific model of washing machine, and Home Appliance Store sells the machine to a customer, can a customer sue Home Appliance Store for breach of the manufacturer's express warranty? While it has been held that a seller does not adopt a manufacturer's express warranty merely by giving notice of that warranty, *State v. Patten*, 416 N.W.2d 168 (Minn. App. 1987), adoption arises where a seller makes an affirmation about the manufacturer's warranty by means of a statement of fact, a promise or some other action which would tend to induce the buyer to purchase the goods. *Scovil v. Chilcoat*, 424 P.2d 87 (Okla. 1967).

7.3.1.5.1. In any event, Home Appliance Store, as a merchant seller, makes an implied warranty of merchantability that may give rise to a separate claim by the customer against the store (unless effectively waived, as discussed in the next chapter).

7.3.1.6. Amended Article 2 added provisions allowing a buyer to assert a breach of an express warranty against a "remote" seller, including warranties contained in advertising. See Amended §§ 2-313A, 2-313B.

Research Assignment 7-1. In your jurisdiction, can a buyer assert a breach of express warranty against a remote seller? Must the buyer have actually relied on the remote seller's warranty?

7.3.2. Implied Warranties of Remote Sellers. Although most jurisdictions allow a remote purchaser to sue a manufacturer for breach of the manufacturer's express warranty, there is much more controversy regarding whether the implied warranties of merchantability or fitness for a particular purpose apply to manufacturers or others in the chain of distribution. To add to the confusion, some courts do not distinguish "vertical privity" (*i.e.*, manufacturer sells to distributor sells to retail store sells to consumer) from "horizontal privity" (*i.e.*, retail store sells to consumer, and a person in the consumer's household is injured by the product). Horizontal privity is separately governed under UCC § 2-318, which we will discuss in more depth in the next chapter.

Peterson v. North American Plant Breeders
354 N.W.2d 625 (Neb. 1984)

[Defendant produces hybrid seeds, including a hybrid corn named the "Migro SPX-8." Plaintiffs purchased the hybrid corn from a dealer, and not from defendant directly. After planting, the seeds emerged, but 65 to 70 percent of the Migro variety corn plants had broken off around the ear level before harvest. Plaintiffs filed suit against the manufacturer alleging, among other claims, breach of the implied warranty of merchantability, seeking damages for the loss of their crop.]

Defendant contends that privity of contract is an essential requirement between defendant seed producer and the ultimate buyer-user where a breach of warranty of merchantability is claimed and there is a claim of consequential damages for economic loss. We have not previously ruled on this issue.

We have held that an implied warranty that food products are wholesome may be asserted for personal injury against a remote manufacturer if the products are shown to have reached the consumer in the same condition in which they left the manufacturer. *Asher v. Coca Cola Bottling Co.*, 172 Neb. 855, 112 N.W.2d 252 (1961). Privity of contract has also been removed as a barrier to asserting an express warranty claim based upon statements made in advertising and other printed matters prepared by the manufacturer. *Koperski v. Husker Dodge, Inc.*, 208 Neb.

29, 302 N.W.2d 655 (1981); *Hawkins Constr. Co. v. Matthews Co., Inc.*, 190 Neb. 546, 209 N.W.2d 643 (1973).

There is a split of authority on the question here presented. *State ex rel Western Seed v. Campbell*, 250 Or. 262, 442 P.2d 215 (1968), follows the traditional rule requiring privity of contract. *Hiles Co. v. Johnston Pump Co.*, 93 Nev. 73, 79, 560 P.2d 154, 157 (1977), represents the contrary rule:

> We perceive no reason to distinguish between recovery for personal and property injury, on the one hand, and economic loss on the other. Cf. *Santor v. A & M Karagheusian, Inc.*, 207 A.2d 305 (N.J. 1965); *Randy Knitwear, Inc. v. American Cyanamid Company*, 181 N.E.2d 399 (N.Y. 1962). Instead, we believe that lack of privity between the buyer and manufacturer does not preclude an action against the manufacturer for the recovery of economic losses caused by breach of warranties. See: *Cova v. Harley Davidson Motor Company*, 182 N.W.2d 800 (Mich. App. 1970); *Kassab v. Central Soya*, 246 A.2d 848 (Pa. 1968); *Lang v. General Motors Corporation*, 136 N.W.2d 805 (N.D. 1965); *Spence v. Three Rivers Builders & Masonry Supply*, 90 N.W.2d 873 (Mich. 1958); *Hoskins v. Jackson Grain Co*., 63 So.2d 514 (Fla. 1953); see also, Schwartz, *The Demise of Vertical Privity: Economic Loss under the Uniform Commercial Code*, 2 Hofstra L. Rev. 749 (1974); Zammit, *Manufacturers' Responsibility for Economic Loss Damages in Products Liability Cases*, 20 N.Y.L.F. 81 (1974).

See, also, *Cameo Curtains, Inc. v. Philip Carey Corp.*, 1981 Mass. Adv. Sh. 411, 416 N.E.2d 995; *Whitaker v. Farmhand, Inc.*, 173 Mont. 345, 567 P.2d 916 (1977); *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977); *Cova v. Harley Davidson Mtr. Co.*, 26 Mich. App. 602, 182 N.W.2d 800 (1970).

We are persuaded that the latter *Hiles Co.* rule applies to the facts here.

Our Legislature has already addressed the scope of warranty recovery for horizontal nonprivity plaintiffs, Neb. U.C.C. § 2-318 (Reissue 1980), but it has remained silent as to vertical nonprivity plaintiffs seeking recovery such as presented here.

Historically, the privity of contract requirement in suits by an injured ultimate purchaser of a product was seen as necessary to prevent “absurd and outrageous consequences” involving unlimited exposure of manufacturers to liability. Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 Yale L.J. 1099 (1960). Such has not been the result in the history of strict liability for defective products litigation for which privity is not required.

The defendant argues that the privity requirement is necessary to prevent it from being exposed to unknown and excessive damages. Recovery for breach of implied warranty is limited to those damages reasonably contemplated by the parties and proximately caused by the breach. Neb. U.C.C. § 2-715 (Reissue 1980). The defendant also argues that if its implied warranty of merchantability is extended to those it expects to ultimately use its seed, and not just to its dealers, then it will in effect be an insurer of its customers' crops. Nothing in this opinion is intended either to suggest such a result or to include buyers dissatisfied with the seed performance that was less or other than expected without regard for all Uniform Commercial Code requirements, § 2-314, and the standard of proof required, § 2-715. The liability arises and that warranty extends to reasonable damages proximately caused by its placing an unmerchantable product in the marketplace. Also, there is no reason that the defendant cannot disclaim its warranty liability by policing its dealers and making sure that its disclaimer reaches the ultimate user of its product during the negotiations for the product's sale. We therefore hold that when a producer of seed places sealed bags of hybrid seed corn in its chain of distribution, it carries with it, unless effectively excluded or modified, an implied warranty of merchantability that protects the ultimate buyer-user in that chain.

Case Notes:

1. Courts are more willing to allow a claim against a manufacturer or other remote seller for ***personal injuries*** rather than property damage or economic loss. So always begin your analysis with a determination of the type of damages involved. In *Rupp v. Norton Coca-Cola Bottling Co.*, 357 P.2d 802 (Kan. 1960), the Kansas Supreme Court, in allowing a claim for personal injuries arising from the breach of the implied warranty of merchantability against the manufacturer, reasoned as follows:

> "Under the law of Kansas an implied warranty is not contractual. It is an obligation raised by the law as an inference from the acts of the parties or the circumstances of the transaction and it is created by operation of law and does not arise from any agreement in fact of the parties. The Kansas decisions are in accord with the general rule laid down in the adjudicated cases. And under the Kansas decisions privity is not essential where an implied warranty is imposed by the law on the basis of public policy." (Quoting *B. F. Goodrich Co. v. Hammond*, 269 F.2d 501, 504 (10th Cir. 1959).)

2. Not all courts allow a claim for breach of implied warranties relating to personal injuries. See, for example, *Rose v. GMC*, 323 F. Supp. 2d 1244 (N.D. Ala. 2004), in which the court refused to allow a claim for breach of implied warranty of merchantability against an automobile manufacturer for personal injuries sustained as a result of an airbag, due to lack of privity.

3. Some (but not all) courts are reluctant to allow a claim for breach of the implied warrant of merchantability or fitness for a particular purpose against a manufacturer or other remote seller where property damage or economic loss (versus personal injuries) are sustained. The problems of extending implied warranties to a remote manufacturer are expressed by the court in *Professional Lens Plan, Inc. v. Polaris Leasing Corp.*, 675 P.2d 887, 898 (Kan. 1984) as follows:

> If contractual privity is not necessary to maintain an action for breach of an implied warranty of fitness [UCC § 2-315], how is it possible for a remote seller to have reason to know any particular purpose for which its goods are required by an unknown ultimate buyer? What is the time of contracting under [UCC § 2-315] between a remote manufacturer and an ultimate purchaser? How does a buyer rely upon the skill or judgment of a seller it has never met or had any dealing with and maybe doesn't even know the existence of? The problems do not end with [UCC § 2-315], they only begin. For example, how is a remote manufacturer to afford itself of the ability to exclude or modify warranties under [UCC § 2-316], when the remote manufacturer does not know to whom it must exclude or modify its warranties? In turn, how is an ultimate purchaser, pursuant to [UCC § 2-607(3)(a)], to give notice of defect to a remote manufacturer whom it does not know? Further, how is [UCC § 2-719] authorizing contractual modification or limitation of remedy to operate between parties who have not dealt directly with each other? Specifically, how is a remote manufacturer to avail itself of [UCC § 2-719(3)] which permits limitation or exclusion of consequential damage liability? An across-the-board extension of implied warranties to non-privity manufacturers or sellers, without regard to the nature of either the involved product or the type of damage sought, would spawn numerous problems in the operation of Article 2 of the Uniform Commercial Code.

4. Some courts allow breach of implied warranty claims to be pursued against manufacturers or other remote sellers regardless of the type of injury involved. The reasoning behind this approach is explained by the court in *Israel Phoenix Assurance Co. v. SMS Sutton, Inc*., 787 F. Supp. 102, 103-04 (W.D. Pa. 1992), as follows:

> Pennsylvania law on the issue of whether privity of contract is required in order to state a claim for breach of warranty has developed over the years. Because breach of warranty claims often parallel strict liability claims, and are used to recover the same damages as strict products liability claims, the development of this area of the law has reflected the development of strict products liability law. This development came to a head, resulting in the abolition of a privity requirement in breach of warranty claims asserted against manufacturers or suppliers by those farther down the chain of distribution, in 1968 in *Kassab v. Central Soya*, 432 Pa. 217, 246 A.2d 848 (1968), overruled on other grounds, *AM/PM Franchise Assoc. v. Atlantic Richfield Co*., 526 Pa. 110, 584 A.2d 915 (1990)[.]
>
> Of course, the damages claimed in *Kassab*, were for damage to the plaintiffs' cows, which constituted their personal property. Following *Kassab*, there remained a question as to whether the Pennsylvania Supreme Court intended to abolish the privity requirement only in cases involving personal injury or property damage as opposed to economic loss. The question arose because of the *Kassab*

court's reason for abolishing the privity requirement, which was to bring into line the law governing strict products liability and breach of warranty claims. Because property damage and personal injury comprise the most usual "products liability" cases, there was room to argue that the *Kassab* court's reasoning would not extend to cases involving purely economic loss or loss to business -- types of damages which arguably arise more often in commercial breach of contract cases than in products liability cases.

In 1989, however, the Pennsylvania Superior Court ruled that *Kassab* "was intended to apply to all breach of warranty cases brought under the warranty provisions of the Uniform Commercial Code for all types of damages, whether they be personal injuries, damage to property or economic loss." *Spagnol Enterprises, Inc. v. Digital Equipment Corp*., 390 Pa. Super. 372, 568 A.2d 948, 952 (1989).

5. Several jurisdictions continue to require privity for claims against a seller for economic loss arising from breach of an implied warranty. See, for example, *Gregory v. Atrium Door & Window Co.*, 415 S.E. 2d 574 (N.C. App. 1992); *Falcon for Import and Trade Co. v. North Central Commodities, Inc.*, 52 U.C.C. Rep. 2d (Callaghan) 896 (D.N.D. 2004); Tex Enterprises, Inc. v. Brockway Standard, Inc., 66 P.3d 625 (Wash. 2003).

Research Assignment 7-2. In your jurisdiction, can a buyer assert a breach of implied warranty against a remote seller? Does the success of the claim turn on whether there was a personal injury?

7.3.3. Notice of Breach. In order for a buyer to bring a breach of warranty claim against a seller, UCC § 2-607(3) requires the buyer to provide to the seller notice of the breach within a reasonable time after the buyer discovers or should have discovered the breach. There is a split of authority whether, when a buyer makes a claim against a remote seller, the buyer needs to give notice only to the direct seller, or whether the remote seller must also receive timely notice of the claim. See Jane Massey Draper, Annotation, *Sufficiency and Timeliness of Buyer's Notice Under UCC § 2-607(3)(a) of Seller's Breach of Warranty*, 89 A.L.R.5th 319 (2001).

Chapter 7 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 9

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 9

Chapter 8. Disclaimer of Warranties; Magnuson-Moss Warranty Act; Third Party Beneficiaries under § 2-318

8.1. Disclaimer of Warranties

8.1.1. Conflicting Warranties. What happens when more than one warranty is given? How are they to be interpreted together? For example, in a sale there may be (1) an implied warranty of merchantability, (2) a description of the goods on the package (such as "high gloss enamel paint"), and (3) an oral affirmation of fact by the salesperson ("this paint will only require one coat").

> 8.1.1.1. Under UCC § 2-317, "[w]arranties whether express or implied shall be construed as consistent with each other and as cumulative," unless such construction is unreasonable. This "cumulative" concept is important. For example, an express warranty does not displace an implied warranty of merchantability if the two warranties can reasonably be construed as cumulative or otherwise consistent with each other.
>
> 8.1.1.2. In those rare cases where warranties cannot reasonably be construed as cumulative or consistent, apply the rules of § 2-317 to determine which of the express warranties will prevail.

Problem 8-1. The packaging on a particular shirt describes the shirt as "wrinkle free." A card attached to the shirt reads: "Dry at normal temperature in standard dryer; remove promptly when drying cycle is finished. Manufacturer makes no warranty that fabric will be wrinkle free if hand-washed, dried at high or low temperatures, or not removed promptly when drying is finished." Can this language be read consistently with "wrinkle free?"

Problem 8-2. A used car dealer sells a car with an express warranty that the seller will repair any defect to the transmission that arises during the next 90 days. The transmission fails after 120 days. Does the buyer have a claim?

8.1.2. Statutory Disclaimer of Warranties and Statutory Prohibitions. Some jurisdictions have enacted nonuniform warranty statutes providing that either (1) an implied warranty is not given in certain transactions, or (2) an implied warranty may not be disclaimed in certain transactions. An example of the former is Montana Code Annotated § 30-2-316(3), which provides:

> (d) in sales of cattle, hogs, sheep, or horses, there are no implied warranties, as defined in this chapter, that the cattle, hogs, sheep, or horses are free from sickness or disease;

(e) in sales of any seed for planting (including both botanical and vegetative types of seed, whether certified or not), there are no implied warranties, as defined in this chapter, that the seeds are free from disease, virus, or any kind of pathogenic organisms.

If you were a buyer of cattle in Montana, it would be important to know that the default rule is that you are not getting an implied warranty. You could then bargain for an express warranty.

An example of the latter is 9A Vermont Statutes Annotated § 2-316(5):

> (5) The provisions of subsections (2), (3) and (4) of this section shall not apply to sales of new or unused consumer goods or services. Any language, oral or written, used by a seller or manufacturer of consumer goods and services, which attempts to exclude or modify any implied warranties of merchantability and fitness for a particular purpose or to exclude or modify the consumer's remedies for breach of those warranties, shall be unenforceable. For the purposes of this section, "consumer" means consumer as defined in chapter 63 of Title 9.

Research Assignment 8-1. Check the warranty law of your state to determine whether there are any nonuniform provisions that provide that (1) an implied warranty is not given in certain transactions, or (2) an implied warranty many not be disclaimed in certain transactions.

8.1.3. Disclaimer of Express Warranties. Having provided for warranties, implied warranties, and express warranties in §§ 2-312 through 2-315, the UCC allows, under the principle of freedom of contract, for the exclusion or modification of such warranties ***if*** the requirements contained in § 2-316 are met. These requirements as to a valid disclaimer vary based upon the type of warranty involved. As a general rule, it is easier to disclaim an implied warranty than an express warranty.

> 8.1.3.1. If an ***express warranty*** exists, under § 2-316(1) any words or conduct negating or limiting the express warranty shall:
>
> > First be construed, if reasonable, as ***consistent*** with the express warranty;
> >
> > If not consistent, they are ***inoperative*** and will not be effective to disclaim the express warranty, ***unless*** the parol evidence rule dictates a different result. (We'll get to the parol evidence rule in Chapter 9.)

For example, if a sales contract describes the vehicle as a "2010 Toyota Matrix" and states conspicuously, "There are no express warranties," the seller has nevertheless given an express warranty that the vehicle is a 2010 Toyota Matrix. To effectively disclaim, the contract would have to have specific language such as "seller makes no warranty or representation that the year or model is in fact as described."

Problem 8-3. Bill is interested in buying Sam's boat. Sam told Bill that the boat had been winterized. Bill agreed to buy the boat, and wrote a check for $10,000. On the bill of sale, Sam writes "**AS IS – NO WARRANTIES GIVEN.**" Bill later discovers that the boat has not been winterized.

(1) Has Sam made a warranty?

(2) If so, applying § 2-316(1), what is the effect of the "as is" language in disclaiming that warranty?

8.1.4. Disclaimer of Implied Warranties.

8.1.4.1. UCC § 2-316(2) sets forth requirements that may be satisfied to exclude or modify an ***implied warranty***, summarized as follows:

To modify/disclaim implied warranty of merchantability:	**To modify/disclaim implied warranty of fitness for a particular purpose**:
disclaimer language must mention "merchantability"	no requirement of mention of "fitness for particular purpose"
may be oral or written	cannot be oral; must be written
if written, must be conspicuous	must be conspicuous
no examples of safe harbor language	safe harbor language: "there are no warranties which extend beyond the description on the face hereof

8.1.4.1.1. "Conspicuous" is defined at UCC § 1-201(b)(10). To be conspicuous, the language must be so written that a reasonable person would notice it, which, according to Official Comment 10 to that section, is a *matter of law* for the court to decide. A non-exclusive listing of "conspicuous" terms includes:

- a heading in capitals
- a heading in contrasting type, font or color to the surrounding text of the same or lesser size
- language other than a heading which is in larger type than the surrounding text
- language other than a heading which is in contrasting type, font or color to

the surrounding text of the same size

- language set off from the surrounding text of the same size by symbols or other marks that call attention to the language

See William H. Danne, Jr., Annotation, *Construction and Effect of UCC § 2-316(2) Providing That Implied Warranty Disclaimer Must be "Conspicuous,"* 73 A.L.R.3d 248 (1976).

Problem 8-4. In a contract for the purchase of a bicycle, a disclaimer of warranties is contained on page 4 of 5 pages. There are no headings; only paragraph numbers. Whereas the surrounding text is in normal letters, the disclaimer is in all capital letters. Has the conspicuousness requirement been met?

8.1.4.2. Curiously, § 2-316(3) provides an alternate set of rules pursuant to which an implied warranty (but not an express warranty) can be disclaimed. ***Your analysis of the disclaimer of implied warranties should never stop at § 2-316(2); if an implied warranty is not effectively disclaimed there, perhaps a disclaimer exists under § 2-316(3).***

8.1.4.2.1. Under § 2-316(3)(a), *all* implied warranties are excluded by expressions like "as is," "with all faults," or similar language that calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty.

8.1.4.2.1.1. Note that unlike § 2-316(2), there is no requirement that the disclaimer must be "conspicuous." But in order to call the buyer's attention to the exclusion, all drafters are wise to use conspicuous language when disclaiming under § 2-316(3)(a). See also Comment 1 to § 2-316, which states that implied warranties may be excluded "only by conspicuous language or other circumstances which protect the buyer from surprise." Compare *O'Neil v. International Harvester Co.*, 575 P.2d 862 (Colo. App. 1978) ("as is" language does not need to be conspicuous) to *White v. First Federal Savings & Loan Ass'n of Atlanta*, 280 S.E.2d 398 (Ga. App. 1981)("as is" language must be conspicuous).

8.1.4.2.1.2. An express limitation on § 2-316(3)(a) is the introductory phrase of "unless the circumstances indicate otherwise." Sometimes circumstances may not allow "as is" or similar language to constitute a disclaimer. For example, usage of trade and course of dealing may be circumstances which make an "as is" clause insufficient to disclaim an implied warranty. *Gindy Mfg. Corp. v. Cardinale Trucking Corp.*, 268 A.2d 345 (N.J. Sup. 1970).

8.1.4.2.2. Under § 2-316(3)(b), there is no implied warranty with regard to defects which an examination would have reasonably revealed, IF the buyer examined the goods before entering the contract OR refused, upon the seller's request, to examine the goods. Comment 8 explains that to bring the transaction within the scope of "refused to examine" in paragraph (b), it is not sufficient for the goods to be merely available for inspection; there must be a demand by the seller that the buyer examine the goods fully.

Problem 8-5. Jane wants to buy a used car from Larry's Auto Sales. Jane takes the car for a test drive. During the test drive, she stops at her mechanic's shop to have the engine checked. One month after the sale, Jane discovers that the catalytic converter is not working, requiring $2,000 in repairs. Can Jane bring a claim for breach of the implied warranty of merchantability against Larry's Auto Sales?

8.1.4.2.3. An implied warranty may be excluded under § 2-316(3)(c) by course of performance, course of dealing, or usage of trade. This subsection was applied in *Spurgeon v. Jamieson*, 521 P.2d 924 (Mont. 1974), where the court found that usage of trade in the farming industry excluded implied warranties in the sale of used farm equipment, with the exception of a 50/50 implied warranty under which each party to the transaction paid for one-half of the cost of repairs.

8.1.4.2.4. Recall from Chapter 6 that the Code does not describe the warranties of good title (§ 2-312(1)) or against infringement (§ 2-312(3)) contained in every contract as implied warranties. Therefore, an effective disclaimer of implied warranties under § 2-316(2) or § 2-316(3) does not disclaim these warranties.

8.1.5. Disclaimer of Warranties of Title and Against Infringement.

8.1.5.1 Although the UCC provides that the warranties of good title and against infringement are found in every contract, and thus they function like an implied warranty, Official Comment 6 to § 2-312 calls our attention to the fact that they *are not designated as implied warranties*! Why is this significant? If these warranties are not to be treated as implied warranties, the rules of § 2-316(3) allowing the exclusion of implied warranties in certain circumstances do not apply, nor does § 2-317(c), which states that an express warranty displaces an inconsistent implied warranty. *Kel-Keef Enterprises v. Quality Components Corp.*, 738 N.E. 2d 524, 536-37 (Ill. App. 2000).

8.1.5.2. Section 2-312(2) provides that the warranties of title can be excluded or modified only by:

8.1.5.2.1 Specific language, such as "Seller disclaims any warranties of title;"

8.1.5.2.2 Circumstances that give the buyer reason to know that the person selling does not claim title in himself (such as a police auction of recovered but unclaimed stolen items); or

8.1.5.2.3 Circumstances that give the buyer reason to know that the seller is purporting to sell only such right or title as he or a third person may have (such as an estate sale by a personal representative).

Problem 8-6. You walk into a pawn shop to buy a used camera. As you enter, you see a blinking neon light that proclaims "all sales as is." Has the pawn shop effectively disclaimed the warranties of title?

8.1.5.3 The Code does not say how the warranty against infringement can be disclaimed. Our guess is that the seller would have to use the same methods that are used to disclaim the warranty of good title. This was the approach taken by the drafters of Amended Article 2. Recall that Amended Article 2 has been withdrawn and is in effect in no jurisdiction. However, it could be cited as persuasive authority for what the Article 2 experts thought should be the rule when there is a gap in the present Article 2.

8.1.6. Post-Sale Disclaimers. Susan purchases a new jacket for mountain climbing. At the time of purchase, there are displays surrounding the jackets, stating that they are machine washable, waterproof, and are appropriate for use in weather as cold as -30° F. Susan purchases one of the jackets. When she gets home she notices a card attached to the inside of the jacket, containing differing warranties and disclaiming all other warranties, express or implied. Does the card attached to the jacket effectively modify or exclude the warranties made by the displays at the time of sale?

8.1.6.1. See *Whitaker v. Farmhand*, 567 P.2d 916, 921 (Mont. 1977), in which the court stated that "a disclaimer or limitation of warranty contained in a manufacturer's manual received by the purchasers *subsequent to the sale* does not limit recovery for implied or express warranties made prior to or at the time of sale." For a discussion of the application of the *ProCD* line of cases to disclaimers read for the first time after the purchase of a product, see Stephen E. Friedman, *Text and Circumstance: Warranty Disclaimers in a World of Rolling Contracts*, 46 Ariz. L. Rev. 677 (2004).

8.1.7. Limitations of Remedy. Most sellers, instead of disclaiming all warranties, give an express warranty but limit the remedy under that warranty. For example, they may agree only to repair or replace defective parts, and they may deny recovery of consequential damages. We will discuss limitations of remedy in Chapter 17.

Problem 8-7. Bob, a rancher, visits Julie, a neighbor, who breeds and sells registered Angus cattle. Over a cup of coffee, Julie writes down on a tablet "Will sell 50 bred registered Angus heifers to Bob for $1250/head, to be delivered within 5 days." Both parties initial the paper.

When Julie drives up with the 50 head of cattle the next day, she asks Bob to sign an acknowledgment that he has received 50 head of registered Angus cattle, and has accepted them "as is." Bob counts the number of cattle delivered, and signs the acknowledgment. A few weeks later, several of the cattle abort, and a veterinarian confirms that those cattle have brucellosis.

(1) What, if any warranties, were created at the time the contract was formed?

(2) Did the acknowledgment effectively disclaim those warranties?

8.2. Magnuson-Moss Warranty Act

8.2.1. Introduction to the Magnuson-Moss Warranty Act. The Article 2 warranty provisions are supplemented by a federal statute – the Magnuson-Moss Warranty Act, 15 U.S.C. § 2301 et seq., which you can find at an online source such as the Legal Information Institute. The Act does not require a seller to provide an express warranty in connection with the sale of a consumer product. However, if a seller of a consumer product decides to offer a written warranty, it must comply with the Act. The Act only applies the marketing and sale of:

- ***consumer products*** (note how that term is defined in § 101(1));
- accompanied by ***written warranties*** (defined in § 101(6)).

The essence of the Act is found in § 102, which provides in subsection (a) that "any warrantor warranting a ***consumer product*** to a consumer by means of a ***written warranty*** shall, to the extent required by rules of the Commission, ***fully and conspicuously disclose*** in simple and readily understood language the terms and conditions of such warranty."

Note also that the definition of a warranty under § 101(6) varies from the definition of an express warranty under UCC § 2-313. In particular, to fall within the Magnuson-Moss Act:

- warranties must be in writing;
- a warranty relating to the nature of the material or workmanship of the warranted product must affirm or promise that the "is *defect free* or *will meet a specified level of performance* over a specified period of time."

Problem 8-8. Answer the following questions after reading the appropriate provisions of the Magnuson-Moss Warranty Act.

(1) Section 101(1): does the Act apply to these transactions:

(a) the purchase by a corporate employer of a microwave oven for an employee break room?

(b) the purchase by a celebrity of a Boeing 737 to fly his entourage around the world for pleasure?

(2) Section 101(6): do the following create a warranty under Magnusson-Moss? Under the UCC?

(a) a television commercial showing a Ginsu knife cutting through beer cans?

(b) a shirt label stating "100% cotton"?

(c) a contract for the purchase of an automobile providing: "For 3 years or 36,000 miles, whichever comes first, manufacturer will repair or replace any defective parts"?

(3) Section 104:

(a) If a warrantor gives a written warranty of a consumer product, does the warrantor have to meet the Federal Minimum Standards for Warranties? Are you sure? Read § 103(a).

(b) Does a seller of a consumer product to a consumer violate the Magnuson Moss Act if the seller in writing states, "THESE GOODS ARE SOLD AS IS. There are no warranties, express or implied."

(4) Section 110(d):

(a) Can you bring a claim for violation of the Magnuson Moss Act in a federal district court in the state in which you live?

(b) If you had a claim for breach of warranty under the UCC, why would you add a claim for violation of the Magnuson Moss Act?

8.2.2. Warranties under the Act. Magnuson Moss requires a manufacturer or other person giving a warranty subject to the act to classify the warranty as "***full***" or "***limited***." See § 103(a). The following chart summarizes the differences between a full and a limited warranty. Why is it you see few warranties designated as "full"?

Magnuson-Moss Warranty Act 15 USC Sections 2301 et seq.	
Full Warranty	Limited Warranty
may reasonably limit duration of written (express) warranty, such as "12 months or 12,000 miles"	same as "full warranty"
must remedy, by repair, replacement or refund of purchase price, a breach within a reasonable time and without charge (if it can't be repaired, must allow refund or replacement, at election of consumer)	no requirement of remedy (but see § 2-719 – if a limited remedy fails of its essential purpose, buyer may pursue any remedy under UCC; i.e., if remedy is limited to repair, and seller is unable to repair, the remedy has failed of its essential purpose)
may not exclude any UCC implied warranties	same as "full warranty"
may not limit the duration of any UCC implied warranties (may not say for example, that implied warranty of merchantability is limited to 12 months or 12,000 miles, even though express warranty is so limited) **Note**: in UCC there is <u>no</u> stated duration of implied warranties; the query (as to merchantability) is whether a failure within, for example, 12 months of purchase makes a good "objectionable in the trade."	may limit the duration of any UCC implied warranties to the duration of the express warranty
may exclude or limit consequential damages ONLY if done so conspicuously on the face of the warranty, and only to extent allowed by state law (see § 2-719 – limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable)	no "conspicuous" requirement for exclusion or limitation of consequential damages; § 2-719 applies – cannot be unconscionable (limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable)
can't impose any unreasonable duty as a condition of express warranty (but can require reasonable notice of defect on part of consumer); for example, can't require consumer to send in warranty registration card	no specific prohibitions on creating conditions to express warranties, but remember overriding good faith (§ 1-304) and unconscionability (§ 2-302)requirements
not required to reimburse consumer for incidental expenses incurred as a result of breach, such as cost of returning good to manufacturer for repair	no specific prohibitions/requirements regarding reimbursement of incidental expenses

Problem 8-9. Read § 108. What, if any portion, of the following manufacturer's warranty is not valid for a CD player under the Magnuson-Moss Warranty Act?

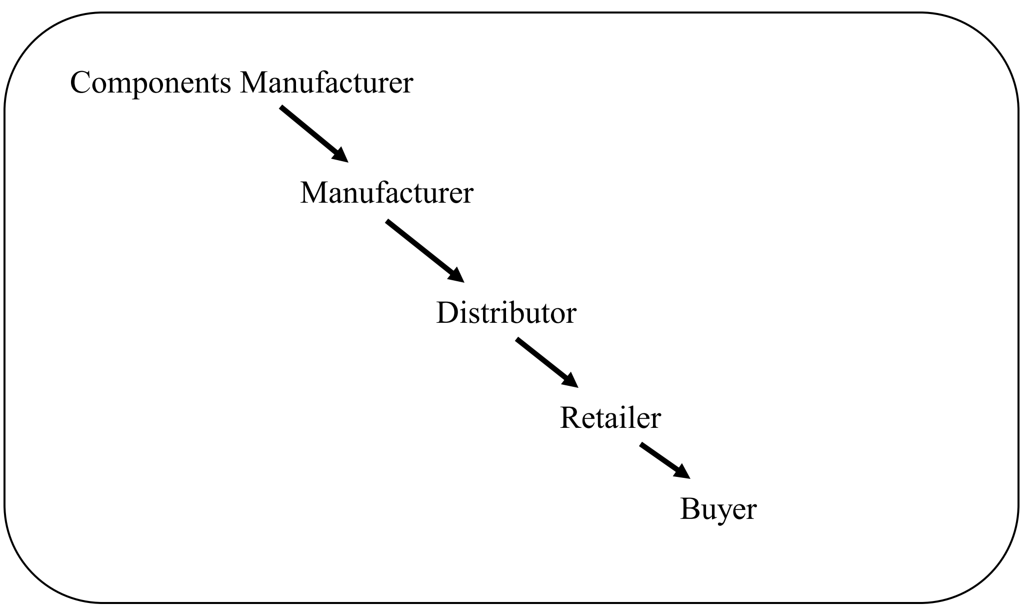
Limited Warranty

> This product is warranted against defects for one year from the date of purchase. Within this period, we will repair the CD player without charge for parts and labor, if you bring the CD player to any authorized retailer along with a sales receipt or other valid proof of the date of purchase. This warranty does not apply to any damage resulting from improper use of the CD player, or damage inflicted by the user or any other person. EXCEPT FOR THIS LIMITED WARRANTY, MANUFACTURER MAKES NO OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE. MANUFACTURER HAS NO LIABILITY FOR ANY INCIDENTAL OR CONSEQUENTIAL DAMAGES.

8.3. Third Party Beneficiaries

8.3.1. Privity. A breach of warranty action is a contract claim. Under the common law principle of privity, only a party to the contract can bring a claim against another party to the contract. In the area of breach of warranty, there are two types of privity, which you must be able to distinguish:

8.3.1.1. ***Vertical privity*** refers to the concept that a series of sales moves a good from the manufacturer to the end purchaser, illustrated as follows:



Under a strict privity doctrine, Buyer could only sue Retailer, who in turn could sue Distributor, who in turn could sue Manufacturer, who in turn could sue Components Manufacturer. Most courts have relaxed the strict privity requirement for breach of a warranty claim, and allow the buyer to sue the manufacturer directly as discussed in Chapter 7.

8.3.1.2. ***Horizontal privity*** is quite different from vertical privity. Here we are talking about someone who is not a party to any contract for sale, but who uses the good, perhaps as a guest of the end purchaser or an employee of the end purchaser. There is no contractual relationship involved between the injured person and someone in the contractual chain of distribution. For example, Grandpa purchases a lawn mower, which topples over and seriously injures a grandchild who is mowing the lawn for Grandpa. Can the grandchild bring a claim for breach of warranty against the seller of the lawnmower? How about a claim against someone further up the chain, such as a manufacturer (this is where you see horizontal privity combining with vertical privity).

8.3.2. UCC § 2-318. UCC § 2-318 was drafted to provide a breach of warranty claim to certain persons who were not in the chain of sales contracts. As originally drafted (with only Alternative A), § 2-318 was not intended to apply to vertical relationships. The development of vertical privity was a matter of common law. Comment 2 to § 3-313 acknowledges that "the warranty sections of Article 2 are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract." Section 2-318 was originally intended to apply to horizontal relationships. See Comment 3 to § 2-318, which states that Alternative A "is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons ***in the distributive chain***." (emphasis added)

8.3.2.1. See the discussion at Chapter 7.3 for case law developments extending breach of express and implied warranty claims to remote sellers under the concept of vertical privity.

8.3.2.2. When you are filing a claim against someone, such as the manufacturer, a distributor, a retail store, who is in vertical privity with the purchaser, ALWAYS try to avoid application of § 2-318, and RELY INSTEAD on the concept of vertical privity. Why? Because § 2-318, particularly Alternative A, which is the most widely adopted alternative, ***strictly limits*** the type of damages awardable, and the class of persons who may bring a claim.

8.3.3. Alternatives. After receiving complaints regarding the narrow scope of Alternative A, and in an attempt to stop states from adopting non-uniform provisions regarding third party beneficiaries, in 1966 the Commissioners added Alternatives B and C to § 2-318. Each state is free to adopt the alternative it prefers. Alternative A is the most restrictive alternative as to who can sue a seller for breach of warranty and for what damages; Alternative C is the least restrictive. For various court interpretations of the three alternatives, see Diane L. Schmauder, Annotation, *Third-party Beneficiaries of Warranties Under UCC § 2-318*, 50 A.L.R.5th 327 (1997).

Research Assignment 8-2. Which alternative was adopted in your jurisdiction?

<table>
<tr><th colspan="4">Problem 8-10. Complete the following chart:</th></tr>
<tr><td></td><td>Who is protected</td><td>For what injury?</td><td>Limits on seller’s power to restrict</td></tr>
<tr><td>Alt. A</td><td>any ____________person
– in buyer’s ______________
– in buyer’s ______________
–guest in buyer’s home
IF reasonable to expect that such person may use, consumer, or be affected by the goods</td><td>personal injury only</td><td>seller may not exclude or limit the class of protected beneficiaries or type of injury protected against (personal injury)</td></tr>
<tr><td>Alt. B</td><td>Any natural person who
____
____
________________________</td><td>personal injury only</td><td>may not exclude or limit the class of protected beneficiaries or type of injury protected against (personal injury)</td></tr>
<tr><td>Alt. C</td><td>Any person (includes entities) who may reasonably be expected to use, consume or be affected by the goods</td><td>________________
________________</td><td>may exclude or limit the class of protected beneficiaries or type of injury protected against, other than injury to the person of individuals (but, for example, could exclude property damages or lost profits; could exclude non-natural persons as beneficiaries)</td></tr>
</table>

8.3.3.1. Under Alternative A, family members have been held to include parents, spouses, children (both minor and adult), siblings, mothers-in-law, grandchildren, nieces and nephews (and this is a non-exclusive list). The family member ***does not have to reside*** in the purchaser's household.

8.3.3.2. Under Alternative A, examples of household members would include a live-in nanny, an unmarried couple, and college roommates. This class ***must reside*** in the purchaser's household (unlike family members).

8.3.3.3. With regard to the protected class of guests under Alternative A, they must be guests ***in the home*** of the purchaser (and not, for example, a guest in the purchaser's car or boat). Many courts have required there to be some connection between the visit to the home and the injury; for example, injury to a guest who is jumping on a trampoline at the purchaser's residence (home including not only the building, but the premises surrounding the home). On the other hand, if a purchaser gives a gift to a friend while the friend is a guest in the purchaser's home, and the purchaser leaves and the gift results in an injury to the friend elsewhere, the friend may not fall in the protected class. Examples of persons who are not "guests" are paying customers, employees, and tenants.

8.3.3.4. Note that an additional requirement to fall under any of the alternatives is that the person must be "reasonably expected to use, consume or be affected by the goods." For example, if a child is injured while opening a beer bottle, can the bottler argue that it is not reasonable to expect a minor child to be opening a bottle of beer?

8.3.3.5. As noted at Section 8.3.2, Comment 3 states that Alternative A is "***not intended*** to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the ***distributive chain***." (emphasis added). However, the courts in most jurisdictions have declined to extend horizontal privity beyond the classes enumerated in Alternative A, believing that if a larger horizontal class had been intended, the legislature would have adopted one of the other two alternatives. See, e.g., *Teel v. American Steel Foundries*, 529 F. Supp. 337 (E.D. Mo. 1981) (declining to extend the Alternative A class members to an employee injured by a product purchased by his employer).

Problem 8-11. Calvary Baptist Church purchased and installed a walk-in freezer that was expressly warranted to have a safety door which could always be opened from the inside. Vicky, a 13-year old member of the congregation, was volunteering in the kitchen, and while inside the walk-in freezer the door shut behind her. She could not open it, and suffered severe frostbite before she was discovered. Can Vicky bring a claim for breach of warranty against the freezer manufacturer under Alternative A? B? C?

Problem 8-12. Landlord Bob installs a water cooler in an apartment which he owns, rented by Ted. The water cooler leaks, and destroys Ted's valuable book collection. Can Ted bring a claim for breach of warranty against the water cooler manufacturer for the property damage under Alternative A? B? C?

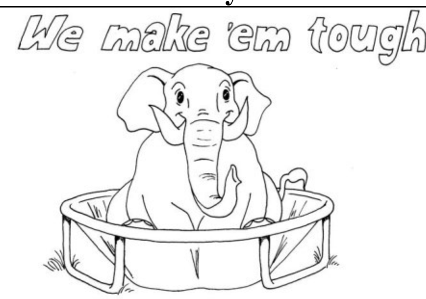
Problem 8-13. We read in Chapter 7 how an express warranty must be part of the "basis of the bargain." Many courts require some knowledge of the existence of the warranty and reliance thereon on the part of the purchaser. Does the "basis of the bargain" apply to plaintiffs who are not purchasers who bring a claim under UCC § 2-318?

8.3.4. Remote Sellers under UCC § 2-318. Assume that you have a person who falls within the horizontal protected class of one of the alternatives. For example, the wife of a purchaser is injured while using a motorcycle helmet purchased by her husband. In an Alternative A state, she is in the protected class as a member of the purchaser's family, and her damages are also within the allowable class of damages (personal injury). She files a claim against the manufacturer, who sold the helmet to a retail store, who sold the helmet to her husband. Is the manufacturer liable?

> 8.3.4.1. Under Alternative A, the wife is able to bring a claim against the seller (note that a "seller's warranty" extends to "his [the seller's] buyer." Who is the seller? The retail store, not the manufacturer. To get to the manufacturer, she will have to rely upon a "vertical" privity concept. Some states incorporate, on top of § 2-318, the vertical privity analysis discussed earlier in these materials and at Chapter 7.3 to allow the family member to sue a manufacturer up the line from the immediate seller. In other words, they allow the wife to bring a claim under § 2-318, then go to common law concepts of vertical privity to extend her claim past the immediate seller up the chain to the manufacturer. But not all states allow this. See, for example, *Williams v. Fulmer*, 695 S.W.2d 411 (Ky. 1985), which disallowed a claim brought by a wife who was injured while using the helmet purchased by her husband.
>
> 8.3.4.2. If the wife's claim had been brought in a jurisdiction with Alternative B or C, she could argue that on their face these sections do not limit privity to the seller's immediate buyer. Note that Alternative A says that the seller's warranty extends to "his buyer" while Alternatives B and C say that "A seller's warranty … extends to any natural person" in B and to "any person" in C. Thus, a court could find that there is no privity requirement under § 2-318 Alternatives B or C (instead of having to rely on common law vertical privity). All that the wife has to show is that it is reasonable for a manufacturer to expect a good to pass through a line of distribution and end up with the end purchaser, who in turn may reasonably be expected to allow others to use such good. However, the problem with relying on § 2-318 to establish vertical privity (versus common law vertical privity) is the limitation of the types of damages awardable under Alternative B (personal injury only), although Alternative C allows any type of damage to be compensated.

8.3.5. Interplay of Disclaimers and Privity. If a disclaimer is made somewhere along the line of distribution, a person otherwise having a claim under the concepts of vertical *or* horizontal privity may not be able to recover against the disclaiming party.

Problem 8-14. Jump High Inc. manufactures trampolines. Jump High Inc. has prepared a brochure describing its trampolines, which includes the following statements and picture:

We build our trampolines to last:	A full **lifetime warranty** on all our frames!
• Built with stronger steel, better stitching, larger triangles, tougher springs and thicker safety pads	
• Our trampoline frames will not warp or buckle	
• Weatherproofed for use all year round	
• Tested to 440 lbs.	

Jump High Inc. sells several trampolines to Big Mountain Recreational Sales, a retailer of sporting goods and outdoor gear, along with several copies of the brochures. Big Mountain also sells one other brand of trampolines. John Jacobson comes into the store looking for a trampoline. The salesman provides John with copies of the manufacturer's brochures for both brands. After reading the brochures, John purchases a Jump High trampoline. One year later, during a birthday party at John's home for his son, Eli, the frame buckles while Eli and 5 of his friends are jumping on the trampoline. The children weigh, on average, 70 pounds each. Two of Eli's friends suffer serious injuries.

(1) Do the two injured children have a breach of warranty claim against Big Mountain Recreational Sales?

(2) Do the two injured children have a breach of warranty claim against Jump High Inc.?

Chapter 8 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapters 10 and 11

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapters 11 and 12

Chapter 9. Parol Evidence Rule; Contract Modification

9.1. The Common Law Parol Evidence Rule

9.1.1. Purpose. The ***parol evidence rule*** is based upon two foundational premises:

- Parties who have reduced their agreement to a writing intended to be a final expression of their understanding should not be allowed to introduce evidence of ***prior oral*** or ***written*** terms or ***contemporaneous*** oral terms that ***contradict*** or ***supplement*** that writing.

- The parol evidence rule gives ***more evidentiary weight*** to writings than to non-written statements.

9.1.2. Meaning of "Parol" Evidence. Contrary to common misperceptions, "parol" when used in the context of the parol evidence rule does not mean "oral." The more accurate definition is "***extrinsic***," meaning extrinsic to the written agreement between the parties. To be more precise, the parol evidence rule may be used to exclude ***written*** or ***oral*** agreements made ***prior*** to the written agreement, as well as ***oral*** (but ***not*** written) agreements that are ***contemporaneous*** with the written agreement. Generally, contemporaneous written agreements are not excluded by the parol evidence rule, even if they contain contradictory terms. See § 9.2.6.1.

Furthermore, the rule is not really a rule of "evidence" – it is a rule of substantive contract law. For example, if objection to its introduction is not timely made, it can still be challenged. And when the trial is in federal court on diversity grounds, the state law of parol evidence will govern.

9.1.3. Exceptions. The common law parol evidence rule does not exclude all types of extrinsic evidence in all situations. Parol evidence ***is admissible*** for certain purposes, including (1) the formation of the contract, (2) the existence of a separate enforceable agreement, (3) the interpretation of the agreement, (4) the validity of the contract, and (5) a subsequent modification of the agreement.

9.1.4. Final Written Expression. The common law parol evidence rule applies to written agreements ***intended to be the final expression*** of the parties' agreement.

> 9.1.4.1 The common law distinguishes between final agreements that are "***completely integrated***" and "***partially integrated***." Some jurisdictions create a rebuttable presumption that a contract reduced to writing is presumed to completely integrated. See, e.g., Mont. Code Ann. § 28-2-905.
>
> 9.1.4.2 A "partially integrated agreement" is a final expression of some of the terms but is not complete or exclusive as to all of the terms. While a party cannot introduce evidence

of a consistent additional term to a completely integrated agreement, evidence of a consistent additional terms is admissible when an agreement is partially integrated. *Restatement (Second) of Contracts* § 216(1) (1981).

9.1.5. Necessary Elements. Because the parol evidence rule entails several elements, all of which must be satisfied before the rule is applied, you should always ask the following questions:

- Is there a written agreement intended to be the final expression of the parties' agreement?
- If so, is the agreement "completely integrated" or "partially integrated"?
- Does the extrinsic evidence offered fall within one of the categories of evidence excluded by the parol evidence rule?
- If so, is the extrinsic evidence being offered for an admissible purpose and thus is not excluded by the parol evidence rule?

9.2. UCC Parol Evidence Rule. The UCC parol evidence rule is found at UCC § 2-202. Read it carefully, keeping in mind the elements of the common law rule.

9.2.1. Under § 2-202, evidence of prior oral or written agreements, or contemporaneous oral agreements, is not admissible ***to contradict*** either (1) agreed terms contained in confirmatory memoranda or (2) a writing intended as the final expression of their agreement. This is consistent with the common law.

9.2.2. UCC § 2-202(a) allows three types of evidence -- usage of trade, course of dealing, and course of performance -- to ***explain or supplement*** a term contained in the writing ***even if*** the parties intended the writing to be complete and exclusive. This is broader than the common law rule, which would not allow evidence of usage of trade, course of dealing, or course of performance to supplement a completely integrated agreement.

9.2.3. The common law allows parol evidence to be admitted for issues relating to the formation, interpretation, or validity of the contract. UCC § 2-202 is silent in these situations, and thus the common law supplements under UCC § 1-103(b). For example, evidence of prior oral or written agreements, or contemporaneous oral agreements, may be introduced to interpret an ambiguous term, or to prove mistake, fraud, misrepresentation, or failure of a condition precedent that would invalidate the contract.

9.2.4. The UCC rules regarding the use of parol evidence regarding the ***modification*** of a contract subsequent to its formation are found at UCC § 2-209, and are discussed at Section 9.3.

Problem 9-1. What types of ***contradictory*** evidence are suppressed by the UCC § 2-202 parol evidence rule, if (1) there are terms in a confirmatory memoranda to which the parties agree or (2) a writing intended as the final expression of their agreement?

___ prior oral agreements

___ prior written agreements

___ contemporaneous oral agreements

___ contemporaneous written agreements

___ oral agreements arising after contract formation

___ written agreements arising after contract formation

Problem 9-2. A written contract for the sale of a car specifies that payments shall be made on the 1st day of each month for 12 months. By telephone conversations afterwards, the car dealer agrees to accept payments on the 15th of each month. Is evidence of the telephone conversation suppressed by UCC § 2-202? Why or why not?

> 9.2.5. In addition to the common law exceptions (see 9.1.3), the UCC itself provides two important exceptions to the parol evidence rule at UCC § 2-202(a) and (b). Under § 2-202(a), the writings of the parties may ***always be explained or supplemented*** by course of dealing, usage of trade, or course of performance. This exception does not, at least on its face, allow ***contradictory*** terms; it only allows explanation of existing terms or supplementation of existing terms. As illustrated in the following case, it is not always easy to distinguish between terms that "explain or supplement" versus terms that contradict.

Columbia Nitrogen Corp. v. Royster Co.
451 F.2d 3 (4th Cir. 1971)

[Columbia Nitrogen Corp. entered into a contract to purchase minimum quantities of phosphate from Royster Co. over a period of several years at specified prices. The market price of phosphate dropped precipitously, and Columbia refused to purchase the phosphate in the quantities that it had agreed to in the written agreement. When Royster brought a claim for breach of contract against Columbia, Columbia defended on the grounds that the contract, when construed in light of the usage of the trade and course of dealing between the parties, imposed no responsibility on Columbia to accept at the quoted prices the minimum quantities stated in the contract. The district court rejected Columbia's argument, determined that Columbia had breached its agreement, and entered judgment in favor of the seller, Royster.]

BUTZNER, Circuit Judge

….

Columbia assigns error to the pretrial ruling of the district court excluding all evidence on usage of the trade and course of dealing between the parties. It offered the testimony of witnesses with long experience in the trade that because of uncertain crop and weather conditions, farming practices, and government agricultural programs, express price and quantity terms in contracts for materials in the mixed fertilizer industry are mere projections to be adjusted according to market forces.

Columbia also offered proof of its business dealings with Royster over the six-year period preceding the phosphate contract [during which Columbia, which produces nitrogen and other fertilizers, had repeatedly and substantially deviated from the prices and quantities at which it had agreed to sell nitrogen to Royster when market prices for nitrogen changed significantly]. This experience, a Columbia officer offered to testify, formed the basis of an understanding on which he depended in conducting negotiations with Royster.

