that section 2-403 could possibly be rewritten to capture these instances with a greater degree of precision. Perhaps all that is necessary is an explicit recognition of the applicability of the doctrine of estoppel, which is presently implicit in the subsection (1) phrase "or had power to transfer."[265]

It is also the opinion of the Task Force that disputes involving secured parties are better left to Article 9. Presumably, the drafters enacted section 9-307 for a reason.[266] If that section is now deemed inadequate, it is wise and desirable to redraft it directly, not indirectly through Article 2. To do otherwise risks compromising the internal structure and harmony of Article 9.

*[PRELIMINARY REPORT - 2-501]*

## *ARTICLE 2, PART 5: PERFORMANCE*

### *A. INTRODUCTION.*

*Article 2, Part 5 contains 15 sections dealing with "performance" of the contract for sale, including §§ 2-509 and 2-510 which cover risk of loss. We will discuss each of these sections seriatim.*

### *B. INSURABLE INTEREST IN GOODS; MANNER OF IDENTIFICATION OF GOODS: § 2-501.*

*Rec. A2.5 (1).*

***No revisions are recommended in the text of § 2-501. Some clarifying revisions in the comments are suggested.***

*The time when "existing" goods are identified to the contract is determined under § 2-501(1). As with title, § 2-401, identification can be made by explicit agreement or, in the absence of agreement, under the rules in § 2-501(1). Upon identification, the buyer obtains both "a special property interest and an insurable interest" in the goods. No serious problems have arisen in the judicial determination of whether identification has occurred.*

*One consequence of identification is that the buyer has a "special property" interest in the goods. This interest enhances the buyer's rights and*

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265 U.C.C. § 2-403(1) (1990).

266 Section 9-307 is Article 9's way of internally dealing with buyers of goods in the ordinary course of business. *See* U.C.C. § 9-307 (1990).

*remedies under the provisions of Article 2, especially where it permits the buyer to take possession of the goods.*[1]

***(A) For clarity, we recommend that all references in Article 2 to "identification" and its effect be collected in a new Comment to § 2-501.***

*Another consequence of identification is that the buyer has an "insurable interest" in the goods. Article 2 does not deal explicitly with insurance, although its availability is assumed in the risk of loss sections.*

***(B) The Study Group endorses the expandable notion of insurable interest in § 2-501(3) and would purge from the comments any suggestion that the insurable interests described in § 2-502(2) limit the general scope of that concept.***

[TASK FORCE - 2-501]

ARTICLE 2 - PART 5

SECTION 2-501

The Task Force agrees with the Study Group's recommendation that all references to "identification" in Article 2 be collected in a new comment to section 2-501.

This useful cross-reference would be helpful because the concept of "identification," although independently insignificant, becomes significant through the application of various Code sections.[266] In particular, identification signifies the moment when the buyer acquires a "special property" interest in the goods.[267] This is the conceptual springboard that takes the buyer from a mere expectation of receiving conforming goods to a cognizable interest in particular goods.[268]

*[PRELIMINARY REPORT - 2-502]*

*C. BUYER'S RIGHT TO GOODS ON SELLER'S INSOLVENCY: § 2-502.*

***Rec. A2.5 (2).***

***(A) The Study Committee recommends that § 2-502 be deleted.***

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*1. See Daniel v. Bank of Hayward, 144 Wis.2d 931, 425 N.W.2d 416 (1988)(holding that the buyer became a BIOCB at the time of identification).*

266 *See, e.g.*, U.C.C. §§ 2-401(1), 2-502 & 2-716(3) (1990) (each of these Code sections is based upon the concept of identification).

267 *See* U.C.C. § 2-501(1) (1990).

268 *See* U.C.C. §§ 2-105(2), 2-501(1) (1990).

*Section 2-502 is the buyer's counterpart to the seller's reclamation right under § 2-702(2). Limitations upon its application (goods must be identified, buyer must have advanced all or part of the price and rights terminate 10 days "after receipt of the first installment on their price") and doubts about its enforceability in bankruptcy[2] prompt the recommendation to delete.*

*Even with § 2-502, the rights of the pre-paying or financing buyer of goods are quite limited under Article 2. The question is whether adequate protection against the seller and creditors of the seller should be obtained by revisions in Article 2 or by revisions in Article 9.*

***(B) The Drafting Committee recommends that Article 9 rather than Article 2 be revised to provide adequate protection to the pre-paying or financing buyer.***

[TASK FORCE - 2-502]

SECTION 2-502

Most members of the Task Force agree with the Study Group's recommendation to delete section 2-502. The potential bankruptcy problem (it raises both a statutory lien[270] as well as a voidable preference[271] problem) is substantial, given the fact that the seller's default, upon which the buyer's right to seller's property under this section depends, will most likely be the seller's bankruptcy.

Further, the recommendation that Article 9, and not Article 2, should be the proper vehicle for solving this problem would appear to be correct because the problem is not one of sales, but one of security. Under this section, the buyer is asserting a right to property of the seller that probably is subject to competing creditors' claims.[272] The priority of the buyer's claim as against either the seller or the seller's other creditors is a question that in any other context would be resolved through the structure of Article 9.

There is, therefore, some concern on the Task Force that a gap will exist in the scope of the buyer's protection until a corresponding change is made in Article 9. Thus, at least one member does not support deletion of section 2-502 until a revision of Article 9 is drafted.

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*2. See Levy, Impact of the New Bankruptcy Code on Article 2, Sales, 14 U.C.C. L.J. 307, 336-38 (1982)(trustee as creditor of seller could avoid reclamation claim).*

270 11 U.S.C. § 545 (1984).

271 11 U.S.C. § 547 (1986).