The district court held that the evidence should be excluded. It ruled that "custom and usage or course of dealing are not admissible to contradict the express, plain, unambiguous language of a valid written contract, which by virtue of its detail negates the proposition that the contract is open to variances in its terms[.]"

A number of Virginia cases have held that extrinsic evidence may not be received to explain or supplement a written contract unless the court finds the writing is ambiguous. E. g., *Mathieson Alkali Works v. Virginia Banner Coal Corp*., 147 Va. 125, 136 S.E. 673 (1927). This rule, however, has been changed by the Uniform Commercial Code which Virginia has adopted. The Code expressly states that it "shall be liberally construed and applied to promote its underlying purposes and policies," which include "the continued expansion of commercial practices through custom, usage and agreement of the parties[.]" [UCC § 1-103(a)(2)]. The importance of usage of trade and course of dealing between the parties is shown by [UCC § 1-303], which authorizes their use to explain or supplement a contract. The official comment states this section rejects the old rule that evidence of course of dealing or usage of trade can be introduced only when the contract is ambiguous. And the Virginia commentators, noting that "this section reflects a more liberal approach to the introduction of parol evidence … than has been followed in Virginia," express the opinion that *Mathieson, supra*, and similar Virginia cases no longer should be followed. (citations omitted) We hold, therefore, that a finding of ambiguity is not necessary for the admission of extrinsic evidence about the usage of the trade and the parties' course of dealing.

We turn next to Royster's claim that Columbia's evidence was properly excluded because it was inconsistent with the express terms of their agreement. There can be no doubt that the

Uniform Commercial Code restates the well-established rule that evidence of usage of trade and course of dealing should be excluded whenever it cannot be reasonably construed as consistent with the terms of the contract. *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, 60 Misc. 2d 720, 304 N.Y.S.2d 191, 203 (1969), *aff'd mem.*, 34 A.D.2d 618, 311 N.Y.S.2d 961 (1970). Royster argues that the evidence should be excluded as inconsistent because the contract contains detailed provisions regarding the base price, escalation, minimum tonnage, and delivery schedules. The argument is based on the premise that because a contract appears on its face to be complete, evidence of course of dealing and usage of trade should be excluded. We believe, however, that neither the language nor the policy of the Code supports such a broad exclusionary rule. [UCC § 2-202] expressly allows evidence of course of dealing or usage of trade to explain or supplement terms intended by the parties as a final expression of their agreement. When this section is read in light of Va. Code Ann. [UCC § 1-303(e)], it is clear that the test of admissibility is not whether the contract appears on its face to be complete in every detail, but whether the proffered evidence of course of dealing and trade usage reasonably can be construed as consistent with the express terms of the agreement.

The proffered testimony sought to establish that because of changing weather conditions, farming practices, and government agricultural programs, dealers adjusted prices, quantities, and delivery schedules to reflect declining market conditions. For the following reasons it is reasonable to construe this evidence as consistent with the express terms of the contract.

The contract does not expressly state that course of dealing and usage of trade cannot be used to explain or supplement the written contract.

The contract is silent about adjusting prices and quantities to reflect a declining market. It neither permits nor prohibits adjustment, and this neutrality provides a fitting occasion for recourse to usage of trade and prior dealing to supplement the contract and explain its terms.

Minimum tonnages and additional quantities are expressed in terms of "Products Supplied Under Contract." Significantly, they are not expressed as just "Products" or as "Products Purchased Under Contract." The description used by the parties is consistent with the proffered testimony.

Finally, the default clause of the contract refers only to the failure of the buyer to pay for delivered phosphate. During the contract negotiations, Columbia rejected a Royster proposal for liquidated damages of $10 for each ton Columbia declined to accept. On the other hand, Royster rejected a Columbia proposal for a clause that tied the price to the market by obligating Royster to conform its price to offers Columbia received from other phosphate producers. The parties, having rejected both proposals, failed to state any consequences of Columbia's refusal to take delivery -- the kind of default Royster alleges in this case. Royster insists that we span this hiatus by applying the general law of contracts permitting recovery of damages upon the buyer's refusal to take delivery according to the written provisions of the contract. This solution is not what the Uniform Commercial Code prescribes. Before allowing damages, a court must first determine whether the buyer has in fact defaulted. It must do this by supplementing and explaining the agreement with evidence of trade usage and course of dealing that is consistent with the contract's express terms. [UCC §§ 1-303(e), 2-202]. Faithful adherence to this mandate reflects the reality of the marketplace and avoids the overly legalistic interpretations which the Code seeks to abolish.

Royster also contends that Columbia's proffered testimony was properly rejected because it dealt with mutual willingness of buyer and seller to adjust contract terms to the market. Columbia, Royster protests, seeks unilateral adjustment. This argument misses the point. What Columbia seeks to show is a practice of mutual adjustments so prevalent in the industry and in prior dealings between the parties that it formed a part of the agreement governing this transaction. It is not insisting on a unilateral right to modify the contract.

Nor can we accept Royster's contention that the testimony should be excluded under the contract clause:

> "No verbal understanding will be recognized by either party hereto; this contract expresses all the terms and conditions of the agreement, shall be signed in duplicate, and shall not become operative until approved in writing by the Seller."

Course of dealing and trade usage are not synonymous with verbal understandings, terms and conditions. [UCC § 2-202] draws a distinction between supplementing a written contract by consistent additional terms and supplementing it by course of dealing or usage of trade. Evidence of additional terms must be excluded when "the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement." Significantly, no similar limitation is placed on the introduction of evidence of course of dealing or usage of trade. Indeed the official comment notes that course of dealing and usage of trade, unless carefully negated, are admissible to supplement the terms of any writing, and that contracts are to be read on the assumption that these elements were taken for granted when the document was phrased. Since the Code assigns course of dealing and trade usage unique and important roles, they should not be conclusively rejected by reading them into stereotyped language that makes no specific reference to them. ... Indeed, the Code's official commentators urge that overly simplistic and overly legalistic interpretation of a contract should be shunned.

We conclude, therefore, that Columbia's evidence about course of dealing and usage of trade should have been admitted. Its exclusion requires that the judgment against Columbia must be set aside and the case retried[.]

Case Notes:

1. Many commentators criticize the results of this case, particularly in view of the hierarchy of UCC § 1-303(e), which provides that express contract terms prevail if express terms cannot reasonably be construed as consistent with course of performance,

course of dealing, usage of trade. One court, refusing to apply course or dealing or usage of trade to negate a particular contract term, stated:

> Certainly customs of the trade should be relevant to the interpretation of certain terms of a contract, and should be considered in determining what variation in specifications is considered acceptable, but this court does not believe that section 2-202 was meant to invite a frontal assault on the essential terms of a clear and explicit contract.

Southern Concrete Services, Inc. v. Mableton Contractors, Inc., 407 F. Supp. 581, 584 (N.D. Ga. 1975).

2. Another court enunciated the following test to determine whether the offered evidence is consistent with the express language of the agreement:

> Additional terms are inconsistent with a written document if the additional terms are not reasonably harmonious with the "language and respective obligations of the parties." Terms that impose new legal obligations on or alter the existing legal obligations of the parties, like those proffered by MSI, are not reasonably harmonious with the terms of a written agreement.

Sagent Tech., Inc. v. Micros Sys., 276 F. Supp. 2d 464, 468 (D. Md. 2003).

3. Your authors suggest this test. If parol evidence rule analysis concludes that the extrinsic term is part of the contract, read the contract as if that term were written into it. Then ask if the two terms can live together in harmony. If so, let the term in to supplement the contract. For example, in *Columbia Nitrogen*, if the contract expressly said "The price is $10,000," and the admitted extrinsic evidence was trade usage to the effect that "The price can be adjusted depending on market conditions," ask if the language would have been harmonious if it had stated:

> The price is $10,000. The price can be adjusted depending on market conditions.

The answer is *yes*, it is harmonious. On the other hand, if the contract expressly stated "The price is $10,000," and the admitted extrinsic evidence was that "The price is $12,000," would the language have been harmonious if the contract had stated:

> The price is $10,000. The price is $12,000.

The answer is *no*, it is not be harmonious.

Problem 9-3. Betty owns a building supplies store. She enters into a written agreement for the purchase of a truckload of various sizes of lumber from Sawmill. The agreement provides that Betty must pay the purchase price within 30 days of delivery. The written agreement says nothing about the packaging of the various sizes of lumber. The truck arrives and the lumber is not packaged in any orderly form; various sizes of lumber are all intermixed. It requires a sizeable amount of effort (and employee hours) on Betty's part to sort and stack the lumber into respective piles according to size.

(1) In an action against Sawmill, may Betty present evidence that it is customary in the lumber industry to deliver an order of a truckload of lumber consisting of various sizes by stacking each size of lumber on a separate pallet banded by wire? Or is such evidence barred under § 2-202?

(2) Will Betty be able to present evidence that it is customary in the lumber industry for sawmills to allow a 5% discount if orders are paid for within 30 days of delivery, which Betty did?

> 9.2.6 UCC § 2-202(b) provides an exception allowing evidence of prior oral or written agreements, or contemporaneous oral agreements, to provide ***consistent additional terms***. However, there is an important ***exception to the exception***. If the parties intended their agreement to be a ***"complete and exclusive statement of the terms of the agreement***," evidence of prior oral or written agreements or contemporaneous oral agreements is ***not admissible*** to introduce any additional terms, whether consistent or not. In other words, if you have a writing (or writings) which set forth some, but not all, of the terms of the agreement, you can introduce evidence establishing consistent (but not contradictory) additional terms. This is consistent with the "partial integration" rule of common law. On the other hand, if you have a comprehensive document which the parties intended to be the "complete and exclusive" expression of the terms of their agreement, you are not allowed to introduce evidence establishing additional terms, whether consistent or not. This rule is consistent with the "complete integration" rule of common law. For a summary of the "partial integration" and "complete integration" rules at common law, see Restatement (Second) of Contracts § 210 (1981).
>
>> 9.2.6.1. What factors should you consider in determining if a writing is "intended also as a complete and exclusive statement of the terms of the agreement?" The formality of the agreement, whether lawyers drafted the agreement, its comprehensiveness, the sophistication of the parties involved, and the length of negotiations are factors mentioned by various courts. Another important (but not conclusive) fact is whether the document itself purports to be the "complete and exclusive" agreement of the parties. This is usually accomplished by the insertion of a "merger" or "integration" clause into the agreement. A merger clause might look like this:

> This agreement signed by both parties constitutes a final written expression of all the terms of this agreement and is a complete and exclusive statement of those terms.

Unfortunately, courts sometimes regard a merger clause as relevant for a completely different purpose: to determine whether a written agreement is to be treated separately from other agreements executed at the same time by the same parties. As a result, a traditionally drafted merger clause can have some unintended and undesirable consequences. For example, in *Schron v. Grunstein*, 917 N.Y.S.2d 820 (N.Y. Sup. Ct. 2011), the court ruled that a credit agreement and a stock purchase option agreement were to be regarded as separate agreements in part because of the existence of a merger clause in the option agreement. On the other hand, in *In re Clements Manufacturing Liquidation Co., LLC,* 521 B.R. 231, (E.D. Mich. 2014), the court ruled that, despite the merger clause, the asset purchase agreement was an integral part of a larger transaction, thus helping to insulate the asset purchase from avoidance as a fraudulent transfer. Practice tip: Draft the merger clause so that it makes clear that evidence of other parts of the transaction is admissible. For example:

> This agreement and [list other agreements] collectively contain the complete and exclusive understanding of the parties with respect to their subject matter. There are no promises or representations of the parties not included in one or more of these documents.

9.2.6.2. In *Intershoe, Inc. v. Bankers Trust Co*., 571 N.E.2d 641 (N.Y. 1991), Intershoe placed a telephone order with defendant concerning a foreign currency futures transaction involving the exchange of Italian lira for United States dollars. Bankers Trust Company sent a confirmation slip to Intershoe including, among others, the following terms: "we [Bankers] have bought from you [Intershoe] ITL 537,750,000" and "we have sold to you USD 250,000.00." The confirmation slip specified a rate of 2,151 lira per dollar and called for delivery of the lira approximately 7 months later, between October 1 and October 31. Intershoe's treasurer signed the slip and returned it to the bank. In mid-October, the bank sent a reminder to Intershoe about the pending transaction, and asked for delivery of the lira. At that point in time, Intershoe said "this is a mistake; we meant to buy lira, not deliver lira," and it sought to present evidence of that mistake. Although the writing was only a few sentences in length, the court found that the written confirmation was "a complete and exclusive" agreement of the parties, and refused to admit evidence of any additional terms, stating:

> Here, the *essential terms* of the transaction are plainly set forth in the confirmation slip: that plaintiff had sold lira to defendant, the amount of the lira it sold, the exchange rate, the amount of dollars to be paid by

> defendant for the lira, and the maturity date of the transaction. ... Nothing in the confirmation slip suggests that it was to be a memorandum of some preliminary or tentative understanding with respect to these terms. On the contrary, it is difficult to imagine words which could more clearly demonstrate the final expression of the parties' agreement than "we have bought from you ITL 537,750,000" and "we have sold to you USD 250,000.00." (Emphasis supplied.)

Id. at 644.

Problem 9-4. The following language is scribbled on a napkin over drinks by two friends and initialed by both parties: "I, John, sell you, Frank, my 1998 Honda Prelude for $1,000, price payable upon delivery."

(1) Is this a written "final expression" of the price?

(2) Is this writing a "complete and exclusive statement of the terms of the agreement?"

(3) Can the seller introduce into evidence a previous letter offering to sell at $1,500 instead of $1,000?

(4) Can the buyer introduce evidence that seller said he would throw in a new spare tire as part of the deal?

Problem 9-5. Change the facts of the previous problem. The seller is a law student, and presents a 15 page agreement detailing the terms of the car purchase, modifying and using a form he got from his father, who is a car dealer. Buyer is also a law student. The agreement sets forth a price of $1,000, but there is no discussion as to when payment will be made.

(1) Is this writing a "complete and exclusive statement of the terms of the agreement?"

(2) Can the buyer introduce evidence that seller said he would throw in a new spare tire as part of the deal?

(3) Can the buyer introduce evidence that in previous dealings between them, they had established a practice of payment within a week of delivery?

Sierra Diesel Injection Service v. Burroughs Corp., Inc.
651 F. Supp. 1371 (D. Nev. 1987)

[The defendant Burroughs Corporation negotiated with plaintiff Sierra Diesel Injection Service to provide a computer system to meet Sierra's accounting needs. In the course of negotiations, Burroughs made both oral and written representations to Sierra regarding its systems, including a written representation contained in a letter that the system “can put your inventory, receivables, and invoicing under complete control.” Sierra, which did not have extensive knowledge or experience regarding computer systems, alleged that it relied upon these representations in entering into a purchase agreement with Burroughs. The agreement, a standardized agreement prepared by Burroughs, contained an integration clause stating that the agreement constituted the entire agreement between the parties and superseded all prior communications. The warranties contained in the final agreement were limited, and the agreement disclaimed all other express and implied warranties.]

EDWARD C. REED, Jr., Chief Judge

….

Defendant further argues that the plaintiff's allegations regarding any oral warranties or promises made before the contracts were signed must be disregarded by virtue of the parol evidence rule, codified at [UCC § 2-202]. This section of the U.C.C. provides that

> [t]erms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:
>
> > [(a) by course of performance, course of dealing, or usage of trade (Section 1-303); and
> >
> > (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.]

This section of the Code contemplates a multifactor analysis. First, the court must determine whether the writing presented to the court is “intended by the parties as a final expression of their agreement to such terms as are included therein.” *Id., see Norwest Bank Billings v. Murnion,* 210 Mont. 417, 684 P.2d 1067, 1071 (1984); *see also Amoco Production Co. v. Western Slope Gas Co.,* 754 F.2d 303, 308 (10th Cir.1985), *S.M. Wilson & Co. v. Smith International, Inc.,* 587 F.2d 1363, 1370 (9th Cir.1978); *Interform Co. v. Mitchell,* 575 F.2d 1270, 1274-78 (9th Cir.1978). If the court determines that the parties did not intend the writing to be a final expression of their agreement with respect to the terms contained therein, then parol evidence of prior and contemporaneous agreements may be considered by the court. *Id.*

The defendant argues that the merger clause contained in the contracts in this case establishes as a matter of law that the writings are the final expression of the parties' agreements, and that the restrictions of the rule therefore come into play. The authorities hold that merger clauses such as this one are strong evidence of integration, but that they are not necessarily conclusive. In *O'Neil v. International Harvester Co.,* 40 Colo. App. 369, 575 P.2d 862 (1978), for example, the buyer of a truck brought an action against the seller and assignee for rescission of the installment purchase contract, for damages for breach of express and implied warranties, and for fraud. The defendants argued that all of the plaintiff's causes of action were barred by the terms of the contract itself which conspicuously disclaimed all warranties not stated in the agreement, and which contained a merger clause which purported to make that writing the final agreement of the parties. Because of the conspicuous disclaimer clause and the express merger clause, the defendants argued that the plaintiff was prevented from introducing any evidence of warranties which were not included in the writing. The trial court had agreed with the defendant, and found that all evidence of oral warranties was made inadmissible by virtue of the integration clause in the contract.

The court of appeals reversed the lower court. Initially, it found that the trial court had properly found no issue of fact as to the warranty disclaimer clause, in that the plaintiff had actually read the clause. This waiver only affected the implied warranties, however. *Id.,* at 865. The trial court had erred in this case by failing to take evidence on the parties' intent regarding the finality of the writing. In this case, the court found, the plaintiff had alleged the existence of oral warranties prior to the execution of the written agreement, as well as conduct following the sale which tended to show that such warranties were indeed made. Because of these facts, the court found that there was a genuine issue of material fact as to the parties' intent regarding integration of the writing, in spite of the existence of a merger clause. *Id.* In view of the existence of such a genuine fact issue, summary judgment was not proper, and the lower court's ruling was reversed. *See also, Amoco Production, supra.*

In the present case, there also appears to be a genuine issue of fact regarding the parties' intent. Although the merger clause does lend weight to the finding of integration here, the plaintiff also claims that oral warranties were made prior to the execution of the contract. Further, the plaintiff also contends that the defendant made numerous efforts to repair the computer system to comply with those alleged warranties. These allegations indicate the existence of a genuine issue of material fact, in that the parties' intent regarding the integration is not clear. Whereas it is possible that these contracts are fully integrated, the evidence presently before the court also permits the opposite conclusion. As in *O'Neil,* therefore, summary judgment on parol evidence grounds is not proper.

FRAUD

In addition, Nevada case law holds that the parol evidence rule may not operate to exclude evidence of fraud in the inducement of contract, even where the court finds an integrated agreement. *See Havas v. Haupt,* 94 Nev. 591, 583 P.2d 1094, 1095 (1978). *See also Oak Industries, Inc. v. Foxboro Co.,* 596 F. Supp. 601, 607 (S.D.Cal.1984). Thus, parol may always be used to show fraud on the inducement of the contract, even if there has been a valid integration, in that fraud in the inducement invalidates the entire contract. *Id.* The plaintiff must therefore be allowed to present evidence of fraud regardless of the possible integration of the writing.

[Defendants sought summary judgment on the fraud claim, asserting that its alleged misrepresentations to the plaintiff were opinions and "puffery" rather than statements of fact, and thus could not support a claim of fraud. The court determined that a genuine issue of material fact existed regarding the factual nature of these statements, and denied Burroughs' motion for summary judgment.]

Case Notes:

1. Upon reconsideration, the federal district court determined that the purchaser's owner was unsophisticated, had little knowledge of computers, and did not understand that the integration clause would preclude prior representations upon which the purchaser had relied. The court concluded that there was no "mutual intent of the parties in this case that the agreement be integrated." *Sierra Diesel Injection Serv., Inc. v. Burroughs Corp*., 656 F. Supp. 426, 428-429 (D. Nev. 1987). Review the factors set forth in Section 9.2.6.1; do you agree with the court's conclusion? The district court's ruling was affirmed. *Sierra Diesel Injection Serv., Inc. v. Burroughs Corp*., 890 F.2d 108 (9th Cir. 1989).

2. The integration clause contained in the agreement provided:

    > "This Agreement constitutes the entire agreement, understanding and representations, express or implied between the Customer and Burroughs with respect to the equipment and/or related services to be furnished and this Agreement supersedes all prior communications between the parties including all oral and written proposals."

    What additional language or actions might you have added to establish the parties' mutual intent that the agreement was, in fact, the final expression of the parties' agreement regarding warranty terms?

Problem 9-6. Review Problem. ABC and XYZ sign the following written agreement:

> ABC Widget Corporation agrees to sell 1,000 Type B widgets to XYZ Corporation.
> Terms: $10,000 payable 30 days after delivery.
> Delivery date: To be determined by the parties.
> This writing represents the complete and exclusive agreement of the parties.
>
> ABC Widget Corp. XYZ Corp.
> By Brad Jones By Jane Smith

(1) Can the parties agree on a delivery date?

(2) Did ABC give XYZ a warranty of merchantability?

(3) Can XYZ introduce evidence that prior to signing the contract, ABC promised that it would deliver the widgets to XYZ at no additional cost?

(4) Can XYZ introduce evidence that in their four prior transactions, ABC delivered the widgets to XYZ at no additional cost?

9.3. Contract Modification

9.3.1. Modification. Does the UCC parol evidence rule suppress oral statements or writings made ***after*** contract formation? In *Trad Industries v. Brogan*, 805 P.2d 54 (Mont. 1991), a written contract specified a certain delivery date for the sale of elk. In subsequent telephone conversations, the parties agreed to a later delivery date. The court stated: "The telephone conversations are not barred by the parol evidence rule. These occurred *after* the writings and pertain to Trad's assertion that the contracts were subsequently modified." *Id.* at 58.

> 9.3.1.1. UCC § 2-209 governs the ***modification***, ***rescission*** or ***waiver*** of contract terms after the contract has been formed.
>
> 9.3.1.2. There is no requirement of consideration to modify a contract. UCC § 2-209(1). This changes the common law "pre-existing duty" rule.

Problem 9-7. A bakery enters into an agreement to purchase a new commercial oven at a price of $10,000, to be delivered and installed in 14 days. A few days after signing the agreement, the seller calls the bakery and states that it may not be able to meet the 14-day delivery date. The seller promises to deliver the oven within 21 days. The purchaser orally agrees to the revised delivery date. Is this oral modification enforceable?

> 9.3.1.3. Under UCC § 2-209(2), the parties are free to provide that a written agreement can be modified only by a signed writing (usually called a ***"no oral modification***" or "***N.O.M.***" clause).
>
> > 9.3.1.3.1. With regard to "no oral modification" clauses in any transactions which are ***not between merchants***, the "no oral modification" clause in a merchant's form must ***be separately signed by the non-merchant***. This requirement of a separate signing is intended to alert non-merchants that they should not rely upon oral assurances. UCC § 2-209(2).

Problem 9-8: A gravel company agrees to provide 25,000 tons of gravel at the rate of 1,000 tons per week to a construction company that is building a road in a private development. The agreement contains a "no oral modification clause." Delivery is not made in accordance with the delivery schedule in the written contract. In the lawsuit that follows for breach of contract, can the gravel company present evidence that subsequent to the execution of the written agreement the delivery schedules had been modified orally to accommodate the actual start-up and discontinuance of construction schedules on the project?

9.3.2. Statute of Frauds. Does the statute of frauds apply to a modification? UCC § 2-209(3) provides that "the requirements of the statute of frauds ... must be satisfied if the contract as modified is within its provisions." According to White & Summers, Uniform Commercial Code § 2-7 (West 6th ed., 2010), there are at least five possible interpretations of this language:

> (1) that if the original contract was within 2-201, any modification thereof must also be in writing; (2) that a modification must be in writing if the term it adds brings the entire deal within 2-201 for the first time, as where the price is modified from $400 to $500; (3) that a modification must be in writing if it falls in 2-201 on its own; (4) that the modification must be in writing if it changes the quantity term of an original agreement that fell within 2-201; and (5) some combination of the foregoing. Given the purposes of the basic statute of frauds section 2-201, we believe interpretations (2), (3), and (4) are each justified, subject of course to the exceptions in 2-201 itself and to any general supplemental principles of estoppel.

Although White & Summers state their opinion that it is not "justified" to apply UCC § 2-209(3) to all modifications of a contract that originally falls within § 2-201, the majority of courts that have addressed the issue have applied the statute of frauds to oral modifications if both the original contract and the contract, as modified, are contracts involving goods with a purchase price in excess of $500. See, for example, *Green Construction Co. v. First Indemnity of America Insurance Co*., 735 F. Supp. 1254, 1261 (D.N.J. 1990); *Trad Industries v. Brogan*, 805 P.2d 54, 59 (Mont. 1991).

Problem 9-9.

(1) A law firm purchases a printer from Office Supplies for $400. The written contract provides that the law firm may return the printer at any time within 30 days following the purchase, for any reason, in which event the full purchase price will be returned. The contract does not contain a "no oral modification" clause. After experiencing several problems in the first week, the law firm manager and Office Supplies manager orally modify the 30-day return period to a 60-day return period. The problems continue sporadically, and the law firm returns the printer on the 59th day after its purchase. Office Supplies refuses to accept it and issue a refund, pointing out the 30-day return period in the contract. Is the modification enforceable?

(2) Does your answer to the preceding question change if the purchase price of the printer under the original contract is $600?

9.3.3. Waiver. If a post-formation oral statement does not constitute an enforceable modification either because of a valid "no oral modification clause" or because of the statute of frauds, the oral statement may nonetheless *operate as a waiver* under UCC § 2-209(4). For example, a contract for the sale of a car is signed, requiring twelve payments of $1,000 on the first of each month. After three months of making payments on the first, the buyer calls the seller and asks for permission to make payments on the 15th. The seller orally agrees and accepts payments on the 15th for several months. Although this does not meet the statute of frauds requirement, and thus is not an effective *modification*, it does constitute a waiver, and the seller is estopped from alleging breach for payments it accepted that were not received on the first day of the month. *Margolin v. Franklin*, 270 N.E.2d 140 (Ill. Ct. App. 1971). Does this mean that every attempt at oral modification can be construed as a waiver? No.

> 9.3.3.1. Waiver is based upon the equitable doctrine of estoppel, and requires that the party attempting to enforce the oral agreement has relied upon the modification to her detriment. See *Trad Indus. v. Brogan*, 805 P.2d 54, 59 (Mont. 1991), the elk case noted at Section 9.3.1. above, in which the court stated: "When a promisee reasonably and foreseeably relies on a promise to his detriment the promise is binding if injustice can be avoided only by enforcement of the promise."
>
> 9.3.3.2. The advantage of the waiver argument is that waivers do not need to satisfy the statute of frauds.
>
> 9.3.3.3. The disadvantage of the waiver argument is that under § 2-209(5) the seller can *unilaterally* retract the waiver by providing reasonable notice to the other party "that strict performance will be required of any term waived," *unless* the retraction would be unjust in view of a material change of position in reliance on the waiver. In contrast, valid modifications *cannot* be unilaterally retracted.

Problem 9-10. Let's go back to the law firm purchase of a printer whose original cost is $600, and the oral modification of a 30-day return period to a 60-day return period. The law firm returns the printer on the 59th day, and Office Supplies refuses to accept it and issue a refund. When Office Supplies raises the statute of frauds defense, will the law firm nonetheless prevail with a waiver argument under § 2-209(5)?

Chapter 9 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapters 6 (parol evidence rule) and 7 (modification)

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Sections 3-10 to 3-13 (parol evidence rule) and 2-7 (modification)

Chapter 10. Delivery Terms and Title Issues

10.1. Delivery Terms.

10.1.1. Identification of Goods. UCC § 2-501 discusses the concept of "identification of goods." Recall that way back in Chapter 2, we saw that § 2-105 defines ***goods*** as things which are movable "at the time of identification to the contract for sale." It is at this point in time at which the buyer acquires certain property rights in the goods, but not necessarily title to or possession of the goods. The buyer might, for example, have an insurable interest in the goods on identification.

This concept is also important in other UCC provisions to determine the rights of sellers and buyers in the goods. For example:

- Replevin of goods in the seller's hands under §§ 2-502 and 2-716(3)
- Destruction of goods in the seller's hands under § 2-613
- Breach by buyer and seller is unable to sell the goods under § 2-709
- Breach by buyer and seller can identify goods in his control at the time of breach under § 2-704

10.1.1.1. Establishing the point in time at which "identification of the goods" occurs depends, in part, upon the type of goods which are the subject matter of the contract. For example, the subject of the sale may be:

10.1.1.1.1. A particular thing in existence at the time the contract is formed. For example, at the Charlie Russell Art Auction I walk into an artist's room and point out a particular painting I want to purchase.

10.1.1.1.2. The item may be part of a larger stock of similar items held at some other location by the seller. For example, Bighorn Sports may have a canoe dangling from the ceiling as part of its sales display, and I want to buy that model of canoe. I won't actually buy the one dangling from the ceiling; the store has a stock of the canoes in its warehouse a few blocks away.

10.1.1.1.3. The goods may not even be in existence yet. For example, I walk into a jewelry store and ask the jeweler to design and make a ring for me.

10.1.1.1.4. The goods may be crops not yet planted or unborn animals. For example, Anheuser-Busch may enter into an agreement in September 2015 for a farmer's 2016 barley crop which has not yet been planted.

10.1.1.2. The process of designating a particular good as the good "to which the contract refers" is "identification." Identification gives the buyer "a special property interest and an insurable interest" in the goods, but not the full bundle of rights that goes with full ownership of the goods.

10.1.2. When Does Identification Occur? UCC § 2-501(1)(a)-(c) provides the framework for determining when identification occurs. These sections apply only ***in the absence*** of an agreement otherwise.

10.1.2.1. The first rule: look at the agreement of the parties to determine if it specifies when identification of the goods occurs. For example, if an artist has made 50 numbered prints of a particular piece of art, the contract may specify a particular methodology for determining which of the 50 prints will be delivered to the buyer. Also remember that usage of trade, course of dealing and course of performance may establish some of the terms of the agreement. For example, if it is customary in the trade to provide the lowest available numbered print, then identification of the print is established by usage of trade.

10.1.2.2. Absent a contractual provision otherwise, § 2-501(1)(a) states that in the context of a contract for the sale of goods ***already existing*** and ***identified***, identification occurs when the contract is made.

10.1.2.2.1. At the Charlie Russell Art Auction, when a buyer walks into an artist's room and points out a particular painting and offers to purchase it for $150, and the artist accepts that offer, the identification of the goods occurs when the artist accepts the offer. At that point in time, the buyer acquires certain rights in the painting, even if the buyer does not take possession of the painting immediately.

10.1.2.2.2. A buyer walks into a drugstore, picks out a can of hairspray, and takes it to the check-out stand. When the check-out person accepts the buyer's money, the contract is formed and identification of the goods occurs at the cash register.

10.1.2.3. What about the situation where I see a canoe dangling from the ceiling in the store, and I tell the salesman I want to buy a canoe of that model? When is the particular canoe that is the subject of the contract identified? Is it when the stocker pulls out one of the several canoes of that model in storage? Is it when the stocker loads it on top of my car? Is it when I pay the purchase price at the cash register?

10.1.2.3.1. Note that § 2-501(1)(b) refers to identification "when goods are shipped, marked or otherwise designated by the seller." However, § 2-501(1)(b) only applies to *future goods*, and thus it is not applicable to this situation, where goods are in existence (see § 2-105(2) for the definition of "future goods").

10.1.2.3.2. So where do we go for guidance in this example? Although this situation commonly occurs, the UCC is silent. First, look to see if the parties have explicitly agreed to a time and manner of identification. For example, the buyer may consent to allowing the store to pick out the particular canoe to be delivered. Or the store may agree to allow the buyer to go into the warehouse and select a canoe. In the absence of a specific agreement, look to usage of trade, course of dealing, and course of performance for contract terms. UCC § 1-201(a)(3).

10.1.2.4. When does identification occur in connection with *future goods* not yet in existence? For example, a buyer goes into a jewelry store and orders a custom-designed ring, and the jeweler accepts the order. Section 2-501(1)(b) governs this situation, and states that the goods are identified when they are "shipped, marked or otherwise designated by the seller as goods to which the contract refers." Does that occur when the jeweler sets aside the stones and gold she will use in making the ring? When she actually begins making the ring? When she places the materials and beginnings of the ring in a box marked with the buyer's name and order number? Or when the ring is completed and delivered to the purchaser?

10.1.2.4.1. Note Comment 2, which states: "the general policy is ***to resolve all doubts in favor of identification***." (Emphasis supplied.)

10.1.2.5. Under § 2-501(1)(c), if the contract is for the sale of (i) animals to be born within 12 months or (ii) crops to be harvested within the longer of 12 months or the next harvest, identification occurs when the young are conceived or the crops are planted.

10.1.3. Tender of Delivery. Once seller agrees to sell the goods, and buyer agrees to buy, the seller has a ***duty to tender delivery*** of the goods to buyer. See § 2-301: "the obligation of the seller is to transfer and deliver...." You need to be able to identify when tender of delivery occurs, because this event determines many other obligations, such as the obligation of the buyer to pay, and when risk of loss passes.

10.1.3.1. Section 2-503(1) requires that "seller put and hold ***conforming*** goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery."

10.1.3.2. The manner, time and place for tender are determined by (i) the agreement and (ii) the applicable provisions of the UCC, including the following provisions of § 2-503(1):

10.1.3.2.1. Tender must be at a ***reasonable hour***. Comment 3 notes that "usage of the trade and the circumstances of the particular case" determine what is a reasonable hour.

10.1.3.2.2. The goods must be ***kept available*** for the period reasonably necessary to enable the buyer to take possession. Comment 3 notes that "usage of the trade and the circumstances of the particular case" determine what constitutes a reasonable period.

10.1.3.2.3. Unless otherwise agreed, the buyer must furnish facilities reasonably suited to the receipt of the goods.

Problem 10-1. I walk into a candy store and order 2 pounds of dark chocolate. The clerk hands me 2 pounds of milk chocolate. Has tender of delivery occurred? Why or why not?

Problem 10-2. I walk into a jewelry store and purchase a watch. The clerk agrees to sell me the one I specify, but it has to be ordered. The watch comes in a few weeks later, and the jewelry store puts my name on it. Has tender of delivery occurred? Why or why not?

Problem 10-3. On Thursday you see a painting you want to buy during an art show. The artist agrees to sell it to you for $200, and you both agree that you will pick it up after the show on Sunday. The artist calls you at noon on Sunday and tells you the painting is available to pick up. Has the artist made an acceptable tender of delivery?

Problem 10-4. A Law firm orders stationery from a stationery store, to be delivered by the store within the next few days to the law firm. The store delivers the stationery on a Saturday, when the law firm is closed. Has the store made an acceptable tender of delivery?

10.1.3.3. The contract terms (whether oral, written, or as determined by usage of trade, course of dealing or course of performance) should specify ***how*** delivery occurs. You need to be able to distinguish between contracts (1) wherein either the seller or buyer agrees to be responsible for delivery, or (2) wherein the parties agree that an independent third party (a "common carrier") is responsible for delivery. Examples of contracts not involving a common carrier:

- When you purchase a bottle of wine at the grocery store, delivery occurs at the cash register, when the buyer takes possession of the goods.
- When you purchase new carpet from a retail carpet store, the seller often agrees to deliver the carpet to your home in its own delivery truck.
- If you purchase furniture at a self-serve furniture store, the seller agrees to simply make the furniture available at its loading dock, and the buyer is responsible for getting it home.

10.1.4. Common Carrier Contracts. When the parties agree for delivery of goods through use of a common carrier (*i.e.*, an independent third party in the business of transporting goods), the UCC has specific rules determining the responsibilities of the seller, buyer, and common carrier. Another less common situation is the use of a warehouse, such as when a farmer stores his grain at a grain elevator owned by a co-operative.

10.1.4.1. When dealing with a common carrier or warehouse, "documents of title," such as a bill of lading, are often (but not always) involved. See § 1-201(b)(16). For example, when a sawmill located in Eureka, Montana delivers 1000 board feet of lumber to a railway for delivery to a hardware store located in Spokane, Washington, the railway will give to the sawmill a bill of lading, acknowledging the quantity and type of lumber it is shipping. The sawmill then forwards the bill of lading to the hardware store, and the hardware store must provide the bill of lading to the railyard in Spokane to pick up the lumber (so not just anybody can take it).

10.1.4.2. There are two types of contracts when using a common carrier.

10.1.4.2.1. In a ***destination contract***, the seller agrees to be responsible for delivering the goods by common carrier to the agreed-upon destination. ***Note: all delivery contracts (whether a "destination" or a "shipment" contract) have an ultimate destination; it is not the presence of a specific destination that makes a contract a destination contract!*** Instead, what makes a destination contract a destination contract is that the seller takes on the responsibility of delivering to the specific destination, rather than just getting it into the hands of a common carrier at seller's warehouse or place of business.

10.1.4.2.2. All contracts which are not destination contracts are ***shipment contracts***. Comment 5 to § 2-503 notes that ***"shipment" contracts are regarded as the normal (or default) contract.***

10.1.4.2.3. The seller has different duties depending upon whether a ***shipment contract*** is involved or a ***destination contract***. Following is a chart of the major categories of shipment contracts and destination contracts:

Shipment Contracts	**Destination Contracts**
F.O.B. place of shipment (§ 2-319(1)(a))	F.O.B. place of destination (§ 2-319(1)(b))
C.I.F., C.F. (§ 2-320)	
F.A.S. vessel (§ 2-319(2))	
F.O.B. vessel port of shipment (§ 2-319(3))	F.O.B. vessel port of destination (§ 2-319(3))

Over the past several years, these UCC terms have become less frequently used as many sellers, buyers, and common carriers have chosen to incorporate into their contracts the more readable and comprehensive set of INCOTERMS developed by the International Chamber of Commerce. See http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules.

Problem 10-5. Read UCC § 2-504. Identify four duties of the seller under a ***shipment contract***:

(1)

(2)

(3)

(4)

10.1.4.3. To determine the duties of the seller under a ***destination contract***, you need to refer to various UCC sections governing specific types of destination contracts. The primary destination contract which we will study is set forth at § 2-319(1)(b) -- the F.O.B. destination contract.

Problem 10-6. Read § 2-319(1)(b). Identify two duties of the seller under an F.O.B. destination contract:

(1)

(2)

10.1.5. Risk of Loss. The time at which the ***risk of loss*** transfers from the seller to the buyer ***is dependent upon the type of contract involved***. The shifting of the risk of loss is very important, and determines who bears the risk of loss for damages to goods in transit. Whoever bears that risk is the person who should pay for insurance against such risk of loss.

Problem 10-7. Read §§ 2-509(1) and 2-510. When does the risk of loss pass from the seller to buyer:

(1) under a shipment contract?

(2) under a destination contract?

(3) when the goods or the tender don't conform to the contract?

There is an important exception in UCC § 2-510. If the goods or the tender ***do not conform*** to the contract, then the risk remains on the seller. This makes sense, because as we will see in a later chapter, the buyer has the right to reject the goods in that situation.

Rheinberg-Kellerei GMBH v. Vineyard Wine Co.
281 S.E.2d 425 (N.C. Ct. App. 1981)

WELLS, Judge

The first question presented by plaintiff's appeal is whether the trial court was correct in its conclusion that the risk of loss for the wine never passed from plaintiff to defendant due to the failure of plaintiff to give prompt notice of the shipment to defendant. Plaintiff made no exceptions to the findings of fact contained in the judgment and does not contend that the facts found were unsupported by the evidence. Our review on appeal is limited to a determination of whether the facts found support the court's conclusions and the judgment entered. Rule 10(a), N.C. Rules of Appellate Procedure; *Swygert v. Swygert*, 46 N.C. App. 173, 180-81, 264 S.E.2d 902, 907 (1980).

All parties agree that the contract in question was a "shipment" contract, *i.e.*, one not requiring delivery of the wine at any particular destination. See J. White & R. Summers, Uniform Commercial Code § 5-2, at 140-42 (1972). The Uniform Commercial Code, as adopted in North Carolina, dictates when the transfer of risk of loss occurs in this situation. G.S. 25-2-509(1)(a) provides, in pertinent part:

> Risk of loss in the absence of breach. (1) Where the contract requires or authorizes the seller to ship the goods by carrier (a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (25-2-505)....

Before a seller will be deemed to have "duly delivered" the goods to the carrier, however, he must fulfill certain duties owed to the buyer. In the absence of any agreement to the contrary, these responsibilities [are set forth in UCC §2-504].

The trial court concluded that the plaintiff's failure to notify the defendant of the shipment until after the sailing of the ship and the ensuing loss, was not "prompt notice" within the meaning of G.S. 25-2-504, and therefore, the risk of loss did not pass to defendant upon the delivery of the wine to the carrier pursuant to the provisions of G.S. 25-2-509(1)(a). We hold that the conclusions of the trial court were correct. The seller is burdened with special responsibilities under a shipment contract because of the nature of the risk of loss being transferred. See W. Hawkland, 1 A Transactional Guide to the U.C.C. § 1.2104, at 102-107 (1964). Where the buyer, upon shipment by seller, assumes the perils involved in carriage, he must have a reasonable opportunity to guard against these risks by independent arrangements with the carrier. The requirement of prompt notification by the seller, as used in G.S. 25-2-504(c), must be construed as taking into consideration the need of a buyer to be informed of the shipment in sufficient time for him to take action to protect himself from the risk of damage to or loss of the goods while in transit. But see J. White & R. Summers, Uniform Commercial Code § 5-2, fn. 12 (1972). It would not be practical or desirable, however, for the courts to attempt to engraft onto G.S. 25-2-

504 of the U.C.C. a rigid definition of prompt notice. Given the myriad factual situations which arise in business dealings, and keeping in mind the commercial realities, whether notification has been “prompt” within the meaning of U.C.C. will have to be determined on a case-by-case basis, under all the circumstances. See W. Hawkland, 1 A Transactional Guide to the U.C.C. § 1.2104, at 106 (1964).

In the case at hand, the shipment of wine was lost at sea sometime between 12 December and 22 December 1978. Although plaintiff did notify its agent, Frank Sutton, regarding pertinent details of the shipment on or about 27 November 1978, this information was not passed along to defendant. The shipping documents were not received by defendant's bank for forwarding to defendant until 27 December 1978, days after the loss had already been incurred. Since the defendant was never notified directly or by the forwarding of shipping documents within the time in which its interest could have been protected by insurance or otherwise, defendant was entitled to reject the shipment pursuant to the term of G.S. 25-2-504(c).

Problem 10-8. Read UCC § 2-509(3). If the parties are not using a common carrier or a warehouse, when does the risk of loss pass from the seller to the buyer in the following situations:

> (1) On Sunday, a car dealer enters into an agreement to sell an automobile to a customer. The agreement provides that the customer will return and pick up the car at the dealer’s lot on Monday. During the day on Monday, before the purchaser picks up the car, a hailstorm causes significant damage to the car. Who is responsible for paying for the hail damage to the car?
>
> (2) On Sunday, a law student enters into an agreement to sell an automobile to another law student. The agreement provides that the buyer will pick up the car Monday; the seller gives the keys to the buyer Sunday night, and cleans and leaves the car in front of the seller’s home so that it is available early Monday morning for the buyer. During the day on Monday, before the buyer picks it up, a hailstorm hits, causing significant damage to the car. Who is responsible for paying for the hail damage to the car?

Problem 10-9. Now that you understand the duties and responsibilities of sellers and buyers, and risk of loss issues, explain whether a buyer would generally prefer a shipment contract or a destination contract? Why?

Problem 10-10. In preparation for the hunting season, Ted signs on to Outdoor Sporting Goods’ website, and orders $500 worth of hunting gear, paying by credit card. The website states: “In-stock merchandise will normally arrive in 3-6 business days after the order is received. Orders are shipped via UPS or USPS.” Fifteen days after he has placed his order, Ted still hasn’t received the goods. When he calls the customer service hotline, the employee of Outdoor Sporting Goods informs Ted that UPS picked up his order two days after he ordered it.

Ted asks Outdoor Sporting Goods to track his order. The spokesperson politely points out that they have completed their responsibilities, and Ted is responsible for all shipment problems. Is Outdoor Sporting Goods correct?

10.1.6. Bailment Contracts. Section 2-509(2) deals with the less common bailment situation in which the goods are held by a third party bailee to be delivered without being moved. A good example of this is a transaction involving agricultural commodities. The farmer delivers his crop to a grain silo, receiving a document of title to the grain. When the farmer sells the grain to a buyer, he transfers to the buyer the document of title, allowing the buyer to obtain the grain from the silo. According to § 2-509(2)(a), at that point the risk of loss of the goods passes to the buyer.

10.1.7. Choice of Law. We discussed choice of law in Chapter 1, Section 1.8. In the absence of the parties' agreement, the general rule is that the law of the place of delivery governs contracts for the sale of goods. *Restatement (Second) of Conflict of Laws* § 191. Under a shipment contract, the place of delivery will be the seller's place of business. For example, if a company in Washington orders equipment to be shipped by UPS from a company in Wisconsin, then the place of delivery under this shipment contract will be Wisconsin, and absent an agreement otherwise, Wisconsin law will govern.

Review Problems: Delivery Terms

(1) Buyer in Billings, Montana faxes Seller in Seattle, Washington and orders 100 widgets for $1,000 to be paid in 30 days. Seller faxes acceptance. At that moment there are 1000 widgets in Seller's warehouse. That night they are destroyed by a fire. Who bears the risk of loss?

(2) Same facts except Seller put 100 of the widgets in a box and put a label on the box that said, "Buyer. Billings, MT." The widgets were then destroyed by a fire. Who bears the risk of loss?

(3) Same contract and a week later, Buyer calls and asks, "Where are my widgets?" Seller says, "Sitting in my warehouse." Is Seller responsible for getting them to Buyer, or is Buyer responsible for getting them from Seller?

(4) Same as the last question, but Seller says, "If you want, I'll have them sent by UPS to Billings," and Buyer says, "Yes, that's what I want." Seller then bills Buyer $1000 plus $75 for shipping. Does Buyer have to pay the $75?

(5) Same as the last question, except UPS loses the widgets. As between Buyer and Seller, who bears the loss?

(6) Same as #4, except Seller said, "I'll pay for the shipping." Seller then sent them by UPS and UPS lost them. As between Buyer and Seller, who bears the loss?

(7) Back to the original contract. Assume Seller agreed that the sale would be "F.O.B. Billings." Seller shipped the widgets by UPS and UPS lost them. Who bears the risk of loss?

10.2. Title

10.2.1. Passage of Title. When does title to the goods pass from the seller to the buyer? Under real property law, there is a "unitary" concept under which an entire bundle of rights passes at the same time. For example, title, risk of loss, and possessory rights all transfer at a single moment in time, when the deed is delivered from the seller to the buyer. In a departure from real property law, when it comes to goods, different rights can pass at different times. For example, risk of loss can pass from buyer to seller before the buyer acquires title or possession of the goods. Rules governing the passage of title are found at UCC § 2-401.

It is worth noting that § 2-401(1) provides that "[a]ny retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest." You will see the significance of this concept when you study UCC Article 9. For example, I sell you my titled automobile on credit, and we provide in our agreement that I will withhold title until you have paid in full. In fact, I have sold the car to you. Recall that § 2-106(1) provides that a sale "consists in the passing of title from the seller to the buyer for a price. (§ 2-401)." Therefore, you have title to the car (even though you do not have the title document) and I have a security interest in the car – the right to repossess it if you default in payment.

10.2.1.1. First look for an agreement of the parties as to when title passes. For example, purchase orders often contain a clause indicating when title to the goods passes from seller to buyer. In addition, consider terms that may be added by usage of trade, course of dealing, and course of performance.

10.2.1.2. Under § 2-401(1), title cannot pass before identification of the goods has occurred.

10.2.1.3. Absent specific agreement otherwise, § 2-401(2) provides the default rules:

- For a ***shipment contract***, title passes at time and place of shipment.
- For a ***destination contract***, title passes upon tender of goods to buyer when the goods are tendered at the stated destination.
- For contracts not involving common carriers, title passes when the seller has performed his obligation to deliver, as determined by the contract.

10.2.1.4. Note that under § 2-401(4), if a buyer rejects non-conforming goods, or otherwise refuses the goods (whether justified or unjustified), title revests in the seller.

10.2.2. Transferor's Title. Section 2-403 provides that a ***purchaser*** of goods acquires all of the title of transferor, unless by agreement the purchaser acquires less than the whole (such as an undivided one-half interest, or a leasehold interest). The term "purchaser," as used here, includes donees. See § 1-201(b)(29). In other words, the transferee receives whatever title the transferor has. If the transferor has good title, the transferee will acquire good title. Similarly, if the transferor has something other than good title, the general rule of § 2-403 is that the transferee inherits the transferor's title problems.

10.2.2.1. As we studied in Chapter 6, unless specifically and validly disclaimed, the seller (whether merchant or non-merchant) warrants that the title conveyed is good, the transfer is rightful, and the goods are delivered free from any security interest or other lien, except for those security interests or liens known by the buyer at the time of contracting. UCC § 2-312.

10.2.2.2. Thus, the purchaser always has a breach of warranty claim against the seller if it turns out that the seller breaches this warranty. For example, if a seller sells a stolen watch to the buyer, the buyer can recover from the seller. But what if the seller has disappeared to Costa Rica? What are the rights of the purchaser of the watch, who paid good money for a stolen watch, and the person from whom the watch was stolen? Section 2-403 addresses the rights of a purchaser versus the rights of third parties who claim a right to the purchased goods.

10.2.2.3. There are three types of title which we will study: ***good title***, ***voidable title***, and ***void title***.

10.2.3. Good Title. The concept of "good title" (not a defined term) has developed in the real property context. It has been defined as a title "free from litigation, palpable defects and grave doubts, comprising both legal and equitable titles, and fairly deducible of record." *First Montana Title Co. v. North Point Square Assoc.*, 782 P.2d 376, 379 (Mont. 1989). Good title is a title free from all liens, encumbrances, and claims of third parties. It vests full rights of ownership in the owner (unless the transferee acquires a partial interest, such as an undivided one-half interest).

10.2.4. Voidable Title. The second sentence of § 2-403 addresses the concept of ***voidable title***, and lists a ***nonexclusive*** list of situations giving rise to voidable title. When a person with voidable title transfers to a ***good faith purchaser for value***, the transferor's "voidable title" becomes "good title" in the hands of the purchaser.