272 U.C.C. § 2-502 (1990).

*[PRELIMINARY REPORT - 2-503]*

*D. MANNER OF SELLER'S TENDER OF DELIVERY: § 2-503.*

***Rec. A2.5 (3).***

***Minor revisions are recommended in the text of and comments to § 2-503.***

*Section 2-503 is an important and complex provision. Without a proper tender of delivery, the buyer has no duty to accept and pay for the goods. § 2-507(1). In addition, an improper tender may permit the buyer to reject the goods or delay passage of the risk of loss. Clarity and commercial reasonableness in these provisions, therefore, are important.*[3]

*No serious problems have emerged in the interpretation and application of § 2-503 by the courts. Some minor issues have arisen, however, and clarifications are required.*

*1. Without FOB terms in the agreement, § 2-319(1), it is not clear when a seller who is authorized to ship the goods is "required to deliver at a particular destination." § 2-503(3). Comment 5 to § 2-503 provides a rule for construction, i.e., that the FOB shipment contract is regarded as normal.*[4]

***(A) We reiterate our recommendation [see A2.3(1)], that this rule of construction be placed in the text of either § 2-319(1) or § 2-503.***

*2. In § 2-503(4), the term "bailee" is not defined. This has caused some confusion in risk of loss cases. In § 2-504(4)(a), it is not stated to whom the bailee's acknowledgment must be made, the seller or the buyer. This same omission appears in § 2-509(2)(b), and has produced at least one major law suit.*[5]

***(B) We recommend that the Drafting Committee prepare a definition of "bailee" for purposes of § 2-503, with appropriate variations for risk of loss issues. In addition, we recommend that § 2-503(4)(b) and § 2-509(2)(b) be revised to state that the bailee's acknowledgment must be "to the buyer." Neither section makes sense unless the buyer knows of the acknowledgment.***

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*3. The statute of limitations begins to run at the time of tender of delivery, even though the tender is improper. § 2-725(1).*

*4. Accord, Ladex Corp. v. Transportes Aereos Nacionales, S.A., 476 So.2d 763 (Fla. App. 1985).*

*5. Jason's Foods, Inc. v. Peter Eckrich & Sons, Inc., 774 F.2d 214 (7th Cir. 1985)(interpreting § 2-509(2)(b) to require an acknowledgment to the buyer).*

*3. Section 2-503(5) applies when the "contract requires the seller to deliver documents. . . ."*

***(C) The Study Group recommends, at the maximum, that all Article 2 sections dealing with documentary transactions be integrated in a separate Part to Article 2. At the minimum, all sections dealing with documentary transactions should be organized in a single new comment to § 2-503. Clear and complete cross references to Article 7 should also be included.***

[TASK FORCE - 2-503]

SECTION 2-503

Comment 5 of section 2-503 states that, unless otherwise denoted, a contract in which the goods are to be shipped is presumed to be a shipment contract and not a "destination" contract. The fact that this rule of construction is in the comments and not the text has not been a problem as far as interpretation is concerned. This result is, therefore, generally assumed to be the case. However, moving this rule from the comments to the Code will eliminate any argument about the validity of this comment as authority. This recommendation by the Study Group is more of a technical correction than a substantive change and, therefore, should not cause any concern.

The Task Force supports the recommendation to define "bailee" within Article 2 for the purposes of section 2-503 and other relevant sections. The lack of a definition of bailee has caused some confusion in the risk of loss cases. Normally, "bailee" signifies a professional bailee such as a warehouseman, as is the case under Article 7.[273] Because Article 2 does not define "bailee," however, a broader definition is possible. The concern is whether the seller can claim status as a bailee. The Report, without indicating its content, merely suggests that a definition is needed. It would appear advisable to adopt the Article 7 definition of "bailee" because a broader definition, which would include the seller of goods, would pose definite problems such as those encountered in interpreting the risk of loss rules.[274]

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273 For purposes of Article 7, "bailee" is defined as a "person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them." U.C.C. § 7-102(1)(a) (1990).

274 Under § 2-509(3), the general rule is that a merchant seller retains

The Task Force also agrees with the recommendation that sections 2-503(4)(b) and 2-509(2)(b) be revised to state that the bailee's acknowledgment must be "to the buyer." Both of these sections require "acknowledgment by the bailee of the buyer's right . . . ."[275] These sections do not state, however, to whom the bailee is to make this acknowledgment. The answer is clear that acknowledgment is to be made to the buyer; neither of these sections makes any sense otherwise. The failure of the Code to explicitly state this, though, has produced at least one major case.[276] This recommendation will not change the Code as it is presently intended to operate, but will merely clarify an existing ambiguity.

*[PRELIMINARY REPORT - 2-504]*

*E. SHIPMENT BY SELLER: § 2-504.*

***No revisions are recommended in the text of § 2-504.***

*Section 2-504 states what the seller must do to tender delivery in an FOB point of shipment contract. See § 2-319(1)(a) & 2-503(2). The last sentence, however, imposes a limitation upon the remedy of rejection under § 2-601: Certain failures in the tender are "a ground for rejection only if material delay or loss ensues." This limitation will be discussed, infra at Rec. A2(6)(1).*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-505]*

*F. SELLER'S SHIPMENT UNDER RESERVATION: § 2-505.*

***No revisions are recommended in the text of § 2-505.***

*The effect of the seller's conduct under § 2-505(1) is clearly stated. There has been no litigation of significance under this subsection and there is no evidence of problems in the field.*

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the risk of loss until the buyer receives the goods. The reason for this rule is that the seller will generally be the party with insurance. By allowing the seller of the goods who is not a commercial bailee to assume that status, the risk will prematurely pass to the buyer once the buyer's right to the goods are acknowledged.

275 This is required under U.C.C. § 2-503(4)(a) (1990) for tender, and under U.C.C. § 2-509(2)(b) (1990) for passage of the risk of loss.