10.2.4.1. If a transferee of property acquires "voidable title," the transferor has a right to recover the goods from the transferee. For example, if a purchaser buys a new car, and the check bounces, the purchaser has acquired "voidable title," and as against the purchaser, the seller has superior rights. But once the transferee, in turn, transfers the goods to a good faith purchaser for value, the new transferee acquires good title, and the original transferor's right to recover the goods is cut off. UCC § 2-403(1)(a)-(d) includes a list of situations where a transferee of goods acquires "voidable title."

a. The transferor was deceived as to the identity of the purchaser;

b. The goods were delivered in exchange for a check which later is dishonored;

c. It was agreed that the transaction was to be a "cash sale;"

d. The delivery was procured through fraud punishable as larcenous under the criminal law, such as theft by trickery, where the transferor voluntarily relinquishes goods, but has been tricked (versus theft, where goods are taken without participation by the transferor).

Note that this list is non-exclusive. As you recall from your contracts class, other instances where a transferee acquires voidable title include purchase from a minor or a person later claiming mental incompetence.

10.2.5. Void Title. In contrast to voidable title, which can morph into good title when the goods have subsequently been transferred to a good faith purchaser for value, *void title is always void*. Where title is void, the rightful owner will prevail against someone who has acquired the goods down the line, even if the current owner was a good faith purchaser for value. Recall your contracts class, for example, that contracts entered into by a person whose mental incapacity has been judicially determined are void. Note, however, that the statute of limitations might bar the rightful owner's claim against the purchaser. An example is the defense mounted by museums against the claimants of art works that were stolen during World War II.

Inmi-Etti v. Aluisi

492 A.2d 917 (Md. App. 1985)

[Inmi-Etti, while visiting in the United States, decided to buy a car and have it shipped back to Nigeria. With the aid of an acquaintance, Butler, she placed an order for a new 1981 Honda Prelude with Wilson Pontiac for a purchase price of $ 8,500. After making a $200 down payment, Inmi-Etti returned to Nigeria, entrusting the cash balance of the purchase price to her sister. In a few weeks, the car came in, the sister paid the balance of the purchase price for Inmi-Etti, and the car was delivered to a sister's home pending shipment to Nigeria. However, Butler took the automobile, claiming that he was entitled to the car because Inmi-Etti owed him some money. He filed a suit against Inmi-Etti, and obtained a default judgment for these alleged amounts owed to him, and sought to execute against the car to satisfy the judgment. This judgment was later set aside, but between obtaining the judgment and receiving notice that it had been set aside, Butler sold the car to a local car dealer, Pohanka, for the discount price of $7,200. Pohanka turned around and sold the car to another purchaser for $8200. Inmi-Etti brought a suit for conversion against Butler and Pohanka. (The defendant Aluisi is the County Sheriff who levied on the car on behalf of Butler).]

KARWACKI, Judge

….

At common law the maxim was: "He who hath not cannot give (nemo dat qui non habet)." Black's Law Dictionary 935 (5th ed. 1979). Although at times the Uniform Commercial Code may seem to the reader as unintelligible as the Latin phrases which preceded it, we find in § 2-403 of the Code a definite modification of the above maxim. That section states:

> (1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. . . .

In short, the answer to the appellant's claim against Pohanka depends on whether Butler had "void" or "voidable" title at the time of the purported sale to Pohanka. If Butler had voidable title, then he had the power to vest good title in Pohanka. If, on the other hand, Butler possessed void title (*i.e.*, no title at all), then Pohanka received no title and is liable in trover for the conversion of the appellant's automobile. Preliminarily, we note that there was no evidence that Butler was a "merchant who deals in goods of that kind" (*i.e.* automobiles). Md. Code, *supra,* §§ 2-403(2) and 2-104(1). Therefore the entrustment provisions of §§ 2-403(2)-(3) do not apply.

It has been observed that:

> Under 2-403, voidable title is to be distinguished from void title. A thief, for example, "gets" only void title and without more cannot pass any title to a good faith purchaser. "Voidable title" is a murky concept. The Code does not define the phrase. The comments do not even discuss it. Subsections (1)(a)-(d) of 2-403 clarify the law as to particular transactions which were "troublesome under prior law." Beyond these, we must look to non-Code state law.

J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 3-11 (2d ed. 1980) (footnote omitted). White and Summers further explain that: subsection (a) of § 2-403(1) deals with cases where the purchaser *impersonates* someone else; subsection (b) deals with "rubber checks"; subsection (c) deals with "*cash sales*"; and subsection (d) deals with cases of *forged checks* and other acts fraudulent to the seller. *Id*. None of these subsections apply to the facts of the present case and we, therefore, must turn to "non-Code state law" to determine whether Butler had voidable title.

Hawkland, *supra,* § 403:04, suggests that "voidable title" may only be obtained when the owner of the goods makes a voluntary transfer of the goods. He reaches that conclusion from the

Code definitions of the words "delivery" and "purchase" and summarizes:

> Section 2-403(1)(d) does not create a voidable title in the situation where the goods are wrongfully taken, as contrasted with delivered voluntarily because of the concepts of "delivery" and "purchaser" which are necessary preconditions. "Delivery" is defined by section 1-201(14) "with respect to instruments, documents of title, chattel paper or securities" to mean "voluntary transfer of possession." By analogy, it should be held that goods are not delivered for purposes of section 2-403 unless they are voluntarily transferred. Additionally, section 2-403(1)(d) is limited by the requirement that the goods "have been delivered under a transaction of purchase." "Purchase" is defined by section 1-201(32) to include only voluntary transactions. A thief who wrongfully takes goods is not a purchaser within the meaning of this definition, but a swindler who fraudulently induces the victim to voluntarily deliver them is a purchaser for this purpose. This distinction, reminiscent of the distinction between larceny and larceny by trick made by the common law, is a basic one for the understanding of the meaning of section 2-403(1)(d).

Hawkland later states that the above language applies generally to § 2-403(1) and not merely to subsection (1)(d). *See* Hawkland, *supra,* §§ 2-403:05. The following cases and, indeed, (a) through (d) of §§ 2-403(1) seem to support Hawkland's theory that only a voluntary transfer by the owner can vest "voidable title" in a "person." In *Mowan v. Anweiler,* 454 N.E.2d 436 (1983) the Court of Appeals of Indiana held that the purchaser of an automobile gained title from his seller who had purchased the car with a bad check and then declared bankruptcy. The transfer from the original owner to the bankrupt seller was clearly voluntary. That same court in *McDonald's Chevrolet, Inc. v. Johnson,* 176 Ind. App. 399, 376 N.E.2d 106 (1978), held that the purchaser of a motor home obtained no title because the motor home was stolen from its original owner by a person who was renting it for a short period of time. The court reasoned that the thief possessed void title (even though at the time of the theft he was in lawful possession), and his transfer to the defendant could not convey good title. Therefore, the plaintiff could recover for the defendant's breach of warranty of title. Another point of interest to the case *sub judice* was the fact that the defendant in *McDonald's Chevrolet* received from the thief, his seller, a facially valid title certificate. The court specifically noted that the defendant's diligence in checking the title and his status as a good faith purchaser were "not determinative" since his seller did not possess "voidable title."

In *Allstate Ins. Co. v. Estes,* 345 So.2d 265 (1977) the Supreme Court of Mississippi held that a good faith purchaser for value could not obtain title to an automobile from his transferor. The court explained:

> Appellee contends that the facially valid Mississippi title, ultimately based upon an Alabama tag receipt issued pursuant to a forged bill of sale, resulted in "voidable title" in Howard [appellee's seller] with its concomitant power. The appellant, Allstate Insurance Company, who obtained valid title subsequent to paying the Florida dealer's loss,

> contends its ownership was unaffected by the intervening good faith "equities" of Estes [the appellee].
>
> The dictate of Section 75-2-403 is clear. Regardless of the number of transactions, one cannot remove himself from the confines of the rule: A purchaser can take only those rights which his transferor has in the subject goods; a thief has neither title nor the power to convey such. *Gurley v. The Phoenix Ins. Co.,* 233 Miss. 58, 101 So.2d 101 (1958). Accordingly, title remained in Allstate and the circuit court order granting possession to Estes was erroneous.

Id. at 266.

In *Schrier v. Home Indemnity Co.,* 273 A.2d 248 (D.C. App.1971) the District of Columbia Court of Appeals held that "voidable title" could only be obtained by "persons who have been entrusted with the possession of the goods they sell by consignors, creditors with unrecorded security interests, and certain other kinds of bailors." *Id*. at 250 (citation and footnote omitted). That court continued: "But a possessor of stolen goods, no matter how innocently acquired, can never convey good title." *Id*.

Without attempting to specify all the situations which could give rise to a voidable title under § 2-403 of the Uniform Commercial Code, we refer to the above authorities to support our conclusion that voidable title under the Code can only arise from a voluntary transfer or delivery of the goods by the owner. If the goods are stolen or otherwise obtained against the will of the owner, only void title can result.

Under the undisputed facts of the present case Butler possessed void title when Pohanka dealt with him. Although the record simply is not sufficient for us to decide whether Butler actually stole the appellant's vehicle, it is undisputed that the appellant at no time made a voluntary transfer to Butler. Thus, Pohanka obtained no title, and its sale of the vehicle constituted a conversion of the appellant's property. We believe the above analysis sufficient to impose liability upon Pohanka. . . . .

Implicit in all that we have said so far is the fact that Butler did not obtain title (voidable or otherwise) merely from the fact that he was able to convince the Motor Vehicle Administration to issue a certificate of title for the automobile to him [which he obtained through a falsified affidavit after having delivered the car to Pohanka.] Although "[a] certificate of title issued by the Administration is prima facie evidence of the facts appearing on it," Md. Code (1977, 1984 Repl. Vol.), § 13-107 of the Transportation Article, the erroneous issuance of such a certificate cannot divest the title of the true owner of the automobile. *Metropolitan Auto Sales v. Koneski,* 252 Md. 145, 249 A.2d 141 (1969); *Huettner v. Sav. Bank of Balto.,* 242 Md. 477, 219 A.2d 559 (1966); *Lawrence v. Graham,* 29 Md. App. 422, 349 A.2d 271 (1975).

Likewise, we find unpersuasive Pohanka's argument that since Butler had possession of the automobile and a duly issued certificate of title in his name, Pohanka should be protected as a "good faith purchaser for value" under § 2-403 of the Commercial Law Article, *supra*. Such status under that section of the Uniform Commercial Code is relevant in situations where the seller (transferor) is possessed of voidable title. It does not apply to the situation presented by the instant case where the seller had no title at all. *McDonald's Chevrolet,* 376 N.E.2d at 109-110. . . .

Accordingly, we shall reverse the summary judgment in favor of Pohanka and enter judgment in favor of the appellant against Pohanka for $ 8,200, an amount representing the agreed fair market value of the appellant's automobile at the time of its conversion. . . .

Case Note. Does Pohanka have any remedy? Hint: review UCC § 2-312(1)(a).

Problem 10-11. Claude inherited a valuable piece of western art from his aunt. While packing his aunt's belongings after her death, the painting was inadvertently placed in a box of goods to be donated to the Salvation Army. Without realizing that the painting was in the box, Claude dropped off the box at the Salvation Army. After unpacking all of the boxes a few weeks later, Claude realized the painting was missing, tracked it down to the Salvation Army, and sought its return. However, the Salvation Army had sold the painting to Bob for $25.00. Did the Salvation Army have void or voidable title? See *Kenyon v. Abel*, 36 P.3d 1161 (Wyo. 2001).

10.2.6. Good Faith Purchaser for Value. Read UCC § 2-403. If a person acquires voidable title, for example, by use of trickery against the rightful owner, and that person then transfers the goods to a good faith purchaser for value, the good faith purchaser for value acquires good title, and cuts off the original owner's rights to the goods.

> 10.2.6.1. "Good faith" is defined at § 1-201(b)(20) as "honesty in fact and the observance of reasonable commercial standards of fair dealing."
>
> 10.2.6.2. "Purchaser" is defined at § 1-201(b)(30) as a person who takes by "purchase," which is defined at § 1-201(b)(29) to include taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue, gift, or any other ***voluntary*** transaction creating an interest in property.
>
> 10.2.6.3. "Value" is defined at § 1-204 to include "any consideration sufficient to support a simple contract."
>
> 10.2.6.4. There is a lot of litigation over what constitutes a "good faith purchaser for value." For example, what if someone offers to sell to you for $2,000 a painting which you know is worth $20,000. Should the bargain price put you on notice that there may be problems with the title to the painting? What constitutes "good faith" was considered in

Hollis v. Chamberlin, 419 S.W.2d 116 (Ark. 1967). Joe purchased a new pick-up camper top from a local dealer, and paid for it with a $1750 check that bounced, thus acquiring "voidable title." Joe then took the camper to another dealer, and sold it to that dealer for $500 cash. Joe advised the second dealer that he wanted to sell the camper because it did not fit properly on his truck, and it obviously did not. It was not even tied down. The camper looked new. No questions were asked as to why it was not tied down. Joe had no bill of sale. The court felt that there were "facts and circumstances which were calculated to have aroused … curiosity" as to ownership of the camper, stating "[i]nadequacy of the price, when very great, is of itself evidence … of an infirmity in [the] seller's title and consideration is to be given it, in connection with other circumstances, in determining whether a buyer is a purchaser without notice." *Id.* at 119. The court concluded that the second dealer was not a "good faith purchaser for value," and thus he did not acquire "good title" but "voidable title," against which the original dealer prevailed.

10.2.7. Entrustment. What if you take your skis to the ski shop for waxing, and an inexperienced employee sells the skis to a customer in the store who wants to buy a good pair of used skis. Does the purchaser acquire good title? This situation is governed by UCC § 2-403(2). When goods are entrusted to a ***merchant*** who ***deals in goods of that kind***, the merchant has the power to transfer all rights of the owner to a ***buyer in ordinary course of business***.

10.2.7.1. Notice that this only applies when you have entrusted goods to a merchant who deals in goods of that kind. So if I take my skis to a friend to be waxed, the friend, not being a merchant of skis, has no power to transfer title to my skis.

10.2.7.2. The purchaser must be a "buyer in ordinary course of business," which is defined at § 1-201(b)(9) as a "person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind." In other words, the goods have to look like the regular inventory of the seller.

10.2.7.2.1. Notice the exclusion of purchases from "pawnbrokers." You cannot qualify as a "buyer in ordinary course of business" when buying at a pawn shop, presumably because everyone knows that thieves often try to sell stolen goods through pawn shops.

10.2.7.3. The statute says that the entruster has the *power* to transfer title, not the *right* to transfer title. Therefore, the person who left his or her skis at the ski shop has a claim against the ski shop itself, but not against the person who bought the skis in ordinary course of business from the ski shop.

Chapter 10 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 13

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 5

Chapter 11. Impracticability (Excuse by Failure of Presupposed Conditions)

11.1. Common Law. At common law, a party to a contract is excused from performing his or her obligations if, "after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made." *Restatement (Second) of Contracts* § 261.

11.1.1. Initially, many courts imposed the strict standard of ***impossibility of performance*** before excusing a party from its contractual obligations. In more recent years, courts have shifted to the adoption and application of the standard of ***impracticability*** (rather than impossibility) as set forth above in § 261 of the Restatement.

11.1.2. The UCC was a forerunner in the development of the shift from "impossibility" to "impracticability." The drafters sought to codify "the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, [under] which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance." *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966).

11.1.3. Under the principle of freedom of contract, the parties may specifically agree to a discharge of their obligations in the event of certain occurrences. These are typically known as ***force majeure*** clauses, and the use of such clauses may preempt application of the common law or the default rules set forth in the UCC.

11.1.4. For a history of the development of the doctrine of impracticability, see J. Wladis, *Impracticability as Risk Allocation: The Effect of Changed Circumstances upon Contract Obligations for the Sale of Goods*, 22 Ga. L. Rev. 503 (1988). For its development in an international context, see M. Baker, *"A Hard Rain's A-Gonna Fall" - Terrorism and Excused Contractual Performance in a Post September 11th World*, 17 Transnatl. Law. 1 2004).

11.1.5. Note that the consequence of excuse is that a party is not in breach. It may be necessary after excuse to make some adjustment between the parties using principles of reliance and restitution. See *Restatement (Second) of Contracts* § 272.

11.2. The UCC Scheme: § 2-615. Four sections in the UCC address changes in circumstances after the formation of a contract for the sale of goods: § 2-613 (Casualty to Identified Goods), § 2-614 (Substituted Performance), § 2-615 (Excuse by Failure of Presupposed Conditions), and § 2-616 (Procedure on Notice Claiming Excuse). We'll start our analysis with § 2-615.

Problem 11-1.

(1) Which party is entitled to excuse under UCC § 2-615?

(2) From what aspect of performance is that party excused?

(3) After reading § 2-615(a), define the elements which must be established:

performance has been made ____________________

by either (1):

the occurrence of a _________________

the non-occurrence of which was a ___________________________ on which the contract was made.

Or by (2)

Good faith compliance with a foreign or domestic ______________________, even if it is later determined to be invalid.

11.2.1. Although UCC § 2-615 specifically refers to a ***seller*** whose performance has become impracticable, most courts have stated that the doctrine of impracticability is available to excuse buyers as well, if the buyer otherwise establishes the elements of § 2-615. *Lawrance v. Elmore Bean Warehouse*, 702 P.2d 930 (Id. App. 1985). See also the last sentence of Comment 9 -- "the reason of the present section may well apply and entitle the buyer to the exemption."

11.2.2. The governmental action excuse, which has been expanded from common law under the UCC to include action by a foreign government, has been traditionally applied by the courts. As noted in Comment 10, the seller's "good faith belief in the validity of the regulation is the test ... and the best evidence of his good faith is the general commercial acceptance of the regulation." In a case involving a contract dispute between an American radio manufacturer and a Swedish company serving as its exclusive distributor to Iran, the court excused the manufacturer from performing its obligations as a result of the U.S. government's informal requirements prohibiting all sales to Iran of goods. *Harriscom Svenska, AB v Harris Corp*., 3 F.3d 576 (2d Cir. 1993).

11.2.3. As noted in Comment 4 to § 2-615, the concepts of "failure of basic assumption" and "impracticability" are fundamental to an understanding of subsection 2-615(a). Both elements must be present before a seller is excused.

11.3. Failure of Basic Assumption. As discussed above, in order to be excused under § 2-615(a), a contingency must occur, the non-occurrence of which was a ***basic assumption*** on which the contract was made.

> 11.3.1. First, the Comments indicate that a contingency must occur which was "unforeseen." Comment 1 refers to "unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting." Comment 4 refers to an "unforeseen contingency which alters the essential nature of the performance." However, complete non-foreseeability is not the test. "After all, as Williston has said, practically any occurrence can be foreseen but whether the foreseeability is sufficient to render unacceptable the defense of impossibility is 'one of degree'. . . ." *Opera Co. of Boston v. Wolf Trap Foundation for the Performing Arts*, 817 F.2d 1094, 1101-02 (4th Cir. 1987).

> 11.3.2. Second, as noted by the court in *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966), even if there is an unforeseen contingency, the risk of the non-occurrence of that contingency "must not have been allocated either by agreement or by custom." If one or the other of the parties assume a risk, even if all of the particulars of that risk are not discussed or known in advance, "this fact should legitimately cause us to judge the impracticability of performance ... in stricter terms than we would were the contingency unforeseen."

> 11.3.3. Other courts have also noted that in order to successfully assert the affirmative defense of commercial impracticability, the party must show that the unforeseen event upon which excuse is predicated is due to factors beyond the party's control. *Roth Steel Products v. Sharon Steel Corp*., 705 F.2d 134, 149-50 (6th Cir. 1983).

> 11.3.4. Two relatively frequent "contingencies" which give rise to the applicability of UCC § 2-615 include failure of a source of supply and unexpected increases in costs. For example, Hunts agrees to deliver 1000 tons of tomato paste to Krogers. Due to unexpected frosts in California, its tomato suppliers are unable to deliver the tomatoes required to manufacture the tomato paste. Or what if, as a result of the frost, tomato prices increase tenfold, making it unprofitable to manufacture the tomato paste? Is the frost an unforeseen contingency the non-occurrence of which was a basic assumption on which the contract was made which will excuse Hunts from its obligation to provide the tomato paste at the agreed-upon price? Read Comments 4 and 5 to § 2-615 and the following cases.

Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc.
465 S.E.2d 306 (N.C. App. 1996)

[Bobby Murray Chevrolet, an authorized dealer of General Motors products, agreed to sell 1,200 school bus chassis to the State of North Carolina. Unfortunately, Bobby Murray Chevrolet was unable to obtain a sufficient number of chassis from General Motors. The purchaser covered by buying the chassis elsewhere, and sued Bobby Murray Chevrolet for the added cost of approximately $150,000. Bobby Murray Chevrolet argued that it was excused from its obligation to deliver the chassis, because its sole source, General Motors, was unable to deliver the chassis to Bobby Murray Chevrolet.]

Bobby Murray admits the bus chassis ordered by plaintiff school boards were never delivered. However, Bobby Murray contends its lack of performance should be excused pursuant to [§ 2-615] . . . .

Bobby Murray asserts two arguments based upon the foregoing statute. It contends the failure of GM to supply the bus chassis was "a contingency the nonoccurrence of which" was a basic assumption of the underlying contracts between Bobby Murray and plaintiffs. Second, Bobby Murray claims governmental regulation [reducing emissions] after 1 January 1991 was an intervening factor which should operate as an excuse. . . .

U.C.C. § 2-615 has its roots in the relatively recent common law doctrines of impossibility of performance and frustration of purpose, which evolved from the original common law rule that parties to a contract were to be held absolutely to its terms. Thomas R. Hurst, *Freedom of Contract in an Unstable Economy: Judicial Reallocation of Contractual Risks Under U.C.C. Section 2-615*, 54 N.C. L. Rev. 545, 549 (1976). The official comments to § 2-615 indicate that both doctrines were intended to be embraced within a U.C.C. concept denominated "commercial impracticability." *Id.* at 554.

Commentators have asserted that the drafters of the U.C.C. intended "commercial impracticability" to allow a more liberal standard in releasing promisors from contracts than the common law had afforded, but have also noted that courts generally have declined to heed such alleged intent. Paula Walter, *Commercial Impracticability in Contracts*, 61 St. John's L. Rev. 225, 227 (Winter 1987).

In order to be excused under § 2-615, a seller of goods must establish the following elements:

(1) performance has become "impracticable";
(2) the impracticability was due to the occurrence of some contingency which the parties expressly or impliedly agreed would discharge the promisor's duty to perform;
(3) the promisor did not assume the risk that the contingency would occur;

> (4) the promisor seasonably notified the promisee of the delay in delivery or that delivery would not occur at all[.]

Hurst, *supra*, at 553-554.

Utilizing the foregoing criteria as well as the official commentary to § 2-615 and case law from other jurisdictions, we now consider Bobby Murray's arguments on appeal.

Initially, Bobby Murray contends an implied condition of its contract with plaintiffs was the ability of GM to manufacture and supply the ordered bus chassis. We agree that when an exclusive source of supply is specified in a contract or may be implied by circumstances to have been contemplated by the parties, failure of that source may excuse the promisor from performance. N.C.G.S. § 25-2-615, Official Comment 5. However, neither contingency is reflected in the record herein.

Bobby Murray insists in its brief that "appellant disclosed in the bid that the chassis would be manufactured by Chevrolet and Plaintiff-Appellees had knowledge that Appellant's sole source of supply was General Motors." However, Bobby Murray points to no record evidence of such knowledge on the part of plaintiffs, and appears to rely solely upon its status as a GM franchisee to support its assertion.

By contrast, we note that the "General Contract Terms and Conditions" on Form TC-1, incorporated into the bid document, contain the following section entitled "MANUFACTURER'S NAMES":

> Any manufacturers' names, trade names, brand names, information and/or catalog numbers used herein are for purpose(s) of description and establishing general quality levels. Such references are not intended to be restrictive and products of any manufacturer may be offered.

Further, no clause in the contract between plaintiffs and Bobby Murray conditioned the latter's performance on its ability to obtain bus chassis from its manufacturer. *See* William H. Henning & George I. Wallach, *The Law of Sales Under the Uniform Commercial Code*, P 5.10[2], S5-4 (1994 Supplement)(generally, where seller fails to make contract with buyer contingent on adequate supply, courts reluctant to excuse seller). Plaintiffs aptly point to Richard M. Smith and Donald F. Clifford, Jr., *North Carolina Practice, Uniform Commercial Code Forms Annotated*, Vol. 1, § 2-615, Form 3 (1968), which indicates a seller of goods may limit its liability by inclusion of the following "Single Source Clause":

> It is expressly understood that the seller has available only one source, [*name of single source*], of [*address*], for the [*name or identify the raw materials obtained by the seller from the single source*] used by the seller in the manufacture of the goods for the buyer under this contract. In the event of any interference or cessation of the supply from the

> seller's source of supply, the seller shall be temporarily, proportionately, or permanently relieved of liability under this contract, depending upon whether the interruption of the source of supply is a temporary interruption, a reduced delivery of materials, or a permanent cessation of supply.

Moreover, assuming *arguendo* GM *was* contemplated by the parties as Bobby Murray's exclusive source, the record reflects that Bobby Murray assumed the risk of its failure to supply the vehicles, as it was foreseeable that GM might not supply the bus chassis. Failure to make express provision for a foreseeable contingency in a sales contract implicitly places the burden of loss on the seller when the contingency comes to fruition. *Barbarossa & Sons, Inc. v. Iten Chevrolet, Inc.*, 265 N.W.2d 655, 659 (Minn. 1978)(contingency that seller would be unable to procure truck from General Motors "was clearly . . . foreseen . . . before entering the contract," and thus seller not excused).

Foreseeability under § 2-615 is an objective standard; it matters not whether the seller thought a certain event would or would not occur, but what contingencies were reasonably foreseeable at the time the contract was made. Henning & Wallach, *supra*, at P 5.10[2], 5-36 (1992). Examination of the record reveals that cancellation of chassis orders by GM was a risk reasonably foreseeable to Bobby Murray. . . .

Official Comment 5 of N.C.G.S. § 25-2-615, regarding failure of sources of supply, warns: "There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail." The comment cites *Canadian Industrial Alcohol Co. v. Dunbar Molasses Co.*, 258 N.Y. 194, 179 N.E. 383 (1932), in which a middleman contracted to supply a buyer with molasses. When the middleman's source was unable to deliver the required amount of molasses, the former claimed the excuse of impossibility. The court declined "to accept this defense because the middleman had not even bothered to obtain a contract from the refinery to cover his obligations." Henning & Wallach, *supra*, at P 5.10[1], 5-35 (1992); c*f. Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964)(when defendant's ability to perform depends upon cooperation of third party, defendant cannot rely on third party's later refusal to cooperate to claim impossibility).

Similarly, the record herein contains no evidence of a contract between Bobby Murray and GM to ensure delivery of the ordered chassis. Robin J. Fleming, fleet sales manager of Bobby Murray, in deposition simply claimed GM had never before failed to produce vehicles for which it had taken orders while he had been with Bobby Murray, notwithstanding provisions in the "Dealer Sales and Service Agreement" to the effect that orders did not bind GM until the vehicles were "Released to Production" and that certain specified factors might affect production.

Moreover, during the time orders were accepted from plaintiffs, Bobby Murray also received a DCS message revealing that GM was experiencing shortages of Allison automatic transmissions. Bobby Murray therefore also had actual notice its source of supply might fail.

[The court also rejected Bobby Murray's argument that government regulations requiring reduced emissions excused its performance of the contract, noting that Bobby Murray, by terms of the parties' agreement, accepted responsibility for keeping abreast of governmental regulations bearing upon the contract.]

Case Notes:

1. As noted in the case, if it is your intent to allow your client to walk away from its obligations under a contract if your client's intended source of supply dries up, it is very important to insert a clause in the agreement to that effect. Even then, as noted in Comment 5, the seller must employ "all due measures to assure himself that his source will not fail."

2. Courts have come to varied conclusions about whether crop failures are foreseeable. In *Cliffstar Corp. v. Riverbend Prod., Inc.*, 750 F. Supp. 81 (W.D.N.Y. 1990), the court reversed a summary judgment opinion that a tomato crop failure was foreseeable, and remanded for a jury trial. In *Clark v. Wallace County Cooperative Equity Exchange*, 986 P.2d 391 (Kan. Ct. App. 1999), the court ruled that a corn crop failure was not sufficient to excuse a seller from delivering the agreed-upon amount of corn.

Lawrance v. Elmore Bean Warehouse
702 P.2d 930 (Id. App. 1985)

Appellant Elmore Bean Warehouse, Inc., had contracted to purchase pinto beans from a grower, Lawrance, at a fixed price. When the market price of the beans dropped dramatically below the contract price, Elmore attempted to avoid paying the agreed price for the beans on the grounds of "commercial impracticability." The grower sued in the magistrate division and recovered judgment for the balance due on the contract. Elmore appealed from the judgment to the district court, but was unsuccessful there. A second appeal was taken to this court. We agree with the two prior decisions holding that the doctrine of "commercial impracticability" is not an avenue by which Elmore can escape its contractual obligation. We affirm the order of the district court.

On May 14, 1981, a representative from Elmore Bean Warehouse (hereinafter referred to as Elmore) approached Lawrance about growing pinto bean seed. That day a written contract was entered into by the parties whereby Lawrance agreed to grow and sell to Elmore eighteen and a half acres of pinto beans and Elmore agreed in turn to pay $ 25 per hundredweight for the beans if they were of commercial quality. An additional $ 3 per hundredweight was to be paid when the pinto beans were certified and another $ 2 per hundredweight was to be added if Lawrance waited until February 15, 1982 for payment.

That fall Lawrance harvested and delivered 240 hundredweight "sacks" of beans. The beans were accepted by Elmore and remained in Elmore's possession. By the fall of 1981 the market price for pinto bean seed had dropped well below the contract price. In January, Elmore asked Lawrance if he would accept $ 18 per hundredweight for the pinto beans. Lawrance declined. The parties did agree orally to extend the time for payment until July 1, 1982. Elmore paid Lawrance $ 1,137.60, fifteen percent of the amount owing on the contract, but the remaining amount due on July 1, 1982 was not paid. Lawrance brought suit to collect the remaining eighty-five percent.

A trial before a magistrate was held. After hearing testimony, the magistrate held Elmore should be held accountable for the full contract price -- $ 30 per hundred-weight.... The magistrate also held that the decrease in the market price was foreseeable and a risk associated with the business; therefore, performance of the contract was not commercially impractical. . . .

This judgment was upheld when Elmore appealed to the district court. Elmore now appeals the district court's decision upholding the magistrate's findings of fact and conclusions of law. The only issue raised in this appeal is whether the lower court erred in failing to rule that Elmore was entitled to relief from the terms of the contract because of commercial impracticability.

Elmore asserts that payment of $ 30 per hundredweight is commercially impractical because of the tremendous drop in the market price and the lack of a market for pinto bean seeds. Commercial impracticability is defined in I.C. § 28-2-615:

> Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:
>
> (a) Delay in delivery or nondelivery in whole or in part by a seller who complies with 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 nonoccurrence of which was a basic assumption on which the contract was made* or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid. [Emphasis added.]

While this language expressly frees only sellers from their obligations, the last sentence of comment 9 to this section of the Idaho/Uniform Commercial Code states that in certain circumstances at least "the reason of the present section may well apply and entitle the buyer to the exemption." Therefore, the provisions are applicable to buyers as long as there is compliance with the statutory requirements. *Hancock Paper Co. v. Champion International Corp.*, 424 F. Supp. 285 (E.D.Pa.1976). *See Northern Illinois Gas Co. v. Energy Cooperative, Inc.*, 122 Ill.App.3d 940, 78 Ill. Dec. 215, 461 N.E.2d 1049 (1984); *see also* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE §§ 3-9, at 128 (2d ed. 1980); Annot., 93 A.L.R.3d 584 §§ 7 (1979).

To prevail under I.C. § 28-2-615 a buyer must prove that his performance was made impracticable by "(1) the occurrence of a contingency; (2) the nonoccurrence of which was a *basic assumption* on which the contract was made; and (3) by which occurrence further performance has become commercially impracticable." *Missouri Public Service Company v. Peabody Coal Company*, 583 S.W.2d 721, 726 (Mo.Ct.App.1979); *cert. denied*, 444 U.S. 865, 100 S.Ct. 135, 62 L.Ed.2d 88 (1979) (emphasis original); J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE §§ 3-9, at 129 (2d ed. 1980). Elmore must show the contract was based on the assumption that the price for pinto bean seed would not decline or that the market would not "dry up." Therefore, whether the nonoccurrence of that event was a basic contract assumption is a question of foreseeability. *See Northern Illinois Gas Company v. Energy Cooperative, Inc., supra*.

Shifting and changing market conditions appear to be the norm of the business world. Therefore, more often than not they are foreseeable. Comment 4 to I.C. § 28-2-615 sheds further light on that subject.

> *Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover*. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. [Citation omitted.] [Emphasis added.]

In the case before us, testimony showed that the market for the pinto bean seed was very favorable at planting time. However, for a variety of reasons, the market price decreased forty percent by the following January. A representative of Elmore admitted the reason he had contracted out for the production of the pinto beans was because "there was a chance of making a profit. . . ." Furthermore, the contract contained no provision to protect him from such a drop in the market price. It appears Elmore risked a change in the market price by signing to buy the beans at a fixed price. The language of comment 4 makes it incumbent upon Elmore to show it can operate only at a loss and that loss will be so severe and unreasonable that failure to excuse performance would result in a grave injustice. *Northern Illinois Gas Co. v. Energy Cooperative, Inc., supra; see Louisiana Power & Light Co. v. Allegheny Ludlum Industries, Inc.*, 517 F. Supp. 1319 (E.D. La.1981). Elmore asserted that if it were required to pay $ 30 per hundred-weight it would be driven into bankruptcy. However, it has failed to furnish specific facts to support that assertion. Therefore, as a matter of law, Elmore was unable to show the decline in the price of pinto bean seed was not reasonably foreseeable.

Analyzing the problem under the common law of impracticality, we turn to § 261 of the RESTATEMENT (2d) OF CONTRACTS (1981). That section states:

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the nonoccurrence of which was a basic assumption

> on which the contract was made, his duty to render that performance is discharged unless the language or the circumstances indicate the contrary.

Comment b, which discusses the meaning of basic assumption, refers to UCC §§ 2-615, codified as I.C. § 28-2-615 in Idaho. Comment b also notes that mere market shifts or financial inability usually do not discharge one's performance. Therefore, the result under I.C. § 28-2-615 and § 261 of the RESTATEMENT (2d) OF CONTRACTS is the same: no relief for Elmore.

The tough stance we are taking in this case is in view of the fact that virtually all contracts which are based upon a fixed price could be subject to modification if a change in the market price would occur. Interpreting the law as appellant suggests would invite countless suits by speculators in the market as well as by persons merely disappointed in their bargains. Few contractual agreements would be secure. As stated in comment 4 to I.C. § 28-2-615, an increase or decrease in prices, even a radical change, is just the thing that fixed price contracts are designed to protect against.

Based upon the foregoing analysis, we affirm the district court's order upholding the magistrate.

11.4. Impracticability. If you are able to establish that a contingency has occurred, the non-occurrence of which was a basic assumption of the agreement, you must also show that the occurrence of such contingency renders performance ***impracticable***. Comment d to *Restatement (Second) of Contracts* § 261 states:

> Performance may be impracticable because extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved. A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either causes a marked increase in cost or prevents performance altogether may bring the case within the rule stated in this Section. Performance may also be impracticable because it will involve a risk of injury to person or to property, of one of the parties or of others, that is disproportionate to the ends to be attained by performance. However, "impracticability" means more than "impracticality." A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover. Furthermore, a party is expected to use reasonable efforts to surmount obstacles to performance (see § 205), and a performance is impracticable only if it is so in spite of such efforts.

Transatlantic Financing Corp. v. United States
363 F.2d 312 (D.C. App. 1966)

[Several months after the nationalization of the Suez Canal, Plaintiff contracted with defendant to deliver a cargo of wheat from Texas to Iran via the Suez Canal for a flat rate. The contract did not specify the route, but the voyage would normally be through the Straits of Gibraltar and the Suez Canal, a distance of 10,000 miles. A month later, and several days after the ship has left Galveston, the Suez Canal was closed by an outbreak of hostilities, so that the only route to Iran was the longer 13,000 mile voyage around the Cape of Good Hope. Plaintiff argued that the unforeseen contingency discharged it from performing at the contract price, and instead it sought remuneration on a quantum meruit basis. The court determined that the closure of the Suez Canal had not specifically been discussed by the parties, nor were there any express terms specifically allocating such a risk to the shipping company. After noting that the shipping company had assumed at least some general risks of shipping problems, the court turned to discuss whether the plaintiff's performance had been rendered impracticable.]

We turn then to the question whether occurrence of the contingency rendered performance commercially impracticable under the circumstances of this case. The goods shipped were not subject to harm from the longer, less temperate Southern route. The vessel and crew were fit to proceed around the Cape. Transatlantic was no less able than the United States to purchase insurance to cover the contingency's occurrence. If anything, it is more reasonable to expect owner-operators of vessels to insure against the hazards of war. They are in the best position to calculate the cost of performance by alternative routes (and therefore to estimate the amount of insurance required), and are undoubtedly sensitive to international troubles which uniquely affect the demand for and cost of their services. The only factor operating here in appellant's favor is the added expense, allegedly $43,972.00 above and beyond the contract price of $305,842.92, of extending a 10,000 mile voyage by approximately 3,000 miles. While it may be an overstatement to say that increased cost and difficulty of performance never constitute impracticability, to justify relief there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case, where the promisor can legitimately be presumed to have accepted some degree of abnormal risk, and where impracticability is urged on the basis of added expense alone. [A footnote here states: See § 2-615, comment 4: "Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance."]

We conclude, therefore, as have most other courts considering related issues arising out of the Suez closure, that performance of this contract was not rendered legally impossible. Even if we agreed with appellant, its theory of relief seems untenable. When performance of a contract is deemed impossible it is a nullity. In the case of a charter party involving carriage of goods, the carrier may return to an appropriate port and unload its cargo, The Malcolm Baxter, Jr., 277 U.S. 323, 48 S.Ct. 516, 72 L.Ed. 901 (1928), subject of course to required steps to minimize damages. If the performance rendered has value, recovery in quantum meruit for the entire performance is proper. But here Transatlantic has collected its contract price, and now seeks quantum meruit relief for the additional expense of the trip around the Cape. If the contract is a nullity, Transatlantic's theory of relief should have been quantum meruit for the entire trip, rather than only for the extra expense. Transatlantic attempts to take its profit on the contract, and then force the Government to absorb the cost of the additional voyage. When impracticability without fault occurs, the law seeks an equitable solution, see 6 Corbin, supra, § 1321, and quantum meruit is one of its potent devices to achieve this end. There is no interest in casting the entire burden of commercial disaster on one party in order to preserve the other's profit. Apparently the contract price in this case was advantageous enough to deter appellant from taking a stance on damages consistent with its theory of liability. In any event, there is no basis for relief.

Case Notes:

1. The courts interpreting the "impracticability" component of UCC § 2-615 have almost universally ruled that an increase in price alone does not render performance impracticable. Note that the increase in this case was approximately 14%. For an expanded discussion of the requirement of something more than a price increase, see *American Trading & Production Corp. v. Shell International Marine*, 453 F.2d 939 (2d Cir. 1972) (where a 75% increase in costs was insufficient to render performance "impracticable.").

2. All courts agree that "the standard by which impracticability should be judged is an objective one," *Alimenta (U.S.A.), Inc. v. Gibbs Nathaniel (Canada) Ltd*., 802 F.2d 1362 (11th Cir. 1986). Commercial impracticability under UCC § 2-615 focuses upon the "the reasonableness of the expenditure at issue, not upon the ability of a party to pay the commercially unreasonable expense." *Asphalt International, Inc. v. Enterprise Shipping Corp*., 667 F.2d 261, 266 (2d Cir. 1981). Under this objective standard, "the focus of the impracticability analysis is upon the nature of the agreement and the expectations of the parties, not to the size and financial ability of the parties." *Alimenta (U.S.A.), Inc. v. Cargill, Inc*., 861 F.2d 650, 652 (11th Cir. 1988).

3. Impracticability more often arises when continued performance will result in a legal violation due to a change in laws. For example, in *International Minerals & Chemical Corp. v. Llano, Inc*., 770 F.2d 879 (10th Cir. 1985), a buyer was excused from its obligation to buy a stated quantity of natural gas, because environmental regulations caused it to modify its operations to require less natural gas than it had originally contracted to purchase. See also *Eastern Air Lines, Inc. v. McDonnell Douglas Corporation*, 532 F.2d 957 (5th Cir. 1976), where an aircraft manufacturer was excused from its contractual obligation to deliver commercial jet airliners on certain scheduled dates because it had voluntarily complied with government requests to expedite production of military equipment needed for the war in Vietnam. And in a non-UCC case, the Montana Supreme Court excused a contractual obligation because of possible environmental contamination if the obligation of drilling a water well were performed. *Cape-France Enters. v. In re Estate of Peed*, 29 P.3d 1011 (Mont. 2001).

4. See Lee Russ, Annotation, *Impracticability of Performance of Sales Contract under UCC § 2-615*, 55 A.L.R.5th 1 (1998).

11.5. Notice. In order to rely upon the excuse defense, UCC § 2-615(c) requires a seller to seasonably notify the buyer that there will be delay or non-delivery. As one hornbook notes:

> In any given case, however, it may be difficult to know whether the excusing contingency will merely cause a delay in delivery or absolutely preclude it. In that circumstance the seller faces a problem as to what kind of notice he must give and whether and when he should begin a plan of allocation. The seller should be protected if he gives seasonable notice of the delay and indicates in good faith that he is uncertain as to whether the delay will ripen into nondelivery and that he will keep the buyer informed of developments as they unfold. Of course, the seller must, thereafter, make good on his promise to keep the buyer informed, and as soon as the seller knows that nondelivery will occur he must notify the buyer of this fact.

3 W. Hawkland, Uniform Commercial Code Series § 2-615:13.

11.5.1. UCC § 1-201(b)(26) states that a person "notifies" another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it.

11.6. Allocation. Under UCC § 2-615(b), if an unforeseen contingency, such as a crop failure, affects only a part of the seller's capacity to perform, the seller must allocate production and deliveries among his customers in any manner which is fair and reasonable. For example, if a farmer has contracted to sell his anticipated crop of 100,000 bushels of barley to be grown on specified land among two purchasers, and as a result of drought the farmer only produces 40,000 bushels, the farmer must allocate the 40,000 bushels in a fair and reasonable manner among the two purchasers.

11.6.1. Professors White and Summers offer a lengthy note about the factors that may be properly considered in a fair allocation:

> One should note that a direction to allocate pro rata is far from an explicit and rigid set of allocation rules. Seller may choose to prorate based upon historic deliveries, historic contract amounts, current needs, current contract amounts and possibly other grounds. By choosing one or another scheme to establish its proration, the seller may be able to favor one set of customers over another to a considerable extent. Moreover if we allow further deviations in the pro rata scheme based upon appropriate priority rules either because of the social utility of certain uses or because of the more serious injuries that some buyers would suffer if they did not receive more than a pro rata share, we leave the seller with a great

> deal of flexibility. We believe that the seller should have considerable flexibility and that courts will not often improve things by putting their oar in. The seller's selfish long-term interest in maintaining a cadre of customers will usually induce a seller to treat most of its customers as it should.

James J. White and Robert S. Summers, Uniform Commercial Code (6th ed.), § 4-10.

11.7. Section 2-616. UCC § 2-616 lays out the buyer's options when the seller's duties have been excused under § 2-615. Assuming the buyer has received notice that the seller will make an allocation or be delayed under that section, if the deficiency "substantially impairs the value of the whole contract" under § 2-612, then the buyer can either terminate the contract or modify it by agreeing to take the allocation. If the buyer does not respond within a reasonable time not exceeding 30 days, the seller can assume the contract has lapsed.

Problem 11-2. Buyer law school has agreed to purchase 150 t-shirts with the law school's logo for its entering 1-L class. The seller informs the buyer that due to an unanticipated event, its manufacturing ability has been impaired and it will be able to ship only 100 of the t-shirts. What are the law school's options? What if the law school does not respond to the seller?

11.8. Section 2-613. UCC § 2-613 governs the situation where a contract requires delivery of goods that have been identified when the contract is made, for example, a particular horse or car. As a ***prerequisite*** to the application of this section, the goods ***must be identified*** when the contract is made. In addition to the identification requirement, the goods also must suffer casualty ***without the fault*** of either party, and the ***risk of loss must not yet have passed*** to the buyer. If the elements are satisfied, then the contract is avoided if the loss is total.

Valley Forge Flag Co. v. New York Dowel & Moulding Import Co.
395 N.Y.S.2d 138 (N.Y. City Civ. Ct. 1977)

In a classic contract action, the plaintiff buyer sues the seller for failure to deliver. The plaintiff then purchased goods on the open market and seeks as damages the difference between the contract price and the subsequent purchase price. These facts are undisputed. However, the defendant alleges that the goods were totally destroyed on shipboard during a heavy storm in transit from Malaysia and therefore it is not liable under the contract. It relies upon section 2-613 of the Uniform Commercial Code which states in pertinent part: "Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer … then (a) if the loss is total the contract is avoided."

Assuming the defendant's claim of total loss is true, the remaining question is whether the goods destroyed were identified when the contract was made.

The facts are that the parties entered into a contract of sale on August 5, 1975. The plaintiff agreed to purchase "30,000 5/16 x 24" Ramin dowels and "100,000 3/8 x 30" Ramin dowels. Delivery was to be in August from Malaysia. A subsequent confirmation order describes the goods as "5/16 x 24" natural dowels and "3/8 x 30" natural dowels.

Section 2-613 of the Uniform Commercial Code conforms to the general rule of contracts that if performance is dependent upon the existence of a specific thing and it is destroyed before the time of performance without fault, a breach by a seller will be excused. (See cases cited 10 NY Jur, Contracts, §§ 365.) For there is an implied condition that impossibility excused performance. *(Dexter v Norton*, 47 NY 62.) However, section 2-613 "has application in the limited situations where the continued existence of identified goods is a presupposition of the agreement. The sale of a unique chattel comes within its scope, but not the sale of chattels, any one of which fitting the description of the contract may be delivered." (Duesenberg and King Commentaries, Bender's Uniform Commercial Code Serv, vol 3A, § 14.13 [3].) Thus, with respect to fungible goods more than just an identification in a sales contract by kind and amount is necessary to come within the meaning of the section. *(Bunge Corp. v Recker*, 519 F2d 449.) There must be a meeting of the minds by the parties as to the particular or actual goods designated to be bought and sold. (Cf. *Dexter v Norton*, 47 NY 62, *supra; Kirsch & Co. v Benyunes*, 105 Misc 648; *International Paper Co. v Rockefeller*, 161 App Div 180.)

The court finds as a fact that the goods in this action were fungible. A dowel is a round wooden rod or stick and interchangeable. Nor is a particular type of wood required. Indeed, the defendant admitted that it could have replaced the dowels by purchasing them on the open market. The plaintiff did. Moreover, the defendant had not entered into a contract with its own supplier until after the sale. The goods had not been shipped, marked, segregated or otherwise designated at the time the sale was made. Therefore, section 2-613 of the Uniform Commercial Code is not applicable because the goods were not "identified" within its meaning. Nor did the defendant generally prove its affirmative defense. Accordingly, plaintiff shall have judgment in the sum of $ 1,265, with interest from October 1, 1975 and costs.

Case Note: UCC § 2-613 is often relied upon by farmers as an excuse for failing to perform if the crops which they have contracted to sell are destroyed. The legal reality is that most crops are fungible and if the specific land upon which they are to be grown is not identified with particularity in the contract, they may not take advantage of § 2-613. They must rely upon § 2-615 instead, and if a particular source is not identified in the contract, they will most likely not prevail under § 2-615 either. See, for example, *Bunge Corporation v. Recker*, 519 F.2d 449 (8th Cir. 1975) (where contract did not identify beans other than by kind and amount, destruction of portion of farmer's crop by weather did not constitute act of God which would excuse performance); *Ralston Purina Company v. McNabb*, 381 F. Supp. 181 (W.D. Tenn. 1974) (in absence of showing contract was to sell crop from specified land, defense of impossibility due to bad weather and flooding unavailable); *Wickliffe Farms, Inc. v. Owensboro Grain Co.*, 684 S.W.2d 17 (Ky. App. 1984) (statutory defense of impossibility not available to seller contracting for delivery of white corn despite drought which struck seller's farm, since contract merely called for delivery of 35,000 bushels of white corn without specifying where such corn was to be grown); *Semo Grain Co. v. Oliver Farms, Inc.*, 530 S.W.2d 256 (Mo. App. 1975) (where contract made no reference to soybeans grown by seller, seller could have fulfilled obligation to deliver soybeans to buyer by acquiring beans from any place or source).

11.9. Section 2-614. UCC § 2-614 allows a party to substitute performance in two situations.

> 11.9.1. Under § 2-614(1), if the agreed-upon shipping method becomes unavailable or commercially impracticable and a commercially reasonable substitute is available, such substitute performance must be tendered and accepted. For example, if a seller has agreed to ship by rail, and a rail strike occurs, the seller may ship by any other commercially reasonable method. On the other hand, a mere increase in the price of shipping by rail would not trigger application of this provision.
>
> 11.9.2. Under § 2-614(2), if the agreed payment method fails because of governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If seller has already delivered the goods, seller must accept the agreed payment, unless the regulation is discriminatory, oppressive or predatory.

11.10. Use of Force Majeure Clauses. UCC §§ 2-613 through 2-615 offer limited and narrow opportunities to excuse a party from performance. For example, § 2-615 requires that a contingency be unforeseen and render performance impracticable. Courts have said that such things as strikes, droughts, shipping failures, and government actions are often foreseeable, and thus such events do not necessarily trigger relief under these UCC provisions. However, under the principle of freedom of contract, the parties are free to enlarge the situations where one of the parties may be excused from performance. These types of clauses are referred to as ***force majeure clauses***. Comment 8 recognizes the ability of the parties to enter such agreements, but cautions that "they are to be read in the light of mercantile sense and reason, for [§ 2-615] sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go."

Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.
178 F. Supp. 2d 1099 (C.D. Cal. 2001)

[The parties entered into related contracts effecting the transfer by the Rhone-Poulenc Rorer (RPR) entities to Watson Labs of exclusive rights to Dilacor XR, a hypertension drug. RPR relied on a third-party, Centeon, as a source of supply to fulfill its obligations to Watson. Centeon had failed some Federal Drug Administration inspections, and was operating under an FDA consent decree. When Centeon failed to fix its various problems, the FDA shut it down, and RPR lost its major source of Dilacor, and thus was unable to meet its obligations to Watson. It notified Watson of this fact, and sought to be excused from further performance under the force majeure clause contained in the contracts.]

Article VIII of the Supply Agreement provides:

> The obligations of RPR and Watson hereunder shall be subject to any delays or non-performance caused by: acts of God, earthquakes, fires, floods, explosion, sabotage, riot, accidents; *regulatory, governmental*, or military *action* or inaction; strikes, lockouts or labor trouble; perils of the sea; or failure or delay in performance by third parties, including suppliers and service providers; or any other cause *beyond the reasonable control of either party* ("Force Majeure Event"). The party which is not performing its obligations under this Agreement as a result of any such event of Force Majeure shall use commercially reasonable efforts to resume compliance with this Agreement as soon as possible.

. . . .

Defendants' Third Motion appears to argue that as a matter of law they are not liable for breach of the Supply Agreement because Article VIII excused their performance obligations. They contend that after the FDA shutdown of the Centeon facility they were not required to perform under the Supply Agreement because of "an unambiguous term in the agreement that provides that a party's nonperformance due to supervening governmental action is excused . . . ."

It is not disputed that the FDA shutdown of Centeon was "governmental action" that at some level caused, or at least contributed to, RPR's nonperformance under the Supply Agreement. RPR argues that therefore the Court should simply give effect to the specifically-enumerated excusing events ("regulatory, governmental … action") agreed to by the parties. . . .

It is not clear whether the parties intended to apply the common law doctrine of *force majeure* or instead intended to supersede that doctrine with the express terms of Article VIII. The Court need not resolve this question because under either the common law of *force majeure* or the express terms of the contract, construed under California law, Defendants may only escape liability if the Centeon shutdown was "beyond the reasonable control of either party." This is so because the plain language of Article VIII requires that any qualifying event, whether specifically enumerated or not, be "beyond the reasonable control of either party." *See Unicover World Trade*

Corp. v. Tri–State Mint, Inc., No. 91–CV–0255–B, 1994 WL 383244, at *10 (D.Wyo.1993) ("After considering the clause as a whole, the Court finds that 'beyond its control' modifies all of the listed causes in the clause."). Moreover, California law reads that element into express *force majeure* clauses anyway:

> We can not [sic] always be sure what 'causes are beyond the control' of the contractor…. No contractor is excused under such an express provision unless he shows affirmatively that his failure to perform was proximately caused by a contingency within its terms; that, in spite of skill, diligence and good faith on his part, performance became impossible or unreasonably expensive. [citations omitted]

Because Article VIII requires that each and every excusing event be "beyond the reasonable control of either party," Defendants' Third Motion seeking a determination that the Centeon shutdown is a qualifying *force majeure* event under Article VIII must be DENIED. However, the Court declines to find as a matter of law that the Centeon shutdown was within the "reasonable control" of Defendants, although it appears likely that Plaintiff can establish at trial that RPR could "control" Centeon. . . . But whether the Centeon shutdown was "beyond the reasonable control" of Defendant nevertheless is a factual question that the Court cannot resolve on a motion for summary judgment. . . .

A closer question is whether, as Plaintiff contends, an event must be "unforeseeable" to excuse performance under Article VIII. Defendants vigorously argue that such a requirement cannot be read into Article VIII. However, as demonstrated above, California law requires (not "permits") that each event claimed to be a "*force majeure*" be beyond the control of the breaching party. *See Nissho-Iwai*, 729 F.2d at 1540. Plaintiff relies upon *URI Cogeneration Partners, L.P. v. Board of Governors for Higher Education*, 915 F. Supp. 1267 (D.R.I. 1996), for the related but separate proposition that a foreseeability requirement may be read into a contractual *force majeure* provision that does not expressly contain any such requirement. In *URI*, the court found that the failure to obtain zoning approval did not fall within one of the specifically enumerated *force majeure* events. Because Rhode Island law "provided little guidance," the court cited New York cases to construe the rather elaborate *force majeure* clause narrowly:

> What distinguishes the Biblical plagues described in [the *force majeure* provision] from a failure to procure zoning permission is the question of foreseeability. As the Board points out, *force majeure* clauses have traditionally applied to unforeseen circumstances--typhoons, citizens run amok, Hannibal and his elephants at the gates--with the result that the Court will extend [the *force majeure* provision] only to those situations that were demonstrably *unforeseeable* at the time of contracting.

Id. at 1287 (emphasis added).

In *URI*, because "zoning was an issue long before" the contract was signed and because the defendant was the party who bore the risk that the lack of governmental approval would preclude performance under the contract, the court held that "failure to win zoning permission was a foreseeable event … and not ... excused by *force majeure ....*" *Id.*

Other courts have found that contractual *force majeure* provisions which are silent on the issue of whether the excusing event must be unforeseeable should be construed to require unforeseeability. *E.g., Gulf Oil Corporation v. Federal Energy Regulatory Commission*, 706 F.2d 444, 453-54 (3d Cir. 1983) ("we conclude that in order to invoke the use of *force majeure* as an excuse under the warranty contract, Gulf as the nonperforming party must show that even though the events which delayed its performance were unforeseeable and infrequent that it had available at the time of their occurrence more than the maximum warranted quantity of gas"). Under Uniform Commercial Code § 2-615, contract performance will only be excused due to impracticability when the purportedly excusing events were unforeseen at the time the contract was executed. *Interpetrol Bermuda v. Kaiser Aluminum*, 719 F.2d 992, 999.

On the other hand, yet other cases indicate that a qualifying event need not be unforeseeable. *See, e.g., Perlman*, 918 F.2d at 1248 ("Because the clause labeled '*force majeure*' in the Lease does not mandate that the *force majeure* event be unforeseeable or beyond the control of [the nonperforming party] before performance is excused, the district court erred when it supplied those terms as a rule of law."); *Sabine Corporation v. ONG Western, Inc.*, 725 F. Supp. 1157, 1170 (W.D. Okla. 1989) ("Plaintiff's argument that an event of *force majeure* must be unforeseeable must be rejected. Nowhere does the *force majeure* clause specify that an event or cause must be unforeseeable to be a *force majeure* event. "); *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corporation*, 736 S.W.2d 715, 720-21 (Tex. Ct. App. 1987) (judicially inserting into a contractual *force majeure* provision "the requirement of unforeseeablility has not been approved by any Texas court, state or federal"). None of these cases applies California law.

The case that the parties have focused on most vigorously, especially at the hearing, is *Eastern Airlines, Inc. v. McDonnell Douglas Corporation*, 532 F.2d 957 (5th Cir. 1976). Plaintiff Eastern Airlines sued the aircraft manufacturer McDonnell Douglas for breach of contract. The crux of the breach was that the defendant failed to deliver 99 airplanes in time. Defendant attributed the delay to a change in concerted governmental policies arising out of the Vietnam War, which caused production of military aircraft to be given priority. Plaintiff thus claimed the breach was excused. The parties agreed to apply California law to the interpretation and enforcement of the contract. The jury awarded more than $ 24 million in damages to Eastern Airlines. The Court of Appeals reversed. In a lengthy analysis of what it characterized as "The Foreseeability Issue," the Court made several observations that favor Watson.

- Exculpatory provisions which are phrased merely in general terms have long been construed as excusing only unforeseen events which make performance impracticable. . . . Courts have often held, therefore, that if a promisor desires to broaden the protections available under the excuse doctrine he should provide for the excusing contingencies with particularity and not in general language …. We will adhere to the established rule of construction because it continues to reflect prevailing commercial practices." *Eastern Airlines*, 532 F.2d at 990-91.

- "Because the purpose of a contract is to place the reasonable risk of performance on the promisor, he is presumed, in the absence of evidence to the contrary, to have agreed to bear any loss occasioned by an event which was foreseeable at the time of contracting …. Underlying this presumption is the view that a promisor can protect himself against foreseeable events by means of an express provision in the agreement …. Therefore, when the promisor has anticipated a particular event by specifically providing for it in a contract, he should be relieved of liability for the occurrence of such event regardless of whether it was foreseeable." *Id.* at 991-92.

Despite these observations, the Court of Appeals held that the trial court's instruction (not quoted in the opinion) was erroneous. The instruction was to the effect that "no event could be an excuse unless it was not reasonably foreseeable at the time the particular contract was entered into." *Id.* at 965, 991. This holding is what Defendants tout, of course. They argue that Watson knew about the Centeon risk and that (as Justice Traynor stated, in language quoted by the Fifth Circuit in *Eastern Airlines*): "When a risk has been contemplated and voluntarily assumed … foreseeability is not an issue and the parties will be held to the bargain they made." *Id* at 992.

The problem for Defendants is that the *force majeure* clause here does not even permit, much less entitle, them to point to the Centeon shutdown as an event giving rise to a *force majeure* defense even though it was foreseeable. The language referring to "regulatory, governmental . . . action" is vague and boilerplate. These words cannot reasonably be construed to reflect that the parties considered that the shutdown of the Centeon plant would be encompassed. In contrast, the clause in the Eastern Airlines-McDonnell Douglas contract was specific. It referred to precisely the kind of governmental action that (according to McDonnell Douglas) caused the delay: "any act of government, governmental priorities, allocation regulations or orders affecting materials, equipment, facilities or completed aircraft …." *Id.* at 963.

The Court holds that under these facts and as a matter of law, Defendants cannot rely on Article VIII to excuse their performance because the shutdown of the Centeon plant was both entirely foreseeable and not encompassed within the *force majeure* clause. In reaching this result, the Court is persuaded by the following factors:

1. Defendants have presented the Court with no evidence to overcome the presumption that RPR "agreed to bear any loss occasioned by an event which was foreseeable at the time of contracting," as was the Centeon shutdown. . . .

2. RPR's express obligation under Paragraph 9.1 of the Supply Agreement to maintain "the manufacturing capacity and capabilities which shall allow it to satisfy the provisions of this Agreement" is inconsistent with allowing it to be excused from performance when the failure resulted (at least in part) from the foreseeable government shutdown of Centeon.

3. Most of the events enumerated in Article VIII are standard, boilerplate *force majeure* occurrences. True, some of the enumerated events, such as natural disasters, are a foreseeable possibility, especially in Southern California (albeit no one can be sure when "the Big One" will hit). But they also are "beyond the reasonable control of either party." In contrast, when parties expressly contemplate a known risk of a regulatory prohibition, they should be expected to allocate that risk expressly, rather than rely upon a boilerplate clause enumerating a parade of horribles that are so unlikely to occur as to make them qualitatively different. In the absence of such allocation, only governmental action not previously contemplated could qualify as *force majeure*. . . .

Problem 11-3. Power Engineering agreed to supply equipment to a company in Iraq, which would use the equipment to train Iraqi jet pilots. To manufacture the product it had agreed to sell to the Iraqi company, Power Engineering entered into an agreement for component parts with Krug. In August 1990, the United Nations imposed an embargo on sales of goods to companies in Iraq, and thus Power Engineering was no longer able to sell its product. It notified Krug that it was canceling its contract with Krug.

(1) Under § 2-615, will Power Engineering prevail in its argument that the embargo against Iraq is an unforeseen contingency which renders the performance of its obligations to buy parts from Krug impracticable? Why or why not?

(2) Would use of a force majeure clause similar to the one used in the Watson Labs case discharge Power Engineering's obligations under the Krug contract? Why or why not?

Chapter 11 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 14

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapters 3-9

Chapter 12. UCC Perfect Tender Rule; Seller's Right to Cure

12.1. Material Breach versus Immaterial Breach. Under common law, a buyer may terminate a contract and his obligation to pay for what he has agreed to buy only if the seller ***materially breaches***. If the breach is not material, the buyer still has a remedy for damages, but he cannot terminate the contract or refuse to perform altogether.

> 12.1.1. The other side of the coin of "material breach" is "substantial performance." If a non-breaching party asserts a material breach on the part of the other party, the breaching party most commonly defends with the argument of "substantial performance."
>
> 12.1.2. For example, a seller agrees to sell a home, and also agrees before the sale to paint the house and clean all the carpets. As of the day of closing, the house has been painted and five of six carpets have been cleaned. The seller has substantially performed, her breach in not cleaning one of the six carpets is immaterial, and the buyer will have to close the purchase. Buyer can, of course, recover the cost she incurs in having the sixth carpet cleaned, but she cannot avoid the contract entirely.
>
>> 12.1.2.1. How do you protect your buyer client to allow the buyer to walk away from the purchase of the home if all of the carpets are not cleaned? Instead of framing the cleaning of the carpets as an obligation, you frame it as an express condition; e.g., "Buyer's obligation to close is expressly conditioned upon Seller's cleaning each and every carpet in the house prior to closing." Express conditions must be strictly complied with; substantial performance will not do.

12.2. Perfect Tender Rule. Having set forth the common law general rule that only a material breach gives rise to the remedy of terminating the contract and discharging the non-breaching party from his obligation to perform, of course there is an exception. Even under the common law, when goods were involved (versus land or services), the buyer had a right to terminate the contract and was discharged from his or her obligation to pay the purchase price if the goods tendered did not perfectly conform to the contract. In other words, with regard to goods, a buyer can reject the goods even for an immaterial defect, or immaterial breach. This is known as the ***perfect tender rule.*** Section 2-601 provides that if the goods or the tender "fail in any respect" to conform to the contract, the buyer ***has the right to reject the goods*** and terminate the contract, in which event the buyer is discharged from his obligation to pay for the goods.

12.3. Qualifications to the Perfect Tender Rule. Does this sound too good to be true if you represent a buyer? If a buyer orders a new car and when it arrives the spare tire is missing, can the buyer reject the car and refuse to pay? If you read § 2-601 alone, it would appear so. But § 2-601 has limitations.

12.3.1. Section 2-602 sets out rules governing a buyer's rightful rejection of goods.

Problem 12-1. Read § 2-602(1) and scan the comments. In order for a buyer's rejection of goods to be rightful, what must the buyer do under § 2-602(1)? See also § 2-606.

> 12.3.1.1. As discussed in more detail at Section 12.7 below, once a buyer rightfully rejects goods, §§ 2-602(2), 2-603 and 2-604 impose certain duties upon a buyer with regard to the rejected goods.

12.3.2. The second limitation on the buyer's absolute right to reject is found at § 2-508, which gives the seller ***a right to cure*** in certain circumstances. The seller's right to cure is a significant limitation on the buyer's right to reject a good for any non-conformity, and we'll review that right in more detail in just a moment.

12.3.3. The third limitation on the perfect tender rule relates to ***installment contracts***. We will review the installment contract rules in more detail later in this chapter.

12.3.4. A fourth limitation on the perfect tender rule is ***the effect of buyer's acceptance*** of non-conforming goods. Once a party has accepted the goods, *the right to reject for any non-conformity disappears*. After acceptance, if a buyer discovers a non-conformity, acceptance can be revoked only in certain situations (we'll discuss revocation of acceptance in the next chapter).

12.3.5. Finally, in rejecting goods, a buyer is subject to the obligation of good faith, as set forth in § 1-304. For example, a buyer orders 100 buffalo hides, and 99 arrive in the shipment. If the real reason for rejection of the 99 hides is a drop in the market price of buffalo hides, rather than the fact that the buyer received only 99, then buyer may not be not acting in good faith, which requires "honesty in fact."

12.3.6. So what is left of the perfect tender rule? White and Summers, Uniform Commercial Code (West 6th ed., 2010) state at § 9-3(b):

> Section 2-601, the only section applicable to one-shot contracts, states a "perfect tender" rule; seller must conform perfectly to its obligation, for the buyer may reject any time "the goods or the tender of delivery fail *in any respect* to conform to the contract." We are skeptical of the real importance of the perfect tender rule[.]
>
> We conclude, and the cases decided to date suggest, that the Code changes and the courts' manipulation have so eroded the perfect tender rule that the law would be little changed if 2-601 gave the right to reject only upon "substantial"

nonconformity. Of the reported Code cases on rejection, few actually grant rejection on what could fairly be called an insubstantial nonconformity, despite language in some cases allowing such rejection.

12.4. Timing and Notice of Rejection. Section 2-602(1) requires a buyer to reject goods ***within a reasonable time*** after their delivery or tender, and to ***seasonably notify*** the seller of the rejection. If a buyer ***fails to reject*** within a reasonable time or to seasonably notify the seller of her rejection of the goods, she is deemed to have accepted the goods (see § 2-606(1)(b)). After acceptance, a buyer is precluded from rejecting the goods (see § 2-607(2)), and can only "revoke acceptance," which is much more difficult to do than rejecting the goods, as we will discuss in Chapter 13.

12.4.1. Section 1-205 states that what is reasonable "depends on the nature, purpose and circumstances" in the particular matter. Notice is "seasonable" if (i) taken within the time agreed or, if no time is agreed, (ii) within a reasonable time.

12.4.2. Section 1-202(d) states that a person "notifies" another person "by taking such steps as may be reasonably required to inform the other person in ordinary course, whether or not the other person actually comes to know of it."

12.4.3. Comment 1 to § 2-602 adds that "reasonable time" must be understood in connection with ***the buyer's right to inspect the goods***, as set forth in § 2-513.

Miron v. Yonkers Raceway, Inc.
400 F.2d 112 (2d Cir. 1968)

[The Mirons delivered their race horse 'Red Carpet' to an auction sponsored by Yonkers Raceway. On October 19, Mr. Finkelstein placed the high bid for the horse at the auction, which was $32,000. By about 3:00 p.m. that day, Yonkers Raceway delivered possession of Red Carpet to Finkelstein, who immediately had the horse transported to his barn. The next morning, Finkelstein's trainer noticed some swelling of the horse's left hind leg, and when the horse was caused to walk and trot, it limped and favored its left hind leg. A veterinarian came out to inspect the horse, and within 24 hours of the horse's delivery, at 11:30 a.m. on October 20, Finkelstein notified Yonkers Raceway that he rejected the horse. Neither Raceway nor Finkelstein paid the Mirons any part of the purchase price for Red Carpet, so they brought a suit seeking the purchase price. The District Court awarded the purchase price to plaintiffs.]

J. JOSEPH SMITH, Circuit Judge

…. [W]e think the trial judge was right in finding that Finkelstein failed to make an effective rejection of the horse under U.C.C. §§ 2-602(1), thereby accepting it under subsection (b). U.C.C. §§ 2-602(1) provides: 'Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.'

Finkelstein accepted the horse, then, if having had a reasonable opportunity to inspect it, he did not reject it within a reasonable time.[14] What is reasonable depends upon an evaluation of all of the circumstances, and we would therefore be reluctant to overturn the findings and conclusions of the trial judge on these issues. He has a feel for the circumstances of the case which we could not possibly have.[15] Moreover, the finding that Finkelstein did not reject the horse within a reasonable time[16] seems to us to be clearly correct.

As the trial judge rightly pointed out, 'The fact that the subject matter of the sale in this case was a live animal … bears on what is a reasonable time to inspect and reject.' Finkelstein's own testimony showed that it is customary, when buying a racehorse, to have a veterinarian or trainer examine the horse's legs, and we agree that the existence of this custom is very important in determining whether there was a reasonable opportunity to inspect the horse. See Official Comment to U.C.C. § 1-204, para. 2. We gather from the record that the reason it is customary to examine a racehorse's legs at the time of sale is that a splint bone is rather easily fractured (there was testimony that a fracture could result from the horse kicking itself), and although the judge made no specific findings as to this, we assume that is generally what he had in mind when he pointed out that 'a live animal is more prone to rapid change in condition and to injury than is an inanimate object.' As we have said, Finkelstein did not have the horse examined either at the place of sale or at his barn later the day of the sale. He thus passed up a reasonable opportunity to inspect Red Carpet.

Finkelstein having had a reasonable opportunity to inspect Red Carpet on the day of the sale, we have no problem with the finding that the attempted rejection on the next day did not come within a reasonable time. In addition to our reluctance to question the trial judge's finding as to what is a reasonable time, we take into account that what is a reasonable time for rejection depends on the purpose of rejection. See U.C.C. § 1-204(2). Where goods are effectively rejected for breach of warranty, the burden of proving that they conform presumably remains on the seller,[17] whereas upon acceptance the buyer has the burden to establish any breach. U.C.C. § 2-

---

14 A 'reasonable opportunity to inspect,' U.C.C. §§ 2-606(1)(b), may of course encompass more than merely a reasonable time to inspect; here, there is no question that Finkelstein had the facilities for inspection available, and the only question on appeal was whether he waited too long.

A reasonable period for rejection overlaps a reasonable opportunity to inspect under U.C.C. §§ 2-606(1)(b). Thus if inspection discloses a defect, there remains the obligation to reject within a reasonable time. But in many cases where the buyer passes up a reasonable opportunity to inspect, he thus fails to reject within a reasonable time, and we think that this is one of those cases, for reasons stated in the text.

15 Cf. the cases in which it has been said that what is a reasonable time for inspection is a question of fact for the jury…. *Anderson Hosiery Co. v. Dixie Knitting Mills, Inc*. 204 F.2d 503, 505 (4th Cir. 1953) [other cites omitted]

16 There is no specific finding, as such, to that effect, but the District Court's opinion makes it clear that the court found that there was no rejection within a reasonable time.

17 The official comment to U.C.C. § 2-602, para. 3, states that the section applies only to rightful rejection by the

607(4). In this case, the subject of the sale is a racehorse warranted to be sound, and the record clearly shows that an injury such as occurred here, rendering a horse unsound, may be a matter of chance, proof of the exact time of injury being very difficult to make. In these circumstances, the burden of proof on the issue of soundness at the time of sale cannot fairly rest on the seller where the buyer has taken possession of the horse, transported it to his barn, and kept it overnight before discovering the injury and informing the seller of it. We conclude that rejection did not take place within a reasonable time after delivery, and Finkelstein thus accepted the horse. In short, since one of the consequences of acceptance is that the buyer bears the burden of proving any breach, the fairness of allocating the burden one way or the other is relevant in determining whether acceptance has occurred-- here, whether rejection took place within a reasonable time.

The defendants have argued strenuously that inspection and rejection on the day after the sale is certainly soon enough, and the argument would gain substantial strength if another sort of defect were involved and we took into account that the customary type of inspection at the time of sale might not disclose aspects of a horse's soundness other than the condition of its legs, and that these aspects, unlike the condition of the legs, would be very unlikely to change overnight. There is nothing in the record as to how much the customary inspection at the time of sale would show; Finkelstein testified only that he has a trainer or veterinarian examine the legs of horses he buys. In any case, if there are defects which are not discoverable by the inspection which the District Court found Finkelstein had a reasonable opportunity to make, the problem is taken care of by U.C.C. § 2-608(1), which provides in relevant part:

> The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it
>
> (b) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

The answer to the argument is that inspection is not necessarily final; where there are defects discoverable by a customary inspection at the time of sale, a buyer in Finkelstein's position will not be excused from making that inspection and rejecting the goods within a reasonable time, if a defect is disclosed, on the ground that there are possible critical defects which only a more thorough inspection would disclose....

The defendants argue that the provision in the Terms and Conditions of Sale that any warranty of the consignor 'shall not extend beyond 24 hours after the fall of the Auctioneer's hammer or until final payment has been made, whichever is sooner,' fixes by agreement, a

---

buyer. Yet acceptance may depend upon whether there has been a rejection under that section, and the allocation of the burden of proving whether there was a defect, and thus whether or not there was 'rightful rejection,' depends upon whether there has been acceptance. See U.C.C. §§ 2-606(1)(b) and 2-607(4). The only sensible construction of these sections would seem to be that non-acceptance, consisting of attempted rejection within a reasonable time after delivery or tender, amounts to rightful rejection if the seller fails to prove that the goods conform, but is a breach if the seller proves conformity.

reasonable time for rejection, U.C.C. § 1-204(1)....

We think this provision must be construed simply as setting a time within which defects must be reported in order for the warranty to be valid. The setting of such a deadline does not necessarily mean that any unreasonable delay in inspection or rejection is acceptable so long as it does not extend past the deadline. Had Red Carpet been obviously lame, hobbling badly at the time he was delivered to Finkelstein, and had Finkelstein nonetheless taken the horse away to his barn without comment, it would be unreasonable to say that Finkelstein nonetheless had twenty-four hours to report the defect, because of this provision. On our view of the case, whether rejection was within a reasonable time must be answered with reference to what inspection for defects is customary, and it appears that Finkelstein had no more excuse for taking the horse away without giving its legs the customary inspection than he would have had for taking it away without comment if it had been hobbling. We will not construe a provision which by its terms sets a maximum time for reporting defects to set a minimum time as well, for some defects may be more readily discoverable than others.

We conclude, then, that Finkelstein accepted the horse by failing to reject it within a reasonable time, and thus had the burden of proving any breach of warranty. As we have already said, we find ample support for the finding that he failed to prove a breach by a fair preponderance of the credible evidence....

Case Note:

> Several factors are important in determining whether there has been a reasonable time to inspect, and whether rejection has occurred within a reasonable time of tender of delivery. These factors include the contract terms, trade usage, the nature of the goods (*i.e.*, whether they are perishable or easily damaged), the nature of the defect (is it difficult to discover?), the sophistication of the buyer, and whether delay makes it more difficult for the seller to exercise its right to cure.

Problem 12-2. On February 1, a friend of yours purchased a 2010 Toyota Corolla with 90,000 miles from Hot Deal Autos for $2,499. Before driving the car off the lot, your friend took a 10-mile test drive in the car with the salesman, and didn't notice any problems. On February 10, the car began to stall and didn't shift easily. When he took it to his auto mechanic, the mechanic told him the transmission needed to be replaced. Your friend called you (an attorney), asking if he can now reject the car and get his money back. What is your advice?

12.5. Seller's Right to Cure. The seller's right to cure, set forth at UCC § 2-508, is a significant limitation on the buyer's right to reject a good for any non-conformity. The extent of a seller's right to cure depends, in part, upon whether *the time for seller's performance has expired*.

> 12.5.1. A seller has ***an absolute right to cure*** under § 2-508(1) if the time for delivery has not yet expired. For example, Downtown Motors has delivered the car Joe ordered 3 days

before the agreed upon delivery date of May 1, and it is the wrong color. In this situation, Downtown Motors has the right to deliver to Joe by May 1 a car which is the right color, if the following two conditions are met:

(a) the seller ***notifies*** buyer of its intent to cure and

(b) the seller ***in fact cures*** within the time for performance by making a conforming delivery.

12.5.2. Section 2-508(2) sets forth the conditions under which a seller may cure a non-conforming tender ***after*** the time for seller's performance has passed.

Problem 12-3. Identify the three requirements which must be met in order for a seller to be allowed to cure a non-conforming tender under UCC § 2-508(2):

(1)

(2)

(3)

Bartus v. Riccardi

284 N.Y.S.2d 222 (City Ct. 1967)

The plaintiff is a franchised representative of Acousticon, a manufacturer of hearing aids. On January 15, 1966, the defendant signed a contract to purchase a Model A-660 Acousticon hearing aid from the plaintiff. The defendant specified Model A-660 because he had been tested at a hearing aid clinic and had been informed that the best hearing aid for his condition was this Acousticon model. An ear mold was fitted to the defendant and the plaintiff ordered Model A-660 from Acousticon.

On February 2, 1966, in response to a call from the plaintiff the defendant went to the plaintiff's office for his hearing aid. At that time he was informed that Model A-660 had been modified and improved, and that it was now called Model A-665. This newer model had been delivered by Acousticon for the defendant's use. The defendant denies that he understood this was a different model number. The hearing aid was fitted to the defendant. The defendant complained about the noise, but was assured by the plaintiff that he would get used to it.

The defendant tried out the new hearing aid for the next few days for a total use of 15 hours. He went back to the hearing clinic, where he was informed that the hearing aid was not the model that he had been advised to buy. On February 8, 1966, he returned to the plaintiff's office complaining that the hearing aid gave him a headache, and that it was not the model he had ordered. He returned the hearing aid to the plaintiff, for which he received a receipt. At that time the plaintiff offered to get Model A-660 for the defendant. The defendant neither consented to nor refused the offer. No mention was made by either party about canceling the contract, and the receipt given by the plaintiff contained no notation or indication that the plaintiff considered the contract canceled or rescinded.

The plaintiff immediately informed Acousticon of the defendant's complaint. By letter dated February 14, 1966, Acousticon, writing directly to the defendant, informed him that Model A-665 was an improved version of Model A-660, and that they would either replace the model that had been delivered to him or would obtain Model A-660 for him. He was asked to advise the plaintiff immediately of his decision so that they could effect a prompt exchange. After receiving this letter the defendant decided that he did not want any hearing aid from the plaintiff, and he refused to accept the tender of a replacement, whether it be Model A-665 or A-660.

The plaintiff is suing for the balance due on the contract. . . .

The question before the court is whether or not the plaintiff, having delivered a model which admittedly is not in exact conformity with the contract, can nevertheless recover in view of his subsequent tender of the model that did meet the terms of the contract.

The defendant contends that since there was an improper delivery of goods, the buyer has the right to reject the same under sections 2-601 and 2-602[(2)(c)] of the Uniform Commercial Code. . . .

The defendant, however, has neglected to take into account section 2-508 of the Uniform Commercial Code which has added a new dimension to the concept of strict performance. This section permits a seller to cure a nonconforming delivery under certain circumstances. Subdivision (1) of this section enacts into statutory law what had been New York case law. This permits a seller to cure a nonconforming delivery *before the expiration of the contract time* by notifying the buyer of his intention to so cure and by making a delivery within the contract period. This has long been the accepted rule in New York. [cites omitted]

However, subdivision (2) of section 2-508 of the Uniform Commercial Code goes further and extends *beyond the contract time* the right of the seller to cure a defective performance. Under this provision, even where the contract period has expired and the buyer has rejected a nonconforming tender or has revoked an acceptance, the seller may "substitute a conforming tender" if he had "reasonable grounds to believe" that the nonconforming tender would be accepted and "if he seasonably notifies the buyer" of his intention "to substitute a conforming tender." (51 N.Y. Jur., Sales, p. 41.)

This in effect extends the contract period beyond the date set forth in the contract itself unless the buyer requires strict performance by including such a clause in the contract.

"The section [§ 2-508(2)] rejects the time-honored, and perhaps time-worn notion, that the proper way to assure effective results in commercial transactions is to require strict performance. Under the Code a buyer who insists upon such strict performance must rely on a special term in his agreement or the fact that the seller knows as a commercial matter that strict performance is required." (48 Cornell L. Q. 13; 29 Albany L. Rev. 260.)

This section seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. (Official Comment, McKinney's Cons. Laws of N. Y., Book 62 ½, Uniform Commercial Code, § 2-508.)

An additional burden, therefore, is placed upon the buyer by this section. "As a result a buyer may learn that even though he rejected or revoked his acceptance within the terms of Sections 2-601 and 2-711, he still may have to allow the seller additional time to meet the terms of the contract by substituting delivery of conforming goods." (3 Bender's Uniform Commercial Code Serv., Sales and Bulk Transfers, §14-02 [1] [a] [ii].)

Has the plaintiff in this case complied with the conditions of section 2-508?

The model delivered to the defendant was a newer and improved version of the model that was actually ordered. Of course, the defendant is entitled to receive the model that he ordered even though it may be an older type. But, under the circumstances, the plaintiff had reasonable grounds to believe that the newer model would be accepted by the defendant.

The plaintiff acted within a reasonable time to notify the defendant of his tender of a conforming model. [UCC § 1-205.] The defendant had not purchased another hearing aid elsewhere. His position had not been altered by reason of the original nonconforming tender.

The plaintiff made a proper subsequent conforming tender pursuant to subdivision (2) of section 2-508 of the Uniform Commercial Code.

Judgment is granted to plaintiff.

Problem 12-4. Would the court in *Bartus* have reached a different conclusion if Mr. Riccardi had specifically stated in the purchase agreement that he would not accept any model other than the Model 660 hearing aid? Why or why not?

12.6. Installment Contracts. Recall the default rule of UCC § 2-307: "[u]nless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery." An installment contract is one where the parties have contracted around that default rule – it is a contract which "requires or authorizes the delivery of goods in separate lots to be separately accepted." For example, if a sawmill agrees to provide 10,000 feet of lumber to a hardware store per month, for a period of twelve months, the parties have entered into an installment contract, even if they try to call it something else. ***The perfect tender rule generally does not apply to installment contracts.*** It is much more difficult for a buyer to cancel an installment contract. Section 2-612(2) governs when a buyer can reject ***a single installment***; and § 2-612(3) governs when the buyer can reject ***the entire contract***, including any remaining installments.

Where the non-conformity relates to ***documents***, the buyer can reject an installment for any non-conformity, subject to the seller's right to cure if appropriate documents are readily procurable. Comment 4 gives as examples of non-conforming documents the absence of insurance documents under a C.I.F. contract, falsity of a bill of lading, or a bill of lading failing to show shipment within the contract period or to the contract destination.

12.6.1. Section 2-612(2) sets forth the general rule that a buyer may reject ***a single installment*** only if (i) the non-conformity ***substantially impairs*** the value of that installment and (ii) the non-conformity ***cannot be cured***.

12.6.1.1. If a single installment is non-conforming, and the non-conformity does not substantially impair the value of that installment, the buyer must accept it, regardless of whether the seller offers to cure the non-conformity. The buyer has a remedy for damages for the breach.

12.6.1.2. If there is ***a substantial impairment*** to a single shipment, there is an obligation on the part of the seller ***to give adequate assurance of a cure***. If adequate assurance of a cure is not forthcoming, the buyer can reject the installment (but not necessarily the entire contract, which we'll discuss in a bit). Comment 5 notes that adequate cures may consist of an "allowance against the price" or of "a further delivery." If the seller gives adequate assurance of a cure, then the buyer must accept that installment, even though its value is substantially impaired, ***unless*** the non-conformity is so great that it substantially impairs the value of the whole contract.

12.6.2. Section 2-612(3) allows the buyer to reject the entire contract, including future installments, when a non-conformity with respect to one or more installments ***substantially impairs the value of the whole contract***. Comment 6 notes that "defects in prior installments are cumulative in effect." The buyer must ***seasonably notify*** the seller of the cancellation.

12.6.3. What is "substantial impairment?" This is UCC parlance for "material breach." Comment 4 indicates that factors to consider include "the quality of the goods . . . , time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract."

12.6.3.1. Can the norm "substantial impairment" be determined by the agreement of the parties? Yes: Comment 4 indicates that the agreement "may require accurate conformity," but "must have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction." For example, you could define "substantial impairment" in the contract to include a deviation in quantity exceeding 5%.

Problem 12-5. A law firm enters into an agreement with The Stationery Store to purchase 10 reams of customized stationery a month for a period of twelve months, at $20.00 per ream. Under industry standards, a ream consists of 500 sheets of paper, and the 500 sheets are wrapped or boxed as a unit. Delivery is to occur on the first Monday of each month.

Month 1: 10 reams of conforming stationery are delivered.

Month 2: 9 reams of conforming stationery are delivered. When notified by the law firm of the shortage, the Stationery Store reduces the purchase price for the missing ream.

Month 3: The Stationery Store fails to deliver any stationery on the first Monday, due to a breakdown of its printing machinery. On Thursday, the firm runs out of stationery. After a frantic call to The Stationery Store, the Store promises to deliver 10 reams of conforming stationery the next day, which it does.

Month 4: 10 reams of conforming stationery are delivered.

Month 5: 10 reams of stationery are delivered, but instead of being packaged 500 sheets per unit, 5,000 sheets of stationery are delivered loose in a single large box.

As the law clerk for the law firm, you are asked to give your opinion whether the law firm can terminate the entire contract. What will you advise?

12.7. Buyer's Duties in Event of Rejection. After a buyer rightfully rejects goods, the buyer has certain duties, as set forth in §§ 2-602 through 2-605. The principal purpose of these provisions is to prevent waste.

12.7.1. Under § 2-602(1), after rejection, any ***exercise of ownership*** by the buyer with respect to the goods or any commercial unit thereof is ***wrongful as against the seller***. If a buyer does exercise ownership, what is the result? Many courts treat an "exercise of ownership" as an acceptance, giving rise to the corresponding obligation to pay for the goods. For example, a company which rejects a copy machine as non-conforming may not then use the machine to make 60,000 copies. *W.M. Hobbs, Ltd. v. Accusystems of Georgia, Inc*., 339 S.E.2d 646 (Ga. App. 1986).

12.7.1.1. Not all uses constitute an "exercise of ownership" which is "wrongful" as against the seller. Sometimes the seller puts the buyer in a situation where the buyer has no choice but to use the rejected goods. For example, if a seller installs non-conforming carpet, and after receiving notice of the buyer's rejection fails to remove it, the buyer's continued use of the carpet is not wrongful. *Garfinkel v. Lehman Floor Covering Co*., 302 N.Y.S.2d 167 (N.Y. Dist. Ct. 1969).

12.7.2. Under § 2-602(2)(b), if the buyer has not paid for the goods and is in possession of the goods at the time of rejection, ***he must hold the rejected goods*** with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them. "Reasonable care" and "sufficient time" are questions of fact, determined, in part by the nature of the goods. For example, vegetables should not be left to sit in the hot sun if the buyer has refrigerated storage available. If the buyer has paid any portion of the price, the buyer has a security interest in the goods and has certain remedies, such as the right to re-sell the goods, as set forth in § 2-711.

12.7.3. Section 2-603 imposes additional requirements on a ***merchant buyer*** in possession of rejected goods.

> 12.7.3.1. If the seller has no agent or place of business at the market of rejection, a merchant buyer is under a duty after rejection of goods in his possession to ***follow any reasonable instructions*** of the seller with respect to the goods.
>
> 12.7.3.2. In the absence of such instructions, the merchant buyer must make ***reasonable efforts to sell*** the rejected goods for the seller ***if they are perishable or threaten to decline in value speedily***.
>
> 12.7.3.3. The merchant buyer who sells goods is entitled to reimbursement from the seller or out of the sales proceeds for reasonable expenses of caring for and selling the goods, including a reasonable commission not to exceed 10% of the gross proceeds.

12.7.4. Under § 2-604, even if the goods are not perishable, if the seller gives no reasonable instructions as to the disposition of the rejected goods, the buyer may store the rejected goods for the seller's account or reship them to the seller or resell them for the seller's account, with reimbursement for reasonable expenses. This section is not limited to merchant buyers.

12.7.5. Section 2-602 states that a rejection "is ineffective unless the buyer seasonably notifies the seller." Additional notice requirements are set forth at § 2-605. This section requires that the buyer identify ***the particular defect*** upon which the rejection is based.

> 12.7.5.1. Failure to provide notice of a particular defect precludes the buyer from relying on the unstated defect to justify rejection or to establish a breach, if the seller ***could have seasonably cured*** the defect.
>
> 12.7.5.2. ***Between merchants***, if the seller has made a request in writing for a "full and final written statement of all defects" on which the buyer proposes to rely, and

the buyer fails to provide such statement, the buyer is precluded from relying on the unstated defects to justify rejection or to establish a breach.

12.8. Summary: The Code Scheme for Delivery

Seller tenders the goods (§ 2-601).
- Buyer inspects for non-conformity (§§ 2-513(1), 2-606(1)(b)).
  - If a non-conformity is discovered:
    - Buyer rejects (§ 2-602), subject to seller's right to cure (§ 2-508), or
    - Buyer accepts on the assumption it will be cured (§ 2-608(1)), or
    - Buyer accepts.
  - If no non-conformity is discovered:
    - Buyer accepts (§ 2-606) and pays contract price (§ 2-607).
      - If a non-conformity is discovered after acceptance:
        - Buyer revokes acceptance (§ 2-608), or
        - Buyer recovers for breach of contract or breach of warranty (§§ 2-607, 2-714, 2-717).

Chapter 12 Additional Sources.

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 12

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010), Chapter 9

Chapter 13. Acceptance; Revocation of Acceptance

13.1. Acceptance. Note that as used in this chapter, the term "acceptance" refers to the buyer's acceptance of the goods which the buyer has agreed to purchase under a previously formed contract. It does not refer to acceptance of an offer which leads to formation of a contract.

As discussed in Chapter 12, the perfect tender rule favors the buyer, and allows the buyer to reject for any non-conformity, subject to certain important limitations (including the obligation to notify the seller of rejection and the seller's right, in certain circumstances, to cure the defect). Once a buyer has ***accepted*** the goods, the rules shift to favor the seller. After acceptance, the buyer ***may no longer reject the goods for any non-conformity***. Section 2-607(2). The buyer does have a more limited right, described as ***revocation of acceptance*** (the more stringent elements of which are discussed at § 13.3 below). Under § 2-606(1), acceptance occurs in one of three ways:

13.1.1. Acceptance occurs after a ***reasonable opportunity to inspect*** the goods, ***if*** the buyer signifies to the seller that either (i) the goods are conforming or (ii) that the buyer will take or retain the goods in spite of their non-conformity.

13.1.1.1. Comment 3 states that "payment made after tender is always one circumstance tending to ***signify acceptance*** of the goods but in itself it can never be more than one circumstance and is not conclusive." (Emphasis supplied.)

13.1.1.2. As we discussed in Chapter 12, what constitutes a "reasonable opportunity to inspect" is a question of fact. Comment 2 states that course of performance, course of dealing, and usage of trade will be important in determining what is "reasonable."

13.1.1.3. Note that if a buyer accepts the goods in spite of their non-conformity, the buyer is not out of luck. The buyer may have a claim for damages arising from the non-conformity or, as we shall see in § 13.3, may have the right to revoke acceptance.

13.1.2. Acceptance occurs after the buyer has had a reasonable opportunity to inspect the goods, ***if*** the buyer ***fails to make an effective rejection*** under UCC § 2-602. Recall *Miron v. Yonkers Raceway, Inc.*, 400 F.2d 112 (2d Cir. 1968) in § 12.4, where the court held that failure to timely inspect and reject a racehorse resulted in acceptance.

13.1.3. The buyer accepts goods if the buyer ***does any act inconsistent with the seller's ownership***. This concept is parallel to the buyer's obligation under UCC § 2-602 not to "exercise ownership" after the buyer has rejected the goods. However, ***not all uses*** constitute "an act inconsistent with seller's ownership" or an "exercise of ownership." For example, if the buyer only uses the goods for purposes of inspection, such as the test-drive of a car which the buyer is interested in purchasing, such use is not inconsistent with the seller's ownership. Furthermore, the seller may put the buyer in a position where the buyer has no choice but to use the goods after rejection, such as continued use of a non-conforming carpet which seller has installed and refuses to remove after the buyer rejects the carpet.

Problem 13-1. A farmer buys an irrigation system pump from an implement dealer. He takes it home and immediately installs it. The pump doesn't work well, but for a period of two weeks the farmer keeps trying different things (such as repositioning the pump, cleaning the pump) to get it to work. After two weeks, the farmer notifies the seller of his rejection of the pump. Does buyer's use of the pump for two weeks constitute an acceptance, which cuts off buyer's right to reject? Why or why not?

13.2. Effect of Acceptance. If the buyer accepts the goods, turn to § 2-607 for the effect of acceptance.

13.2.1. After acceptance, the buyer ***must pay the contract price***. UCC § 2-607(1). If the buyer has accepted in spite of a non-conformity, under § 2-717 the buyer may deduct the damages resulting from the non-conformity from the purchase price.

13.2.2. Under § 2-607(2), if a buyer accepts the goods, the buyer ***no longer has the right to reject the goods***.

13.2.3. Although the buyer may have lost his right to reject the goods as a result of acceptance, the buyer still has a claim for damages if there is a non-conformity. Under § 2-607(3)(a), after acceptance, the buyer must ***within a reasonable time*** after discovery of a breach ***notify*** the seller of the breach or ***be barred from any remedy***.

13.2.3.1. See Comment 4: the "content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched."

13.2.3.2. The courts are split on whether "remote sellers" are also required to receive notice of a breach, or if the buyer only needs to give notice of breach to her immediate seller. See Jane Massey Draper, Annotation, *Sufficiency and Timeliness of Buyer's Notice Under UCC § 2-607(3)(a) of Seller's Breach of Warranty*, 89 A.L.R.5th 319 (2001).

Problem 13-2. Buyer buys an air conditioner in July from Sears. A few days after using it, buyer discovers pools of water standing on the floor. He waits until September to notify Sears of the problem. Is notice reasonable? What if buyer purchases the air conditioner in November on sale, and doesn't use it until June, at which time he notices the pools of water and immediately calls Sears and complains.

13.2.4. After acceptance, the ***burden is on the buyer*** to establish any breach with respect to the goods accepted.

13.3. Revocation of Acceptance. At this point, you are well aware that if a buyer accepts goods, the buyer may no longer reject the goods for any non-conformity. After acceptance, is the buyer stuck with a product that turns out to be defective? That is, although the buyer still has the right to other remedies, can the buyer rescind the contract and be excused from paying the purchase price for the goods? Section 2-608 provides limited circumstances where a buyer may ***revoke acceptance***, return the goods, and be relieved from his obligation to pay. Turn to UCC § 2-608.

13.3.1. In order to revoke acceptance, the non-conformity must ***substantially impair*** the value of the good to the buyer "to him"

AND EITHER

a. The buyer accepted aware of the non-conformity, but reasonably assuming that it would be cured (and it hasn't been seasonably cured);

OR

b. The buyer had not discovered the non-conformity at the time of acceptance, either because (i) the non-conformity was difficult to discover, or (ii) her acceptance was reasonably induced by seller's assurances (which, for example, may have caused her not to inspect).

Many of the cases explore whether the language "to him" creates a subjective test of non-conformity, which might allow the buyer to claim that a trivial defect was important to the particular buyer. For example, in *Harper v. Mitchell*, 1985 WL 4040 (Tenn. App.), the court stated: "While it is true that [§ 2-608] creates a subjective test in the sense that the requirements of a particular buyer must be examined and deferred to, the evidence with regard to the substantial impairment to a particular buyer must be measured in objective terms…. Thus, the 'substantial impairment' requirement should be construed to exclude attempted revocations based upon trivial defects or defects that can be easily repaired."

Problem 13-3. Helen, a rancher, enters into an agreement for the purchase of a new pick-up. The contract specifically provides that the pick-up will come with a full-sized spare tire, because Helen lives 30 miles out of town on a gravel road, and she doesn't trust that a puny spare tire would hold up on such roads. When the pick-up arrives, Helen forgets to check on the spare tire. A month later, while crawling under the pick-up to get a puppy that has scrambled under it, she looks up and notices that the spare tire (attached to the undercarriage) is one of those puny things.

(1) Can Helen **reject** the pick-up at this point in time under §§ 2-601 and 2-602 for the non-conforming spare tire? Why or why not?

(2) Assume that Helen has, in fact, accepted the pick-up, and her right to reject has been cut off. May Helen now **revoke her acceptance** on the ground that the non-conforming spare tire substantially impairs the value of the pick-up to her?

(3) Assume that you have concluded that the non-conforming spare tire is a substantial impairment. Which one of the remaining requirements for revocation as set forth in § 2-608(1)(a) or (b) has been met (if any)?

(4) If Helen cannot revoke her acceptance, are there any other remedies available to her?

13.3.1.1. Note that a buyer may not revoke acceptance based upon defects which were not known to him at the time of acceptance ***because of his own failure to make a reasonable investigation***. In *Hummel v. Skyline Dodge, Inc.*, 589 P.2d 73 (Colo. App. 1978), a used car dealer was interested in buying a car for re-sale on his lot. He was aware that it had been in a previous accident. He kicked the wheels, opened the hood, and took it for a spin around the block. He then bought the car. A few weeks later, he took it to a mechanic who told him the frame was bent and there was a crack in the engine mount. The court would not allow him to revoke acceptance, noting that he "had an unlimited opportunity to inspect the car prior to agreeing to purchase it."

13.3.1.2. Note also that if a purchaser knowingly buys something with a defect, the purchaser cannot subsequently revoke acceptance based upon that defect, unless the purchaser had reason to believe that the defect would be cured.

13.3.1.3. See Lee R. Russ, Annotation, *What Constitutes "substantial impairment" Entitling Buyer to Revoke his Acceptance of Goods Under UCC § 2-608(1)*, 38 A.L.R. 5^{th} 191 (1996).

13.3.2. Under UCC § 2-608(2), revocation of acceptance must occur within a ***reasonable time*** after the buyer discovers (or should have discovered) the defect and ***before any substantial change*** in the condition of the goods not attributable to the defect.

13.3.2.1. Comment 4 indicates that attempts to repair should be taken into account in determining what constitutes a "reasonable time" within which to revoke. For example, if a car dealer repeatedly attempts to repair a car, and fails to do so, the period of repair will extend the time within which a buyer may reasonably revoke. See, for example, *McCullough v. Bill Swad Chrysler-Plymouth, Inc.*, 449 N.E.2d 1289 (Oh. 1983), where revocation nine months after acceptance was timely, because of the seller's repeated (but failed) attempts at repair during that period.

13.3.2.2. Another important factor is the difficulty in discovering the defect. In *Smith v. Penbridge Assocs., Inc.*, 665 A.2d 1015 (Pa. Sup. Ct. 1995), Donna Smith purchased a breeding pair of emus in August 1992. In October, as the breeding season commenced, both emus started to grunt. Donna became suspicious, because typically only male emus grunt. She called the seller, who recommended that Donna do an internal exam of the emus to determine their gender. As a result of this exam, Donna discovered that both emus were male, and she immediately provided sellers with notice of revocation of her acceptance of the breeding pair. The seller argued that Donna should have discovered the problem sooner, but the court disagreed, noting the difficulty of determining the gender of an emu.

13.3.3. The buyer ***must notify*** the seller of the revocation within a reasonable time ***after discovery*** of the grounds for revocation. Comment 4 to § 2-608 notes that the parties may by their agreement limit the time for notification.

13.3.3.1. At least one court has ruled that notice one year after discovery of a defect is unreasonable as a matter of law. *Sstech Ry. Tech. Proprietary, Ltd. v. Herzog Servs*., *Inc.*, 1996 WL 362956 (D. Mo. 1996).

Wilk Paving, Inc. v. Southworth-Milton, Inc.
649 A.2d 778 (Vt. 1994)

Opinion by ALLEN, C.J.

Defendant Southworth-Milton, Inc., appeals from a judgment in favor of plaintiff, Wilk Paving, Inc., in the amount of the purchase price of an asphalt roller that plaintiff had purchased from defendant. After a bench trial, the court ruled that plaintiff was entitled to revoke acceptance and effectively had revoked acceptance under the Uniform Commercial Code (UCC), see 9A V.S.A. §§ 2-101 to 2-725 (Article 2, Sales). We affirm.