276 Jason's Foods, Inc. v. Peter Eckrich & Sons, Inc., 774 F.2d 214 (7th Cir. 1985).

*§ 2-505(2) clarifies the effect of a shipment under reservation that was in violation of the contract for sale. See § 2-513(3). No problems of substance have arisen under this section.*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-506]*

*G. RIGHTS OF FINANCING AGENCY: § 2-506.*

***No revisions are recommended in the text of § 2-506.***

*"Financing agency" is defined in § 2-104(2). No action is required here.*[6]

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-507]*

*H. EFFECT OF SELLER'S TENDER: DELIVERY ON CONDITION: § 2-507.*

***Rec. A2.5 (4).***

***The Study Group recommends the following revisions in § 2-507.***

*1. § 2-507(1).*

*Assuming that the required manner of the tender of delivery is established, see § 2-503, § 2-507(1) implements the seller's general obligation to "transfer and deliver" the goods, § 2-301, by conditioning the buyer's duty to accept and pay upon tender of delivery by the seller. Section 2-511(1), on the other hand, conditions the seller's duty to tender upon "tender of payment" by the buyer. If the duties of both the seller and buyer are conditioned upon tender by the other,*[7] *who tenders first?*

*Where the agreement does not say, Article 2 provides no help. Thus, if neither party tenders delivery, neither party has any duty to complete the exchange.*

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*6. Callaghan's UCC Case Digest has reported just one case citing § 2-506 since Year One of the Code.*

*7. See Restatement, 2d Contracts § 233(1), which provides: "Where performances are to be exchanged under an exchange of promises, and the whole of one party's performance can be rendered at one time, it is due at one time, unless the language or the circumstances indicate the contrary."*

***(A) To avoid this stalemate, the Study Group recommends that § 2-507(1) be revised to state that, unless otherwise agreed, the seller has the duty to tender delivery first, but no duty to deliver the goods until the buyer has tendered payment. Thus, the seller would breach if it failed to tender delivery at the time when performance was due.***[8]

*2. § 2-507(2).*

*Section 2-507(2), combined with § 2-511(3), has been interpreted to support the common law "cash sale" exception to the general proposition that an unsecured seller cannot reclaim goods delivered to a buyer: If the seller delivers to the buyer in exchange for a check that is dishonored, the seller may reclaim the goods from the buyer.*[9] *Where dishonored checks are involved, the reclamation right against the buyer is clearly subject to the rights of a good faith purchasers for value under § 2-403(1)(b). The rights in other cash transactions against other creditors and purchasers, however, are not stated in § 2-507(2). Moreover, Comment 3 (now deleted under PEB Commentary #1) states a somewhat arbitrary ten day limitation on reclamation derived from § 2-702(2), which provides a limited reclamation right where the seller delivers goods to a insolvent buyer in a credit transaction.*

*Uncertainties in the proper scope of the "cash seller" exception and its overlap with the "insolvency" exception in § 2-702(2)*[10] *suggest that revisions are needed in the relevant Code sections.*[11]

***(B) The Study Group recommends that § 2-507(2) be deleted and the "cash payment" exception be integrated with the "insolvency" exception in § 2-702(2). The structure and content of this integration will be discussed infra at Rec. A2.7(2).***

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*8. Upon tender by the seller, the buyer, unless otherwise agreed, has a right to inspect the goods before the duty to accept and pay arises. § 2-513(1). Imposing on the seller the duty to tender first facilitates the exchange without imposing additional risks upon either party.*

*9. See Holiday Rambler Corp. v. First National Bank & Trust Co. of Great Bend Kansas, 723 F.2d 1449 (10th Cir. 1983).*

*10. An important difference between the two reclamation rights is their effect in bankruptcy. The "cash seller" does not have the same protection as the "insolvency seller" under § 546(c) of the Bankruptcy Code. See Mann & Phillips, The Reclaiming Cash Seller and the Bankruptcy Code, 39 S.W.L.J. 603 (1985).*

*11. See PEB Commentary #1 on the Uniform Commercial Code (1989)(cash seller's reclamation right should not be barred before non-payment is discovered).*

[TASK FORCE - 2-507]

SECTION 2-507

The Task Force agrees with the Study Group's recommendation that section 2-507(1) be revised to state that, unless otherwise agreed, the seller has the duty to tender delivery first, but has no duty to deliver the goods until the buyer has tendered payment.

Assuming that the required manner of the tender of delivery is established,[277] section 2-507(1) implements the seller's general obligation to "transfer and deliver" the goods[278] by conditioning the buyer's duty to accept and pay upon the seller's tender of delivery. On the other hand, section 2-511(1) conditions the seller's duty to tender on the "tender of payment" by the buyer. Therefore, no one is obligated to go first. To resolve this stalemate, section 2-507 should be redrafted to provide that, unless otherwise agreed, the seller has the duty to tender delivery first, but has no duty to deliver the goods until the buyer has tendered payment. Imposing on the seller the duty to tender first facilitates the exchange without imposing additional risks on either party because the seller does not have a duty to tender delivery before the contractually agreed upon time. Thus, this suggested revision eliminates a structural problem in the Code without interfering with any substantive rights or duties.

Finally, the Task Force sees no reason why section 2-507(2) should not be deleted and the text integrated into section 2-702(2). These two sections overlap, and it makes sense to consolidate them.

*[PRELIMINARY REPORT - 2-508]*

*I. CURE BY SELLER OF IMPROPER TENDER OR DELIVERY; REPLACEMENT: § 2-508.*

*Section 2-508 gives the seller a limited right to "cure" a non-conforming tender rejected by the buyer, whether the buyer likes it or not. Professor Peters called it a "significant" innovation that was "remarkably obscure" and almost "impossible to define."[12] Furthermore, there is no comparable provision for the buyer.[13]*

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277 *See* U.C.C. § 2-503 (1990).

278 U.C.C. § 2-301 (1990).

*12. Roadmap at 210. For Peters' critique, see Id. at 210-15.*

*13. Peters notes that §§ 2-511(2) and 2-614(2) provide a "minor analogue" for the buyer. Id. at 222, note 73.*

*Section 2-508(1) defines the scope of "cure" when the "time for performance has not yet expired" and § 2-508(2) deals with other cases. By agreement, the parties may expand or narrow the right to cure. Although § 2-508 assumes a rightful rejection by the buyer, see §§ 2-601 & 2-602(1), the "cure, when properly done, limits the buyer's power to cancel the contract for breach. Section 2-508, therefore, manifests a policy which favors preservation of the contract.*[14] *In general, the Study Group endorsed and was prepared to expand this policy.*

***Rec. A2.5 (5).***

***The Study Group recommends the following revisions in the text of § 2-508.***

*1. § 2-508(1).*

*§ 2-508(1) applies when (a) the buyer has made a "rightful"*[15] *rejection, see § 2-602(1), (b) the time for performance has not expired, (c) the seller "seasonably" notifies the buyer of the intention to cure, and (d) the seller, "within the contract time," makes a "conforming delivery."*

***(A) The Study Group recommends that § 2-508(1) be revised to permit a cure when the buyer has justifiably revoked acceptance under § 2-608, provided that the other conditions in § 2-508(1) are satisfied. There is no good reason for limiting cure to cases of rejection where the "time for performance has not yet expired."***

***Section 2-508(1) provides that the seller may cure by making a "conforming delivery." Most agree that this can be done by tendering new or additional goods but, unless otherwise agreed, not by offering only a money allowance. A more controversial question is whether a cure can be effected by repairs that conform the goods to the contract.***[16] ***The Drafting Committee should decide when, if ever, a cure under § 2-508(1) can be done by repairing rather than replacing defective goods.***

*2. § 2-508(2).*

*§ 2-508(2) defines the seller's right to cure where the buyer has rightfully rejected a non-conforming tender and the time for performance under the*

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*14. See Lawrence, Cure in Contracts for the Sale of Goods: Looking Beyond § 2-508, 21 U.C.C. L.J. 291 (1989).*

*15. The text does not so state, but the context otherwise requires.*

*16. See, e.g. Zabriskie Chevrolet, Inc. v. Smith, 99 N.J. Super. 441, 240 A.2d 195 (Law Div. 1968) (where consumer buys a new car, replacing defective with new transmission not an effective cure).*

*contract has expired. If the seller "had reasonable grounds to believe" that the tender "would be acceptable with or without money allowance" and "he seasonably notifies the buyer," the seller has a "further reasonable time to make a conforming tender."*

*(B) Although concluding that the "reasonable grounds" test should be administered in an expansive manner, the Study Group was concerned about the imprecision of the test. Should it apply in cases where the seller is unaware of a nonconformity in the goods?[17] Suppose the tender is rejected for delay. Should the seller still be able to "substitute a conforming tender?" We think the answer to both questions should be yes and recommend that the Drafting Committee revise § 2-508(2) accordingly.*

*The question of what is a proper cure also arises under § 2-508(2). Does "cure" include repair by the seller of the non-conformity or the grant of a money allowance, as well as the substitution of new, conforming goods? The answer is clearly yes if repair or money allowance are authorized by the agreement between the parties. The answer is less clear where there is no agreement, and there is some dispute in the literature.[18] We recommend that the Drafting Committee resolve this question in a revised § 2-508(2).*

*The Study Group disagreed on whether a "cure" should be permitted after acceptance and after the time for performance had passed, even though the acceptance had been rightfully revoked under § 2-608(1). Resolution of this issue is left for the Drafting Committee and, in any event, depends upon whether the "perfect" tender rule in § 2-601 is retained or rejected.*

*3. Other issues.*

*(C) We agreed that under either subsection, the buyer's remedies are suspended after receipt of the seller's timely notice until the seller fails to make a timely and proper cure. Within the scope of § 2-*

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*17. See, e.g., T.W. Oil, Inc. v. Consolidated Edison Co. of New York, Inc., 57 N.Y.2d 574, 443 N.E.2d 932 (1982)(cure permitted under § 2-508(2) even though seller unaware of nonconformity).*

*18. If the buyer has rightfully rejected, why should the seller be able to impose repair or a money adjustment in lieu of different, conforming goods? It is one thing when that type of cure is part of relevant trade usage or practice or otherwise agreed. In the absence of persuasive policy arguments to the contrary, why shouldn't a literal interpretation of the statutory language "to substitute a conforming tender" be given? But see Priest, Breach and Remedy for the Tender of Nonconforming Goods Under the UCC: An Economic Approach, 91 Harv. L. Rev. 960 (1978).*

***508, a rejection or revocation of acceptance can be analogized to a demand for adequate assurance, see § 2-609, which is satisfied by a timely cure.***

***Finally, the scope and content of § 2-508 obviously depend upon any revisions made in the "perfect tender" rule.***

[TASK FORCE - 2-508]

SECTION 2-508

Virtually all of the difficulties with section 2-508 arise because courts and commentators have failed to grasp the reason for each of its subdivisions.[279] Responsibility for this failure rests squarely on the drafters, for they did not clearly state in the comments what they intended.

Nothing in the drafting history of section 2-508 suggests that it was intended to be a broad dispute resolution mechanism encouraging the parties to compromise in the spirit of preserving the contract. Rather, the section contains two carefully drawn subdivisions, each providing a solution to related, but different problems. The subdivisions are part of the same section because the solution to each problem is similar: cure by the seller.[280] Another common thread between the two subdivisions is that they both regulate the opportunistic merchant buyer, who, because of an unfavorable market shift, seizes upon a defect in the seller's tender to avoid the contract.[281] Furthermore, the rules in section 2-508 were intended to apply only to single delivery (non-installment) contracts.[282] Installment contracts have more lenient cure provisions.[283]

Subdivision 2-508(1) covers the buyer who rejects an early non-conforming tender and then refuses to accept a conforming

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279 The intent of the drafters must be understood to properly evaluate a section. This intent is important so that some idea can be gained as to how the section was intended to function, not so that a revision can mechanically follow that intent. With this knowledge, the revisers can then decide what corrective action, if any, is required.

280 *See* U.C.C. § 2-508(1), (2) (1990).

281 *See infra* notes 286-88 and accompanying text.

282 Comment on Section 7-9 (S101) Breach in Installment Contracts at 2 (1948) in the Llewellyn Papers, file J(IX)(2)(b) (reproduced in App. F).

283 U.C.C. § 2-612(2) (1990) (using a substantial impairment test). *See infra* text at notes 359-76 (discussing the more lenient cure provisions for installment contracts).

retender within the contract time, on the ground that the contract was repudiated and terminated by the initial non-conforming tender.[284] Subdivision (1) gives the seller the right to make a conforming retender upon notice to the buyer, provided the seller can do so within the contract time for delivery.[285] Llewellyn envisaged that the buyer who would most likely be frustrated by this right to cure would be a buyer who rejected the second tender because of a market shift.[286] In effect, the subdivision disables this buyer from claiming that the early non-conforming tender is a repudiation.