On October 10, 1989, plaintiff purchased the roller, relying in part on representations in a brochure provided by defendant that the machine was versatile, well-suited for plaintiff's typical paving jobs, reliable, and easy to maintain. As part of the purchase contract, defendant warranted repair and replacement of defective parts for one year and disclaimed all other warranties. On December 8, 1989, plaintiff discovered that the right rear vibratory motor was leaking oil and that the electrical system required repair. Plaintiff was advised to deliver the roller to defendant's place of business, and on December 18, 1989, the repair work was done to correct the foregoing problems. In addition, defendant replaced a blown fuse, tightened loose hydraulic lines that were leaking oil, resealed a hydraulic feedline to the vibratory motor, and gave the roller a general tune-up. Thereafter, plaintiff did not use the roller until the spring, when weather permitted resumption of paving projects.

On June 7, 1990, oil was observed to be leaking from the brake housing, requiring replacement of the housing and seals. On June 21, 1990, defendant found that the front drive motor was leaking oil from the parking brake piston. On June 29, 1990 the water pump seal was leaking and required disassembly, cleaning, and resealing. On August 16, 1990, the starter failed because of loose wiring in the principal wiring harness and starter. On August 28, 1990, the oil plug broke off, causing oil to leak over the surface of the pavement being applied. As a result, plaintiff had to replace the affected surface. All but the last of these problems were reported to defendant. Plaintiff also complained that the problems with the internal hydraulics made it difficult to drive the roller onto a trailer for transporting.

In September 1990, plaintiff's president informed defendant that he no longer wanted the machine and requested a return of the purchase price, less a reasonable rental fee for the time plaintiff used the roller during the summer. In November 1990, the roller was parked in plaintiff's lot and covered with a tarp. Examinations of the roller by experts in 1992 in preparation for trial disclosed that it was still leaking oil.

After trial, plaintiff was awarded the purchase price of the roller, but was denied recovery for consequential damages. Defendant then moved to alter or amend the judgment to provide defendant a setoff of the reasonable rental value of the roller. Defendant also moved to amend its answer to assert setoff as an affirmative defense. Both motions were denied.

On appeal, defendant contends that it was not afforded an opportunity to cure the roller's defects, that plaintiff failed to prove a nonconformity sufficient to create a right of revocation of acceptance, and that any such right to revoke was waived when plaintiff continued to use the roller. Defendant also challenges the trial court's ruling regarding the right to setoff. Plaintiff cross-appeals the denial of consequential damages.

Defendant first argues that plaintiff should be barred from any recovery for revoking acceptance without first giving defendant an opportunity to cure defects in the roller. As a general rule, once a buyer accepts tender the buyer must, within a reasonable time after discovery of a breach, notify the seller of the breach or be barred from any remedy. 9A V.S.A. § 2-607(3)(a). This notice requirement affords a seller the opportunity to cure the claimed defects or minimize the buyer's losses. *Desilets Granite Co. v. Stone Equalizer Corp*., 133 Vt. 372, 375, 340 A.2d 65, 67 (1975). The right to cure has limits, however: "the buyer . . . is not bound to permit the seller to tinker with the article indefinitely in the hope that it may ultimately be made to comply with the warranty." *Orange Motors of Coral Gables, Inc. v. Dade County Dairies, Inc*., 258 So. 2d 319, 321 (Fla. Dist. Ct. App. 1972).

The record amply supports the trial court's conclusion that defendant had a reasonable opportunity to cure but failed to do so. The court's findings are based on evidence that a series of mechanical problems plagued the roller from the start of plaintiff's ownership. Almost without exception, plaintiff reported the problems to defendant, who, at various times over nine months, attempted repairs sufficient to keep the roller working as promised. Under the circumstances of this case, plaintiff afforded defendant adequate opportunity to make good on its representations before revoking acceptance.

Defendant next asserts that plaintiff failed to prove a nonconformity sufficient to create a right of revocation. Revocation of acceptance is governed by UCC § 2-608(1), which provides:

> The buyer may revoke his acceptance of a . . . commercial unit whose non-conformity substantially impairs its value to him if he has accepted it. . . .
>
> (b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

9A V.S.A. § 2-608(1).

Defendant argues that the warranty was not breached because each oil leak was from a different seal, and defendant repaired or was prepared to repair all such leaks within the warranty period. The trial court took a broader view of the evidence, and concluded that defendant breached the express warranty that the roller required only simple and light maintenance, was ideal for base surface application, and would perform exceptionally well on plaintiff's usual jobs. This conclusion is amply supported by the findings with respect to the deficiencies. A seller cannot bar revocation by repairing or agreeing to repair numerous defects; at some point a buyer may say "enough is enough" and revoke acceptance. *Rester v. Morrow*, 491 So. 2d 204, 210 (Miss. 1986). Defendant's argument that it never repaired or replaced the same part twice is not persuasive because the string of malfunctions substantially impaired the value of the roller. Moreover, the breakdowns undermined plaintiff's confidence in the ability of the machine to do the job. In light of these findings, the court reasonably concluded that the roller did not conform to defendant's warranties, notwithstanding defendant's repair efforts.

Defendant also contends that plaintiff waived any right to revoke acceptance by continuing to use the roller after giving notice of revocation. Defendant asserts that the trial court erred in finding that revocation occurred in November 1990, when the machine was parked, and in finding that the roller was used only once thereafter, inadvertently, by one of plaintiff's employees. According to defendant, plaintiff revoked acceptance in June 1990, when plaintiff's president telephoned the manufacturer and offered to pay a reasonable rental fee in exchange for a return of the roller. The record shows, however, that after additional repairs during the summer of 1990, this offer was communicated to the defendant on August 27, 1990. Plaintiff's president testified that he made the call "to see what they wanted to do for me." In late September, plaintiff's president just demanded the return of his money. The court found that defendant made repairs to the roller during the summer of 1990 and continued to assure plaintiff that the problems would be corrected up to and after revocation. In August 1990, plaintiff's mechanic replaced a broken oil plug, a burnt-out starter and wiring. Plaintiff's president testified that the roller was used on two subsequent jobs in October of that year.

A buyer who revokes acceptance has the same rights and duties with regard to the goods involved as if they had been rejected. 9A V.S.A. § 2-608(3). With limited exceptions, a buyer's exercise of ownership after rejection is wrongful as against the seller. *Id.* § 2-602(2)(a); see *id.* § 2-603(1) (buyer under duty to attempt to sell rejected perishable goods on seller's account if seller has no agent or place of business at market of rejection), *id.* § 2-604 (if seller gives no instructions within reasonable time after buyer's rejection, buyer may store, reship, or sell on seller's account). Nevertheless, continued use of goods whose acceptance has been revoked does not vitiate the revocation if the use was reasonable. *McCullough v. Bill Swad Chrysler-Plymouth, Inc.*, 5 Ohio St. 3d 181, 449 N.E.2d 1289, 1292 (Ohio 1983). Reasonable use is a question of fact that depends on whether: (1) the seller tendered instructions concerning return of the rejected goods upon notice of the revocation; (2) business needs or personal circumstances compelled the buyer's continued use; (3) the seller continued to offer assurances that the nonconformities would be cured or that the buyer would be recompensed for dissatisfaction and inconvenience during the period of continued use; (4) the seller acted in good faith; and (5) the seller suffered undue prejudice as a result of the continued use. *Id*. at 1293.

The court found that the continued use after revocation was a good faith attempt to mitigate damages, that defendant continued to assure plaintiff that repairs would be successful and that the use was reasonable under the circumstances. The record does not disclose any instructions by the defendant to plaintiff regarding permanent return of the roller, or evidence of prejudice from continued use. We agree with the trial court that the use of the roller during the month of October, after buyer had given notice, was not unreasonable. Therefore, plaintiff's post-revocation use did not waive the revocation of acceptance.

Finally, defendant contends it was entitled to a setoff against plaintiff's recovery in the amount of the reasonable value of plaintiff's use of the roller. Defendant did not request a setoff in its pleadings or at trial. Defendant maintains that the right to setoff need not be explicitly pled, because the notion of a setoff inheres in the common-law remedy of rescission imposed by the trial court. Setoff, however, is an affirmative defense that is waived if a party fails to plead it. *Wursthaus, Inc. v. Cerreta*, 149 Vt. 54, 57, 539 A.2d 534, 536 (1987); see V.R.C.P. 8(c)....

Case Notes:

1. What event is the measuring date from which the buyer must reasonably notify the seller of the buyer's revocation of acceptance? In this case, when did revocation of acceptance occur? How much time had elapsed? What factors should a court consider in its determination of whether a buyer has waited too long to notify seller of its revocation of acceptance?

2. Once a buyer has revoked acceptance of the goods, it is never a recommended practice to continue to use them. See, for example, *Griffith v. Stovall Tire & Marine, Inc*., 329 S.E.2d 234 (Ga. App. 1985), where a buyer's continued use of an automobile for 120,000

miles after revocation was found to constitute a re-acceptance under § 2-606(1)(c), and *Wadsworth Plumbing & Heating Co. v. Tollycraft Corp.*, 560 P.2d 1080 (Or. 1977), where a buyer's continued use of a boat after revocation for fishing trips (right up to the time of trial) constituted re-acceptance after revocation. However, not all post-revocation use is fatal. In *Fablok Mills, Inc. v. Cocker Machine & Foundry Co.*, 310 A.2d 491 (N.J. 1973), the court stated:

> Avoidance of an absolute rule against continued use is counseled by the overriding requirement of reasonableness which permeates the Code. We conceive that in certain situations, continued use of goods by the buyer may be the most appropriate means of achieving mitigation.

What sort of factors or circumstances would be important for a court to consider in determining the reasonableness of post-revocation use by a buyer?

3. This court stated that the "notice requirement [of § 2-608(2)] affords a seller the opportunity to cure the claimed defects or minimize the buyer's losses." Take a look again at UCC § 2-508. Both § 2-508(1) and (2) refer to a seller's right to cure in the context of "rejection" of goods. Section 2-508 does not refer to "revocation of acceptance" as an event giving rise to a right to cure. Several courts have held that a seller's right to cure only arises in the context of ***rejection*** of goods under the perfect tender rule, and not in the context of ***revocation of acceptance***. See, for example, *Gappelberg v. Landrum*, 666 S.W.2d 88 (Tex. 1984) where a customer bought a large-screen television on September 5. When the television stopped working on September 26, the buyer revoked his acceptance. The store offered to cure by replacing the television. The buyer insisted on the return of his purchase price. Off to court they went. The court ruled that the buyer was entitled to a return of his purchase price, stating that seller's right to cure only arose after rejection, and not after revocation of acceptance. This is likewise the conclusion of White & Summers, *Handbook of the Law under the Uniform Commercial Code* § 9-5. See also *Bonebrake v. Cox*, 499 F.2d 951 (8th Cir. 1974), which limited a seller's right to cure to cases of rejection.

4. Another condition to a proper revocation of acceptance is that revocation occur "before any substantial change in condition of the goods which is not caused by their own defects." The "substantial change in condition" is intended to protect a seller from being required to take back used or mistreated goods. White & Summers, *Handbook of the Law under the Uniform Commercial Code* § 9-4. In *Lackawanna Leather Co. v. Martin & Stewart, Ltd.*, 730 F.2d 1197 (8th Cir. 1984), a buyer purchased cattle hides, and began to process them by chemically treating them and splitting them. During this process, the purchaser discovered that the hides were defective, and revoked acceptance. The seller pursued an action to recover the purchase price. The seller asserted that the hides had been "substantially changed" as a matter of law and that no instruction concerning revocation of acceptance should have been given to the jury. The court ruled in favor of

the buyer, noting that the defect could only be discovered during the processing, the seller was aware that the processing was required to make the hides usable, and the processing enhanced rather than impaired the value of the hides.

13.4. Return of Goods after Revocation. After acceptance has been revoked, must the buyer return the goods to the seller? UCC § 2-608(3) states that a buyer who rightfully revokes acceptance "has the same rights and duties with regard to the goods involved as if he had rejected them." Those rules are found at UCC §§ 2-602(2) - (3), 2-603, 2-604, and 2-605. Turn back to § 12.7 for a review of these obligations.

13.4.1. Under UCC § 2-711(3), where a buyer has rightfully rejected goods or revoked acceptance, the buyer has a security interest in any goods in her possession, to the extent the buyer has paid all or a portion of the purchase price, and to the extent the buyer incurred costs in their inspection, receipt, transportation, or care. The buyer may re-sell the goods to satisfy this security interest.

13.4.2. In *J.F. Daley Int'l, Ltd. v. Midwest Container & Indus. Supply Co.*, 849 S.W.2d 260 (Mo. App. 1993), the buyer revoked acceptance of thousands of plastic bottles which it purchased from seller, after it was discovered that the bottles leaked. The buyer failed to return the bottles to the seller. In upholding the appropriateness of the buyer's conduct, the court noted:

> In this case, however, there was no evidence of any instructions by [seller] other than to ship the bottles back to [seller] at [buyer's] expense. As [buyer] points out, § 400.2-603(1) further provides that a seller's instructions are not reasonable if, on demand, indemnity for expenses is not forthcoming. [Seller] repeatedly declined to pay for return shipment of the bottles. Thus, [buyer] had no obligation to abide by [seller's] instructions. Further, according to [seller's employee], [seller] would have ground the bottles up for remanufacture. Thus, the evidence supports the inference that the remaining bottles were of little or no value to anyone else, thereby excusing any effort by [buyer] to sell them on the open market.

Id. at 265.

13.5. Effect of Breach on Risk of Loss. The normal risk of loss rules set forth at § 2-509 (discussed in Chapter 10) are displaced by § 2-510, if there is a breach giving rise to the right to reject, or if there is a rightful revocation of acceptance.

13.5.1. Under § 2-510, if a tender or delivery of goods fails to conform to the contract and gives rise to a right of rejection under the perfect tender rule (§ 2-601), the risk of loss remains on the seller until cure or acceptance.

Problem 13-4. Whoopie Cereals purchases corn from AgraCorn, F.O.B. AgraCorn's place of business (to be shipped via railcar). AgraCorn agrees to deliver the corn to the carrier (a shipment contract). During shipment, the railcar topples over, destroying the corn.

(1) Who bears the risk of loss if the corn conformed to the contract at the time of delivery by AgraCorn of the corn to the carrier? See UCC § 2-509(1)(a).

(2) Who bears the risk of loss if the corn, at the time it was delivered by AgraCorn to the railcar, was infested with bugs?

> 13.5.2. Under UCC § 2-510(2), if there is acceptance, which the buyer then revokes, the buyer bears the risk of loss to the extent of the buyer's insurance coverage, but the seller is responsible for any deficiency in the buyer's insurance coverage.

Problem 13-5. Law Firm purchases a new computer from Office Supply. After one week of use, it determines that the computer has a defective motherboard, and the Law Firm faxes a notice of revocation of its acceptance to Office Supply. While Office Supply is arranging for the computer to be picked up, an electrical storm causes a surge which totally destroys the computer. The law firm's insurance coverage will pay up to 80% of its value. Who pays for the remaining 20%?

Chapter 13 Additional Sources

Scott J. Burnham, Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis (Wolters Kluwer 2d ed., 2012), Chapter 12

James J. White and Robert S. Summers, Uniform Commercial Code (West 6th ed., 2010)

Chapter 14. Anticipatory Repudiation

14.1. Common Law Development of Anticipatory Repudiation. Logically, can you have an actual breach of the contract before the performance is due? No. But if a person who has promised to perform "repudiates" by telling you (expressly or impliedly) that he does not intend to perform when the time comes for performance, you have an "anticipatory repudiation." (A "repudiation" is a refusal to perform.)

> 14.1.1. The concept of anticipatory repudiation developed under common law. At common law, an ***express repudiation*** is a clear, positive, unequivocal refusal to perform (orally or in writing) prior to the date performance is due.
>
> > 14.1.1.1. An example of a clear and unequivocal repudiation would be: "I'm not going to perform at the concert as I promised to do."

Problem 14-1. Bette Midler has agreed to perform at a concert on May 1. On April 15, she sends a fax stating: "I'm not sure if I will be able to perform on May 1. Will keep you posted." Is this an express repudiation at common law? Why or why not?

> 14.1.2. In addition to an express repudiation, common law recognizes an ***implied repudiation***. An implied repudiation results from voluntary conduct "where the promisor puts it out of his power to perform so as to make substantial performance of his promise *impossible*." *Taylor v. Johnston*, 539 P.2d 425 (Cal. 1975). For example, if I have a contract to sell you my car, and then I sell it to someone else, I have impliedly repudiated. Note that Restatement (Second) of Contracts § 250 refers to "a voluntary affirmative act which renders the obligor unable or apparently unable to perform. . . ." In other words, as long as a reasonable person would believe performance is not possible, the conduct may be treated as an anticipatory repudiation.

Problem 14-2. Lindsay Lohan agreed to perform in a movie that would start filming on May 1. On April 15, the producer read in an industry newsletter that Lindsay had checked into a six-week in-patient drug rehabilitation program. Is this an implied repudiation at common law? Why or why not?

> 14.1.3. At common law, the prospective breach must be serious enough to qualify as a material breach of the contract. An indication of intent to deviate in some minor way from the promised performance may not be sufficient.

Problem 14-3. Sally has agreed to perform at a concert on May 1 at 8:00 p.m. She agreed to arrive 30 minutes early to rehearse with the band. On April 28, she calls the concert hall and advises them that she will not be able to arrive until 7:50 (instead of 7:30), due to a change in airline schedules. Can the concert hall treat this as an anticipatory repudiation at common law?

14.2. Remedies at Common Law. What rights does the non-breaching party have at common law when the other party repudiates the contract?

14.2.1. The non-breaching party may treat the repudiation as an anticipatory breach, and immediately cancel the contract and seek damages. The non-breaching party is also excused from further performance.

14.2.2. In the alternative, the non-breaching party may wait until the time for performance, and exercise his remedies for actual breach at that time.

14.2.3. If the non-breaching party elects to await performance, the repudiating party may retract its repudiation. See Restatement (Second) of Contracts § 256.

14.3. UCC Rules Governing Anticipatory Repudiation.

14.3.1. Overview. A bit of vocabulary. In Code usage, *repudiation* is a bad thing. If one party *repudiates*, the issue is whether the other party may *cancel* because there has been a breach. The Code reserves *termination* for putting an end to the contract for a reason other than breach. See § 2-106(4).

The UCC has specific provisions governing anticipatory repudiation (see §§ 2-609 through 2-611). Section 2-610 provides for what happens when there is an anticipatory repudiation. Recognizing that it is difficult under common law to determine whether an anticipatory repudiation has, in fact, occurred, the UCC adopted § 2-609, which provides a process by which a party can determine whether there has been an anticipatory repudiation by requesting adequate assurance of performance. Thus, where there is *not* a clear, unequivocal repudiation, § 2-609 provides a seller or buyer who has become concerned about the other party's words, conduct, or reputation with a mechanism to establish an actual repudiation, and thereby have a right to cancel.

Using the UCC as a forerunner, many courts have applied the "adequate assurance" concept to non-UCC cases. See Restatement (Second) of Contracts § 251.

14.3.2. Under § 2-609(1), if ***reasonable grounds for insecurity*** arise with respect to the performance of a party, the other party may ***in writing*** demand adequate assurance of due performance. Until she receives such assurance, the party requesting adequate assurance may suspend performance if commercially reasonable. See Matthew C. Brenneman, *Sales: What Constitutes "Reasonable Grounds for Insecurity" Justifying Demand for Adequate Assurance of Performance Under UCC § 2-609*, 37 A.L.R. 5th 459 (2015).

> 14.3.2.1. It is essential to be able to analyze whether "reasonable grounds for insecurity" exist before relying upon § 2-609. Under § 2-609(2), between merchants, reasonableness is to be ascertained by commercial (and not legal) standards. *If you do not have reasonable grounds to make a demand, your demand will not be justified, and a failure to respond to an unjustified demand will not ripen into a repudiation*. See Comment 3 to § 2-609.
>
> 14.3.2.2. Although § 2-609 requires that a demand for adequate assurance be made ***in writing***, some courts have overlooked the writing requirement, and have allowed an oral demand to satisfy the statutory requirements. *AMF, Inc. v. McDonald's Corp.*, 536 F.2d 1167 (7th Cir. 1976).
>
> 14.3.2.3. If the demand is justified, the party making the demand ***may suspend performance*** until assurance is given. See Comment 2 to § 2-609.

Problem 14-4. In March 2012, Farmer Fred entered into a contract to sell 10,000 bushels of malting barley to Mike's Microbrew, a regional beer brewery located in Missoula. The purchase price is $3.00/bushel, to be delivered to the Fairfield elevator by Farmer Fred on or before September 30, 2012. In the middle of August 2012, shortly before harvest, Farmer Fred receives the following letter from Mike's Microbrew:

> *Dear Fred,*
> *We spent a lot of money launching our most recent micro-brew, Beergeek, aimed at lawyers, accountants and other professionals. Unfortunately, it hasn't been as well received as we had hoped. It looks like we might not be needing the 10,000 bushels of barley we agreed to buy from you.*
> *Sincerely yours,*
> *Mike*

When he receives this letter from Mike's Microbrew, Farmer Fred comes in to see you for advice.

> Is this a repudiation?
> What is the best advice for you to give at this point in time?

Problem 14-5. Mattel has entered into a one-year contract to provide Barbie Dolls to a regional toy store chain on credit. At a recent toy convention, an officer of Mattel hears that this store chain is in trouble financially. At least one other toy manufacturer tells the Mattel officer, confidentially, that this retailer has not paid its bills in a timely fashion. Does this information constitute reasonable grounds which would allow Mattel to request adequate assurance of the retailer's performance under its contract with Mattel?

> 14.3.3. If a party receiving a justified demand ***fails to provide*** within a ***reasonable time*** (not to exceed thirty days) ***adequate assurance*** of due performance, the party making the demand may treat such failure as a repudiation of the contract. Section 2-609(4).
>
> > 14.3.3.1. Read Comment 4, which explains what constitutes "adequate" assurance.

Problem 14-6. Mattel decides to send a letter to the regional store chain, requesting adequate assurance that the store chain is able to perform its obligations (including timely payment) under the one-year contract. The store chain responds by writing: "You have nothing to worry about. We've lined up a loan with our bank, and will be able to pay you on time. Please ship as agreed in our contract." Is this assurance adequate?

> > 14.3.3.2. Read Comment 5 regarding the 30-day period. Can there be some situations in which a reasonable period is less than 30 days?

Problem 14-7. Assume that, unbeknownst to Mattel, the rumors heard by Mattel at the toy convention were in fact unfounded. Mattel sends its letter seeking adequate assurance, and the store chain, incensed at the insulting inference that it is financially troubled, refuses to answer. Is the store chain's failure to respond a repudiation under § 2-609?

AMF, Inc. v. McDonald's Corp.
536 F.2d 1167 (7th Cir. 1976)

CUMMINGS, Circuit Judge

AMF, Incorporated, filed this case in the Southern District of New York in April 1972. It was transferred to the Northern District of Illinois in May 1973. AMF seeks damages for the alleged wrongful cancellation and repudiation of McDonald's Corporation's ("McDonald's") orders for sixteen computerized cash registers for installation in restaurants owned by wholly-owned subsidiaries of McDonald's and for seven such registers ordered by licensees of McDonald's for their restaurants. In July 1972, McDonald's of Elk Grove, Inc. sued AMF to recover the $20,385.28 purchase price paid for a prototype computerized cash register and losses sustained as a result of failure of the equipment to function satisfactorily. Both cases were tried together during a fortnight in December 1974. A few months after the completion of the bench trial, the district court rendered a memorandum opinion and order in both cases in favor of each defendant. The only appeal is from the eight judgment orders dismissing AMF's complaints against McDonald's and the seven licensees. We affirm.

In 1966, AMF began to market individual components of a completely automated restaurant system, including its model 72C computerized cash register involved here. The 72C cash register then consisted of a central computer, one to four input stations, each with a keyboard and cathode ray tube display, plus the necessary cables and controls.

In 1967 McDonald's representatives visited AMF's plant in Springdale, Connecticut, to view a working "breadboard" model 72C to decide whether to use it in McDonald's restaurant system. Later that year, it was agreed that a 72C should be placed in a McDonald's restaurant for evaluation purposes.

In April 1968, a 72C unit accommodating six input stations was installed in McDonald's restaurant in Elk Grove, Illinois. This restaurant was a wholly- owned subsidiary of McDonald's and was its busiest restaurant. Besides functioning as a cash register, the 72C was intended to enable counter personnel to work faster and to assist in providing data for accounting reports and bookkeeping. McDonald's of Elk Grove, Inc. paid some $20,000 for this prototype register on January 3, 1969. AMF never gave McDonald's warranties governing reliability or performance standards for the prototype.

At a meeting in Chicago on August 29, 1968, McDonald's concluded to order sixteen 72C's for its company-owned restaurants and to cooperate with AMF to obtain additional orders from its licensees. In December 1968, AMF accepted McDonald's purchase orders for those sixteen 72C's. In late January 1969, AMF accepted seven additional orders for 72C's from McDonald's licensees for their restaurants. Under the contract for the sale of all the units, there was a warranty for parts and service. AMF proposed to deliver the first unit in February 1969, with installation of the remaining twenty-two units in the first half of 1969. However, AMF established a new delivery schedule in February 1969, providing for deliveries to commence at the end of July 1969 and to be completed in January 1970, assuming that the first test unit being built at AMF's Vandalia, Ohio, plant was built and satisfactorily tested by the end of July 1969. This was never accomplished.

During the operation of the prototype 72C at McDonald's Elk Grove restaurant, many problems resulted, requiring frequent service calls by AMF and others. Because of its poor performance, McDonald's had AMF remove the prototype unit from its Elk Grove restaurant in late April 1969.

At a March 18, 1969, meeting, McDonald's and AMF personnel met to discuss the performance of the Elk Grove prototype. AMF agreed to formulate a set of performance and reliability standards for the future 72C's, including "the number of failures permitted at various degrees of seriousness, total permitted downtime, maximum service hours and cost." Pending mutual agreement on such standards, McDonald's personnel asked that production of the twenty-three units be held up and AMF agreed.

On May 1, 1969, AMF met with McDonald's personnel to provide them with performance and reliability standards. However, the parties never agreed upon such standards. At that time, AMF did not have a working machine and could not produce one within a reasonable time because its Vandalia, Ohio, personnel were too inexperienced. After the May 1st meeting, AMF concluded that McDonald's had cancelled all 72C orders. The reasons for the cancellation were the poor performance of the prototype, the lack of assurances that a workable machine was available and the unsatisfactory conditions at AMF's Vandalia, Ohio, plant where the twenty-three 72C's were to be built.

On July 29, 1969, McDonald's and AMF representatives met in New York. At this meeting it was mutually understood that the 72C orders were cancelled and that none would be delivered.

In its conclusions of law, the district court held that McDonald's and its licensees had entered into contracts for twenty-three 72C cash registers but that AMF was not able to perform its obligations under the contracts. Citing Section 2-610 of the Uniform Commercial Code and Comment 1 thereunder, the court concluded that on July 29, McDonald's justifiably repudiated the contracts to purchase all twenty-three 72C's.

Relying on Section 2-609 and 2-610 of the Uniform Commercial Code, the court decided that McDonald's was warranted in repudiating the contracts and therefore had a right to cancel the orders by virtue of Section 2- 711 of the Uniform Commercial Code. Accordingly, judgment was entered for McDonald's.

The findings of fact adopted by the district court were a mixture of the court's own findings and findings proposed by the parties, some of them modified by the court. AMF has assailed ten of the 124 findings of fact, but our examination of the record satisfies us that all have adequate support in the record and support the conclusions of law.

Whether in a specific case a buyer has reasonable grounds for insecurity is a question of fact. Comment 3 to UCC § 2-609; Anderson, Uniform Commercial Code, § 2-609 (2d Ed. 1971). On this record, McDonald's clearly had "reasonable grounds for insecurity" with respect to AMF's performance. At the time of the March 18, 1969, meeting, the prototype unit had performed unsatisfactorily ever since its April 1968 installation. Although AMF had projected delivery of all twenty-three units by the first half of 1969, AMF later scheduled delivery from the end of July 1969 until January 1970. When McDonald's personnel visited AMF's Vandalia, Ohio, plant on March 4, 1969, they saw that none of the 72C systems was being assembled and learned that a pilot unit would not be ready until the end of July of that year. They were informed that the engineer assigned to the project was not to commence work until March 17th. AMF's own personnel were also troubled about the design of the 72C, causing them to attempt to reduce McDonald's order to five units. Therefore, under Section 2-609 McDonald's was entitled to demand adequate assurance of performance by AMF.[7]

However, AMF urges that Section 2-609 of the UCC (note 5 supra) is inapplicable because McDonald's did not make a written demand of adequate assurance of due performance. In *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co*., 532 F.2d 572, 581 (7th Cir. 1976), we noted that the Code should be liberally construed[8] and therefore rejected such "a formalistic approach" to Section 2-609. McDonald's failure to make a written demand was excusable because AMF's Mr. Dubosque's testimony and his April 2 and 18, 1969, memoranda about the March 18th meeting showed AMF's clear understanding that McDonald's had suspended performance until it should receive adequate assurance of due performance from AMF (Tr. 395; AMF Exhibit 79; McD. Exhibit 232).

After the March 18th demand, AMF never repaired the Elk Grove unit satisfactorily nor replaced it. Similarly, it was unable to satisfy McDonald's that the twenty-three machines on order would work. At the May 1st meeting, AMF offered unsatisfactory assurances for only five units instead of twenty- three. The performance standards AMF tendered to McDonald's were unacceptable because they would have permitted the 72C's not to function properly for 90 hours per year, permitting as much as one failure in every fifteen days in a busy McDonald's restaurant. Also, as the district court found, AMF's Vandalia, Ohio, personnel were too inexperienced to produce a proper machine. Since AMF did not provide adequate assurance of performance after McDonald's March 18th demand, UCC Section 2-609(1) permitted McDonald's to suspend performance. When AMF did not furnish adequate assurance of due performance at the May 1st meeting, it thereby repudiated the contract under Section 2-609(4). At that point, Section 2-610(b) (note 3 supra) permitted McDonald's to cancel the orders pursuant to Section 2-711 (note 6, supra), as it finally did on July 29, 1969.

In seeking reversal, AMF relies on *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, *supra*, 532 F.2d at 581. There we held a party to a contract could not resort to UCC Section 2-609 since there was no demonstration that reasonable grounds for insecurity were present. That case is inapt where, as here, McDonald's submitted sufficient proof in that respect. But that case does teach that McDonald's could cancel the orders under Sections 2-610 and 2-711 because of AMF's failure to give adequate assurance of due performance under Section 2-609.

Judgment Affirmed.

---

7 McDonald's was justified in seeking assurances about performance standards at the March 18th meeting. The parts and service warranty in the contracts for the twenty-three 72C's was essentially a limitation of remedy provision. Under UCC § 2-719(2) if the 72C cash registers failed to work or could not be repaired within a reasonable time, the limitation of remedy provision would be invalid, and McDonald's would be entitled to pursue all other remedies provided in Article 2. Because McDonald's would have a right to reject the machines if they proved faulty after delivery and then to cancel the contract, it was consistent with the purposes of Section 2-609 for McDonald's to require assurances that such eventuality would not occur. See Comment 1 to UCC § 2-719.

8 UCC Section 1-102(1) provides that the Code "shall be liberally construed and applied to promote its underlying purposes and policies."

Case Notes:

1. When did someone first think about applying UCC § 2-609 to this situation?

2. Was the court correct to "liberally construe" § 2-609? See § 1-102.

3. If a more literal court had found that § 2-609 was not complied with under these facts, would McDonald's have lost the case?

4. Consider footnote 7. If at the May meeting, AMF had said, "We absolutely, positively, are going to be able to deliver only 20 of the 23 cash registers on time," would McDonald's have been justified in terminating the contract?

14.4. Common Law Still Relevant. Section 2-609 provides ***one basis*** for anticipatory repudiation – failure to provide adequate assurance within a reasonable time of receiving a written justified demand for adequate assurance. However, this is not the only situation which may give rise to anticipatory repudiation under the UCC. For example, you may have a clear and unequivocal refusal to perform under a contract for the sale of goods. Where you have a clear and unequivocal refusal to perform, you do not need to go through the "adequate assurance" process of § 2-609; you can immediately treat the refusal to perform as an anticipatory repudiation. Comment 2 suggests that it may be easier to establish an anticipatory repudiation under the UCC than under the common law:

> It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation.

14.4.1. In summary, you can have an anticipatory repudiation in the context of the sale of goods (i) under common law by virtue of an unequivocal express repudiation or conduct making performance impossible (an implied repudiation), or (ii) by using the § 2-609 adequate assurance process to morph an uncertainty about performance into a repudiation.

14.4.2. Once you have a repudiation under common law principles of express or implied repudiation, or by virtue of a failure to provide timely adequate assurance under § 2-609, you then move to § 2-610 to determine the rights of the non-repudiating party.

Problem 14-8. In January 2012 Liz Claiborne, a clothing manufacturer, contracts to buy a large amount of woolen fabric from Montana Wool Company. The contract specifies the price as \$4/yard, payable 30 days after Liz receives delivery. The date of delivery is specified as March 15. In February, Liz receives a letter from Montana Wool stating "We are so sorry, but we must rescind our agreement. I hope this doesn't stop you from doing business with us in the future." Can you go straight to the remedies for repudiation at § 2-610, or must you first request adequate assurance under § 2-609?

Suppose that Montana Wool writes to Liz: "The woolen fabric is ready and will be timely shipped. However, due to unforeseen increases in our price of wool, we are increasing the price from $4.00/yard to $4.50 yard." Repudiation?

14.5. Rights of Non-Repudiating Party under § 2-610. After determining that an anticipatory repudiation has occurred (either under § 2-609 or by other express or implied conduct), move to § 2-610 to determine the non-repudiating party's rights.

> 14.5.1. Note that these rights arise only if the repudiation will ***substantially impair*** the value of the contract to the non-repudiating party.

Problem 14-9. Suppose instead that Montana Wool's letter had said: "Due to machinery problems that have since been fixed, we are writing to inform you that we will not be able to deliver the woolen fabric by March 15. We will guarantee delivery by March 20 at the latest." Is this a repudiation which substantially impairs the value of the contract to Liz Claiborne?

> 14.5.2. If there has been a repudiation which will substantially impair the value of the contract to the non-repudiating party, the non-repudiating party may choose between two alternatives:
>
> > 14.5.2.1. Await performance for a commercially reasonable time (§ 2-610(a)); or
> >
> > 14.5.2.2. Resort to any remedy for breach (including cancellation of the contract), even if the non-breaching party has urged retraction or has indicated she would await performance. Section 2-610(b).
>
> 14.5.3. Under either option, the non-breaching party may elect to suspend his own performance or salvage unfinished goods. Section 2-610(c).
>
> 14.5.4. If the non-repudiating party elects to wait, it incurs the risk of retraction (discussed below); retraction will cut off the non-repudiating parties' right to resort to other remedies.

14.6. Retraction.

> 14.6.1. Under § 2-611(1), before performance is due, the repudiating party may ***retract*** her repudiation ***unless***:
>
> > The non-breaching party has resorted to its available remedy of ***canceling*** the contract; or
> >
> > The non-breaching party has ***materially changed her position*** or otherwise indicated that she considers the repudiation final.

14.6.2. An effective retraction reinstates the repudiating party's rights under the contract (although the non-breaching party may sue for any damages caused by any delay occasioned by the repudiation). Section 2-611(3).

14.6.3. Retraction may be by any reasonable method which clearly indicates that the repudiating party intends to materially perform. If the non-breaching party has made a justified demand for adequate assurance, the retraction must include adequate assurance. Section 2-611(2).

Problem 14-10. The Downtown Bar orders a specially manufactured machine from Specialty Manufacturing to chip ice, to be used in its famous recipe for mint juleps. The order is placed in January, with delivery specified by May 1, so that it will be in place prior to the Kentucky Derby. On March 1, Specialty Manufacturing writes to the Downtown Bar, stating that because of labor problems at its plant, it will not be able to deliver the machinery by May 1. The Downtown Bar starts looking for a replacement machine, but not certain if it will be able to find a replacement, it doesn't say anything to Specialty Manufacturing yet. On March 7, Specialty Manufacturing writes to the Downtown Bar that the labor problems are over, and it will be able to deliver by May 1. A few days after receiving this second letter, the Downtown Bar finds a company willing to manufacture the machine.

Can the Downtown Bar cancel the contract now? Why or why not?

Would your answer change if prior to receiving the second letter from Specialty Manufacturing (but still without having said anything directly to Specialty Manufacturing), the Downtown Bar entered into a contract with a new manufacturing company and paid $1,000 down for the replacement machine?

14.7. Seller's Right of Reclamation. If a seller ships goods to a buyer on credit and then discovers that the buyer is unlikely to be able to pay, it is too late for the seller to suspend performance and demand assurances. But under § 2-702, the seller may have a right to reclaim the goods.

The seller has the right only if the buyer is *insolvent*, a term defined at § 1-201(b)(23).

The seller's right is subordinate to the rights of a good faith purchaser, which includes a secured creditor. For example, The Bank has a perfected security interest in Retailer's inventory. Seller sells goods on credit to Retailer and the goods are inventory in the hands of Retailer. Retailer was insolvent during this time and then goes bankrupt within 10 days of delivery of the goods. Seller has a right of reclamation as against Retailer, but The Bank's security interest in the goods has priority over Seller's claim.

Chapter 14 Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 15

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 6-2

Chapter 15. Common Law Remedy Principles and Seller's Remedies under the UCC

15.1. Common Law Remedy Principles

15.1.1. Basic Common Law Remedy Concepts. To the extent not displaced by the UCC, common law principles governing remedies continue to apply to both buyers and sellers. Let us review some of those principles. At common law, you must first establish that one of the parties has breached the agreement. If a breach exists, the non-breaching party is entitled to be compensated for the losses suffered by the non-breaching party as a result of the breach. See § 1-305. However, the following ***common law principles*** may limit the non-breaching party's ability to recover damages: causation, foreseeability, certainty, and mitigation.

> 15.1.1.1. The non-breaching party must establish that the breach ***caused*** the damage (*i.e.*, causation).
>
> 15.1.1.2. The damages must have been ***reasonably foreseeable*** at the time of contracting. This limitation often makes it difficult to obtain consequential damages. As stated in Restatement (Second) of Contracts § 351, damages "are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made."
>
> > 15.1.1.2.1. Section 2-715(2) adopts the principle of foreseeability by limiting buyer's consequential damages to "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know...."

Problem 15-1. Missoula Music Shop agreed to sell a violin to Brenda, which Brenda intended to use in an upcoming audition for a scholarship to be awarded by the University of Montana. The Music Shop had to special order the violin, and promised to deliver it on February 1. The audition was scheduled for February 10. On January 31, the Music Shop informed Brenda that it would not be able to deliver the violin until February 15, after the audition. Brenda used her old violin at the audition, and did not receive the scholarship. Brenda sues Missoula Music Shop for the $10,000 scholarship she would have been awarded if she had won the competition. Is the Music Shop liable for these damages?

Problem 15-2. On February 1, Farmer Bob ordered a new tractor from the local implement dealer, which he intended to use to plant his spring wheat crop in May. The implement dealer promised to deliver the tractor by May 1. However, the implement dealer did not deliver the tractor until May 15. As a result of the delay, Farmer Bob was unable to plant 500 of his 2000 acres. He seeks damages from the implement dealer for his lost profits on the 500 acres. Will

Bob be able to establish that the damages were foreseeable?

15.1.1.3. The non-breaching party must be able to prove the amount of the damages ***with reasonable certainty***.

15.1.1.3.1. Damages need not be calculated with mathematical accuracy. See Comment 1 to § 1-305, which "rejects any doctrine that damages must be calculable with mathematical accuracy." You can estimate or approximate damages, as long as there is some certainty involved.

Problem 15-3. Let's go back to Farmer Bob. What sort of evidence would you submit to establish Bob's lost profits on the 500 acres?

15.1.1.4. The breaching party may raise the affirmative defense of ***mitigation***, pursuant to which the non-breaching party has an obligation to reasonably ***mitigate*** his/her damages.

15.1.1.4.1. The only explicit reference to mitigation in Article 2 appears in § 2-715(2), which adopts the principle of mitigation by limiting buyer's consequential damages to those "which could not reasonably be prevented by cover or otherwise." Nevertheless, the common law principle must always be applied.

Problem 15-4. Let's go back to Farmer Bob. If you represented the implement dealer, what arguments would you make regarding mitigation?

15.1.1.5. Under the principle of ***freedom of contract***, the parties, ***by agreement***, may to some extent expand or limit otherwise available remedies or the measure of damages. However, because many of the principles are so strong, we will say that such provisions are not always enforceable.

Problem 15-5. What if the purchase agreement between the implement dealer and Farmer Bob contained a clause specifically stating that seller was not responsible for any consequential damages resulting from a breach, including lost profits? See § 2-719.

15.1.2. Purpose of Remedies. The primary purpose of a contract remedy is to put the non-breaching party in as good a position as that party would have been in had the contract been performed. This is often referred to as the non-breaching party's ***expectation interest***, or the rule of the ***expectancy***. See Restatement (Second) of Contracts § 347. We will see that even though the Code contains a lot of formulas for calculating damages, these are just ways of computing the expectancy.

15.1.2.1. Section 1-305 incorporates the concept of fulfilling a party's expectation interest by stating that the "remedies provided by [the UCC] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed...."

15.1.2.2. Sometimes a plaintiff may not be able to prove the value of the expectation interest with certainty or may conclude that another measure would be more favorable. In those situations, a party may seek two other measures of damages:

15.1.2.2.1. ***Reliance Interest.*** The purpose of this interest is to reimburse the non-breaching party for losses incurred by reliance on the contract, such as expenses incurred in preparing to perform. The rationale is to put the non-breaching party in the same position as if the contract had not been made rather than as if the contract had been performed.

15.1.2.2.2. ***Restitution Interest***. The purpose of this interest is to restore to the non-breaching party any benefit conferred by her on the other party.

15.1.3. Material versus Immaterial Breach and Effect on Remedies. At common law, it is important to classify a breach as ***material*** or ***immaterial,*** because the remedies available depend upon the materiality of the breach. In both cases, damages are available as a remedy. However, it is only when a breach is material that the non-breaching party may be fully excused from further performance of his or her obligations, and may terminate the contract. Except for certain situations, such as ***installment contracts***, the concept of materiality is not determinative of remedies under the UCC. For example, recall from § 12.2 that the perfect tender rule of § 2-601 allows the buyer to reject goods for ***any non-conformity*** (subject to the seller's right to cure and certain other limitations); and § 2-607(1) requires the buyer to pay at the contract price for any goods accepted rather than claim that its obligation to pay under the contract was discharged on grounds that the breach was material.

15.1.4. Terminology. Different terms are used to describe different types of damages.

15.1.4.1. ***Direct damages***: Damages that flow directly and immediately from a breach. In the context of the sale of goods, a seller's direct damages include the lost profit that a seller would have made upon the sale of the goods. A buyer's direct damages would include any increase in price the buyer would have to pay to replace goods that seller fails to deliver.

15.1.4.2. ***Incidental damages*****:** Damages reasonably associated with or related to actual damages.

15.1.4.2.1. A seller's incidental damages include costs reasonably incurred in stopping delivery, in transporting or storing the goods after the buyer's breach, or costs incurred in connection with the return or resale of the goods. Section 2-710.

15.1.4.2.2. A buyer's incidental damages include costs reasonably incurred in inspection, receipt, transportation and storage of goods rightfully rejected; and reasonable expenses incurred in connection with effecting cover. Section 2-715(1). See John S. Herbrand, Annotation, *Buyer's Incidental and Consequential Damages from Seller's Breach Under UCC § 2-715*, 96 A.L.R. 3d 299 (1979).

15.1.4.3. ***Consequential damages*: ** Consequential damages include losses that do not flow directly and immediately from a breach, but that result indirectly from the breach.

15.1.4.3.1. Section 2-715(2) defines a ***buyer's*** consequential damages to include:

i. any loss resulting from general or particular requirements and needs of which the seller knew (or had reason to know) at the time of contracting, and which could not have been reasonably prevented by cover or otherwise; and

ii. injury to person or property proximately resulting from any breach of warranty.

15.1.4.3.2. The UCC ***does not include a provision allowing consequential damages for sellers***. See, for example, § 2-708(1), which allows incidental but not consequential damages to a seller. Section 1-305 states that consequential damages are not allowed unless as specifically provided elsewhere in the UCC. Based on § 1-305, several courts have held that the lack of a provision specifically allowing consequential damages to seller does, in fact, prevent the seller from recovering any consequential damages. See, for example, *Firewood Mfg. Co. v. General Tire, Inc*., 96 F.3d 163 (6th Cir. 1996) (court disallowed interest as a consequential damage for seller). Amended § 2-708 would have allowed consequential damages for sellers.

15.1.4.3.3. In most jurisdictions, attorney's fees are not allowed as part of incidental or consequential damages. Exception: if a party has to defend a foreseeable claim by a third party because of the breach, the breaching party may be held responsible for attorney's fees incurred.

For example, Seller agreed to sell widgets to Buyer, knowing that Buyer planned to resell them to Third Party. Seller repudiated and Buyer was not able to provide widgets to Third Party, which sued Buyer. In its claim against Seller, Buyer cannot recover attorney's fees expended in pursuing that claim. However, Buyer can recover from Seller attorney's fees it expended defending the claim of Third Party.

15.1.4.4. The terms "***general damages"*** and ***"special damages***" are the terms used in pleading for direct and consequential damages. A plaintiff does not have to notify the defendant of general damages because they are, as defined in Black's Law Dictionary, "damages that the law presumes follow from the type of wrong complained of." In other words, one would generally be aware that such damages would naturally arise from a breach; they could have been fairly and reasonably contemplated by both parties at the time the contract was made. But because special damages do not naturally arise from a breach, the plaintiff must plead them with particularity so the defendant has notice of them.

Problem 15-6. Wilbur Reed operates a small greenhouse in Missoula known as Reed's Greenhouse. In May, Reed's Greenhouse received orders from various Missoula retail outlets, such as K-Mart, for Christmas poinsettias. On June 2, Reed then ordered 5,000 poinsettia cuttings from McCalif, a large California grower of poinsettias, for $1.00 each. The shipment of poinsettia cuttings were received by Reed on August 11. When the boxes were opened, it was clear that all but 500 of the cuttings were ruined because they had not been packed properly. Because it was so late in the season, McCalif could not provide replacement plants to Reed. Classify the following damages incurred by Reed as direct, incidental or consequential:

1. the purchase by Reed from a Seattle grower of 3,000 poinsettia cuttings at $1.75/each (which was the most he could find at this point in time, and the lowest price he could find)

2. the lost profit of $5.00 per plant on the sale of 2,000 poinsettias which Reed was unable to replace

3. the cost of transporting the 3,000 replacement poinsettias to Missoula

Problem 15-7. Now let's classify damages when the seller is the non-breaching party. John is an appliance salesman. At noon on March 15, a customer comes into the store and agrees to purchase a washing machine for $500. John is very excited, because if he delivers 125 major appliances to buyers between January 1 and March 15, he qualifies for a free trip to the NCAA basketball championships (valued at $2,500), sponsored by the appliance manufacturer. This sale would be his 125th, and John enthusiastically explains these facts to the customer as they are signing the purchase agreement. After the contract is signed, John closes early and goes out to celebrate with a few beers. That afternoon, when the appliance is delivered, the customer refuses delivery, telling the carrier that he has changed his mind, and he is not going to buy the washing machine. John learns of these facts the next day. Classify each of the following damages as direct, incidental or consequential:

1. the cost of delivering the washing machine back to the store

2. the lost profit on the sale of the appliance

3. the lost trip to the NCAA

15.1.5. Non-compensatory Damages. Tort law is often solicitous of injured feelings, but contract law is not. Except in unusual cases, contract law does not compensate for non-economic injuries, nor does contract law allow punitive damages.

15.1.5.1. One of the principles of contract law is that of ***efficient breach***. This principle prevents a party from having to perform an inefficient contract. The party may deliberately breach a contract, as long as the breaching party pays compensatory (versus punitive) damages arising from its breach. In other words, the breaching party is allowed to breach a contract, if it decides that it is cheaper to breach than to continue performing under the contract. Punitive damages discourage parties to a contract from committing efficient breaches. Section 1-305 provides that punitive ("penal") damages may not be had unless specifically provided by the UCC.

15.1.5.2. With regard to non-economic injuries, such as emotional distress, such damages are excluded "unless the breach also caused bodily harm or the contract ... is of such a kind that serious emotional disturbance was a particularly likely result." Restatement (Second) of Contracts § 353. A contract for the sale of a casket is one of those rare contracts which could give rise to a cause of action for liability based on mental suffering. See, e.g., *Hirst v. Elgin Metal Casket Co*., 438 F. Supp. 906 (D. Mont. 1977).

15.1.6. Burden of Proof. The party seeking damages has the burden of proof to establish damages caused by a breach.

15.2. UCC Seller Remedies

15.2.1. Summary of Seller Remedies. Section 2-703 sets forth seller's remedies in general. The remedies are ***cumulative***; for example, the seller can withhold delivery of the goods, cancel the contract, *and* sue for damages. See Comment 1 to § 2-703. Note, however, that the seller is not entitled to be over-compensated. See § 1-305. The remedies available to an aggrieved seller include:

- the right to withhold or stop delivery of goods;
- the right to resell the goods and recover damages as provided at § 2-706;
- the right to recover damages for nonacceptance as provided at § 2-708, using the market price as the measure of damages or, in appropriate cases, the lost profit on the sale;

- in certain circumstances, the right to recover the purchase price of the goods as provided at § 2-709; or

- the right to cancel the contract.

15.2.2. Recovery of Purchase Price. See § 2-709.

15.2.2.1. There are only three situations which allow a seller to recover the purchase price from the buyer:

- Where the buyer ***has accepted*** the goods (§ 2-709(1)(a))(and most courts interpret this provision to mean that the buyer is in possession of the goods);

- Where the goods have been destroyed *after* the risk of loss has passed to the buyer (§ 2-709(1)(a)); and

- Where the seller is ***unable to re-sell goods*** identified to the contract at a reasonable price (§ 2-709(1)(b)).

15.2.2.2. If the seller has the goods and successfully sues for the price, he must hold any goods which have been identified to the contract and which are still in his control for the buyer. Section 2-709(2).

15.2.2.3. For situations giving rise to the right to sue for the purchase price, see the cases noted in John S. Herbrand, Annotation, *Seller's Recovery of Price of Goods from Buyer Under UCC § 2-709*, 90 A.L.R. 3d 1141 (1979).