Subdivision 2-508(2) was intended to cover a related abuse by the buyer. This abuse arises in commercial contexts in which there is a pattern of the buyer accepting goods with minor non-conformities in return for a price adjustment.[287] In good times, the buyer takes the goods because he can "move" them. In bad times, the buyer may seize upon the minor non-conformities to reject the goods and terminate, what has become for him, an unprofitable contract. This results in injustice and hardship to a seller who has relied upon the pattern of acceptance with adjustment.[288]

If this pattern has clearly hardened into a trade usage, the seller has the contractual right to rely on the pattern of acceptance with adjustment. If the buyer rejects a tender satisfying that pattern, it has breached the contract.[289] If the pattern is not a trade usage, the existence of the pattern raises a question as to whether it is part of the agreement by course of dealing, or whether it is a waiver of the buyer's right to reject for any non-conformity, that the buyer can revoke by due notice.[290] In case of doubt, Llewellyn

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284 W. HAWKLAND, SALES AND BULK SALES 122 (1958).

285 U.C.C. § 2-508(1) reflects the better pre-code caselaw. *See* 2 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT 721-22 & 722 n.5 (rev. ed. 1948). The right to cure under § 2-508(1) may be subject to the buyer's right to demand adequate assurance of performance under § 2-609. *See infra* text accompanying notes 320-27.

286 Revised Uniform Sales Act: Second Draft § 42-A, Comment at 185 (Dec. 1941), *reprinted in* 1 A.L.I. and N.C.C.U.S.L., Uniform Commercial Code Drafts 465 (1984).

287 Selected Comments to Uniform Revised Sales Act, General Comment on Parts II and IV: Formation and Construction 14, 18 (1948) in the Llewellyn Papers, file J(IX)(2)(a) [hereafter General Comment] (reproduced in App. A). *See also* 21 A.L.I. *Proceedings* 71, 179 (1944).

288 21 A.L.I. *Proceedings* 71, 179 (1944). *See also* 1-1954 New York Law Revision Commission Rep. 124.

289 U.C.C. § 2-508 comment 4 (1990); General Comment, *supra* note 287, at 19.

290 General Comment, *supra* note 287, at 14-15.

favored treating the pattern as a waiver.[291] That approach is reflected in subdivision 2-508(2). Thus, where the seller has relied upon the pattern of acceptance with price adjustment to tender goods that do not strictly comply with the literal terms of the contract, the buyer cannot use the seller's technical non-compliance to reject and avoid the contract. Instead, once he gives notice that he is revoking his waiver (by rejecting the goods), he must give the seller the opportunity to furnish goods that strictly comply.[292]

It was also the intent of the drafters that subdivision 2-508(2) not apply to consumer buyers.[293] Thus, the "shaken faith" doctrine, which largely represents courts' refusals to apply that subdivision to consumer buyers, is consistent with the drafters' intent.

The comments to section 2-508 should be revised to make clear (a) the specific abuses that underlie each subdivision, and (b) subdivision 2-508(2) does not apply to consumer buyers.

1. *Revocation of Acceptance and Right to Cure*

Does the seller have a right to cure under section 2-508 when the buyer initially accepts the goods and then properly revokes its acceptance under section 2-608? This issue arises where the buyer has revoked his acceptance under subdivision 2-608(1)(b) based on a non-conformity not known to him when he accepted.[294] The Task Force believes that the seller should have the right to cure. However, the analysis is not the same for each subdivision of section 2-508.

a. *Subdivision 2-508(1).* The Study Group recommends that a seller be permitted to cure under subdivision 2-508(1) if the buyer initially accepts and then justifiably revokes acceptance.[295] The Task Force agrees with this result.

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291 *Id. See also* U.C.C. § 2-208 comment 3 (1990).

292 This approach was consistent with some pre-code caselaw. *See* 2 WILLISTON, *supra* note 285, at 778 n.4.

293 General Comment, *supra* note 287, at 19. *Cf.* Draft for a "Uniform Sales Act, 1940," Comment on Section 21 at 25, *reprinted in* 1. A.L.I. and N.C.C.U.S.L., Uniform Commercial Code Drafts 192 (1984); N.C.C.U.S.L., Consideration in Committee of the Whole of the First Tentative Draft of the Amendments to the Uniform Sales Act 6 (1940), *reprinted in* N.C.C.U.S.L. Archives Publications, microfiche 32.0-A (Hein, 1983).

294 The other ground for revocation, stated in § 2-608(1)(a), applies only where the seller has failed to cure.

295 Prelim. Rpt., Part 5, Rec. A2.5(5)(A), *supra* p. 1136; *id.*, Part 6, Rec. A2.6(6)(B), *infra* p. 1168.

Initially, one should realize that under subdivision 2-508(1) the issue of whether a seller has a right to cure following revocation is unlikely to arise. In most instances, the time for the seller's performance will have expired by the time the buyer learns of the defect and revokes acceptance, so that cure under subdivision 2-508(1) will not be available to the seller.[296] If the buyer revokes acceptance before the seller's time to perform has expired, however, the Study Group correctly concludes that the seller should have the right to cure within the original time for performance.

Subdivision 2-608(3) implies this result, but it has been ignored by courts. What is needed to effectuate the Study Group's recommendation is not textual amendments, but revisions to the comments to section 2-508 and/or section 2-608 to make it clear that subdivision 2-608(3) permits the seller to cure under subdivision 2-508(1) when the buyer revokes acceptance under subdivision 2-608(1)(b).[297]

b. *Subdivision 2-508(2).* The Study Group split on the question of whether a seller should have the right to cure under subdivision 2-508(2) when the buyer justifiably revokes acceptance. The Task Force believes that the seller should have such a right to cure if he satisfies the requirements of that subdivision.

The issue of cure under subdivision 2-508(2) can arise when the buyer has properly revoked acceptance because the tests for the buyer's right to revoke and the seller's right to cure, are dissimilar. The test for right to cure under subdivision 2-508(2) focuses on what the seller had reason to know, while the test for revocation under subdivision 2-608(1) looks to whether the nonconformity is a substantial impairment of value to the buyer.[293] It

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296 *See* U.C.C. § 2-508(1) (1990) (cure only allowed if it can be done before the contractual time for performance has expired).

297 The seller's right to cure should be subject to the buyer's right to demand adequate assurance of performance where applicable. *See infra* text accompanying notes 320-27.

298 An early draft of the comment to what is now § 2-608 explicitly stated that the substantial impairment of value test did not depend on what the seller had reason to know or actually knew. *See* Comment on Section 98, Revocation of Acceptance in Whole or in Part, 1, in the Llewellyn Papers, file J(IX)(2)(b).

> It is the value *to the buyer* which must be substantially impaired, Subsection 1, preamble. This does not depend . . . on what the seller had reason to know at the time of contracting, as does the recovery of consequential damages . . . . With regard to revocation of acceptance the seller who carries an obligation and whose goods fail to meet that

is possible for the seller to have reasonable grounds to believe that his tender is acceptable, even though that tender substantially impairs the value of the goods to the buyer. Thus, for example, a minor defect within the pattern of acceptance and adjustment, might be a substantial defect to this particular buyer justifying revocation of acceptance.

It is clear that if the seller has notice prior to entering into the contract that strict conformity is required, he has no right to cure under subdivision 2-508(2).[299] If the buyer does not notify the seller and the circumstances of the sale do not otherwise put the seller on notice that strict conformity will be required, the seller should have a right of cure under subdivision 2-508(2) if the non-conformity is within the pattern of acceptance with price adjustment. Subdivision 2-508(2) protects the buyer against serious inconvenience by requiring that the seller cure within a reasonable time.[300]

The most efficient means of clarifying the seller's right to cure when the buyer revokes acceptance is to revise the comments to section 2-508 and/or section 2-608.[301]

2. *Subdivision 2-508(2): Reasonable Grounds to Believe Non-Conforming Tender Would be Acceptable*

Under subdivision 2-508(2), the seller has a right to cure a non-conforming tender even after the time for his performance has expired if the seller had reasonable grounds to believe that its initial tender would be acceptable. The Study Group expresses concern with the imprecision of this "reasonable grounds" test. The imprecision results from the drafters' failure to clearly describe the circumstances that underlie this subdivision. The purpose of the subdivision was to disable a bad faith merchant buyer from avoiding a contract for a minor defect in goods by invoking the literal terms of the contract when the seller had relied on the common mercantile

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> obligation takes his chances, despite absence of advance knowledge, on whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer.

*Id.* (examples omitted).

299 U.C.C. § 2-508 comment 2 (1990).

300 U.C.C. § 2-508(2) & comment 3 (1990) ("The words 'a further reasonable time to substitute a conforming tender' are intended as words of limitation to protect the buyer.").

301 *See supra* text accompanying note 297.

pattern of acceptance of goods with minor defects in return for a price adjustment.[302]

In order to satisfy the "reasonable grounds" test, the seller must prove the pattern of acceptance with adjustment and that the seller was reasonable in believing that this pattern would apply to the rejected tender. Comment 2 to section 2-508 details circumstances in which the seller could not reasonably rely on the pattern.

Two issues that arise under the "reasonable grounds" test remain to be discussed: First, can a seller who is unaware of a non-conformity satisfy the "reasonable grounds" test? Second, is delay in delivery covered by subdivision 2-508(2)?

a. *Can a Seller Who is Unaware of the Non-conformity of its Tender Satisfy the "Reasonable Grounds" Test?*

This issue can arise where the seller obtained the goods from its supplier and did not inspect them before sale to the buyer. It is an issue not addressed in the drafting history. The drafters seem to have assumed that the seller would know of the non-conformity. The resolution of the issue must be accomplished by construing subdivision 2-508(2) in accordance with its underlying purpose.[303] The answer depends on whether the non-conformity is substantial or minor.

(1) *Substantial Defect.* If the non-conformity is a substantial defect and thus not covered by the pattern of acceptance with adjustment, the seller's ignorance of the defect should not give him the right to cure under subdivision 2-508(2). That subdivision protects a seller who relies on the pattern from a buyer who seeks to avoid the contract by invoking the literal terms of the contract and rejecting goods with a minor defect. This risk is substantially different from the risk that the seller's supplier will furnish him with goods that have substantial defects. In the first instance, the seller is unfairly surprised by the buyer's insistence on strict compliance when the buyer has not done so in the past. Consequently, the seller is granted a further reasonable time to comply. In the second instance, it is the supplier who has surprised the seller, and the buyer does nothing wrong when it rejects a defective tender that is outside the pattern of acceptance with adjustment. Here

302 *See supra* text accompanying notes 288-89.
303 U.C.C. § 1-102 comment 1.

the supplier, not the buyer, should bear the burden of the costs associated with the defect.

In addition, it is unsound to have the seller's right to cure and, therefore, the buyer's right to rescind, depend on the state of the seller's knowledge. If a substantial defect of which the seller was reasonably unaware could be cured under subdivision 2-508(2), but not a substantial defect of which the seller is aware, then the seller's right to cure would depend on what the seller knows. The less he knows the better. This situation is undesirable.

(2) *Minor Defect.* What about where the seller is ignorant of a minor defect, one that does satisfy the pattern of acceptance with price adjustment? The better answer is to give the seller the right to cure. The reason for this conclusion is that, otherwise, a bad faith buyer, who bases his decision to reject for a minor defect on the condition of the market, will escape sanction. Good faith behavior seems to be the fundamental principle of section 2-508.[304] Furthermore, the seller may have relied on the pattern in non-specific ways. For example, his supplier may have proven to be reliable in the past and furnished conforming goods or goods with only minor defects, so that the seller did not deem it necessary to inspect the goods before tendering them to the buyer. This reliance deserves protection. Finally, it seems unsound as a practical matter to have the buyer's right to rescind the contract turn on the state of the seller's knowledge. The buyer will have to initiate the rescission process by rejecting and stating his reasons. If the seller then offers to cure a minor defect, the buyer cannot know whether or not the seller has that right if the issue turns on whether the seller knew of the defect when it shipped the goods.