Problem 15-8. Susan owns and operates a jewelry store. Betty comes into the store and agrees to purchase a large emerald ring for $12,000. Betty agrees to pick up the ring the next day, and deliver a check for the purchase price at that time. The next day, Betty calls and cancels the contract. Can Susan sue for the purchase price under § 2-709? Why or why not?

Problem 15-9. A Montana farmer agrees to sell a carload of grain to a specialty bakery located in Spokane, Washington. The contract is F.O.B. Collins, Montana elevator. After the grain is delivered to the Collins elevator with notice to buyer and it has been loaded onto the train, there is a derailment on its way to Spokane that renders the grain worthless. Can the farmer sue for the purchase price? Why or why not? (Hint: review the seller's obligations under this contract and when the risk of loss passes in §§ 10.1.4 and 10.1.5.)

Problem 15-10.

1. The sponsors of the annual Conrad Whoop-up Rodeo enter into a contract with Sam's Silver Designs to design and manufacture 10 custom-made silver-plated belt buckles to award to the winner of each rodeo event, at the price of $200 each. Before Sam has begun work on the belt buckles, the rodeo sponsors call and repudiate the contract. Can Sam sue for the $2,000 purchase price of the buckles under § 2-709?

2. Suppose that Sam orders the metal and starts work. After pouring and molding all of the belt buckles, but before stamping them with the words "Whoop-up Champion," the rodeo sponsors cancel the contract due to low ticket sales for the rodeo. Can Sam sue the rodeo sponsors for the $2,000 purchase price of the buckles under § 2-709?

3. Assume that Sam has completed the belt buckles with the words "Whoop-up Champion" stamped on them and then the rodeo sponsors repudiate the contract. Sam successfully sues for the purchase price under § 2-709. What must Sam do with the belt buckles in his possession?

15.2.3. Remedy of Resale. Under § 2-706, a seller ***may resell goods*** identified to the contract in ***good faith*** and in a ***commercially reasonable manner*** at either a ***private sale*** or a ***public sale*** (auction) and recover damages under the following formula:

Contract price
- Resale price
+ incidental damages
- expenses saved by seller

15.2.3.1. In addition, § 2-706 requires that the seller give the buyer ***notice*** of his intent to resell. Since the remedy gives the seller the difference between the contract price and the resale price, the buyer has an interest in seeing that the seller gets as a high a resale price as possible.

15.2.3.1.1. Under § 2-709(3), for a ***private sale***, the seller must give the buyer reasonable notification of his intention to resell. Although some sellers have argued that the buyer should have reasonably known that the seller would resell, most courts have required strict compliance with the notice provision.

15.2.3.1.2. Under § 2-709(4), for a ***public sale***, the seller must give the buyer reasonable notice of the time and place of the auction, ***unless*** the goods are perishable or threaten to decline quickly in value.

15.2.3.2. Needless to say, there is lots of litigation over whether the method, manner, time, place and terms of re-sale were commercially reasonable. These issues are very similar to the issues that arise in secured transactions (Article 9) when the creditor sells the repossessed goods. See Carolyn Kelly MacWilliam, Annotation, *Resale of Goods Under UCC § 2-706*, 101 A.L.R.5th 563 (2002).

Problem 15-11. Dollar Store decides to go out of business, and enters into an agreement to sell all of the inventory and shelving to Bargain Buyers for $48,000. Dollar will have to pay $2,000 to ship the goods to Bargain. A few days prior to the closing, Bargain Buyers repudiates the contract.

1. Dollar pays a broker who found the buyer a commission of $2,500 to find a private buyer who will pay $44,000 for the goods. The buyer is closer to Dollar and it will have to pay only $1,000 in shipping. Dollar notifies Bargain of its intention to resell. How much can Dollar recover from Bargain under § 2-706?

2. Assume instead Dollar sells the inventory and shelving at a public auction, but fails to give any notice of the auction to Bargain Buyers. The auction generates $35,000 in sales proceeds, and Dollar Store sues Bargain Buyers for the $15,000 difference, plus costs of the auction. Will Dollar prevail under § 2-706? Why or why not? If it does not prevail, are any other remedies available to it?

What if the remedy provisions of the purchase agreement allowed the sellers to re-sell the goods at private or public auction, *without notice* to buyers? In other words, is the notice requirement a default rule that the parties are free to change. In this situation, can Dollar Store collect $15,000 (plus the cost of the auction) from Bargain Buyers?

15.2.4. Market Price Remedy. Under § 2-708(1), instead of re-selling the goods and seeking damages under § 2-706, a seller may seek damages from a breaching buyer based upon the market price of the goods, applying the following formula:

Contract price
- market price at the time and place for tender
+ incidental damages
- expenses saved by seller

Problem 15-12. Salmons of Seattle has on hand a quantity of processed frozen salmon fillets. On August 1 it contracts to sell a large quantity of these fillets to Better Foods of Boise, Idaho for a price of "$2/pound F.O.B. Boise." Delivery is to be made by rail on August 21. On August 4, before the shipment has been delivered by Salmons of Seattle to the railroad, Better Foods cancels the contract. Review § 10.1.4 if you are not clear on the meaning of the shipping terms. Additional facts that you may (or may not) need to answer the questions follow (prices per pound):

Market price of fillets at Boise on August 1	$2.04
Market price of fillets at Seattle on August 1	$1.54
Market price at Boise on August 4	$1.92
Market price at Seattle on August 4	$1.40
Market price at Boise on August 21	$1.14

Market price at Seattle on August 21	$1.00
Cost of shipping from Seattle to Boise (per pound)	$ .05

1. If Salmons sues Better Foods under § 2-708(1), what amount should it receive?

2. What if instead the contract price had been agreed to as "$1.95 F.O.B. Seattle?"

3. What if Better Foods could demonstrate that upon hearing of the cancelation, Salmons had very quickly been able to arrange sale of the shipment to another buyer at $1.50/lb?

> 15.2.4.1. How do you establish market price if there is no readily available market price at the time and place of tender? Go to § 2-723, which provides that where market prices are not readily available, "the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place."

15.2.5. Lost Profit. If the measure of damages under § 2-708(1) is ***inadequate***, then the seller can seek recovery under § 2-708(2), which allows as damages the seller's lost profit on the sale, *including reasonable overhead*, plus incidental damages.

Problem 15-13. Sonic Sales sells a wide-screen television set to Barbara for $1,500, to be delivered the next day. It has several of this model in stock, and can always order more from the manufacturer. This model is going for the same price at other appliance dealers around town. Before the television is delivered, Barbara calls and repudiates the contract. Sonic Sales re-sells the television for $1,500 within a few days to another buyer.

1. What would the measure of damages be under § 2-706, assuming notice of re-sale had been given to Barbara (and no other costs or savings are involved)?

2. What would the measure of damages be under § 2-708(1), assuming that the market price is $1,500, and there are no other costs or savings involved?

3. Is the measure of damages under §§ 2-706 and 2-708(1) inadequate? Why or why not?

Kenco Homes, Inc. v. Williams

972 P.2d 125 (Wash. App. 1999)

Opinion by Morgan, J.

Kenco Homes, Inc., sued Dale E. Williams and Debi A. Williams, husband and wife, for breaching a contract to purchase a mobile home. After a bench trial, the trial court ruled primarily for Williams. Kenco appealed, claiming the trial court used an incorrect measure of damages. We reverse.

Kenco buys mobile homes from the factory and sells them to the public. Sometimes, it contracts to sell a home that the factory has not yet built. It has "a virtually unlimited supply of product," according to the trial court's finding of fact.

On September 27, 1994, Kenco and Williams signed a written contract whereby Kenco agreed to sell, and Williams agreed to buy, a mobile home that Kenco had not yet ordered from the factory. The contract called for a price of $ 39,400, with $ 500 down. [Before a necessary appraisal of the site had taken place, Williams stopped payment and repudiated the contract. He told the trial court he did so because he “found a better deal elsewhere.”]

When Williams repudiated, Kenco had not yet ordered the mobile home from the factory. After Williams repudiated, Kenco simply did not place the order. As a result, Kenco's only out-of-pocket expense was a minor amount of office overhead.

On November 1, 1994, Kenco sued Williams for lost profits. After a bench trial, the superior court found that Williams had breached the contract; that Kenco was entitled to damages; and that Kenco had lost profits in the amount of $ 11,133 ($ 6,720 on the mobile home, and $ 4,413 on the site improvements). The court further found, however, that Kenco would be adequately compensated by retaining Williams’ $ 500 down payment.... [Author’s note – we will see in Chapter 17 where the court got the $500 figure.]

Under the Uniform Commercial Code (UCC), a nonbreaching seller may recover "damages for non-acceptance" from a breaching buyer. The measure of such damages [in § 2-708] is as follows:

> (1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (RCW 62A.2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (RCW 62A.2-710), but less expenses saved in consequence of the buyer's breach.
> (2) *If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done* then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (RCW 62A.2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

As the italicized words demonstrate, the statute's purpose is to put the nonbreaching seller in the position that he or she would have occupied if the breaching buyer had fully performed (or, in alternative terms, to give the nonbreaching seller the benefit of his or her bargain). A party claiming damages under subsection (2) bears the burden of showing that an award of damages under subsection (1) would be inadequate. [cites omitted]

In general, the adequacy of damages under subsection (1) depends on whether the nonbreaching seller has a readily available market on which he or she can resell the goods that the breaching buyer should have taken. When a buyer breaches before either side has begun to perform, the amount needed to give the seller the benefit of his or her bargain is the difference between the contract price and the seller's expected cost of performance. Using market price, this difference can, in turn, be subdivided into two smaller differences: (a) the difference between the contract price and the market price, and (b) the difference between the market price and the seller's expected cost of performance. So long as a nonbreaching seller can reasonably resell the breached goods on the open market, he or she can recover the difference between contract price and market price by invoking subsection (1), and the difference between market price and his or her expected cost of performance by reselling the breached goods on the open market. Thus, he or she is made whole by subsection (1), and subsection (1) damages should be deemed "adequate." But if a nonbreaching seller cannot reasonably resell the breached goods on the open market, he or she cannot recover, merely by invoking subsection (1), the difference between market price and his or her expected cost of performance. Hence, he or she is not made whole by subsection (1); subsection (1) damages are "inadequate to put the seller in as good a position as performance would have done;" and subsection (2) comes into play.

The cases illustrate at least three specific situations in which a nonbreaching seller cannot reasonably resell on the open market. In the first, the seller never comes into possession of the breached goods; although he or she plans to acquire such goods before the buyer's breach, he or she rightfully elects not to acquire them after the buyer's breach. In the second, the seller possesses some or all of the breached goods, but they are of such an odd or peculiar nature that the seller lacks a post- breach market on which to sell them; they are, for example, unfinished, obsolete, or highly specialized. In the third situation, the seller again possesses some or all of the breached goods, but because the market is already oversupplied with such goods (*i.e.*, the available supply exceeds demand), he or she cannot resell the breached goods without displacing another sale. Frequently, these sellers are labeled "jobber," "components seller," and "lost volume seller," respectively; in our view, however, such labels confuse more than clarify.

To illustrate the first situation, we examine *Copymate Marketing v. Modern Merchandising*, 660 P.2d 332 (Wash. App. 1983), a case cited and discussed by both parties. In that case, Copymate had an option to purchase three thousand copiers from Dowling for $ 51,750. Before Copymate had exercised its option, it contracted to sell the copiers to Modern for $ 165,000. It also promised Modern that it would spend $ 47,350 for advertising that would benefit Modern. It told Dowling it was exercising its option, but before it could finish its purchase from Dowling, Modern repudiated. Acting with commercial reasonableness, Copymate responded by canceling its deal with Dowling and never acquiring the copiers. It then sued Modern for its lost profits and prevailed in the trial court. Modern appealed, but this court affirmed. Because Copymate had rightfully elected not to acquire the copiers, it had no way to resell them on the open market; subsection (1) was inadequate; and subsection (2) applied.

To illustrate the second situation, we again examine Copymate. Based on substantial evidence, the Copymate trial court found that after Modern's repudiation, Copymate had "no active or reasonably available market for the resale of the . . . copiers." One reason was that the copiers had been in storage in Canada for nine years; thus, they seem to have been obsolete. Again, then, Copymate could not resell the copiers on the open market; subsection (1) was inadequate; and subsection (2) provided for an award of "lost profits."

To illustrate the third situation, we examine *R.E. Davis Chemical Corp. v. Diasonics*, 826 F.2d 678 (7th Cir. 1987). In that case, Davis breached his contract to buy medical equipment from Diasonics. Diasonics was in possession of the equipment, which it soon resold on the open market. Diasonics then sued Davis for "lost profits" under subsection (2), arguing that "it was a 'lost volume seller,' and, as such, it lost the profit from one sale when Davis breached its contract." The trial court granted summary judgment to Davis, but the appellate court reversed and remanded for trial. Other courts, the appellate court noted, "have defined a lost volume seller as 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." This definition, the appellate court ruled, lacks an essential element: whether the seller would have sold an additional unit but for the buyer's breach. On remand, then, Diasonics would have to prove (a) that it could have produced and sold the breached unit in addition to its actual volume, and (b) that it would have produced and sold the breached unit in addition to its actual volume.

In this case, Kenco did not order the breached goods before Williams repudiated. After Williams repudiated, Kenco was not required to order the breached goods from the factory; it rightfully elected not to do so; and it could not resell the breached goods on the open market. Here, then, "the measure of damages provided in subsection (1) is inadequate to put [Kenco] in as good a position as [Williams'] performance would have done;" subsection (2) states the applicable measure of damages; and Kenco is entitled to its lost profit of $ 11,133….

15.2.6. Unfinished Goods. Under § 2-704(2), the seller may complete the manufacture of unfinished goods if the seller reasonably believes that will mitigate the damages caused by the buyer's breach. It is instructive to compare this section with the common law rule exemplified in the case of *Rockingham Co. v. Luten Bridge Co*., 35 F.2d 301 (4th Cir. 1929). In that case, after the County contracted for the building of a bridge, it breached the contract by telling the contractor it did not want the bridge. The contractor nevertheless completed the bridge and claimed the contract price. The court held that after repudiation, a party may not continue to perform and thereby increase the damages. What is the difference between a contractor being told to stop construction on a bridge and a seller being told to stop construction on a good?

Problem 15-14. Buyer asked Seller to build a custom machine for it. The price was $100,000, of which $90,000 is cost and $10,000 is anticipated profit. Seller ordered $50,000 worth of parts and began assembly of the machine. At that point Buyer repudiated the contract.

1. Assuming Seller can sell what it has built for scrap worth $5,000, what can Seller recover as damages?

2. At the time of repudiation, Seller reasonably believes it can complete the machine and find a buyer for it. It does, and sells the completed machine for $90,000. What can Seller recover as damages?

3. Same facts as #2 except Seller can't find a buyer for the completed machine and has to sell it for scrap worth $10,000. What can Seller recover as damages?

Chapter 15. Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 16

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 7

Chapter 16. Buyer Remedies under the UCC

16.1. Summary of Buyer Remedies. Under §§ 2-711 through 2-716, different remedies are available to a buyer, depending upon whether (1) the buyer accepts the goods, or (2) the buyer does not have the goods because either (i) the buyer rightfully rejects or revokes acceptance of goods, or (ii) the seller fails to deliver or otherwise repudiates the contract.

16.1.1. If a buyer ***accepts*** and keeps ***non-conforming goods***, a buyer may:

- Recover damages for the non-conformity, including damages for any breach of warranty (§ 2-714); and

- Upon notice, deduct his damages from any part of the purchase price still due (§ 2-717).

16.1.2. If the seller ***fails to make delivery*** or otherwise ***repudiates*** (*i.e.*, buyer never gets the goods), or if the buyer ***rightfully rejects*** goods or ***rightfully revokes acceptance*** of goods, (*i.e.* gets the goods but returns them to the seller), the buyer may ***cancel*** the contract, ***recover any portion of the price paid,*** and either:

- "cover" and pursue damages under § 2-712;

- recover damages for nondelivery based on market price as provided in § 2-713; or

- in certain circumstances, seek ***specific performance*** or ***recovery*** of the goods, as allowed under §§ 2-502 or 2-716.

In addition, a buyer has a ***security interest*** in goods in his possession to the extent of (i) any payments made on their price and (ii) any expenses reasonably incurred in their inspection, receipt, transportation, care and custody. This means that the buyer may hold such goods and resell them to satisfy the amounts secured, remitting any balance to the seller.

16.2. Remedies Where Buyer Accepts Non-conforming Goods. Recall from Chapter 12 that the buyer may have a right to reject nonconforming goods. However, if the buyer accepts them, the buyer still has a remedy. Section 2-714 is the starting point to determine the measure of damages when a buyer accepts and keeps non-conforming goods.

16.2.1. The measure of damages is different, depending upon the basis of the claim.

16.2.1.1. Under § 2-714(1), if the damages result from a claim ***other than breach of warranty*** (a common example is a failure to deliver on time) the measure of damages is "the loss resulting in the ordinary course of events from the seller's breach as determined ***in any manner which is reasonable."*** In addition, the buyer may pursue "any incidental and consequential damages" as allowed in § 2-715.

Problem 16-1. Darla ordered eight bridesmaid dresses, to be delivered one day prior to her wedding, at a cost of $100 per dress. The seller did not deliver the dresses until two hours after the scheduled hour of the wedding, causing a three-hour delay of the wedding. The delay adversely affected other contracted services, including the limousine rental, the video and photography service contract, and the rental of the church and of an adjacent area for the wedding reception. Needless to say, all this caused the bride emotional distress. As Darla's attorney, what damages would you seek?

16.2.1.2. In Chapters 6 and 7, we identified the warranties that a buyer may get under the Code. Under § 2-714(2), if the damages arise from a breach of one of these warranties, the measure of damages is the ***difference*** at the time and place of acceptance ***between the value of the goods accepted*** and ***the value they would have had if they had been as warranted***, unless special circumstances show proximate damages of a different amount. In addition, the buyer may recover incidental and consequential damages under § 2-715.

As we will see in Chapter 17, we are accustomed to sellers using their freedom of contract to provide for a different remedy for breach of warranty, such as repairing or replacing the defective part. Nevertheless, it is important to keep in mind that the default rule gives the buyer money damages for a breach of warranty.

Problem 16-2. Buyer orders a solar panel for $25,000 and pays for it. As part of the contract, Seller promises that the solar panel has characteristics that are found only in solar panels that sell for $75,000. In fact, the panel as delivered does not perform as promised, and is worth only $20,000. Buyer decides to keep the solar panel and sue for damages. How much can Buyer recover?

A. $55,000.

B. $50,000.

C. $20,000

D. $5,000.

Schroeder v. Barth, Inc.
969 F.2d 421 (7th Cir. 1992)

BAUER, Chief Judge

Lester and Viola Schroeder, an elderly couple, wanted nothing more than a reliable, comfortable motor home to provide them with transportation and housing on their leisurely travels around the country. With that in mind, on March 13, 1981, they bought a 1981 Barth MCC Model 35 motor home from Motor Vacations Unlimited, of Elgin, Illinois, for $146,705.00. The Schroeders took delivery of the vehicle in July 1981. It came with a manufacturer's one year limited warranty. Barely 2,600 miles and five months later, on December 3, 1981, Lester Schroeder wrote a letter to Charles Dolan of Motor Vacations Unlimited cataloguing sixty-one separate problems he had experienced with the motor home since taking delivery. Dolan sent a copy of the letter and list to Richard Bibler, Assistant to the President of Barth, Incorporated ("Barth"), the manufacturer ....

On March 7, 1985, the Schroeders, citizens of Florida, filed a complaint against Barth, an Indiana corporation, in the United States District Court for the Northern District of Indiana. [The Schroeders sought damages of $146,705.] On March 15, 1991, nearly ten years after the Schroeders purchased the motor home, the court granted Barth's motion for summary judgment on damages, and entered judgment for the Schroeders in the amount of $2,113 plus costs.

Because there is no dispute that a breach of Barth's express warranty occurred, and that the Schroeders sustained damages as a result of that breach, the only issue is the amount of those damages. Indiana's Uniform Commercial Code provides that the appropriate measure of damages for breach of an express warranty "is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." IND. CODE § 26-1-2-714(2). The alternative methods to calculate those damages, set out in *Michiana Mack, Inc. v. Allendale Rural Fire Protection District,* 428 N.E.2d 1367 (Ind. App. 1981), are (1) the cost to repair, (2) the fair market value of the goods as warranted less the salvage value of the goods, or (3) the fair market value of the goods as warranted at the time of acceptance less the fair market value of the goods as received at the time of acceptance. *Id.* at 1370. It is the Schroeders' burden to prove the amount of their damages, and theirs alone. "It is not the function of the trial court to fashion equitable remedies to relieve [them] of that burden." *Id.* at 1371.

Nowhere in the two-inch thick record of the seven years of proceedings below do the Schroeders indicate under which of *Michiana Mack's* alternative methods they calculate their damages. They simply, adamantly, insist their damages are $ 146,705, which coincidentally is the price of the motor home. Unfortunately for the Schroeders, however, recapture of the purchase price is not an available remedy under § 26-1-2-714(2). It is appropriate only when the buyer has rejected the goods or revoked acceptance. *Michiana Mack,* 428 N.E.2d at 1372. And despite repeated opportunities to offer more, the only evidence of damages they proffered was Lester

Schroeder's subjective opinion that the motor home was worthless.

In its memorandum in support of its motion for summary judgment, Barth argued that although the cost to repair is not the only method to calculate breach of express warranty damages, it is the preferred method. More importantly, as Barth pointed out, it was the only method for which there was supporting evidence. That evidence, provided in the affidavit of Barth's Assistant to the President, Richard Bibler, was an itemized list of the Barth-warranted components of the motor home the Schroeders claimed were defective. Bibler gave a dollar figure, based on personal knowledge, for each item, "with a generous time allowance for each repair, at a retail labor rate of $ 35.00 per hour and, where applicable, a part or parts at retail price." Bibler Affidavit, Exhibit A to Defendant's Memorandum in Support of its Motion for Summary Judgment, Rec. Doc. No. 48, at 2 & 3. Contrary to the Schroeders' contention, Barth met its burden to identify for the court the absence of any genuine issue of material fact: it admitted liability, it admitted the Schroeders sustained damages, and using the preferred method, it provided the court with sufficient evidence to calculate those damages.

So the burden shifted to the Schroeders. "When a moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio,* 475 U.S. 574, 586 (1986). But once again, in their response to Barth's motion, the Schroeders offered only Lester's affidavit and argued that the owner of a motor home is competent to testify as to its value. In their statement of genuine issues of fact, the Schroeders offered that "Mr. Bibler may be entitled to his opinion that the Schroeders' damages are limited to the cost of repair, which he claims to be $ 2,211.25. Mr. and Mrs. Schroeder have their own opinion. The motor home was worthless." Plaintiffs' Statement of Genuine Issues, Rec. Doc. No. 51, at 2. The problem with this response is that it offers only subjective opinion, not the kind of documentary evidence that [the nonmovant must produce to support his contentions].

Although Lester's opinion may be competent evidence of the value of the motor home to the Schroeders, it is not sufficient to meet their burden of proving damages under any of *Michiana Mack's* alternative methods....

Moreover, fixing damages at the cost to repair also was appropriate. The Schroeders wholly failed to meet their burden to establish their damages, under any one of *Michiana Mack's* alternative methods, and as we noted above, a trial court will not relieve them of that burden. As odd as it may be, Barth provided the only evidence of damages in the record, and that is the cost to repair.

The Schroeders also argue that the district court erred in failing to award them incidental and consequential damages. Ever since *Hadley v. Baxendale*[5] [[5]The case, 9 Ex. 341, 156 Eng. Rep. 145 (1854), not the screen actor, whose credits include *Behind the Green Door.*] courts have allowed recovery in breach of contract actions for all damages that were reasonably foreseeable to the parties at the time of contract formation. Indiana's courts are among them. *See,* *e.g., Indiana Ins. Co. v. Plummer Power Mower,* 590 N.E.2d 1085 (Ind. App. 1992). In their complaint, in addition to the $146,705 damages, the Schroeders asked for "expenses reasonably incurred." But as with their breach of warranty damages, they fail to prove exactly what expenses they reasonably incurred in connection with the defective Barth-warranted components of the motor home. The only evidence they offer is contained in a letter from Lester to Charles Dolan of Motor Vacations Unlimited. In it, Lester says:

> We signed the contract in March, took delivery in July and still can't use it. My insurance costs me $150.00 a month, telephone calls mount up and I am doing a lot of this work myself, and communications are not getting the job done.
>
> Have already made one trip to Globe, 250 miles. Next trip they want me to leave the vehicle for a week, that's another 250 miles. To stay in a motel gets to [sic] expensive, will have to drive a car up and back, that's another 250 miles. Then the return trip to pick up the motor home will be another 250 miles and then will the work be done that time. It is 1200 miles to the factory, these trips to Globe come to 1000 miles. Why don't [sic] the factory pay for fuel and let this vehicle get the repairs it needs at the factory. And yet it had been at the factory for about 3 weeks the last time and the work still was not finished and had to wait.

These statements are wholly insufficient for the Schroeders to carry their burden of establishing their damages as a consequence of, and incidental to, defects of the Barth-warranted components.

For the foregoing reasons, the judgment of the district court is

AFFIRMED.

Case Note. The Schroeders wanted as damages the amount they paid for the vehicle. What are the alternatives for obtaining that remedy?

16.3. Notice. Before a buyer can seek damages under § 2-714, the buyer must give notification of the non-conformity to the seller as required under § 2-607(3).

16.3.1. Turn to § 2-607(3). The notice must be ***within a reasonable time*** after the buyer discovers or should have discovered the breach.

16.3.2. Comment 4 to § 2-607(3) states that the purpose of the notification requirement is "to defeat commercial bad faith, ***not to deprive a good faith consumer of his remedy***." (Emphasis supplied.) Comment 4 also notes that "a reasonable time" for notification from a retail consumer is to be judged by different standards than the time period applicable to a merchant.

16.3.3. Comment 4 also explains that the content of the notification need not include a "clear statement of all the objections," but "need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched." However, several courts have required much more than some notice that a transaction is "troublesome." In fact, one court has said that Comment 4 is flat wrong in stating that mere notice that a transaction is "troublesome" is sufficient. That court required a clear statement informing the seller that the "trouble" experienced by a buyer constitutes a breach. *K&M Joint Venture v. Smith Int'l, Inc.*, 669 F.2d 1106 (6th Cir. 1981).

16.3.4. To whom must the notice be sent? If a buyer purchases a defective product, and intends to bring a claim against both the seller and the manufacturer, must the buyer notify both of the breach?

Cooley v. Big Horn Harvestore Systems, Inc.
813 P.2d 736 (Colo. 1991)

In July 1980, plaintiffs Robert Cooley and Rita Cooley executed two agreements with defendant Big Horn Harvestore Systems, Inc. (hereinafter Big Horn), in connection with their purchase of a Harvestore automated grain storage and distribution system for use in their dairy operation. Big Horn is an independent distributor of Harvestore systems pursuant to agreements with defendant A.O. Smith Harvestore Products, Inc. (hereinafter AOSHPI), the manufacturer of the Harvestore system. The Cooleys purchased the Harvestore system to improve the efficiency and productivity of their dairy....

In early 1981, the Cooleys began to feed their herd with grain stored in the Harvestore system. Shortly thereafter, the health of the herd began to deteriorate and milk production substantially declined. The Cooleys informed Big Horn of these developments, and over the succeeding eighteen months Big Horn representatives made repairs to the structure, gave advice to the Cooleys concerning feed ratios, and assured the Cooleys that the system was functioning properly.

The health of the cows continued to deteriorate. Some died, and the Cooleys ultimately sold the remainder of the herd in 1983. The plaintiffs then filed this action against Big Horn and AOSHPI seeking damages based on claims of breach of implied warranties of merchantability and fitness for a particular purpose, breach of express warranties, breach of contract because of the failure of essential purpose of a limited remedy of suit for breach of warranty to repair or replace any defective part thereof (hereinafter referred to as the "failure of essential purpose" claim) [see § 2-719(2)], negligence, deceit, and revocation of acceptance ….

The Court of Appeals held that a commercial buyer seeking recovery from a manufacturer for a breach of contract claim resulting in property damage alone must, pursuant to the provisions of § 4-2-607(3)(a), 2 C.R.S. (1973), give the manufacturer timely notice of the claimed breach as a condition precedent to any recovery. The plaintiffs contend that they complied with the notice provisions of the statute by giving timely notice of their failure of essential purpose claim to Big Horn. We agree with the plaintiffs' contention.

Section 4-2-607(3)(a), 2 C.R.S. (1973), provides that "where a tender has been accepted: (a) the buyer must within a reasonable time after he discovers or should have discovered any breach, notify the seller of breach or be barred from any remedy …." This provision serves as a condition precedent to a buyer's right to recover for breach of contract under the statute. *Palmer v. A.H. Robins Co.*, 684 P.2d 187, 206 (Colo. 1984). The question of what constitutes a reasonable time is dependent on the circumstances of each case. *White v. Mississippi Order Buyers, Inc.*, 648 P.2d 682 (Colo. App. 1982). The parties agree that the plaintiffs gave timely notice to Big Horn of their claim but did not directly notify AOSHPI of such claim.

The notice provision of § 4-2-607(3)(a) serves three primary purposes. It provides the seller with an opportunity to correct defects, gives the seller time to undertake negotiations and prepare for litigation, and protects the seller from the difficulties of attempting to defend stale claims. *Palmer v. A.H. Robins Co.; Prutch v. Ford Motor Co.*, 618 P.2d 657 (Colo. 1980). See generally White and Summers, Uniform Commercial Code § 11-10 at 481 (3d ed. 1980). The Code defines 'seller' as "a person who sells or contracts to sell goods." § 4-2-103(1)(d), 2 C.R.S. (1973). The official comment to the Code states in pertinent part that "the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy." § 4-2-607, 2 C.R.S. comment 4 (1973).

In *Palmer v. A.H. Robins Co.,* 684 P.2d 187, this court construed the statute's notice provision in the context of a product liability action. In *Palmer*, a consumer injured through use of a defective intrauterine device sought recovery for damages against the manufacturer of the product, A.H. Robins Co. Although the plaintiff, prior to initiating litigation, notified the immediate seller, her doctor, of the fact that she allegedly sustained injuries as a result of defects in the product, she did not so notify Robins. Robins argued that the plaintiff's claims against it should be dismissed for failure to comply with § 4-2-607(3)(a).

We rejected that argument. We construed the term "seller" as used in § 4-2-607(3)(a) to "refer only to the immediate seller who tendered the goods to the buyer." *Palmer* at 206. We explained that "under this construction, as long as the buyer has given notice of the defect to his or her immediate seller, no further notification to those distributors beyond the immediate seller is required." *Id.* We also observed that a relaxed notification requirement was especially appropriate in *Palmer* because the plaintiff was a lay consumer who "would not ordinarily know of the notice requirement." *Id.* at 207 n.3.

The Court of Appeals concluded that the plaintiffs here were commercial purchasers who suffered only economic loss, as distinguished from the lay consumer who sought relief in *Palmer*. Assuming, arguendo, that the plaintiffs here were commercial purchasers, it must be observed that our decision in *Palmer* required construction of a statute adopted by the General

Assembly for application in all commercial contexts. The language of § 4-2-607(3)(a) is unambiguous: it requires a buyer to give notice of a defective product only to the "seller." See 2 Anderson, Uniform Commercial Code § 2.607:24. The General Assembly has not elected to require advance notice to a manufacturer of litigation for breach of the manufacturer's warranty of a product, and we find no compelling reason to create such a condition precedent judicially in the context of commercial litigation. The filing of a lawsuit is sufficient notice to encourage settlement of claims, and applicable statutes of limitation protect manufacturers from the difficulties of defending against stale claims. [Citations omitted.]

Several courts considering whether a purchaser seeking recovery under a manufacturer's warranty must give notice to the manufacturer as well as to the seller of the product under statutory provisions similar to § 4-2-607(3)(a) have reached a similar result. See, e.g., *Firestone Tire and Rubber Co. v. Cannon*, 53 Md. App. 106, 452 A.2d 192 (1982), aff'd, 295 Md. 528, 456 A.2d 930 (1983). Some courts have reached contrary results. See *Morrow v. New Moon Homes, Inc.*, 548 P.2d 279 (Alaska 1976); *Branden v. Gerbie*, 62 Ill. App. 3d 138, 379 N.E.2d 7, 19 Ill. Dec. 492 (1978); *Western Equip. Co. v. Sheridan Iron Works, Inc.,* 605 P.2d 806 (Wyo. 1980). Many such courts have recognized that in most nationwide product distribution systems, the seller/representative dealer may be presumed to actually inform the manufacturer of any major product defects. *Goldstein v. G.D. Searle & Co.*, 62 Ill. App. 3d 344, 347-48, 378 N.E.2d 1083, 1086-87, 19 Ill. Dec. 208 (1978); see also Prince, Overprotecting the Consumer? § 2-607(3)(a). Notice of Breach in Non-Privity Contexts, 66 N.C.L. Rev. 107, 151 (1987). Furthermore, as one commentator has noted, "it is perhaps more reasonable to treat notice to an immediate seller as sufficient against a remote seller than vice versa, in view of the immediacy of relation that exists in the one instance but not in the other." Phillips, Notice of Breach in Sales and Strict Tort Liability Law: Should There be a Difference?, 47 Ind. L.J. 457, 473 (1971); see also *Snell v. G.D. Searle & Co.*, 595 F. Supp. 654, 656 (N.D. Ala. 1984) (applying Alabama law); *Firestone Tire and Rubber Co. v. Cannon*, 53 Md. App. 106, 452 A.2d 192 (1982), aff'd, 295 Md. 528, 456 A.2d 930 (1983). This presumption forms the basis of the principle that a remote manufacturer may raise as its own defense the buyer's failure to give timely notice to the immediate seller. See, e.g., *Snell v. G.D. Searle & Co*., 595 F. Supp. 654, 656 (N.D. Ala. 1984) (applying Alabama law); *Owens v. Glendale Optical Co*., 590 F. Supp. 32, 36 (S.D. Ill. 1984) (applying Illinois law); *Goldstein v. G.D. Searle & Co*., 62 Ill. App. 3d 344, 347-48, 378 N.E.2d 1083, 1086-87, 19 Ill. Dec. 208 (1978). In view of the unambiguous language of § 4-2-607(3)(a), we conclude that a purchaser injured by a product is not required to give notice of such injury to a remote manufacturer prior to initiating litigation against such manufacturer.

AOSHPI urges us to adopt the rationale expressed in *Carson v. Chevron Chemical Co*., 6 Kan. App. 2d 776, 635 P.2d 1248 (1981). In that case three farmers brought suit against a herbicide manufacturer and dealer to recover damages for breach of warranties. Observing that in ordinary buyer-seller relationships the Kansas Commercial Code equivalent of § 4-2-607(3)(a) requires that notice of an alleged breach need only be given to the buyer's immediate seller, *Carson* at 1256, the Kansas Court of Appeals concluded that the plaintiffs were required to notify the manufacturer under the particular circumstances of that case. The court explained its holding as follows:

> In those instances, however, where the buyer and the other parties to the manufacture, distribution and sale of the product are closely related, or where the other parties actively participate in the consummation of the actual sale of the product, the reasons for the exclusion of such other parties from the K.S.A. 84-2-607(3)(a) notice provision cease to exist.
>
> *Id*.

In our view, the rationale of *Carson* supports the result we reach. The Kansas Court of Appeals emphasized that under the circumstances disclosed by the evidence the defendant was in effect a direct seller to the plaintiffs. Here, AOSHPI, the manufacturer, was isolated and insulated from the plaintiffs. The contract specified that Big Horn was the seller. AOSHPI, if a seller, was a seller to Big Horn, not to the plaintiffs. As far as the plaintiffs were concerned, the only direct relationship established by the contract and by the conduct of the parties was their relationship with Big Horn. Under these circumstances, to require the plaintiffs to give statutory notice to AOSHPI when not specifically required to do so by statute would unreasonably promote commercial bad faith and inequitably deprive good faith consumers of a remedy, contrary to the purpose of the statute. We reject such a construction.

Case Notes:

> 1. What about a plaintiff who is not a purchaser, but a third party beneficiary of a warranty claim under § 2-318, such as a member of the purchaser's family? Must the third party beneficiary give notice under § 2-607(3) before she can bring a claim against either the seller or the manufacturer? Several courts have not required a third party beneficiary bringing a horizontal claim under § 2-318 to provide notice, even to the seller. See *Taylor v. American Honda Motor Co., Inc.*, 555 F. Supp. 59 (D. Fl. 1982).
>
> 2. Some courts have found that notice upon a seller constituted notice against the manufacturer, on the rationale that the seller was ***the agent*** of the manufacturer. See, for example, *Church of Nativity of Our Lord v. WatPro, Inc.*, 491 N.W.2d 1 (Minn. 1992).
>
> 3. For more cases discussing the notice requirements under § 2-607(3), see Jane Massey Draper, Annotation, *Sufficiency and Timeliness of Buyer's Notice Under UCC § 2-607(3)(a) of Seller's Breach of Warranty*, 89 A.L.R.5th 319 (2001), and Wanda Ellen Wakefield, Annotation, *Necessity that Buyer of Goods Give Notice of Breach of Warranty to Manufacturer Under UCC § 2-607, Requiring Notice to Seller of Breach*, 24 A.L.R.4th 277 (1983).

16.4. Buyer's Remedy of "Cover." Section 2-712 provides the buyer's remedy of "cover," or procuring substitute goods. Where the buyer has rightfully rejected or revoked acceptance, or if the seller has failed to deliver or otherwise repudiates the contract, the buyer may ***cancel the contract*** and ***recover any portion of the purchase price paid***. In addition, the buyer may ***reasonably*** purchase substitute goods, but in doing so the buyer must act in ***good faith*** and ***without unreasonable delay***. After covering, the buyer may recover damages from seller under the following formula:

Cost of cover
- Contract price
+ incidental and consequential damages
- expenses saved by buyer

16.4.1. The substitute goods ***do not have to be identical*** with those called for under the contract. Comment 2 to § 2-712 specifies that the goods must be "commercially usable as reasonable substitutes under the circumstances of the particular case."

16.4.2. The buyer is not obligated to cover; the buyer may choose another remedy. However, if buyer fails to cover, buyer will not be able to recover those consequential damages ***which could have been mitigated by cover***. See Comment 3 to § 2-712.

16.4.3. See generally Annotation, *What Constitutes "cover" Upon Breach by Seller Under UCC § 2-712(1)*, 79 A.L.R. 4th 844 (1990).

Problem 16-3. Brianna has agreed to purchase a temperature-regulated wine storage unit, the Vintner's Deluxe, for $1,000 plus a $50 delivery fee from Serena's Cellars, payable on delivery. The unit has a glass door, black framing, and a burgundy interior, to match Brianna's redecorated kitchen. The temperature is 68° at the top (for red wine), and 48° at the bottom (for white wine). The delivery crew arrives the next day with a large box marked "Vintner's Deluxe," but when the unit is removed, it turns out to have a burnt orange interior instead of a burgundy interior, which clashes terribly with Brianna's decor. Brianna rejects the cooler. Serena calls later in the day and tells Brianna that she can't find any units with a burgundy interior; the manufacturer has stopped making that color line. Desperate to have the wine storage unit installed by the time of her scheduled "kitchen warming" party next weekend, Brianna starts looking on E-bay. After hours of searching, she finally finds a Vintner's Deluxe with a burgundy interior. She purchases it for $1,200, plus $25 in shipping and insurance costs.

1. What is the measure of Brianna's damages against Serena's Cellars under § 2-712(2)?

2. What if the cooling unit which Brianna eventually bought for $1,200 was not the exact same model as she had originally contracted for with Serena's Cellars; instead, it has capacity for 15

bottles of wine instead of 12 bottles of wine, but it was the only model she could find in the right colors?

16.5. Buyer's Remedy of Market Price Damages. As an alternative to the remedy of cover, § 2-713 allows buyer to recover damages for seller's failure to deliver or repudiation. The measure of damages is calculated using the following formula:

  Market price at the time buyer learned of breach
- Contract price
+ incidental and consequential damages
- expenses saved by buyer

16.5.1. Comment 1 states that the appropriate market to refer to in determining the market price is the place where the buyer would have obtained cover had she pursued that remedy. Comment 1 proceeds to state that this would be the place of tender, unless the goods are rejected or acceptance is revoked after delivery, in which event the market would be the place of arrival.

16.5.2. If the market price is difficult to prove, § 2-723 provides that you can refer to the price prevailing within any reasonable time or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute. However, notice must be given to the seller if buyer intends to use a time or place other than those described in § 2-713.

Problem 16-4. Let's go back to Brianna and the wine storage unit which she had agreed to purchase for $1,000, plus $50 delivery. What if the average retail price for the exact same unit was $1,200 (plus $50 delivery), but Brianna was able to find the same unit on clearance at a store going out of business for $900 (which did not offer delivery, so she borrowed a friend's pick-up and brought it home herself). Calculate her damages under § 2-712 (cover) and § 2-713 (market price). Which choice of remedies would you recommend she pursue?

Tongish v. Thomas
840 P.2d 471 (Kan. 1992)

[Tongish agreed to deliver to Decator Co-op Association [Co-op] an agreed upon amount of sunflower seeds at a specified price of $8 to $13 per hundredweight, depending upon the size of the seeds. Co-op, in turn, had agreed to deliver these seeds to Bambino Bean & Seed, Inc., for the price it paid to Tongish plus $.55 per hundredweight handling fee. Its total profit on the re-sale of the sunflower seeds would have been $ 455.51. Due to a short crop, bad weather, and other factors, the market price of sunflower seeds quickly doubled from the prices set forth in the Tongish/Co-op contract. After partially fulfilling the contract, Tongish notified Co-op he would not deliver any more sunflower seeds to Co-op and instead sold the seeds to Thomas. Tongish initially sued Thomas, but Thomas was dismissed as a defendant. Co-op intervened as a third-party defendant and claimed breach of contract by Tongish. Computation of Co-op's damages under § 2-713 (market price of $16 to $26 per hundredweight) would have amounted to approximately $8,000 in damages, versus the Co-op's actual lost profit of $455.51.]

This case presents the narrow issue of whether damages arising from the nondelivery of contracted-for sunflower seeds should be computed on the basis of K.S.A. 84-1-106 [now § 1-305] or K.S.A. 84-2-713. That is, whether the buyer is entitled to its actual loss of profit or the difference between the market price and the contract price. The trial court awarded damages on the basis of the buyer's actual loss of profit. The Court of Appeals reversed the judgment, holding that the difference between the market price and the contract price was the proper measure of damages (*Tongish v. Thomas*, 16 Kan. App. 2d 809, 829 P.2d 916 [1992]). The matter is before us on petition for review….

Following a bench trial, the district court held that Tongish had breached the contract with no basis therefor. Damages were allowed in the amount of $ 455.51, which was the computed loss of handling charges. Co-op appealed from said damage award. The Court of Appeals reversed the district court and remanded the case to the district court to determine and award damages pursuant to K.S.A. 84-2-713 (the difference between the market price and the contract price).

The analyses and rationale of the Court of Appeals utilized in resolving the issue are sound and we adopt the following portion thereof:

"The trial court decided the damages to Co-op should be the loss of expected profits. Co-op argues that K.S.A. 84-2-713 entitles it to collect as damages the difference between the market price and the contract price. Tongish argues that the trial court was correct and cites K.S.A. 84-1-106 as support for the contention that a party should be placed in as good a position as it would be in had the other party performed. Therefore, the only disagreement is how the damages should be calculated.

"The measure of damages in this action involves two sections of the Uniform Commercial Code: K.S.A. 84-1-106 and K.S.A. 84-2-713. The issue to be determined is which statute governs the measure of damages. Stated in another way, if the statutes are in conflict, which statute should prevail? The answer involves an ongoing academic discussion of two contending positions. The issues in this case disclose the problem.

"If Tongish had not breached the contract, he may have received under the contract terms with Coop about $5,153.13 less than he received from Danny Thomas. Coop in turn had an oral contract with Bambino to sell whatever seeds it received from Tongish to Bambino for the same price Coop paid for them. Therefore, if the contract had been performed, Coop would not have actually received the extra $5,153.13.

"We first turn our attention to the conflicting statutes and the applicable rules of statutory construction. K.S.A. 84-1-106(1) [now § 1-305] states:

> 'The remedies provided by this act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this act or by other rule of law.'

"If a seller breaches a contract and the buyer does not 'cover,' the buyer is free to pursue other available remedies. K.S.A. 84-2-711 and 84-2-712. One remedy, which is a complete alternative to 'cover' (K.S.A. 84-2-713, Official comment, para. 5), is K.S.A. 84-2-713(1), which provides:

> 'Subject to the provisions of this article with respect to proof of market price (§ 84-2-723), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this article (§ 84-2-715), but less expenses saved in consequence of the seller's breach.'

"Neither party argues that the Uniform Commercial Code is inapplicable. Both agree that the issue to be determined is which provision of the UCC should be applied. As stated by the appellee: 'This is really the essence of this appeal, *i.e.*, whether this general rule of damages [K.S.A. 84-1-106] controls the measure of damages set forth in K.S.A. 84-2-713.' However, Tongish then offers no support that K.S.A. 84-1-106 controls over K.S.A. 84-2-713. The authority he does cite (*M & W Development, Inc. v. El Paso Water Co.*, 6 Kan. App. 2d 735, 634 P.2d 166 [1981]) is not a UCC case and K.S.A. 84-2-713 was not applicable.

"The statutes do contain conflicting provisions. On the one hand, K.S.A. 84-1-106 offers a general guide of how remedies of the UCC should be applied, whereas K.S.A. 84-2-713 specifically describes a damage remedy that gives the buyer certain damages when the seller breaches a contract for the sale of goods.

"The cardinal rule of statutory construction, to which all others are subordinate, is that the purpose and intent of the legislature govern. [cites omitted] When there is a conflict between a statute dealing generally with a subject and another statute dealing specifically with a certain phase of it, the specific statute controls unless it appears that the legislature intended to make the general act controlling.... The Kansas Supreme Court stated in *Kansas Racing Management, Inc. v. Kansas Racing Comm'n*, 244 Kan. 343, 353, 770 P.2d 423 (1989): 'General and special statutes should be read together and harmonized whenever possible, but to the extent a conflict between them exists, the special statute will prevail unless it appears the legislature intended to make the general statute controlling.'

"K.S.A. 84-2-713 allows the buyer to collect the difference in market price and contract price for damages in a breached contract. For that reason, it seems impossible to reconcile the decision of the district court that limits damages to lost profits with this statute.

"Therefore, because it appears impractical to make K.S.A. 84-1-106 and K.S.A. 84-2-713 harmonize in this factual situation, K.S.A. 84-2-713 should prevail as the more specific statute according to statutory rules of construction.

"As stated, however, Co-op protected itself against market price fluctuations through its contract with Bambino. Other than the minimal handling charge, Co-op suffered no lost profits from the breach. Should the protection require an exception to the general rule under K.S.A. 84-2-713?

"In *Panhandle Agri-Service, Inc. v. Becker*, 231 Kan. 291, 292, 644 P.2d 413 (1982), a farmer agreed to sell 10,000 tons of alfalfa to the buyer for $ 45 per ton. At the time the seller breached the contract, the market price was $ 62 per ton. 231 Kan. at 293. The court found, pursuant to K.S.A. 84-2-713, that the damages amounted to $ 17 per ton or the difference between the market price and the contract price. The court stated: 'We find nothing which would justify the trial court in arriving at damages using loss of business profits which are consequential damages.' 231 Kan. at 298.

"In *Baker v. Ratzlaff*, 1 Kan. App. 2d 285, 564 P.2d 153 (1977), the seller contracted to sell all the popcorn planted on 380 acres for $ 4.75 per hundredweight. The seller breached, and the trial court found that the market price for popcorn was $ 8 per hundredweight when the buyer learned of the breach. The court held that the proper measure of damages would be the difference between the market price and the contract price as provided in K.S.A. 84-2-713. 1 Kan. App. 2d at 290.

"Neither *Panhandle* nor *Baker* involved a conflict between the two UCC provisions. The difference between the market price and the contract price placed the nonbreaching party in as good a position as that party would have been if the contract had been performed. The decisions can be distinguished from this case, however, in that Co-op protected itself against market price fluctuations with the Bambino contract.

"There is authority for appellee's position that K.S.A. 84-2-713 should not be applied in certain circumstances. In *Allied Canners & Packers, Inc. v. Victor Packing Co.*, 162 Cal. App. 3d 905, 209 Cal. Rptr. 60 (1984), Allied contracted to purchase 375,000 pounds of raisins from Victor for 29.75 cents per pound with a 4% discount. Allied then contracted to sell the raisins for 29.75 cents per pound expecting a profit of $ 4,462.50 from the 4% discount it received from Victor. 162 Cal. App. 3d at 907-08.

"Heavy rains damaged the raisin crop and Victor breached its contract, being unable to fulfill the requirement. The market price of raisins had risen to about 80 cents per pound. Allied's buyers agreed to rescind their contracts so Allied was not bound to supply them with raisins at a severe loss. Therefore, the actual loss to Allied was the $ 4,462.50 profit it expected, while the difference between the market price and the contract price was about $ 150,000. 162 Cal. App. 3d at 909.

"The California appellate court, in writing an exception, stated: 'It has been recognized that the use of the market-price contract-price formula under § 2-713 does not, absent pure accident, result in a damage award reflecting the buyer's actual loss. [Citations omitted.]' 162 Cal. App. 3d at 912. The court indicated that § 2-713 may be more of a statutory liquidated damages clause and, therefore, conflicts with the goal of § 1-106. The court discussed that in situations where the buyer has made a resale contract for the goods, which the seller knows about, it may be appropriate to limit 2-713 damages to actual loss. However, the court cited a concern that a seller not be rewarded for a bad faith breach of contract. 162 Cal. App. 3d at 912-14.

"In *Allied*, the court determined that if the seller knew the buyer had a resale contract for the goods, and the seller did not breach the contract in bad faith, the buyer was limited to actual loss of damages under § 1-106. 162 Cal. App. 3d at 915.

"The similarities between the present case and *Allied* are that the buyer made a resale contract which the seller knew about. (Tongish knew the seeds eventually went to Bambino, although he may not have known the details of the deal.) However, in examining the breach itself, Victor could not deliver the raisins because its crop had been destroyed. Tongish testified that he breached the contract because he was dissatisfied with dockage tests of Co-op and/or Bambino. Victor had no raisins to sell to any buyer, while Tongish took advantage of the doubling price of sunflower seeds and sold to Danny Thomas. Although the trial court had no need to find whether Tongish breached the contract in bad faith, it did find there was no valid reason for the breach. Therefore, the nature of Tongish's breach was much different than Victor's in *Allied*.