In sum, the seller's ignorance of the specific defect should not be relevant in applying the "reasonable grounds" test. If the goods have substantial defects, then the seller should not have the right to cure under subdivision 2-508(2). If the goods have only minor defects, then the seller should have the right to cure.

b. *Is Delay in Tender or Delivery Covered by Subdivision 2-508(2)?*

The Study Group recommends revision of subdivision 2-508(2) so that it covers delay in tender.[305] Although the motive that

304 U.C.C. § 1-203 comment (1990).

305 Prelim. Rpt., Part 5, Rec. A 2.5(5)(B), *supra* p. 1137.

prompts the Study Group to recommend this revision is laudable, subdivision 2-508(2) is not the place to deal with rejection for delay in tender.

The basic premise of section 2-508 is that the buyer is ultimately entitled to insist on strict compliance with the terms of the contract.[306] Thus, the text of both subdivisions require the curing seller to make a tender or delivery that is "conforming."[307] It is impossible to cure a delayed tender by substituting a conforming (i.e., timely) tender because *a fortiori* the contractual time for performance has already passed. Accordingly, delayed tenders cannot have been intended to be covered by subdivision 2-508(2).[308]

Nor should subdivision 2-508(2) be revised to include delayed tenders. This change will only muddle the question of what constitutes cure under section 2-508. Now the test is clear: only a tender that conforms to the seller's obligations under the contract is acceptable. If the test is expanded to include delays, which are inherently incurable under section 2-508, the clarity of the original test suffers.

The better approach is to deal with delayed tenders under some other doctrine that sorts out bad faith rejections from good faith rejections. Thus, for example, a court confronted with what it suspects is bad faith rejection for delay might conclude that the delayed tender qualifies under the contract either on the theory that the parties initially understood the delivery term to incorporate any leeway shown by trade usage or course of dealing,[309] or on the theory that the buyer waived past delays and is disabled from

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306 Comment on Section 5-8 (S77) Cure of Improper Tender or Delivery. Replacement 1 (Mar. 1948) in the Llewellyn Papers, file J(X)(2)(f) (reproduced in App. E); N.C.C.U.S.L., Consideration in Committee of the Whole of the Revised Uniform Sales Act 139 (1943) in the Llewellyn Papers, file J(V)(2)(h); 21 A.L.I., Proceedings at 179 (1944); N.C.C.U.S.L., Report of the Special Committee on the Revised Uniform Sales Act; Appendix (1943), *reprinted in* N.C.C.U.S.L. Handbook of The N.C.C.U.S.L. and Proceedings of The Fifty-Third Annual Conference at 176 (1943).

307 U.C.C. § 2-106(2) (1990) & comment 2 (indicating that conforming requires "exact performance by the seller of his obligations").

308 *Cf.* U.C.C. § 2-711 comment 1 (1990) (emphasis added) ("Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, *except for any delay involved.*").

309 U.C.C. § 2-106 comment (1990); General Comment, *supra* note 287, at 1-3.

retracting his waiver as to the tender in question because the seller relied on the waiver and tendered after the time required by the literal terms of the contract.[310] If no trade usage or prior dealings exist that justify delayed delivery, a court could use the general obligation of good faith to frustrate a buyer who rejects in bad faith. The Study Group's recommendation to add an explicit statement to section 2-601 requiring that the buyer reject in good faith will buttress this approach.[311]

3. *What Constitutes Cure?*

On this matter the text of each subdivision is quite clear: to cure, the seller must make a "conforming" tender or delivery. This means that the tender or delivery must accord with the seller's obligations under the contract.[312] Two issues arise under this test: can tender of repaired goods or tender of money constitute cure?

a. *Can Tender of Repaired Goods Effect A Cure?*

The Study Group takes no position on this issue. It recommends that the Drafting Committee decide when, if ever, repaired goods effect a cure.[313] The original drafters contemplated that, in some instances, tender of repaired goods could effect a cure.[314] Repaired goods should constitute a cure when they satisfy the contract description. This decision is heavily fact dependent. Perhaps the most the Drafting Committee could do would be to include in the comments a statement that repaired goods can effect a cure only when the repaired goods would pass without objection in the trade under the contract description.

b. *Can Money Allowance Effect A Cure?*

The Study Group takes no position on this issue, but recommends that it be resolved by the Drafting Committee.[315]

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310 *See* sources cited *supra* note 309. *See also* U.C.C. § 2-209(5) (1990).

311 Prelim. Rpt. Part 6, Rec. A2.6(1)(A), *infra* p. 1158. The Comment to revised § 2-601 should clearly state that where the buyer rejects for a nonconformity which is not the real reason for the buyer's dissatisfaction, the rejection is not in good faith.

312 U.C.C. § 2-106(2) & comment 2 (1990).

313 Prelim. Rpt., Part 5, Rec. A2.5(5)(A), *supra* p. 1136.

314 *Cf.* U.C.C. § 2-510 comment 2 (repair of goods given as example of cure).

315 *Id.* at Rec. A2.5(5)(B), *supra* p. 1137.

If the contract permits money allowance against the price, section 2-508 does not apply.[316] If not so permitted, a money allowance would not conform to the contract and cannot be a cure under section 2-508. One of the basic premises of that section is that the buyer is entitled to insist upon exact compliance with the terms of the contract.[317] Despite the existence of a pattern of acceptance with price adjustment, if that pattern has not become part of the contract, the buyer can insist on strictly conforming goods. He is not required to take goods with minor defects plus a money allowance.[318]

4. *Suspension of Buyer's Remedies Pending Seller's Cure: Relationship of Section 2-508 to Section 2-609*

The Study Group recommends that under both subdivisions of section 2-508, the buyer's remedies for breach be suspended until the seller fails to make a timely or proper cure after properly invoking its right to cure.[319] The Study Group analogizes this result to suspension of the buyer's remedies when the buyer demands adequate assurance of performance under section 2-609. This proposal raises a further issue: what is the relationship of the seller's right to cure and the buyer's right to demand adequate assurance of performance under section 2-609.

a. *Subdivision 2-508(1).* Suspension of the buyer's affirmative remedies is not necessary under subdivision 2-508(1). That subdivision deals with anticipatory conduct. It clarifies that no anticipatory breach occurs if time remains to retender.[320] Since there is no breach, the buyer has no affirmative remedies to suspend.[321]

As to the relationship of subdivisions 2-508(2) to section 2-609, early drafts of what is now subdivision 2-508(1) gave the seller the right to cure within the contract time only if the buyer

316 U.C.C. § 2-508 comment 4 (1990).

317 *See supra* note 306 and accompanying text.