"Section 2-713 and the theories behind it have a lengthy and somewhat controversial history. In 1963, it was suggested that 2-713 was a statutory liquidated damages clause and not really an effort to try and accurately predict what actual damages would be. Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 Yale L.J. 199, 259 (1963).

"In 1978, Robert Childres called for the repeal of § 2-713. Childres, *Buyer's Remedies: The Danger of Section 2-713*, 72 Nw. U. L. Rev. 837 (1978). Childres reflected that because the market price/contract price remedy 'has been the cornerstone of Anglo-American damages' that it has been so hard to see that this remedy 'makes no sense whatever when applied to real life situations.' 72 Nw. U. L. Rev. at 841-42.

"In 1979, David Simon and Gerald A. Novack wrote a fairly objective analysis of the two arguments about § 2-713 and stated:

'For over sixty years our courts have divided on the question of which measure of damages is appropriate for the supplier's breach of his delivery obligations. The majority view, reinforced by applicable codes, would award market damages even though in excess of plaintiff's loss. A persistent minority would reduce market damages to the plaintiff's loss, without regard to whether this creates a windfall for the defendant. Strangely enough, each view has generally tended to disregard the arguments, and even the existence, of the opposing view.' Simon and Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 Harv. L. Rev. 1395, 1397 (1979).

"Although the article discussed both sides of the issue, the authors came down on the side of market price/contract price as the preferred damages theory. The authors admit that market damages fly in the face 'of the familiar maxim that the purpose of contract damages is to make the injured party whole, not penalize the breaching party.' 92 Harv. L. Rev. at 1437. However, they argue that the market damages rule discourages the breach of contracts and encourages a more efficient market. 92 Harv. L. Rev. at 1437.

"The *Allied* decision in 1984, which relied on the articles cited above for its analysis to reject market price/contract price damages, has been sharply criticized. In Schneider, *UCC § 2-713: A Defense of Buyers' Expectancy Damages*, 22 Cal. W. L. Rev. 233, 266 (1986), the author stated that *Allied* 'adopted the most restrictive [position] on buyer's damages. This Article is intended to reverse that trend.' Schneider argued that by following § 1-106, 'the court ignored the clear language of § 2-713's compensation scheme to award expectation damages in accordance with the parties' allocation of risk as measured by the difference between contract price and market price on the date set for performance.' 22 Cal. W. L. Rev. at 264.

"Recently in Scott, *The Case for Market Damages: Revisiting the Lost Profits Puzzle*, 57 U. Chi. L. Rev. 1155, 1200 (1990), the *Allied* result was called 'unfortunate.' Scott argues that § 1-106 is 'entirely consistent' with the market damages remedy of 2-713. 57 U. Chi. L. Rev. at 1201. According to Scott, it is possible to harmonize §§ 1-106 and 2-713. Scott states, 'Market damages measure the expectancy ex ante, and thus reflect the value of the option; lost profits, on the other hand, measure losses ex post, and thus only reflect the value of the completed exchange.' 57 U. Chi. L. Rev. at 1174. The author argues that if the nonbreaching party has laid off part of the market risk (like Co-op did) the lost profits rule creates instability because the other party is now encouraged to breach the contract if the market fluctuates to its advantage. 57 U. Chi. L. Rev. at 1178.

"We are not persuaded that the lost profits view under *Allied* should be embraced. It is a minority rule that has received only nominal support. We believe the majority rule or the market damages remedy as contained in K.S.A. 84-2-713 is more reasoned and should be followed as the preferred measure of damages. While application of the rule may not reflect the actual loss to a buyer, it encourages a more efficient market and discourages the breach of contracts." *Tongish v. Thomas*, 16 Kan. App. 2d at 811-17.

At first blush, the result reached herein appears unfair. However, closer scrutiny dissipates this impression. By the terms of the contract Co-op was obligated to buy Tongish's large sunflower seeds at $ 13 per hundredweight whether or not it had a market for them. Had the price of sunflower seeds plummeted by delivery time, Co-op's obligation to purchase at the agreed price was fixed. If loss of actual profit pursuant to K.S.A. 84-1-106(1) would be the measure of damages to be applied herein, it would enable Tongish to consider the Co-op contract price of $ 13 per hundredweight plus 55 cents per hundredweight handling fee as the "floor" price for his seeds, take advantage of rapidly escalating prices, ignore his contractual obligation, and profitably sell to the highest bidder. Damages computed under K.S.A. 84-2-713 encourage the honoring of contracts and market stability.

As an additional argument, Tongish contends that the application of K.S.A. 84-2-713 would result in the unjust enrichment of Co-op. This argument was not presented to the trial court.

Even if properly before us, the argument lacks merit. We discussed the doctrine of unjust enrichment in *J. W. Thompson Co. v. Welles Products Corp.*, 243 Kan. 503, 758 P.2d 738 (1988), stating:

> "The basic elements on a claim based on a theory of unjust enrichment are threefold: (1) a benefit conferred upon the defendant by the plaintiff; (2) an appreciation or knowledge of the benefit by the defendant; and (3) the acceptance or retention by the defendant of the benefit under such circumstances as to make it inequitable for the defendant to retain the benefit without payment of its value." 243 Kan. at 512.

Before us is which statutory measure of damages applies. This is not a matter of one party conferring a benefit upon another.

The judgment of the Court of Appeals reversing the district court and remanding the case for the determination and award of damages pursuant to the provisions of K.S.A. 84-2-713 is affirmed. The judgment of the district court is reversed.

16.6. Specific Performance. Specific performance is an ***equitable remedy***, exercisable within the ***discretion of the court***, if ***damages are inadequate***. Since the remedy requires the court to order the seller to perform the contract, courts are reluctant to order it since it may require court supervision. Also note that when a court awards money damages, it does not order the defendant to pay the damages. If the defendant does not pay, the plaintiff must attempt to collect the judgment. But if a court orders specific performance, then the non-complying defendant may be in contempt of court. Specific performance is often granted with respect to enforcement of a contract to buy or sell real property since each parcel of real property is unique and the court can transfer the property if the defendant refuses. The UCC employs a slightly more liberal attitude for granting specific performance. Section 2-716 provides that specific performance may be decreed "where the goods are unique" or "in other proper circumstances."

16.6.1. If specific performance is a remedy which your client will want to pursue, you may increase your client's chances of obtaining specific performance if you include a provision in the contract allowing a non-breaching party to seek specific performance. However, the parties' agreement is not binding on the court.

16.6.2. See generally Andrea G. Nadel, Annotation, *Specific Performance of Sale of Goods Under UCC § 2-716*, 26 A.L.R.4th 294 (1983).

Problem 16-5. In early February Bill agrees to purchase an original painting from Russell Chatham for $15,000. The agreement provides that Bill will pick up the painting on February 28, and will pay the purchase price at that time. On February 15, the artist writes to Bill and advises Bill that he has decided to donate the painting to a charitable auction. For this reason, he will not be delivering the painting. Would you advise Bill to file a lawsuit seeking specific performance? Why or why not?

Chapter 16. Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 17

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 6

Chapter 17. Limitation of Remedies

17.1. Freedom of Contract. Under the principle of "***freedom of contract***," the parties to a contract may agree to expand or limit otherwise available remedies. However, as we will discuss in more detail below, the principle of freedom of contract is not without limitations. For example, an ***unconscionable*** limitation of a remedy is not enforceable.

> 17.1.1. Parties to a contract may agree to ***expand or limit remedies*** otherwise available (§ 2-719(1)(a)). For example, a pizza restaurant owner who orders a custom-built brick oven may agree to the limited remedy of repair or replacement if the oven doesn't work properly.

Problem 17-1. Section 2-709 allows a seller to sue for the purchase price in only a few situations. Can the buyer agree to a clause allowing an action for the price in circumstances other than those listed in § 2-709?

> 17.1.2. Parties to a contract may agree to ***expand or limit damages*** (§ 2-719(1)(a)). For example, the parties can agree to cap damages to the purchase price of the goods involved.

Problem 17-2. The various seller remedy provisions of the UCC, such as § 2-708, limit a seller's damages to direct and incidental damages; consequential damages are excluded. Under the principle of "freedom of contract," will an agreement allowing a seller to seek consequential damages be enforced?

> 17.1.3. Parties to a contract may agree (i) to specify how damages will be calculated, or (ii) to the ***liquidation*** of damages (§ 2-718(1)). For example, if a supplier fails to timely deliver a pre-fabricated concrete form necessary to complete construction of a bridge, the contractor and supplier can agree to liquidated damages of $500 per day of delay.

> 17.1.4. Parties to a contract may agree to ***expand or limit warranties*** otherwise applicable. By limiting a warranty, you, in effect, limit a remedy. For example, a dealer selling a used car may properly disclaim any and all express and implied warranties relating to the car.

17.2. Liquidated Damages Clauses. Both common law and the UCC allow the parties to determine in advance what damages are payable in the event of breach, referred to as a "liquidated damages" clause. However, limitations apply.

17.2.1. Under § 2-718(1), an agreement to liquidate damages must be ***reasonable*** in light of:

- The actual harm caused by the breach (*i.e.*, is the liquidated damages amount proportionate to the anticipated actual damages);

- The difficulties of proof of loss (*i.e.*, are damages otherwise difficult to prove); and

- The inconvenience or nonfeasability of otherwise obtaining an adequate remedy (*i.e.*, would it be difficult, due, for example, to the nature of the goods involved, court costs or the non-residency of a defendant, to pursue other remedies).

17.2.2. Section 2-718(1) provides that "a term fixing unreasonably large liquidated damages is void as a ***penalty***." This limitation protects the doctrine of ***efficient breach***, which allows, even encourages, a party to be able to deliberately breach an agreement which may no longer make economic sense to perform, as long as the breaching party pays actual (versus punitive) damages.

17.2.2.1. See generally Kristine Cordier Karnezis, Annotation, *Contractual Liquidated Damages Provisions Under UCC Art 2*, 98 A.L.R.3d 586 (1980).

17.2.3. The "hindsight" problem. Many courts are troubled when the liquidated damages turn out to be unreasonable in light of the actual harm caused by the breach. The following case discusses this problem.

California and Hawaiian Sugar Co. v. Sun Ship, Inc.
794 F.2d 1433 (9th Cir. 1986)

NOONAN, Circuit Judge

BACKGROUND
….

C and H is an agricultural cooperative owned by fourteen sugar plantations in Hawaii. Its business consists in transporting raw sugar-the crushed cane in the form of coarse brown crystal-to its refinery in Crockett, California. Roughly one million tons a year of sugar are harvested in Hawaii. A small portion is refined there; the bulk goes to Crockett. The refined sugar – the white stuff – is sold by C and H to groceries for home consumption and to the soft drink and cereal companies that are its industrial customers.

To conduct its business, C and H has an imperative need for assured carriage for the raw sugar from the islands. Sugar is a seasonal crop, with 70 percent of the harvest occurring between

April and October, while almost nothing is harvestable during December and January. Consequently, transportation must not only be available, but seasonably available. Storage capacity in Hawaii accommodates not more than a quarter of the crop. Left stored on the ground or left unharvested, sugar suffers the loss of sucrose and goes to waste. Shipping ready and able to carry the raw sugar is a priority for C and H.

In 1979 C and H was notified that Matson Navigation Company, which had been supplying the bulk of the necessary shipping, was withdrawing its services as of January 1981. While C and H had some ships at its disposal, it found a pressing need for a large new vessel, to be in service at the height of the sugar season in 1981. It decided to commission the building of a kind of hybrid-a tug of catamaran design with two hulls and, joined to the tug, a barge with a wedge which would lock between the two pontoons of the tug, producing an "integrated tug barge." In Hawaiian, the barge and the entire vessel were each described as a Mocababoo or push boat.

C and H relied on the architectural advice of the New York firm, J.J. Henry. It solicited bids from shipyards, indicating as an essential term a "preferred delivery date" of June 1981. It decided to accept Sun's offer to build the barge and Halter's offer to build the tug.

In the fall of 1979 C and H entered into negotiations with Sun on the precise terms of the contract. Each company was represented by a vice-president with managerial responsibility in the area of negotiation; each company had a team of negotiators; each company had the advice of counsel in drafting the agreement that was signed on November 14, 1979. This agreement was entitled "Contract for the Construction of One Oceangoing Barge for California and Hawaiian Sugar Company By Sun Ship, Inc." The "Whereas" clause of the contract identified C and H as the Purchaser, and Sun as the Contractor; it identified "one non-self-propelled oceangoing barge" as the Vessel that Purchaser was buying from Contractor. Article I provided that Contractor would deliver the Vessel on June 30, 1981. The contract price was $25,405,000.

Under Article I of the agreement, Sun was entitled to an extension of the delivery date for the usual types of force majeure and for "unavailability of the Tug to Contractor for joining to the Vessel, where it is determined that Contractor has complied with all obligations under the Interface Agreement." (The Interface Agreement, executed the same day between C and H, Sun, and Halter provided that Sun would connect the barge with the tug.) Article 17 "Delivery" provided that "the Vessel shall be offered for delivery fully and completely connected with the Tug." Article 8, "Liquidated Damages for Delay in Delivery" provided that if "Delivery of the Vessel" was not made on "the Delivery Date" of June 30, 1981, Sun would pay C and H "as per-day liquidated damages, and not as a penalty" a sum described as "a reasonable measure of the damages" – $17,000 per day.

Sun did not complete the barge until March 16, 1982. Although Sun paid C and H $17,000 per day from June 30, 1981 until January 10, 1982, it ultimately denied liability for any damages, and this lawsuit resulted.

ANALYSIS

….

Represented by sophisticated representatives, C and H and Sun reached the agreement that $17,000 a day was the reasonable measure of the loss C and H would suffer if the barge was not ready. The anticipated damages were what might be expected if C and H could not transport the Hawaiian sugar crop at the height of the season. Those damages were clearly before both parties. As Joe Kleschick, Sun's chief negotiator, testified, he had “a vision” of a “mountain of sugar piling up in Hawaii” - a vision that C and H conjured up in negotiating the damage clause. Given the anticipated impact on C and H's raw sugar and on C and H's ability to meet the demands of its grocery and industrial customers if the sugar could not be transported, liquidated damages of $17,000 a day were completely reasonable.

The situation as it developed was different from the anticipation. C and H was in fact able to find other shipping. The crop did not rot. The customers were not left sugarless. Sun argues that, measured by the actual damages suffered, the liquidated damages were penal.

We look to Pennsylvania law for guidance. Although no Pennsylvania case is squarely on point, it is probable that Pennsylvania would interpret the contract as a sale of goods governed by the Uniform Commercial Code. *Belmont Industries, Inc. v. Bechtel Corp.,* 425 F. Supp. 524, 527 (E.D. Pa.1976). The governing statute provides that liquidated damages are considered reasonable “in the light of anticipated or actual harm.” 12A Pa. Cons. Stat. Ann. 2-718(1) (Purdon 1970) (Pennsylvania's adoption of the Uniform Commercial Code).

The choice of the disjunctive appears to be deliberate. The language chosen is in harmony with the Restatement (Second) of Contracts § 356 (1979), which permits liquidated damages in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. Section 356, Comment b declares explicitly: “Furthermore, the amount fixed is reasonable to the extent that it approximates the loss anticipated at the time of the making of the contract, even though it may not approximate the actual loss.”

Despite the statutory disjunctive and the Restatement's apparent blessing of it, the question is not settled by these authorities which must be read in the light of common law principles already established and accepted in Pennsylvania. *Carpel v. Saget Studios, Inc.,* 326 F. Supp. 1331, 1333 (E.D. Pa.1971); 13 Pa.C.S.A. § 1103. Prior to the adoption of the Uniform Commercial Code, Pennsylvania enforced liquidated damage clauses that its courts labeled as nonpenal, but equitable considerations relating to the actual harm incurred were taken into account along with the difficulty of proving damages if a liquidated damage clause was rejected, e.g. *Emery v. Boyle,* 200 Pa. 249, 49 A. 779 (1901). We do not believe that the *U.C.C.* overrode this line of reasoning. Indeed, in a lower court case, decided after the *U.C.C.*'s enactment, it was stated that if liquidated damages appear unreasonable in light of the harm suffered, “the contractual provision will be voided as a penalty.” *Unit Vending Corp. v. Tobin Enterprises,* 194

Pa. Super. 470, 473, 168 A.2d 750, 751 (1961). That case, however, is not on all fours with our case: *Unit Vending* involved an adhesion contract between parties of unequal bargaining power; the unfair contract was characterized by the court as "a clever attempt to secure both the penny and the cake" by the party with superior strength. *Id.* at 476, 168 A.2d at 753. Mechanically to read it as Pennsylvania law governing this case would be a mistake. The case, however, does show that Pennsylvania courts, like courts elsewhere, attempt to interpret the governing statute humanely and equitably….

The net actual damages suffered by C and H were $368,000. As a matter of law, Sun contends that the liquidated damages are unreasonably disproportionate to the net actual damages.

C and H urges on us the precedent of *Bellefonte Borough Authority v. Gateway Equipment & Supply Co.,* 442 Pa. 492, 277 A.2d 347 (1971), forfeiting a bid bond of $45,000 on the failure of a contractor to perform a municipal contract, even though the loss to the municipality was $1,000; the disproportion was 45 to 1. But that decision is not decisive here. It did not purport to apply the Uniform Commercial Code. Rules appropriate for bids to the government are sufficiently different from those applicable between private parties to prevent instant adoption of this precedent. A fuller look at relevant contract law is appropriate.

Litigation has blurred the line between a proper and a penal clause, and the distinction is "not an easy one to draw in practice." *Lake River Corp. v. Carborundum Co.,* 769 F.2d 1284, 1290 (7th Cir.1985) (per Posner, J.). But the desire of courts to avoid the enforcement of penalties should not obscure common law principles followed in Pennsylvania. Contracts are contracts because they contain enforceable promises, and absent some overriding public policy, those promises are to be enforced. "Where each of the parties is content to take the risk of its turning out in a particular way" why should one "be released from the contract, if there were no misrepresentation or other want of fair dealing?" *Ashcom v. Smith,* 2 Pen. & W. 211, 218-219 (Pa. 1830) (per Gibson, C.J.). Promising to pay damages of a fixed amount, the parties normally have a much better sense of what damages can occur. Courts must be reluctant to override their judgment. Where damages are real but difficult to prove, injustice will be done the injured party if the court substitutes the requirements of judicial proof for the parties' own informed agreement as to what is a reasonable measure of damages. Pennsylvania acknowledges that a seller is bound to pay consequential damages if the seller had reason to know of the buyer's special circumstances. *Keystone Diesel Engine Co. v. Irwin,* 411 Pa. 222, 191 A.2d 376 (1963). The liquidated damage clause here functions in lieu of a court's determination of the consequential damages suffered by C and H….

Proof of this loss is difficult – as difficult, perhaps, as proof of loss would have been if the sugar crop had been delivered late because shipping was missing. Whatever the loss, the parties had promised each other that $17,000 per day was a reasonable measure. The court must decline to substitute the requirements of judicial proof for the parties' own conclusion. The Moku Pahu, available on June 30, 1981, was a great prize, capable of multiple employments and enlarging the uses of the entire C and H fleet. When sophisticated parties with bargaining parity have agreed what lack of this prize would mean, and it is now difficult to measure what the lack did mean, the court will uphold the parties' bargain. C and H is entitled to keep the liquidated damages of $3,298,000 it has already received and to receive additional liquidated damages of $1,105,000 with interest thereon, less setoffs determined by the district court….

> 17.2.4. Deposits. Section 2-718(2) governs situations where a buyer has made a deposit on goods, and then breaches before delivery, and there is no liquidated damages clause in the agreement. In that situation, the seller may retain 20% of the purchase price or $500, whichever is smaller, and must return the balance of the deposit to the purchaser. However, § 2-718(3) provides that if the seller's damages under other Code sections are greater than those provided by § 2-718(2), the seller is free to recover damages under those sections.

Problem 17-3. A corporation entered into an agreement to purchase a used plane for $75,000, making a $10,000 down payment at the time of signing. The agreement contained a clause providing that "the deposit shall be retained by the seller as liquidated damages in the event of a breach by buyer." The buyer repudiated the contract before taking delivery of the plane. Will a court allow the seller to retain the $10,000 down payment as liquidated damages?

Problem 17-4: Nancy orders a new dryer from White's Appliance Store for a total purchase price of $600. She pays a deposit of $200. There is no liquidated damages clause in the purchase agreement. She later repudiates the contract.

1. How much of the deposit, if any, may White's retain as liquidated damages under § 2-718(2)?

2. If it has incurred damages in the amount of $200, may White's retain the entire deposit?

> 17.2.5. Section 2-302 also provides that a court may refuse to enforce an unconscionable contract. Is it possible that a clause that otherwise meets the requirements of § 2-718 may nonetheless be found to be unconscionable under § 2-302?
>
>> 17.2.5.1. Comment 1 to § 2-302 states that the test for unconscionability is "whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.... The principle is one of the prevention of oppression and unfair surprise ... and not of disturbance of allocation of risks because of superior bargaining power."
>>
>> 17.2.5.2. A novel solution to the liquidated damages problem is found in the California Civil Code (but not applicable to UCC transactions):

California Civil Code § 1671. **Validity; standards for determination; applicability of section**

(a) This section does not apply in any case where another statute expressly applicable to the contract prescribes the rules or standard for determining the validity of a provision in the contract liquidating the damages for the breach of the contract.

(b) Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.

(c) The validity of a liquidated damages provision shall be determined under subdivision (d) and not under subdivision (b) where the liquidated damages are sought to be recovered from either:

> (1) A party to a contract for the retail purchase, or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes; or
>
> (2) A party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support.

(d) In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

17.3. Limitation of Remedies under § 2-719. Section 2-719(1)(a) specifically allows the parties to (i) expand or limit ***remedies*** or (ii) limit or alter the measure of ***damages***. However, § 2-719 also imposes restrictions on this contractual freedom.

> 17.3.1. Comment 1 states that "at least ***minimum adequate remedies***" must be available under the contract. If a limitation of remedies or damages is such as to ***effectively deprive*** a party of any remedy, such limitation will not be enforceable. There must be "at least a fair quantum of remedy for breach" available. For example, a clause in a purchase agreement for a computer limiting damages to $1.00 would effectively deprive the buyer of any adequate remedy.
>
> 17.3.2. As with all contract clauses, § 2-302 also requires that any limitation or modification of remedies or damages not be ***unconscionable***. See Comment 1 to § 2-719.
>
> 17.3.3. Another limitation is found at § 2-719(1)(b), which provides that any remedies mentioned are ***optional unless*** the remedy is ***expressly agreed to be exclusive***, in which

case it is the sole remedy available. In other words, you need to clearly make a limited remedy the exclusive remedy, or it will only be one of many available.

Problem 17-5. Kodak provides, in its standard sales terms, that "If your camera is defective in materials or workmanship, we will repair your camera at no extra charge within one year after purchase. No other warranties apply." A buyer who purchased a Kodak camera which was defective sought to recover his purchase price. Applying § 2-719(1)(b), is the purchaser limited to a repair of the camera? Why or why not?

17.3.4. Another limitation on a party's ability to limit remedies is set forth at § 2-719(2). If an exclusive or limited remedy is provided, and the remedy ***fails of its essential purpose***, then the buyer may resort to any remedy as provided under the UCC. In other words, the parties are not free to provide an exclusive remedy that does not work!

Problem 17-6. Let's go back to the Kodak camera in Problem 5. Assume that the contract provided that "Buyer's sole and exclusive remedy in the event of a breach is the repair of the camera by manufacturer." If a buyer returns a defective camera and the manufacturer is not able to repair the camera, may the buyer seek a return of his purchase price? Why or why not?

17.3.5. Another limitation on the ability of the parties to limit remedies or damages by agreement is found at § 2-719(3). This provision allows ***consequential damages*** to be limited or excluded ***unless*** the limitation or exclusion is ***unconscionable***. It goes on to say that "limitation of consequential damages for ***injury to the person*** in the case of ***consumer goods*** is ***prima facie unconscionable***," whereas the limitation of consequential damages in a commercial setting is not.

17.3.5.1. Notice that § 2-719(3) allows the limitation or exclusion of ***consequential*** damages if such limitation is not unconscionable. Can you limit ***direct*** damages? ***Incidental*** damages? Yes, if such limitation is consistent with § 2-719(1). Of course, under § 2-302, any limitation of direct or incidental damages is also subject to the test of unconscionability.

17.3.5.2. The limitation or exclusion of consequential damages when ***personal injuries*** arise in connection with the sale of ***consumer goods*** is ***prima facie unconscionable.*** Section 1-201(b)(11) defines *consumer* to mean "an ***individual*** who enters into a transaction ***primarily*** for ***personal, family or household purposes***."

17.3.5.3. See Milton Roberts, Annotation, *Unconscionability, Under UCC § 2-302 or § 2-719(3), of Disclaimer of Warranties or Limitation or Exclusion of Damages in Contract Subject to UCC Article 2 (Sales)*, 38 A.L.R.4th 25 (1985).

Problem 17-7. An 18-year old high school student wants to earn some extra money, so she buys a lawn mower for $300 and does lawn work for her neighbors after school. The lawn mower comes with a one-year warranty, but limits any damages (including consequential damages) for breach of the warranty to the retail list price of the lawn mower. As a result of a defective blade, the blade shatters while the student is using it and she suffers serious personal injuries, as well as other losses, such as the lost opportunity to earn money.

Is the limitation of damages, including consequential damages, ***prima facie*** unconscionable? Why or why not?

Problem 17-8. George owns and stores a valuable gun collection in his house, and he purchases an alarm system to install in his home for the protection of this collection. The alarm system was sold with the sole and exclusive remedy of "repair or replacement of parts or the system." When a burglar arrived, the siren did not go off, nor did the system alert the monitoring agency as promised, all because of a defective battery. The manufacturer of the alarm system replaced the defective battery.

1. Is the "repair or replacement of parts or the system" a minimum adequate remedy?

2. Did the remedy fail of its essential purpose?

3. Is George entitled to recover the value of his stolen gun collection?

> 17.3.6. Often, a purchase agreement will contain a single clause which contains (i) a limited warranty, (ii) a limitation of remedy (such as repair or replacement), and (iii) a limitation of damages. The following language, which is typical of that found in purchase agreements, is based on the contractual provisions at issue in the case of *Cooley v. Big Horn Harvestore Systems, Inc.,* 813 P.2d 736 (Colo. 1991):
>
>> If within one year from the date of sale, any product sold under this purchase order, or any part thereof, shall prove to be defective in material or workmanship upon examination by the Manufacturer, the Manufacturer will supply an identical or substantially similar replacement part f.o.b. the Manufacturer's factory, or the Manufacturer, at its option, will repair or allow credit for such part. NO OTHER WARRANTY, EITHER EXPRESS OR IMPLIED AND INCLUDING A WARRANTY OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE HAS BEEN OR WILL BE MADE BY OR ON BEHALF OF THE MANUFACTURER OR THE SELLER OR BY OPERATION OF LAW WITH RESPECT TO THE EQUIPMENT AND ACCESSORIES OR THEIR INSTALLATION, USE, OPERATION, REPLACEMENT OR REPAIR. NEITHER THE MANUFACTURER NOR THE SELLER SHALL BE LIABLE BY VIRTUE OF THIS WARRANTY, OR OTHERWISE, FOR ANY SPECIAL OR CONSEQUENTIAL LOSS OR DAMAGE RESULTING FROM THE USE

> OR LOSS OF THE USE OF EQUIPMENT AND ACCESSORIES. THE BUYER RECOGNIZES THAT THE EXPRESS WARRANTY SET FORTH ABOVE IS THE EXCLUSIVE REMEDY TO WHICH HE IS ENTITLED AND HE WAIVES ALL OTHER REMEDIES, STATUTORY OR OTHERWISE.

The question which has been presented to several courts is the following: If the manufacturer is unable to repair or replace the defective goods, and thus the limited remedy has failed of its essential purpose, does the separate limitation on consequential damages fail with it? Or should the limitation on damages be enforced unless it fails on its own merits; *i.e.*, if it is found to be unconscionable?

> 17.3.6.1. The majority of jurisdictions have concluded that a limitation of remedy clause is distinct from a limitation of damages clause, even if they are commingled in a single contract provision (as above). The limitation of remedy clause must be analyzed under § 2-719(2), and if it "fails of its essential purpose," the buyer may then pursue any other available remedy. However, when the buyer pursues other available remedies, the second clause limiting consequential damages will be enforced, unless it fails the unconscionability test of § 2-719(3). See, for example, *Rheem Manufacturing Co. v. Phelps Heating & Air Conditioning*, 746 N.E. 2d 941 (Ind. 2001).

> 17.3.6.2. A minority of jurisdictions have ruled that if a limited remedy fails of its essential purpose, all other limitations stated in connection with it (such as a limitation of damages) also fail. For example, in *Cooley v. Big Horn Harvestore Systems, Inc.*, 813 P.2d 736 (Colo. 1991), from which the above language is adapted, the manufacturer could not repair the equipment as promised, and thus the remedy failed of its essential purpose. The court found that the limitation on damages was written in the context of the limitation of remedy, that they were dependent upon each other, and because the limitation of remedy failed, the limitation on consequential damages also failed.

> 17.3.6.3. A subminority of jurisdictions that strike the limited remedy also strike the limitation on damages if it is in the same paragraph, but not if it is in a separate paragraph.

Research Assignment 17-1. What is the rule in your jurisdiction? When a court strikes a limitation of remedy clause, does it also strike the limitation on consequential damages?

Problem 17-9. Chapter 17 Review Problem.

The following facts are taken from *Schlenz, v. John Deere Co.*, 511 F. Supp. 224 (D. Mont. 1981). What issues arise and how would you analyze them?

In May, 1976, plaintiff LeVon Schlenz purchased a round hay baler that was manufactured and marketed by defendants. On or about June 26, 1976, LeVon Schlenz's right forearm was severed when his arm became caught in the round hay baler. LeVon Schlenz seeks $15 million in compensatory and punitive damages. Plaintiff Delores Schlenz, the wife of LeVon Schlenz, seeks $1 million for loss of consortium.

Plaintiffs filed their complaint on April 24, 1980, slightly less than four years after the injury.

In the purchase order, defendants included language which "EXPRESSLY DISCLAIMS THE IMPLIED WARRANTIES OF MERCHANTIBILITY AND FITNESS." The accompanying warranty for the round hay baler specifically provided that defendants do "NOT MAKE ANY IMPLIED WARRANTY OF MERCHANTIBILITY OR FITNESS." In each case, the warranty disclaimers were printed in significantly larger typeface than the other printing in the body of the text. In each case, the warranty disclaimers were the only words in the body of the text printed in capital letters.

Plaintiffs state that, prior to the purchase of the round hay baler, plaintiff LeVon Schlenz received John Deere Company advertising and promotional materials, including an operator's manual for the John Deere 500 round baler. LeVon Schlenz claims that he relied on the statements in the promotional materials in deciding to purchase the John Deere 500 round baler.

The John Deere 500 round baler operator's manual specifically provides that:

> The safety of the operator was one of the prime considerations in the minds of John Deere engineers when this baler was designed. Shielding, simple adjustments, and other safety features were built into the baler wherever possible.

Defendants, by means of conspicuous language, both in the purchase order and in the attached warranty, disclaimed all express warranties.

Defendants issued a printed warranty on the John Deere 500 round baler. The warranty limited purchaser remedies to replacement or repair of defective parts. The warranty provided: "[i]n no event will the dealer, John Deere or any company affiliated with John Deere be liable for incidental or consequential damages or injuries...."

Chapter 17. Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 18

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 13-8 to 13-12

Chapter 18. Statute of Limitations

18.1. Introduction. The Article 2 Statute of Limitation provision, § 2-725, is not a model of clarity. As noted by Professor Larry Garvin in *Uncertainty and Error in The Law of Sales: The Article Two Statute of Limitations*, 83 B.U. L. Rev. 345 (2003), many courts have interpreted the various portions of § 2-725 differently. See also David J. Marchitelli, Annotation, *Causes of Action Governed by Limitations Period in UCC § 2-725*, 49 A.L.R.5th 1 (1997). A look at Amended § 2-725 indicates some of the problems that the revisers addressed and how they might be resolved. Recall that the Amendments have been withdrawn, but they could be cited as persuasive authority on the issue.

We will heed the advice of White & Summers, *Handbook of the Law under the Uniform Commercial Code* § 12-9, who say, "In summary, we can do little more than warn the lawyer not to make hasty judgments about the applicable statute of limitations or about when it will commence to run." The variables we will look at are 1) how long is its duration? 2) what event starts it running? and 3) what events toll it (keep it from running)?

18.2. Duration – How long is it? The duration of the statute of limitations under § 2-725 is ***four years***. However, by agreement, the parties may reduce the statute of limitations to ***not less than one year***, but they may ***not extend*** the statutory period. The revision would add a qualification for consumers: "in a consumer contract, the period of limitation may not be reduced."

> 18.2.1. Many states have adopted a non-uniform version of § 2-725. Note also that the general statute of limitations for a contract in many jurisdictions has a limitations period that is longer than four years; furthermore, unlike § 2-725, it might have one statute for written contracts and another for oral contracts.

Research Assignment 18-1. Check the language of § 2-725 in your jurisdiction to see if it varies from the uniform version. Also find the statute of limitations for contracts and determine how long it is and whether there is a separate statute for oral contracts.

> 18.2.2. What statute of limitations applies when a contract involves both the sale of goods and the sale of non-UCC items (such as an agreement for the sale of a ranch, including land, equipment and cattle)? First, under the principle of freedom of contract, the parties could agree whether the UCC or non-UCC law applies. Absent such an agreement, in a mixed transaction such as this, the court will apply either the "predominant factor" or "gravamen" test to determine which statute of limitations applies (see § 1.4).

> 18.2.3. Often a claim sounds in both tort and contract. For example, a purchaser of a good may assert a breach of warranty claim, a product liability claim, and a fraudulent misrepresentation claim. In that situation, which statute of limitations applies? In many jurisdictions, the injured party may elect the theory he will pursue and the statute of

limitations governing the elected theory will apply. *Weibel v. Ronan State Bank*, 776 P.2d 837 (Mont. 1989). Other jurisdictions are not as generous. Some require a lawsuit sounding in both tort and contract to be filed within the shorter statutory period of limitations. See, for example, *Becker v. Volkswagen of America, Inc.*, 125 Cal. Rptr. 326 (Ct. App. 1975), where the California court held that in a breach of warranty claim that also sounded in negligence, the shorter one-year period of limitations for negligence applied.

A person who suffers a personal injury sometimes brings a claim in tort and sometimes brings a claim for consequential damages for breach of warranty (recall *Schlenz v. John Deere* in Chapter 17 Problem 9). But if the only injury is to the goods themselves, can the claim be brought in tort? The states are split. In *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Pratt and Whitney Canada, Inc.*, 815 P.2d 601 (Nev. 1991), the Nevada Supreme Court stated:

> In a well-reasoned case, a unanimous United States Supreme Court expressed what is essentially the basis for our ruling in the instant case. The factual predicate for the court's decision in *East River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858 (1985), involved a defective first-stage steam reversing ring within one of the ship's turbines that had nearly disintegrated. The defective component damaged the turbine. Thus, although the ship itself was not damaged, property other than the defective component was damaged. The court denied liability, stating:
>
> > When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong. The tort concern with safety is reduced when an injury is only to the product itself. When a person is injured, the "cost of an injury and the loss of time or health may be an overwhelming misfortune," and one the person is not prepared to meet.

Query: Why isn't the decision of the U.S. Supreme Court mandatory authority that the states must follow? In some jurisdictions, the matter is addressed by statute. See, e.g., RCW 7.72.030.

18.3. Accrual -- What event starts it running? Under § 2-725(1), an action must be commenced within four years after ***the cause of action has accrued***. Section § 2-725(2) provides that "a cause of action accrues when the breach occurs." When does the breach occur? That depends upon the type of claim involved. You may recall that in tort, the cause of action generally accrues when the wrong is or should have been discovered. Warranty law, however, does not necessarily follow that rule.

Problem 18-1. Answer the questions below pursuant to § 2-725(2):

1. For what type of claim does the cause of action accrue when the breach is or should have been discovered?

2. For what type of claim does the cause of action accrue when tender of delivery occurs?

3. For what type of claim does the cause of action accrue when the breach occurs?

Problem 18-2. When does the cause of action accrue in the following situations?

1. The goods are delivered on October 1 but the buyer does not pay for them.

2. The goods are delivered on October 1. The buyer charges the purchase to his credit card, then does not pay the credit card debt.

3. The seller has promised to deliver the goods on October 1, but on August 1 the seller tells the buyer, "I absolutely positively will not deliver on October 1." See Amended § 2-725(2)(b).

Problem 18-3. When does the cause of action accrue for breach of the following warranties?

1. 15 year paint

2. This boat is unsinkable

3. Muffler guaranteed as long as you own your car

4. Goods are warranted to be free from defects for a period of 12 months from purchase

5. These hiking boots will survive even the toughest trail

6. Seller will repair or replace all defective parts for a period of one year from the date of delivery

7. This work was painted by John Singer Sargent.

Problem 18-4. When does a claim for breach of warranty of title and against infringement occur? For example, in January, 2008, you purchase a Blackberry. In June, 2011, you learn that Research in Motion has brought an infringement claim against Blackberry. See Amended § 2-725(3)(d).

18.4. Suits against Manufacturers and Remote Sellers. We discussed in Chapters 7 and 8 the issue of whether a buyer has a warranty claim against a remote seller; e.g. the claim of a buyer against the manufacturer or distributor rather than the immediate seller, such as the store she bought it from. For a breach of warranty claim (other than a warranty of future performance), the cause of action accrues ***when tender of delivery occurs***. Often, a company manufactures a good, then delivers it to a distributor, who delivers it to a retailer, who delivers it to the end-user. Which of these deliveries is the relevant delivery? What are the policy reasons for each view? See the Official Comment and Amended § 725(3)(b).

Problem 18-5. On September 24, 1999 Martha buys a pair of kids' pajamas from Discount Sellers. She puts them in a drawer, and they are not worn for the first time until October 11, 2000. While the daughter wearing the pajamas is putting a log in the fireplace, a spark hits the pajamas, and they go up in flames, causing serious injuries to the daughter. Which of the following events starts the running of the statute of limitations for a claim for breach of the implied warranty of merchantability against the manufacturer:

January 10, 1995	Pajamas, Inc. delivers a stock of the pajamas to The Bon Marche
March 1, 1997	Because the pajamas don't sell well, The Bon Marche delivers its remaining stock of the pajamas to Discount Seller.
September 24, 1999	Discount Seller sells the pajamas to Martha.
October 11, 2000	The injury occurs.
September 1, 2003	The lawsuit is filed.

Problem 18-6. What if a third party beneficiary brings the claim? For example, a guest in the house wears the pajamas and is injured.

18.5. Indemnity. Assume, in the above example, that the injured daughter sues Discount Seller on September 1, 2008 (within the four-year statute of limitations), and a judgment is entered against Discount Seller on January 5, 2010 (after the four-year statute of limitations has expired). Can Discount Seller now file a suit seeking indemnity against Pajamas, Inc. more than four years after the cause of action accrued?

> 18.5.1. A right to indemnity may arise by contract, or in equity. The equitable principle of indemnity "recognizes the right of one compelled to pay damages caused by another to shift the burden of that loss to the responsible party." *Jones v. Aero-Chem Corp.*, 680 F. Supp. 338 (D. Mont. 1987).
>
> 18.5.2. There is a split of authority on when a claim arising under an indemnity must be filed. Some courts have ruled that the claim for indemnity accrues only after the party seeking indemnity has been damaged (*i.e.*, a judgment has been entered against them). See, e.g., *City of Wood River v. Geer-Melkus Construction Co.*, 444 N.W.2d 305 (Neb. 1989). Under this line of cases, the statute of limitations for filing the indemnity claim

arises when the judgment (or other determination of liability, such as a settlement agreement) is entered against the party seeking indemnification. Other courts have held that a claim for indemnity must be brought within the statute of limitations governing the underlying claim. *Moroni Perry v. Pioneer Wholesale Supply Co*., 618 P.2d 214 (Utah 1984). See Amended § 725(2)(d).

18.6. Breach of Warranties for Future Performance. Generally, lack of knowledge or discovery of a breach is not a fact which will toll the statute of limitations. Section 2-725 specifically states a cause of action accrues at the time of breach, "regardless of the aggrieved party's lack of knowledge of the breach." However, there is one important exception: "where a warranty ***explicitly extends to future performance*** of the goods," then the cause of action accrues "when the breach is or should have been discovered." Once again, there is a divergence of opinions as to when a warranty is a "normal" warranty, or when it is a warranty that "explicitly extends to future performance."

18.6.1. Recall *Schlenz.* Schlenz purchased the hay baler from John Deere in May, 1976. The injury occurred on June 26, 1976. Assuming there is a 3-year statute of limitations in tort, when did the statute run on his tort claim? When did the statute run on his breach of warranty claim? The court stated that the complaint was filed on April 24, 1980, "slightly less than four years after the injury and the alleged breach of warranty." Is the date of the injury relevant? What if he had filed the complaint on June 1, 1980?

18.6.2. This issue often arises in the sale of art, as indicated in the following case.

Rosen v. Spanierman
894 F.2d 28 (2d Cir. 1990)

MESKILL, Circuit Judge

This appeal requires us to examine the New York statute of limitations for breach of warranty concerning a sale twenty years ago of a painting where the purchaser only recently learned that the painting was a fake....

BACKGROUND

….

In 1968, as an anniversary gift for her daughter and son-in-law, Norma and Hobart Rosen, Frances Lipman purchased a portrait entitled "The Misses Wertheimer" from Ira Spanierman Gallery. Ira Spanierman is the sole owner of the gallery. Hobart Rosen negotiated with Spanierman for the purchase, and when they had reached an agreement on price the Rosens instructed Lipman to send Spanierman a check for $15,000. Lipman never saw the painting prior to the purchase and had no direct dealings with Spanierman.

Spanierman prepared an invoice that contains the following warranty: "This picture is fully guaranteed by the undersigned to be an original work by John Singer Sargent." The invoice also represented that the painting had been "acquired from a member of the Wertheimer family," a fact that, if true, would enhance the value of the painting. Plaintiffs assert that Spanierman made similar oral representations to Hobart Rosen prior to the purchase. The invoice was addressed to Lipman "c/o" the Rosens, and the painting was shipped directly to the Rosen home.

Spanierman subsequently provided appraisals of the painting for insurance purposes at the Rosens' request.... The 1986 appraisal estimated the value of the painting to be $ 130,000.

In 1984 the Rosens learned that a "catalogue raisonne" of John Singer Sargent's work was being prepared. Hoping that their painting would be included, the Rosens sent photographs of it and other information to Warren Adelson of the Coe Kerr Gallery in New York, which was involved in the preparation of the catalog. The Rosens did not communicate with Adelson again regarding their painting until after they had attempted to sell it as discussed below.

The Rosens subsequently decided to sell the painting and asked for appraisals from Sotheby's Parke Bernet and Christie's Appraisals (Christie's) in New York. The appraisals ranged from $175,000 to $250,000. Upon placing the painting with Christie's for auction in 1987, however, the Rosens were informed that it was a fake. They then met with Warren Adelson of the Coe Kerr Gallery, who agreed that the painting was not an authentic work of Sargent and stated that he had immediately suspected the painting was not genuine when the Rosens first contacted him in 1984.

The Rosens commenced this action against Spanierman in 1987 for common law fraud, negligent misrepresentation, breach of warranty and professional negligence. The original complaint named only Hobart and Norma Rosen as plaintiffs. In his answer, Spanierman raised as an affirmative defense the Rosens' lack of standing to bring the suit. The Rosens amended the complaint to add Frances Lipman as plaintiff.

Spanierman denied that the painting was a fake and moved for summary judgment, asserting, *inter alia*, the bar of the statute of limitations and plaintiffs' failure to state a claim of fraud. The district court granted Spanierman's summary judgment motion and dismissed the complaint in its entirety. Lipman and the Rosens appeal only the dismissal of the fraud and breach of warranty claims.

DISCUSSION

A. *Breach of Warranty*

Under § 2-725 of New York's Uniform Commercial Code the statute of limitations on an action for breach of contract is four years from the time the cause of action accrues. N.Y. U.C.C.

§ 2-725(1) (McKinney 1964). The plaintiffs purchased the painting from Spanierman in 1968, and therefore their action clearly was untimely unless the statute was extended for some reason. Lipman and the Rosens assert that their action falls within the exception to the four year limitations period contained in subdivision two of § 2-725, which states:

> A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty *explicitly extends* to future performance of the goods and discovery of the breach *must await* the time of such performance the cause of action accrues when the breach is or should have been discovered.

Id. § 2-725(2) (emphasis added).

The district court assumed, and the parties agree, that a painting "performs" for purposes of the statute by being what it is purported to be, *i.e.*, an authentic work of the artist. *See* 711 F. Supp. at 753 (citing *Lawson v. London Arts Group*, 708 F.2d 226, 228 (6th Cir. 1983)). The district court then concluded that the statute of limitations on plaintiffs' breach of warranty claims had run because Spanierman's warranty did not explicitly extend to future performance and because discovery of the alleged defect in the painting did not necessarily await future performance. *Id.* at 754-55.

We note that the Court of Appeals for the First Circuit reached these same conclusions on nearly identical facts. *See Wilson v. Hammer Holdings, Inc.*, 850 F.2d 3, 4-7 (1st Cir. 1988) (construing Mass. Gen. L. ch. 106, § 2-725(2)); *see also Lawson*, 708 F.2d at 228 (discovery of nonauthenticity of painting did not *necessarily* await future performance). We agree with the First Circuit in its interpretation of § 2-725 as it applies to the authenticity of works of art.

1. Explicit Extension of Warranty

Lipman and the Rosens contend that Spanierman's warranty explicitly extended to future performance for three reasons: (1) authenticity is a permanent quality, and any warranty of authenticity therefore necessarily extends to the future; (2) under New York law, a warranty explicitly extends to future performance when the nature of the product implies performance over an extended period; and (3) Spanierman's subsequent appraisals indicate his intent to extend the warranty to the future and acted to revive the warranty.

The argument that a warranty of authenticity necessarily extends to future performance is unconvincing. Lipman and the Rosens are, in essence, asking us to create an exception to § 2-725's explicitness requirement when the warranty concerns an immutable quality. We decline this invitation to invade what is properly the domain of the state legislature. *See Wilson*, 850 F.2d at 6. As the district court recognized, subdivision 2 of § 2-725 is itself an exception to the general statute of limitations on breach of warranty claims. It would be inappropriate to expand this exception beyond its plain terms by dispensing with the condition that, to take advantage of the exception, the warranty *explicitly* extend to future performance. *See Stumler v. Ferry-Morse Seed Co.*, 644 F.2d 667, 671 (7th Cir. 1981) ("The mere expectation, however reasonable, that due to the type of product involved the statute of limitations on the warranty claims would not begin to run until discovery of the defect rather than upon delivery does not fit such a claim into the exception to the general rule.")

Plaintiffs maintain that a warranty of authenticity explicitly extending to future performance is difficult to imagine: it would make little sense, they assert, to warrant something as authentic "for its lifetime." But this does not present a reason for ignoring the plain language of § 2-725(2). The fact that a warranty of authenticity does not fit neatly within the statute as written does not justify judicial modification of the statute's requirements.

Plaintiffs' argument that New York law deems a warranty explicitly to extend to the future when the nature of the product implies performance over an extended period of time also is without merit. Plaintiffs rely on *Mittasch v. Seal Lock Burial Vault, Inc.*, 42 A.D.2d 573, 344 N.Y.S.2d 101 (2d Dep't 1973) (burial vault warranted to be satisfactory "at all times"), and *Parzek v. New England Log Homes, Inc.*, 92 A.D.2d 954, 460 N.Y.S.2d 698 (3d Dep't 1983) (logs guaranteed to be free from defects). The court in *Mittasch*, however, found the warranty's language to be explicit, and merely buttressed its conclusion with the fact that the nature of the product implied performance over an extended period. *See Mittasch*, 42 A.D.2d at 574, 344 N.Y.S.2d at 103. *Parzek* offers little analysis, and any statements are dicta because the court did not apply § 2-725 due to the defendant's failure to raise the statute of limitations as a defense. *See Parzek*, 92 A.D.2d at 955, 460 N.Y.S.2d at 699.

Plaintiffs' final argument fares no better. They cite no authority for their proposition that Spanierman's subsequent appraisals extended his warranty to future performance. The argument is unpersuasive because the appraisals themselves contain no warranties and the appraisals were completely separate transactions from the sale of the painting. The appraisals therefore could not, as plaintiffs maintain, revive Spanierman's original warranty.

Thus, the district court correctly held that the discovery rule of § 2-725(2) does not apply because the warranty did not explicitly extend to future performance.

2. Discovery "Must Await" Future Performance

The district court went on to hold that, even if the warranty had been explicit as to future performance, plaintiffs' discovery of the alleged lack of authenticity did not, as required by the statute, necessarily await future performance because plaintiffs could have discovered the defect immediately after the sale. 711 F. Supp. at 754. Plaintiffs contend that, to discover the alleged defect in the painting, they would have had to obtain the opinion of a second expert and that this would be an unreasonable burden to place on amateur collectors of art. They also assert that the district court was clearly erroneous, in the absence of expert testimony or affidavit, in finding that they could have discovered the alleged defect prior to their attempt to sell the painting. We reject both contentions.

Plaintiffs argue that requiring a purchaser of art to obtain a second expert opinion is unreasonable because most buyers do not call upon their paintings to "perform" until they try to sell them, and if a collector makes his purchase from a reputable dealer, he normally has no reason to suspect the authenticity of what he buys. But § 2-725(2) makes clear that it only applies where discovery of a defect *necessarily* awaits future performance. If the defect is discoverable as soon as the good is purchased, § 2-725(2) simply does not apply. *See Wilson*, 850 F.2d at 7 (purchasers of painting easily could have discovered problem). While we would hesitate to deem the alleged defect here readily discoverable if extraordinary measures were required to detect the flaw, a painting's lack of authenticity is readily apparent to the trained eye of an art expert. A purchaser who spends a considerable sum of money for a painting undoubtedly will, as the Rosens did here, obtain appraisals for insurance purposes. Requiring a purchaser to obtain that appraisal from an expert other than the seller is not an onerous burden. *See Dawson v. G. Malina, Inc.*, 463 F. Supp. 461, 463 (S.D.N.Y. 1978) (plaintiff in breach of warranty action alerted to possible lack of authenticity during same year as purchase when he showed photograph of vase to an expert)....

In sum, the discovery exception to the statute of limitations contained in § 2-725(2) does not apply, and plaintiffs' breach of warranty claims accrued at the time tender of delivery was made in 1968. The cause of action therefore is untimely. A contrary holding would provide purchasers of art with greater protection than purchasers of other types of goods, and would leave art dealers exposed to breach of warranty claims indefinitely, a result that we do not believe was intended by the New York legislature. *See Wilson*, 850 F.2d at 7 . . . .

Case Notes:

1. Section 2-725 states that creation of a warranty extending to future performance must be ***explicit***. Courts have interpreted this to mean that such language must be distinctly stated, in plain language, clear, not ambiguous, express, unequivocal. *Binkley Co. v. Teledyne Mid-America Corp.*, 333 F. Supp. 1183 (E.D. Mo. 1971)). Would it have mattered if the seller had said, "This painting is by Sargent and will continue being by Sargent"?

2. Most courts have held that warranties referencing indefinite time periods such as "in the future," "permanent," or even "lifetime" are not warranties which extend to future performance. For example, in *Spring Motors Distributors, Inc. v. Ford Motor Co.*, 465 A.2d 530 (N.J. Super. 1983) (rev'd on other grounds at 489 A.2d 660 (N.J. 1985)), the warranty booklet provided by Ford stated that "your vehicle has been designed to give long, reliable service with the simplest and least costly maintenance requirements possible." The court found this language insufficient to create a warranty "extending to future performance," noting that the key to creating a "future performance" warranty is to

state a ***specific time period***, such as "90 days" or "five years." For example, "34 months/34,000 miles" is sufficient language to create a warranty which extends to future performance. *Wienberg v. Independence Lincoln-Mercury, Inc*., 948 S.W.2d 685 (Mo. App. 1997).

See generally the cases collected in David B. Harrison, Annotation, *What Constitutes Warranty Explicitly Extending to "future performance" for Purposes of UCC § 2-725(2)*, 93 A.L.R.3d 690 (1979).

3. The majority of jurisdictions hold that an ***implied warranty*** by its nature is not an explicit guarantee of future performance, because as an implied warranty, it is not based upon any expression by the manufacturer or seller. *Williston Basin Inter. Pipeline v. Rockwell Int'l*, 1993 Mont. Dist. LEXIS 660. In one suit, homeowners who had purchased brick alleged breach of the implied warranty of merchantability due to the deterioration of the brick. The suit was commenced approximately 9 years after the brick had been delivered for the construction of the residence. The plaintiffs contended that the warranty of merchantability explicitly extended to future performance, since (1) the nature of brick is such that a buyer can reasonably expect it to last for many years, and (2) the cause of action should not accrue until the discovery of a defect. The deterioration of the brick had not begun, and was not discovered, until approximately 3 years prior to the institution of the suit. Rejecting this contention, the court observed that the term "explicit" was not defined to include mere implication, but meant that which was plain in language, unequivocal, and clear. *Beckmire v Ristokrat Clay Products Co.,* 343 N.E.2d 530 (Ill. App. 1976).

18.7. Promises to Repair or Replace. In Chapter 17 we discussed how a seller can limit the remedy for breach of warranty; for example, instead of money damages, a seller can limit the remedy to a promise to repair or replace the defective goods. For purposes of the statute of limitations, it is essential to "distinguish between a warranty as to future performance and a limitation of remedy in the form of a commitment to repair or replace for a stated period of time." Ronald Anderson, Anderson on the Uniform Commercial Code, §2-725:129 (3d ed. 1994) A warranty to repair or replace does not ensure future performance, "rather, it anticipates potential defects and specifies the buyer's remedy during the stated period." *Nebraska Popcorn, Inc. v. Wing,* 602 N.W.2d 18, 24 (Neb. 1999). In *Nebraska Popcorn,* the manufacturer of a motor truck scale provided a limited remedy that "it will repair or replace... any part... [that] is defective in material or workmanship for a period of one (1) year from date of shipment." *Id*. at 62. The court held that this was a remedy to be provided within a certain time frame, and ***not a warranty*** as to future performance because there was no explicit guarantee that the product would be free from defects for a specified number of years. See Amended § 2-725(2)(c) for the proposed rule on breach of a "remedial promise."

18.8. Tolling -- what events toll it (keep it from running)? Section 2-725(4) states that "this section does not alter the law on tolling of the statute of limitations." Tolling is an equitable concept, which prevents one party from asserting the statute of limitations as a defense if certain circumstances exist. Courts are divided on whether repair attempts toll the statute of limitations.

18.8.1. In *Holbrook, Inc. v. Link-Belt Const. Equipment Co.*, 2 P.3d 638 (Wash. App. 2000), the court stated:

> In the alternative, Holbrook argues that we should apply the "repair doctrine" to toll the four-year statute of limitations based on the repair attempts of Howard-Cooper, Link-Belt, and Isuzu. If this were the case, the statute of limitations would be tolled only if (1) "evidence reveals that repairs were attempted"; (2) "representations were made that the repairs would cure the defects"; and (3) "the plaintiff relied upon such representations." *Amodeo v. Ryan Homes, Inc.,* 595 A.2d 1232, 1237 (Pa. Super. 1991).
>
> But the repair doctrine has been endorsed in few jurisdictions. *See* 5 Ronald A. Anderson, Anderson on the Uniform Commercial Code § 2-725-131, at 295-96 (3d ed. 1994); 67A Am. Jur. 2d *Sales* § 947, at 350 (1985); Gary D. Spivey, Annotation, *Promises or Attempts by Seller to Repair Goods as Tolling Statute of Limitations for Breach of Warranty,* 68 A.L.R.3d 1277, 1280 (1976). The apparent reason that the majority of jurisdictions reject the repair doctrine is that granting exceptions to specific statutes of limitation is the prerogative of the legislature. *See Binkley Co. v. Teledyne Mid-Am. Corp.,* 333 F. Supp. 1183, 1187 (E.D. Mo. 1971), *aff'd,* 460 F.2d 276 (8th Cir. 1972). It can be argued that the repair doctrine conflicts with the purpose for applying the four-year limitations period to breach of warranty claims stated in the Official Comment to the section – to permit commercial sellers to discard their warranty records at the end of the "normal commercial record keeping period." S*ee Ogle v. Caterpillar Tractor Co.,* 716 P.2d 334, 340 (Wyo. 1986).

18.8.2. In *Sierra Diesel Injection Service v. Burroughs Corp., Inc*., 648 F. Supp. 1148 (D. Nev. 1986), a federal court applying Nevada law stated:

Other courts have accepted the proposition that repair promises and attempts can toll the running of the statute of limitations. See *Daughtry v. Jet Aeration Co*., 18 Wash. App. 155, 566 P.2d 1267, rev'd on other grounds, 91Wash.2d 704, 592 P.2d 631 (1979). Although no Nevada case directly discusses the point, this tolling concept is thus widely accepted in other jurisdictions and is found in several well reasoned cases. Where the state courts are silent on a matter, it is this Court's task to use its "own best judgment in predicting how the state's highest court would decide the case." *Fiorito Bros., Inc. v. Fruehauf Corp*., 747 F.2d 1309, 1314 (9th Cir. 1984) quoting *Takahashi v. Loomis Armored Car Service*, 625 F.2d 314, 316 (9th Cir. 1980). In that the more persuasive opinions from other jurisdictions adopt this method of tolling, the Court finds that the Nevada Supreme Court would also assume this position if it were presented with this question.

Chapter 18. Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 20

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 12-9

Chapter 19. Assignment and Delegation

19.1. Introduction. To approach assignment and delegation, it is best to break a contract down into the respective rights and duties of the parties, and to think of each of those rights and duties as a commodity that can be bought and sold. It is important to get the vocabulary down: *rights* are *assigned*, and *duties* are *delegated*.

Example. Seller agrees to sell 10 steel beams to Buyer for $10,000 on June 1. Seller has the *right* to receive payment of $10,000 on June 1, and Buyer has the *right* to receive tender of the steel on June 1. Seller has the *duty* to tender the steel on June 1, and Buyer has the *duty* to tender the $10,000 on June 1.

Those rights and duties can be assigned and delegated. Seller might notify Buyer: don't pay me, pay my creditor instead. Buyer might notify Seller: don't tender the steel to me, tender it to ABC Co. Those would be assignments of rights. Seller might notify Buyer: you won't be getting the steel from me -- you will be getting it from Steelco. Buyer might notify Seller: I won't be paying you – payment will come from ABC Co. Those would be delegations of duties.

The UCC rules determine whether those assignments and delegations are enforceable. Section 2-210 contains the rules on assignment and delegation. They are quite similar to the common law rules, and the policy strongly favors free assignment and delegation. Let's look at those rules.

19.2. Delegation of duty. Read § 2-210(1). It permits an obligor (one who is obligated to do something) to delegate a duty except in two situations:

- unless otherwise agreed
- unless the other party has a substantial interest in having his original promisor perform.

19.2.1. The second exception. We will discuss the first exception shortly. The second exception, prohibiting delegation when there is a "choice of person" sounds like it might arise frequently. In our example, Buyer might claim that it chose Seller to tender the steel because Seller is a reliable party with whom it has always dealt. On the other hand, it doesn't have as much confidence in Steelco and specifically chose not to deal with Steelco initially. Therefore, Buyer argues that it does not have to accept Seller's delegation of the duty to Steelco. Buyer will probably lose that argument. Steel beams are a commodity with certain specifications, and will be the same whether they come from Seller or Steelco.

The choice of person exception might kick in if the goods were to be specially manufactured. For example, if you ask a particular tailor to make me a handmade suit, and the tailor says, "I'm kind of busy now, so I will have the suit made by my nephew," I think you could say that you have a substantial interest in having the particular tailor make the suit. A handmade suit is not a commodity, and the quality may well be a function of the person chosen to make it.

19.2.2. The party delegating remains liable. Moreover, the last sentence of § 2-210(1) states a very important rule in delegation: No delegation of performance relieves the party delegating of any duty to perform or any liability for breach. In other words, by delegating its duty to Steelco, Seller does not step out of the picture. Seller remains liable for Steelco's performance and breach. The same is true for Buyer's delegation of the duty to pay. Buyer's delegation to ABC Co. of the duty to pay Seller does not relieve Buyer of the obligation to pay. In fact, it gives Seller two parties to whom it can look for payment.

19.2.3. Demand for Assurances. Additional protection is given to the obligee (the party to whom performance is due) by § 2-210(6). Recall the demand for assurances under § 2-609 discussed in connection with Anticipatory Repudiation in § 14.3. According to § 2-210(6), if the delegation raises reasonable grounds for insecurity, then the obligee may demand assurances from the delegatee (the party to whom the duty was delegated). In our example, if Buyer was reasonably concerned about Steelco's performance, it could demand assurances from Steelco; if it did not get reasonable assurances, presumably it could regard the delegation as ineffective.

Problem 19-1. A law student went into a bar and was approached by a derelict, who asked, "Will you buy me a drink?" The law student replied, "Sure, if you agree to pay my student loans." The derelict said, "It's a deal," and the law student bought him a drink. Is the derelict liable to pay the loans?

19.3 Assignment of rights. Read § 2-210(2). It supports assignment of rights except in two situations:

- unless otherwise agreed (and as we will see, that exception is subject to a major exception)
- unless the assignment would materially change the duty of the other party or increase the burden on him or impair materially his chance of obtaining return performance.

Normally it does not matter to an obligor to whom it tenders the goods. Especially in a shipment contract (recall from § 10.1 that this requires the seller to deliver the goods to a carrier rather than to a particular destination); it does not materially change the duty of the seller to ship the goods to A rather than to B.

19.3.1. An example of an assignment that materially changes the duty of a party might arise in the case of one business buying out another. The acquiring party assumes the rights and duties of the acquired party. Assume Smallco had a requirements contract (recall from § 2-306 that this is a provision measuring quantity by the requirements of the buyer) allowing it to buy all the steel it requires from Steelco at a certain price. Smallco is then acquired by Bigco, which claims it has been assigned the right to buy all the steel it requires from Steelco. It would seem that this assignment increases the burden on Steelco, so it would not be enforceable.

19.3.2. Frequently, the right to receive payment is assigned. A seller might, for example, assign its right to payment to a creditor. Although it is just as easy for the buyer to pay the creditor as to pay the seller, sometimes that assignment might "impair materially his chance of obtaining return performance." For example, if the seller needed the payment to buy machinery it was going to use to complete the order, then the buyer might be concerned if the seller assigned its right to the money.

19.3.3. Recall that in a delegation, the delegating party remains liable for the performance of the delegate. When a party assigns rights, however, "the assignee stands in the shoes of the assignor," and the assignor drops out of the picture. For example, Seller informs Buyer that it has assigned to Creditor its right to payment for the steel. Buyer nevertheless pays Seller. Creditor has a claim against Buyer to enforce the obligation, and Buyer would have to recover from Seller in restitution. If the steel was defective, to the extent of the amount due, Buyer would assert that claim against Creditor rather than against Seller.

Problem 19-2. Sarah sold some lawn furniture to Brenda for $2,000, which was to be paid in one month. Prior to receiving payment from Brenda, Sarah became short on cash and approached Friendly Finance. Friendly agreed to pay her $1,900 in return for an assignment to Friendly of the right to payment.

Friendly claimed payment from Brenda, who discovered that she had a breach of warranty claim against Sarah because the furniture was not as described. She figured she was damaged in the amount of $100. Can Brenda include an explanation with her payment and deduct that amount from the amount she pays Friendly?

19.4. Prohibition of assignment and delegation. Just as the default rules allow parties to freely assign and delegate, the freedom of contract rules allow parties to prohibit assignment and delegation. Recall that both subsections (1) and (2) of § 2-210 provide that an exception to the rule of free assignment and delegation is "unless otherwise agreed." There are, however, a number of limitations on a party's right to prohibit assignment and delegation.

19.4.1 There is an explicit exception to the right to prohibit the assignment of rights in § 2-210(2), which limits that right with the language "except as otherwise provided in

Section 9-406." The problem is that accounts receivable financing, which is facilitated by Article 9, depends on the availability of accounts receivables that are unencumbered by restrictions. For example, assume Steelco went to the bank to get financing. "What have you got for collateral?" the banker will ask. Steelco will respond, "We have the right to receive payment from all of our buyers, and we will be happy to assign those rights to you in order to secure our loan." That sounds good to the bank – but if there was an effective prohibition of assignment in the agreement between Steelco and its buyers, then the bank would not be able to recover from the buyer. So the drafters of Article 9 came up with a simple solution – restrictions on the assignment of accounts are not effective. Therefore it doesn't matter what the parties say in their agreement about prohibiting assignment; the statute will trump it in the case of secured financing.

19.4.2. The parties themselves sometimes get tripped up when they attempt to prohibit assignment and delegation. Instead of drafting a provision stating that assignment of rights and delegation of duties is prohibited, they state something like "This contract may not be assigned." Because rights rather than contracts are assigned, this language creates an ambiguity as to what the parties meant by the language they used. Surprisingly, this occurs frequently enough that the drafters of the Code came up with a provision that addresses it! Subsection 2-210(4) provides that "a prohibition of assignment of 'the contract' is to be construed as barring only the delegation to the assignee or the assignor's performance." So when the prohibition is drafted ambiguously, the resolution is that rights may still be assigned, but duties may not be delegated.

19.4.3. A more subtle limitation on the parties' right to prohibit assignment and delegation is the remedy awarded by some courts for breach of the prohibition. Many courts hold that delegating a duty in the face of a no-delegation clause does not make the delegation ineffective; it merely entitles the injured party to damages. In our original example, if Buyer and Seller had agreed that "delegation of duties is prohibited," and Seller nevertheless delegated to Steelco its duty to tender the steel, in such a jurisdiction, the delegation to Steelco would be effective -- Buyer would have to accept the steel from Steelco and look to Seller for any damages resulting from the breach. In other jurisdictions, the delegation would not be effective and Buyer would not have to accept performance by Steelco.

Practice tip: To make clear that an attempted delegation in the face of a provision barring delegation is not effective, the drafter should expressly provide that any attempted delegation is void.

Problem 19-3. Brenda learned her lesson and did not want to be bothered by her seller's creditors. The next time she made a contract with Sarah, she insisted that the contract state "no rights under this contract may be assigned."

1. Nevertheless, Sarah assigned the debt to Friendly. If Friendly demanded payment from Brenda, is it a good defense that the contract prohibits an assignment of rights?

2. Alternately, Brenda's next contract with Sarah stated, "This contract may not be assigned." Brenda then told Sarah that she was transferring the contract to her neighbor, who would receive the goods and make the payment. Is the transfer effective?

Research Assignment 19-1. What is the rule in your jurisdiction on the consequence of a party delegating a duty in the face of a clause prohibiting the delegation of duties?

Bel-Ray Co., Inc. v. Chemrite (Pty) Ltd.
181 F.3d 435 (3d Cir. 1999)

STAPLETON, Circuit Judge

Lubritene Ltd. ("Lubritene") and four of its directors and officers appeal the District Court's order compelling them to arbitrate claims brought against them by Bel-Ray Company, Inc. ("Bel-Ray"). Lubritene claims the District Court erroneously concluded that it was bound under its predecessor's arbitration agreement. The directors and officers contend that the District Court erred because it lacked personal jurisdiction over them, and because they are not bound by their corporate principal's agreement to arbitrate. We agree that Lubritene is bound to arbitrate this dispute and that the District Court had personal jurisdiction over the directors and officers. We conclude, however, that the directors and officers are not bound to arbitrate Bel-Ray's claims against them. Accordingly, we will affirm in part and reverse in part.

I.

Bel-Ray is a New Jersey corporation engaged in the business of manufacturing specialty lubricants for the international mining, industrial and consumer markets. Bel-Ray has developed special formulas and blending technology for its products and maintains them in the highest confidentiality. Between 1983 and 1996, Bel-Ray entered into a series of agreements with Chemrite (Pty.) Ltd., a South African corporation, for the blending and distribution of Bel-Ray products in South Africa. Ivor H. Kahn, Cesare Carbonare, Ian Robertson, and Pierre Van Der Riet (the "Individual Appellants") were officers or directors, as well as shareholders, of Chemrite.

In January of 1996, the parties entered into the most recent set of these agreements (the "Trade Agreements") by executing a (i) Distributor Sales Agreement, (ii) Blending Manufacturing License Agreement, and (iii) License Agreement to Trade Name. The Trade Agreements allowed Chemrite to market and sell Bel-Ray products, and to produce and market products under Bel-Ray's trade name in South Africa. Each agreement contains two clauses relevant to this appeal. First, each agreement required arbitration of "any and all disputes relating to th[e] agreement or its breach" in Wall Township, New Jersey. Arbitration was to proceed under the American Arbitration Association rules and New Jersey substantive law. Second, the agreements specifically require Bel-Ray's written consent to any assignment of Chemrite's interests under the Trade Agreements.

On August 20, 1996, Chemrite sent Bel-Ray a fax indicating that it had changed its name to "Lubritene (Pty) Ltd." The change became more than nominal on October 10, 1996, when Chemrite sold its lubricant business, expressly including its rights under the Trade Agreements to Lubritene, a newly formed business entity, and Chemrite entered liquidation. Lubritene continued Chemrite's lubricant business at the same location with the same employees and management, and the Individual Appellants became Lubritene shareholders, directors and officers. Lubritene and Bel-Ray continued to conduct business in the same manner under the Trade Agreements. In November of 1996, Lubritene sent Bel-Ray a package of documents that included the October 10th sale of assets documents and thereby informed Bel-Ray that Lubritene was a new and separate company.

In the Spring of 1997, the parties engaged in a series of negotiations. These negotiations were initially motivated by Bel-Ray's interest in acquiring a stake in Lubritene. When it became clear that such an acquisition was not in the cards, the negotiations turned to focus upon modifying the Trade Agreements to add additional industrial products and to extend their terms to six years. During negotiating sessions in South Africa, Lubritene representatives queried Bel-Ray representative Linda Kiefer as to whether Bel-Ray believed there was a legally binding agreement between Lubritene and Bel-Ray. According to Keifer:

> [she] explained to them that, not being an attorney, [she] could not comment on the legal enforceability of the [Trade Agreements], but told them that Bel-Ray's attorneys had advised [her] that technically and legally we do have an agreement. Moreover, [she] pointed out that both Bel-Ray and Lubritene had continued to conduct business in the same manner without interruption, since the agreements were signed ... [and] that [she] understood from Bel-Ray's attorneys that as long as we both continued to do business according to the terms of the existing agreements while we discussed a possible new relationship, Bel-Ray had an implied agreement with Lubritene on the same terms as the existing agreements with Chemrite.

Six Lubritene affiants, however, contend that Keifer stated that "technically and legally there is *no* agreement between Lubritene and Bel-Ray" because any assignment of the Chemrite agreement required Bel-Ray's written consent, which had not yet been granted.

Soon after these negotiations, a former Lubritene director brought internal corporate documents to Bel-Ray's attention. Among these documents were the minutes of a Lubritene board meeting held in anticipation of the Spring 1997 negotiations "to resolve the legal stance Lubritene (Pty) Ltd must take in respect of the Bel-Ray Company Inc[.] agreement." Lubritene's counsel advised the board at the meeting that:

> while admittedly the [Trade Agreements were] entered into between Chemrite Southern Africa (Pty) Ltd[.,] and Bel-Ray Company Inc.[,] after the deregistration/liquidation of Chemrite Southern Africa (Pty) Ltd [.], Bel-Ray still continued to deal commercially with Lubritene (Pty) Ltd and therefore, Bel-Ray's conduct has basically assumed that the assigned agreements were in fact assigned to Lubritene (Pty) Ltd.[.] However, the agreements state that the transfer of the agreements must be approved in writing by BelRay.

Id. The board then resolved to (i) liquidate Chemrite; (ii) "continue to trade with Bel-Ray Company Inc as is and not [to] suggest any changes to the current agreement when Linda Kiefer and Bernie Meeks visit South Africa in April"; (iii) create another new company and transfer all of Lubritene's business other than Bel-Ray to that company so that Lubritene "will have no assets" and "[i]f Bel-Ray decides to take legal action against Lubritene (Pty) Ltd, there will be nothing left in the company and hence Bel-Ray will not recover any damages"; and (iv) when Bel-Ray seeks to renew the Trade Agreements to inform them that the Trade Agreements were with Chemrite, "which does not exist anymore and that the agreements are no longer valid." *Id.* The minutes end by instructing that "[i]t is vital that we do not alert Bel-Ray to our plans and hence we must be very cautious and circumspect when we *ALL* meet with them in April." *Id.* (emphasis in original).

Bel-Ray alleges that these minutes and the other documents brought to them by the former Lubritene director reveal that Lubritene, and the Individual Appellants as its officers and directors, conspired to misappropriate Bel-Ray's technology and other proprietary information and intentionally defrauded Bel-Ray by leading it to believe that Lubritene would abide by the Trade Agreements. Additionally, they allege that Lubritene marketed Bel-Ray products falsely under Lubritene's trade name, and conversely marketed inferior Lubritene products under Bel-Ray's trade name thereby damaging Bel-Ray's business reputation.

Bel-Ray filed this action in the United States District Court for the District of New Jersey to compel Lubritene and the Individual Appellants to arbitrate their claims under the Trade Agreements' arbitration clauses. Bel-Ray alleges that Lubritene's actions amount to the business torts of (i) unfair competition, (ii) fraud, and (iii) misappropriation. Bel-Ray also claims that these same actions constitute breaches of the Trade Agreements.[3]

Lubritene and the Individual Appellants, jointly represented, filed an answer asserting *inter alia* lack of personal jurisdiction and counterclaims. The counterclaims alleged that Bel-Ray had commenced related proceedings in South Africa to enjoin Lubritene from continuing to use

3 Additionally, Bel-Ray alleges that Lubritene owes it $64,532.60 for products received but not paid for. These products were purchased under bills of lading between Bel-Ray and Lubritene that included arbitration clauses for disputes regarding amounts owed. The parties do not discuss these claims in their briefs to this Court. Nonetheless, it would appear that compelling arbitration of these claims was proper.

its intellectual property and trade name, and requested the District Court to either (i) stay the proceedings, or (ii) enjoin Bel-Ray from seeking to compel arbitration because it had waived its right to arbitrate by initiating the South African litigation. Two months later, the Individual Appellants filed a motion on their counterclaims requesting a stay, or alternatively, summary judgment enjoining Bel-Ray from seeking to compel arbitration.

The District Court denied the appellants' motion. Months later, the Court granted Bel-Ray summary judgment and entered an order compelling arbitration on August 10, 1998. Lubritene and the Individual Appellants appeal this order.

II.

The District Court had jurisdiction under 9 U.S.C. § 203 because this action to compel arbitration between international parties falls under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. *See* 9 U.S.C. §§ 201-208. We have jurisdiction pursuant to 28 U.S.C. § 1291. We review the District Court's summary judgment order compelling arbitration *de novo* and apply the same test that the District Court should have applied.

III.

We begin with the propriety of the District Court's order to the extent it compelled Lubritene to arbitrate Bel-Ray's claims. Under the Federal Arbitration Act ("FAA"), a court may only compel a party to arbitrate where that party has entered into a written agreement to arbitrate that covers the dispute. *See* 9 U.S.C. §§ 2 & 206. The arbitration clauses in the Trade Agreements are the only written agreements to arbitrate offered in this case. It is undisputed that these agreements were entered into by Chemrite and Bel-Ray, and that Chemrite subsequently assigned the agreements to Lubritene. If these assignments are effective, then the District Court's order should be affirmed. Lubritene, however, contends that the assignments are ineffective because Bel-Ray did not consent to the assignments in writing as the Trade Agreements require. They therefore argue that there is no written agreement to arbitrate and we must reverse the District Court's order.

Thus, according to Lubritene, this case turns on the effect to be given to the Trade Agreements' requirement that Bel-Ray consent in writing to any assignment of Chemrite's interest. As noted, the Trade Agreements are international agreements between United States and South African parties. To determine the legal effect of this provision, we must first resolve the threshold matter of which jurisdiction's contract law we should apply. Ordinarily, this would require a conflict of laws analysis to determine which state had the weightier interest in having its law apply in resolving the relevant issue. Because of a failure of proof discussed below, however, we will apply the law of the forum . . . .

Lubritene claims that it cannot be bound by Chemrite's agreement to arbitrate because, as a matter of contract law, the written consent provision prevents it from becoming Chemrite's assignee. Lubritene, however, has not raised the issue of whether South African contract law applies to its claim, nor has it provided any evidence to prove the substance of that law.[4] We therefore will apply the law of the forum….

This case was brought in New Jersey. Thus, we now turn to consider that state's contract law. The New Jersey Supreme Court has not yet addressed the effect of contractual provisions limiting or prohibiting assignments. Nevertheless, we are not without guidance because the Superior Court's Appellate Division recently addressed this issue in *Garden State Buildings L.P. v. First Fidelity Bank, N.A.,* 305 N.J. Super. 510, 702 A.2d 1315 (1997). There, a partnership had entered a loan agreement with Midatlantic Bank for the construction of a new hotel. The parties subsequently entered into a modification agreement to extend the loan's maturity date, which provided that: "No party hereto shall assign this Letter Agreement (or assign any right or delegate any obligation contained herein) without the prior written consent of the other party hereto and any such assignment shall be void." *Id.* at 1318. Midatlantic subsequently assigned the loan to Starwood without obtaining the partnership's prior written consent. The partnership acknowledged Starwood's rights under the loan agreement by making payments to, and eventually entering a settlement agreement with, Starwood. Nonetheless, the partnership filed suit against Midatlantic for damages arising from its breach of the modification agreement's assignment clause. It argued that it was not required to void the assignment, but could recognize its validity while still preserving its right to sue Midatlantic for breach of its covenant not to assign without the partnership's written consent.

To resolve this claim the Appellate Division looked to § 322 of the Restatement (Second) of Contracts, which provides in relevant part:

> (2) A contract term prohibiting assignment of rights under the contract, unless a different intention is manifested....
> (b) gives the obligor a right to damages for breach of the terms forbidding assignment *but does not render the assignment ineffective...*

Restatement (Second) of Contracts § 322 (1981) (emphasis added). The Court, distinguished between an assignment provision's effect upon a party's "power" to assign, as opposed to its "right" to assign. A party's "power" to assign is only limited where the parties clearly manifest a different intention. According to the Court:

4 The only information regarding South African law that Lubritene has provided relates to the distinct issue of successor liability. This information relates to Lubritene's claim that, if the District Court properly considered successor liability, it should have used South African, not New Jersey, law on the issue. Lubritene's primary argument, however, is that the District Court need not consider successor liability principles because this case can be resolved as a matter of contract law. In the course of making this argument, Lubritene does not raise the issue of which country's contract law applies.

> “[t]o reveal the intent necessary to preclude the power to assign, or cause an assignment violative of contractual provisions to be wholly void, such clause must contain express provisions that any assignment shall be void or invalid if not made in a certain specified way.” Otherwise, the assignment is effective, and the obligor has the right to damages.

Garden State, 702 A.2d at 1321 (quoting *University Mews Assoc's v. Jeanmarie,* 122 Misc.2d 434, 471 N.Y.S.2d 457, 461 (1984)). The Court concluded that the parties had sufficiently manifested their intent to limit Midatlantic's power to assign the loan because the anti-assignment clause clearly provided that assignments without the other party's written consent “shall be void.” *Id.* at 1322.

In adopting § 322, New Jersey joins numerous other jurisdictions that follow the general rule that contractual provisions limiting or prohibiting assignments operate only to limit a parties' right to assign the contract, but not their power to do so, unless the parties' manifest an intent to the contrary with specificity. [citations omitted.] To meet this standard the assignment provision must generally state that nonconforming assignments (i) shall be “void” or “invalid,” or (ii) that the assignee shall acquire no rights or the nonassigning party shall not recognize any such assignment. *See Garden State,* 702 A.2d at 1321 (“clause must contain express provisions that any assignment shall be void or invalid if not made in a certain specified way”); *Cedar Point,* 693 F.2d at 754 n. 4 (same); *Allhusen,* 103 N.E.2d at 893; *Sullivan,* 465 N.Y.S.2d at 238; *University Mews,* 471 N.Y.S.2d at 461. In the absence of such language, the provision limiting or prohibiting assignments will be interpreted merely as a covenant not to assign, or to follow specific procedures-typically obtaining the non-assigning party's prior written consent-before assigning. Breach of such a covenant may render the assigning party liable in damages to the non-assigning party. The assignment, however, remains valid and enforceable against both the assignor and the assignee.

The Trade Agreements in this case contain the following assignment provisions: (i) the Distributor Sales Agreement § 7.06 provides that the “Agreement and the obligations and rights under this Agreement will not be assignable by [Chemrite] without express prior written consent of Bel-Ray, which may be withheld at the sole discretion of Bel-Ray”; (ii) the Blending and Manufacturing License Agreement § 7.05 provides that the “Agreement and the obligations and rights hereunder will not be assignable by [Chemrite] without the express prior written consent of BEL-RAY”; and (iii) the License Agreement to Trade Name § 6.06 provides that the “Agreement, and the obligations and rights under this agreement will not be assignable without the express written consent of all Parties to this Agreement.” None contain terms specifically stating that an assignment without Bel-Ray's written consent would be void or invalid. Several courts have considered virtually identical clauses and concluded that they did not contain the necessary express language to limit the assigning party's power to assign.

The Trade Agreements' assignment clauses do not contain the requisite clear language to limit Chemrite's “power” to assign the Trade Agreements. Chemrite's assignment to Lubritene is therefore enforceable, and Lubritene is bound to arbitrate claims “relating to” the Trade

Agreements pursuant to their arbitration clauses. We therefore agree with the District Court that Bel-Ray was entitled to an order compelling Lubritene to arbitrate….

IV.

The order of the District Court compelling arbitration will be reversed and the case will be remanded to it with instructions to enter an order compelling only Lubritene to arbitrate.

Case Note:

Not all courts follow the Restatement rule. In *Rother-Gallagher v. Montana Power Co*., 522 P.2d 1226 (Mont. 1974), the court stated:

> Appellants further argue that the transfer of rights in the contract between the Rother companies and the partnership is not in violation of the nonassignment clause relying on the holdings of the California Supreme Court in the cases of *Trubowitch v. Riverbank Canning Co.*, 30 Cal.2d 335, 344, 182 P.2d 182, 188; *People v. McNamara Corporation Limited*, 28 Cal.App.3d 641, 104 Cal. Rptr. 822. In these cases the California Supreme Court held that where there is a transfer of an interest, or an assignment of a contract, the court will look to see how it affects the interests of the parties by the nonassignability clause of the contract and will allow it if it can be made without a change of the beneficial interest in and to the contract.
>
> However, as argued by the respondent, this is not the law of Montana. We do not follow *Trubowitch*. Rather it has long been the law of this state established in 1912 by the case of *Winslow v. Dundom*, 46 Mont. 71, 82, 125 P. 136, that provisions for nonassignment in a contract will be upheld. The key case, *Standard Sewing-Machine Co. v. Smith*, 51 Mont. 245, 248, 152 P. 38, holds that nonconsent to assignment (where nonassignability is set forth in the contract) destroys or precludes the establishment of privity between an alleged assignee and the other party.

Problem 19-3. Review Problem: Assignment and Delegation

A Law School administration invited White & Summers to deliver a commencement address on the topic of sales law, for which they would be paid a fee of $1,000. No other terms were discussed. The Law School ordered a case of champagne and various hors d'oeuvres from ABC Catering, Inc. for a reception following the address.

A month before commencement, White & Summers informed the Law School that they were asking Scott Burnham to speak in their place and that they wanted the fee to be donated to the

University of Michigan. At the same time, ABC Catering informed the Law School that it was asking XYZ Catering to handle the reception.

When the law students heard about those events, they sought an injunction to prevent the transfers. They stated in their application that they strongly preferred the views of White & Summers to those of Burnham, that they had had bad experiences with XYZ Catering, and that they disliked the Michigan football program.

You are the judge. You have called the students and all the parties in for a conference. Explain to them what issues you perceive, and how you view their rights and obligations.

Chapter 19. Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 19

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 4-13

Chapter 20. Article 2A -- Leases of Goods

20.1. History of Article 2A. In the 1980s, commercial leasing of goods became wide-scale. For example, most airlines began to lease, rather than buy, their fleet of airplanes. Leasing became popular for several reasons, including tax and accounting advantages. Although Article 2 in § 2-102 purports to apply to "transactions in goods," most operative provisions relate only to sales of goods. For example, the definition of "contract" and "agreement" under § 2-106 are limited to those relating to the sale of goods. To govern leases of goods, the Uniform Law Commission promulgated Article 2A in 1987, and revised it in 1990. Currently, every state except Louisiana has enacted Article 2A. Amended Article 2A, like Amended Article 2, has been withdrawn from consideration.

20.1.1. For further reading on Article 2A, see Amelia H. Boss and Stephen T. Whelan, The ABCs of the UCC: Article 2A Leases, Kelly S. Murphy, *Survey: Lease Law*, 16 U. Ark. Little Rock L. Rev. 153 (1994), and Michael I. Spak, *Pledge Allegiance to the Code: Dodging the Draft with Liberty and Leases for All*, 13 J. L. & Com. 79 (1993).

20.2. Definition of Lease. It is important to initially distinguish between a ***lease*** and a ***sale with a reservation of a security interest***, because the rights of the parties and the rights of third parties vary depending upon the type of transaction involved. The UCC looks at the substance of the transaction, and not the form of the transaction or what the parties may call it. For example, if a law firm enters into a 24-month "lease" of a copy machine, with the right to purchase it for $1.00 at the end of the term, this will be treated as a sale rather than a lease, regardless of the title of the agreement.

20.2.1. Section 2A-103(1)(j) defines a "lease" as "a transfer of the right to possession and use of the goods for a term in return for some consideration." The crucial factor is that in a true lease, the lessor enjoys a reversionary interest in the property; that is, it will come back to the lessor at the end of the lease.

20.2.2. The definition adds that "a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease."

20.2.2.1. A "sale" is defined at § 2-106(1) as "the passing of title from the seller to the buyer for a price."

20.2.2.2. "Security interest" is defined in § 1-201(b)(35) as "an interest in personal property or fixtures which secures payment or performance of an obligation." Section 1-203, "Lease Distinguished from Security Interest," elaborates on the distinction.

20.3. Lease or Security Interest? Section 1-201(b)(35) defines a "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation." The problem is that like goods subject to a security interest, the goods subject to the lease may be repossessed if the lessee does not pay. But unlike the creditor obtaining a security interest, the lessor does not have to file notice of its interest to have priority over other creditors or to recover the goods in bankruptcy. It is usually another creditor with an interest in the goods or the bankruptcy trustee who claims that the alleged lease is really a security interest. The real work of "sharpening the line between true leases and security interests disguised as a lease," in the words of Official Comment 2, is done at § 1-203.

20.3.1. While there are a number of tests we will look at, these tests are always subject to the principle found in § 1-203(a) that the issue "is determined by the facts of each case."

Several courts have noted that the key aspect of a true lease is whether the lessor retains a meaningful residual interest. As stated by E. Carolyn Hochstadter Dicker & John P. Campo in *FF&E and the True Lease Question: Article 2A and Accompanying Amendments to UCC Section 1-201(37)*, 7 Am. Bankr. Inst. L. Rev. 517 (1999), "[c]ourts interpreting both Old and New UCC 1-201(37) [§ 1-203] have consistently held that the principal characteristic of a lease, which distinguishes it from a secured transaction, is that it allows the lessee the right to use the leased property with an attendant opportunity to return the property to the lessor while it still has 'substantial useful economic life.'"

20.3.2. Section 1-203 establishes a ***two-prong*** objective test to determine whether a transaction is a lease or a sale with a retained security interest in the seller. The first step under § 1-203(b) is to determine if the obligation of the lessee to make rental payments ***is terminable by the lessee*** during the term of the lease. ***If yes***, then the transaction is a true lease. ***If no***, the purported lease is a sale ***if*** any one of four other tests, listed at § 1-203(b)(1) through (4), is satisfied.

Remember**:** you only get to these additional tests if the first prong is met, *i.e.*, if the lessee's obligation to make rental payments during the term of the lease is *not* subject to termination by the lessee.

- The first test is to determine whether the original lease term is equal to or greater than the remaining economic life of the goods.

- The second test is to determine whether the lessee is either bound to renew the lease at the end of the original term for the remaining economic life of the goods or to become the owner of the goods. For example, a clause requiring the lessee to purchase the goods at the end of the lease would satisfy this test.

- The third test is to determine whether the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration.

- The fourth test is to determine whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration.

20.3.3. Application of the foregoing tests requires an analysis of the "remaining economic life" of the leased property and whether the consideration to be paid under a purchase or renewal option is "nominal."

20.3.3.1. Section 1-203(d) provides that additional consideration is ***nominal*** if it is less than the lessee's reasonably predictable cost of performing if the option is not exercised. Additional consideration is not nominal if the renewal rental or optional purchase price is based upon predicted fair market values at the time the option is to be performed.

20.3.3.2. Section 1-203(e) provides that "remaining economic life" and "fair market value" are determined with reference to the facts and circumstances ***at the time the transaction is entered into***.

20.3.4. Finally, § 1-203 sets forth certain factors which do not, in and of themselves, turn a lease into a sale with a retained security interest. For example, if the lessee agrees to assume the risk of loss of the goods, or to pay insurance and maintenance costs during the term of the lease (normally an incident of ownership), these facts alone do not make the purported lease a disguised sale.

20.3.5. The § 1-203 factors are discussed at length in E. Carolyn Hochstadter Dicker & John P. Campo, *FF&E and the True Lease Question: Article 2A and Accompanying Amendments to UCC Section 1-201(37)*, 7 Am. Bankr. Inst. L. Rev. 517 (1999).

Problem 20-1. As graduation day approaches, you decide to acquire your dream car, a 2008 Volkswagen 2.0 turbo Passat, which retails for $24,975. Since you don't have that much cash now, and you don't want to borrow any more money until you make a dent in your law school loans, you consider a lease on the following terms: $399.00/month for 36 months, plus an up-front payment of $2,000. As lessee, you would be responsible for insurance, maintenance and repairs. At the end of the 36-month lease, you will have an option to purchase the vehicle or return it to the dealer. Considering the following variables, is this a "lease" governed by Article 2A, or a "disguised security interest sale" governed by Articles 2 and 9?

1. You can cancel the lease at any time during the 36 month period, as long as you pay a $1,000 fee for early termination.

2. You cannot cancel the lease during its term, and must continue to make payments even if the vehicle is damaged. At the end of the lease, you have the option to purchase the car for its then "blue book" retail value.

3. You cannot cancel the lease during its term, and must continue to make payments even if the vehicle is damaged. At the end of the lease, you have the option to purchase the car for $100.

20.4. Consumer Leases. Once it has been determined that the transaction is a lease, the next step is to determine whether it is a "consumer lease." There are special rules applicable under Article 2A to consumer leases. For example, § 2A-106 invalidates a choice of law clause, except where the law chosen is that of the state of the consumer's residence or where the goods will be kept. A forum selection clause is limited to those forums which would (absent the forum selection clause) otherwise have jurisdiction over the consumer. As another example, § 2A-108, Unconscionability, provides in subsection (2) that in a consumer lease unconscionable acts include those in inducing the contract or collecting a claim, and subsection (4) provides for recovery of attorney's fees.

> 20.4.1. Section 2A-103(1)(e) defines a "consumer lease" as "a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a personal, family, or household purpose [if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed ______]." Each state has the option to establish a point at which the amount of money involved takes the lease out of being a consumer lease. For example, Washington filled in the bracketed language with $25,000. Wash. Rev. Code § 62A.2A-103(1)(e) (2013).

Problem 20-2. Jim enters a 36-month lease at $150/month for a 4-wheeler. Jim intends to use the 4-wheeler to get around his apple orchard, and for recreational purposes on weekends and whenever else he can get away. Is this a consumer lease?

Problem 20-3. Jim, who lives in Spokane, Washington, leases a 4-wheeler for personal purposes from a business located in Idaho. The lease provides that any lawsuit arising out of the lease will be governed by Idaho law and resolved in an Idaho court. Is either of these provisions enforceable?

20.5. Finance Leases. Article 2A also defines a special type of lease at § 2A-103(1)(g), the ***finance lease***. As noted in Official Comment (g) to § 2A-103, a typical finance lease involves three parties: (i) the seller ("supplier") of the equipment, (ii) a third party, whose purpose is to finance the purchase price of the equipment and who serves as lessor; and (iii) the lessee, who selects the supplier and the equipment, and who uses the equipment. In effect, the lessee is relying upon the seller/ supplier to provide the goods and to stand behind any warranties relating to the goods, and is relying upon the lessor as the source of financing of the goods. Thus, Article

2A limits the ability of the lessee to bring a breach of warranty or other type of claim against the lessor, who is intended to be a financier rather than a supplier of the goods.

Problem 20-4. Sam manufactures refrigerated units for the storage of medicine, specially designed to meet the space requirements and storage needs of each particular hospital which buys his products. Sam agrees to manufacture storage equipment for use by Happy Hospital. To stay within the equipment budget adopted by its Board of Directors, Happy Hospital indicates to Sam that it wants to enter into a lease instead of buying the equipment. Sam needs the money from the sale to finance his expanding operations, and isn't willing to enter a lease, but he has worked in the past with a company which buys hospital equipment for re-lease to hospitals. Accordingly, Sam enters into an agreement to sell the specially manufactured equipment to Finance Company for cash, who then turns around and leases the equipment to Happy Hospital.

1. Who is the "supplier" (§ 2A-103(1)(x))?

2. What is the "supply contract?" (§ 2A-103(1)(y))?

3. Who is the "lessor?" (§ 2A-103(1)(p)?

4. Who is the "lessee?" (§ 2A-103(1)(n))?

5. If the refrigerated units turn out to be defective, can Happy Hospital sue Finance Company for breach of warranties? Sam? See § 2A-103(1)(g)(iii).

20.6. Lease-Purchase Agreements. A number of jurisdictions regulate "rent to own" transactions. In these transactions, the consumer leases the goods for a period of time that is up to the consumer, but if she leases them for a certain period of time, she becomes the owner of the goods. See, e.g., Wash. Rev. Code § 63.19 (2013). Courts in those jurisdictions have tended to read these types of acts as providing "cumulative" remedies or requirements to those supplied by other statutes, such as the UCC or statutes regulating consumer sales or retail installment contracts. See, e.g., *Miller v. Colortyme*, 518 N.W.2d 544 (Minn. 1994). If you represent a client in this type of business, you should advise the client to abide by all applicable statutes. Thus, an agreement falling under both the UCC (as a consumer lease or as a sale with a retained security interest) and this act should be drafted in a manner which complies with both regulatory schemes.

Research Assignment 20-1. Find out whether your jurisdiction regulates "rent-to-own" transactions. If so, note the limited scope of the statute, in terms of what is and what is not included, and note which provisions of the act merely require disclosures and which are regulatory. What are the remedies for violation of each type of provision?

Problem 20-5. A rent to own agreement conspicuously discloses, among other things, that the cash price of a television set is $520, that if the lessee makes 52 weekly payments of $20 the lessee acquires ownership, and that until the amount of $1,040 is paid, the lessee has no ownership interest. Is the lessor in violation for failing to disclose that the effective interest rate is 250%?

20.7. Provisions of Article 2A. Most of the provisions of Article 2A are analogous to the comparable provision of Article 2, with changes to accommodate the fact that the article is dealing with leases rather than sales, and sometimes to update or clarify a provision. A couple of examples of the latter are that the dollar amount to bring a transaction within the Statute of Frauds in § 2A-201(1) is $1,000, and the Exclusion of Warranties in § 2A-214 requires that both the disclaimer of the implied warranty of merchantability using the word *merchantability* and the disclaimer using the term "as is" be by a conspicuous writing.

This similarity is by design. The Official Comments to Article 2A provisions begin with a "Uniform Statutory Source" that cites the analogous Article 2 provisions. The "Changes" and "Purposes" in the Official Comment typically explain how the sales provision was modified to be applicable to a lease transaction, and the reason for the modification. Finally, the "Cross References" and "Definitional Cross References" typically cite the appropriate Article 2 analogue.

Problem 20-6. Look at § 2A-201, the Statute of Frauds. What differences between that provision and § 2-201 do you see? How do the Official Comments help you understand the provision?

20.8. Remedies. The remedies provisions of Article 2A are analogous to those of Article 2, but notice that the expectancy of the lessor is to have an income stream in the future. Thus, the concept of ***present value*** must be used when computing future losses. Section 2A-501(1) states that default is determined by the agreement and by Article 2A. More so than in sales transactions, parties to a lease often define events of default by contract. For example, the lease may provide that it is an event of default for the lessee to fail to insure the leased goods or to move them to a different location.

The significant remedy provisions with their Article 2 analogues are as follows:

20.8.1. Lessee's remedies. Section 2A-508 [cf. § 2-711] is an overview of Lessee's remedies for Lessor's default.

> 20.8.1.1. Cover. Section 2A-518 [cf. § 2-712]. The formula is:
>
> present value of rent for the comparable term under the new lease agreement
> - present value of rent for the remaining term of the original lease agreement
> + incidental and consequential damages
> - expenses saved

The replacement lease must be "substantially similar." Note that damages are calculated "as of the date of the commencement of the term of the new lease agreement."

20.8.1.2. Market. Section 2A-519 [cf. § 2-713]. The formula is:

present value of the market rent for the comparable period
- present value of rent for the remaining term of the original lease agreement
+ incidental and consequential damages
- expenses saved

Note that damages are calculated by the market rent "as of the date of the default."

20.8.1.3. Breach of warranty. Section 2A-519(4) [cf. § 2-714]. The formula is:

present value if the goods had been as warranted for the lease term
- present value of the use of the goods accepted
+ incidental and consequential damages
- expenses saved

20.8.1.4. Lessee's incidental and consequential damages. Section 2A-520 [cf. § 2-715].

Problem 20-7. On January 1, Lessor leases equipment to Lessee for 12 months at $500 per month. On June 30, Lessor breaches. On August 1, Lessee leases substantially similar equipment for 12 months at $700 per month. What are Lessee's cover damages?

Problem 20-8. On January 1, Lessor leases equipment to Lessee for 12 months at $500 per month. On June 30, Lessor breaches. Lessee decides not to lease substitute goods. If it had, it would have paid $700 per month. What are Lessee's market damages?

20.8.2. Lessor's remedies. Section 2A-523 [cf. § 2-703] is an overview of Lessor's remedies for Lessee's breach. Under § 2A-523(2), "the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner." This is often the lost rent.

20.8.2.1. Repossession and Disposition. Sections 2A-525 to 527 [cf. § 2-706]. The formula is:

unpaid rent
+ the present value of the total rent for the remaining lease term of the original lease
- the present value of the rent under the new lease for the comparable period
+ incidental damages
- expenses saved

Note that incidental damages under § 2A-530 includes expenses of the default and disposition. Note also that consequential damages are not recoverable.

20.8.2.2. Market. Section 2A-528 [cf. § 2-708]. The formula is:

unpaid rent
+ the present value of the total rent for the remaining lease term of the original lease
- the present value of the market rent for the comparable period
+ incidental damages
- expenses saved

Section 2A-528(2) [cf. § 2-708(2)] provides for "lost profit" for a volume lessor.

20.8.2.3. Action for the rent. Section 2A-529 [cf. § 2-709]. The present value of the promised rental amount is available under subsection (1)(a) where the lessee has possession of the goods, or the goods have been lost or damaged after the risk of loss passed to the lessee; and under subsection (1)(b) where the lessor is unable to dispose of the goods or the circumstances indicate that effort to do so would be unavailing. The lessor may also recover incidental damages but must deduct expenses saved.

208.2.4. Lessor's incidental damages. Section 2A-530 [cf. § 2-710].

Problem 20-9. On January 1, Lessor leases a computer to Lessee for 24 months at $100 per month. After one year, the computer has become obsolete, so Lessee cancels the lease and returns the computer. After spending $150 advertising the sale, Lessor holds a sale of the computer but no one buys it. What are Lessor's damages?

Problem 20-10. On January 1, Lessor leases equipment to Lessee for 12 months at $500 per month. On June 30, Lessee breaches. Lessor recovers the goods and on August 1 re-leases them for $400 per month. Lessor spent $600 to recover the goods and to dispose of them. What are Lessor's damages?

Chapter 20. Additional Sources

Scott J. Burnham, *Glannon Guide to Sales: Learning Sales Through Multiple-Choice Questions and Analysis* (Wolters Kluwer 2d ed., 2012), Chapter 21

James J. White and Robert S. Summers, *Uniform Commercial Code* (West 6th ed., 2010), Chapter 22-3 (issue of true lease or security interest)