318 The rule is otherwise for installment contracts. *See infra* note 371 and accompanying text (discussing § 2-612). The reference to "money allowance" in U.C.C. § 2-508(2) probably refers to the mercantile pattern of acceptance with price adjustment.

319 Prelim. Rpt., Part 5, Rec. A2.5(5)(C), *supra* p. 1137-38.

320 *See supra* notes 284-85 and accompanying text.

321 The buyer has affirmative remedies only on anticipatory repudiation, U.C.C. § 2-610(b) (1990), or on present breach by the seller, *id.* § 2-711(1).

was given adequate assurance of performance.[322] In response, it was objected that the seller should have the full time specified in the contract to perform without having to put up a bond or make a guaranty for timely performance.[323] Llewellyn, in turn, responded that the buyer should not be left to wonder whether the seller would be able to perform in a timely manner after having initially failed to make a proper tender.[324] The solution was to predicate the right to cure upon the seller's giving notice to the buyer that he would cure within the contract time.[325] In effect, the seller's word that it will cure is treated as adequate assurance for the buyer.[326]

There may, however, be instances in which the buyer should be permitted to utilize the procedures of section 2-609. First, suppose the seller gives notification of his intention to cure, but it reasonably appears to the buyer that the seller may not be able to cure in a timely manner. The buyer should have the right to demand further assurances and to treat the seller as having anticipatorily repudiated if the seller does not comply with that demand. Second, suppose the seller notifies the buyer that it will try, but cannot guarantee, to timely cure. The buyer should not be forced to wait. Perhaps the best solution is to include in the comments a statement that, ordinarily, the seller's promise to cure is sufficient, but that in circumstances similar to those outlined above, the buyer can resort to the procedures of section 2-609.

b. *Subdivision 2-508(2).* Suspension of the buyer's affirmative remedies is necessary under subdivision 2-508(2). Unlike subdivision 2-508(1), which deals with anticipatory conduct, subdivision (2) deals with present breach, for which the buyer has affirmative remedies under subdivision 2-711(1). Comment 1 to section 2-711 makes the point that a proper cure effectively precludes the buyer's

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322 Draft for A "Uniform Sales Act, 1940" § 67(4); *reprinted in* 1 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 237 (1984); Revised Uniform Sales Act, Second Draft § 42-A and Comment (1941), *reprinted in* 1. A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 185-86 (1984); Revised Uniform Sales Act: Supplement; Part V, Sections 41-51; Section 42-C(2) (1942) in the Llewellyn Papers, file J(III)(2)(b).

323 N.C.C.U.S.L. Consideration in Committee of the Whole of the Revised Uniform Sales Act 58-60 (1942), *reprinted in* N.C.C.U.S.L., N.C.C.U.S.L Archives Publications, microfiche 32.0-B(2) (Hein 1983).

324 *Id.*

325 *Id.*

326 *Cf.* U.C.C. § 2-609 comment 4 (1990) (mere promise by seller of good repute suffices as adequate assurance).

remedies. From this statement it might be implied that the buyer's remedies are suspended pending cure, but this point should be expressly stated in either the text or comments to section 2-711.

The drafting history does not contain any discussion of the relationship of the seller's right to cure under subdivision 2-508(2) and the buyer's right to demand adequate assurance of performance under section 2-609. The drafters' silence on this point most likely results from the fact that subdivision 2-508(2) was intended to apply to limited circumstances (seller relying on mercantile pattern of acceptance and adjustment; bad faith buyer invoking literal terms of contract)[327] in which the buyer's expectation of due performance is not materially impaired. On principle, it seems that the seller's offer of cure under subdivision 2-508(2) should be treated the same as an offer of cure under subdivision 2-508(1). Normally, the seller's word that it will cure will suffice. If other circumstances indicate that cure is uncertain or unlikely, however, the buyer should have the right to invoke section 2-609.

*[PRELIMINARY REPORT - 2-509]*

*J. RISK OF LOSS IN THE ABSENCE OF BREACH: §§ 2-509.*

*1. Introduction.*

*Sections 2-509 and 2-510, which deal with risk of loss, are important innovations in Article 2. Section 2-509 rejects title as the test for who has the risk of loss and, instead, puts the risk on the party with control of the goods. This approach assumes that the party in control will be in the best position, cost and other factors considered, to prevent loss or to insure the goods against the loss. Thus, unless reallocated by § 2-510, the "least cost" insurer will bear the risk whether insurance has been obtained or not.*[19]

*There is no evidence that these assumptions about insurance are false or that the clear principles of § 2-509 do not work well in practice.*[20]

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327 *See supra* notes 287-88 and accompanying text.

*19. For example, a seller with the risk who is not insured must bear the economic loss of the goods and may still have obligations to deliver substitutes under the contract. See § 2-613. Similarly, a buyer with the risk of loss who is not insured must bear the economic loss of the goods and may still be liable to the seller for the price. § 2-709(1)(a).*

*20. See Howard, Allocation of Risk of Loss Under the UCC: A Transactional Evaluation of §§ 2-509 & 2-510, 15 U.C.C. L.J. 334 (1983); Comment, Risk of Loss in Commercial Transactions: Efficiency Thrown Into the Breach, 65 Va. L. Rev. 557 (1979).*

*Accordingly, the recommended revisions to § 2-509 will be minor. On the other hand, there is doubt whether § 2-510, a complex provision, serves any useful purpose. More radical surgery on § 2-510, therefore, is required.*[21]

*A final note. Except for defining insurable interest, § 2-501(2), and invoking the availability of insurance in §§ 2-509 & 2-510, Article 2 has little to say about the law of insurance. Thus, if the parties are in fact insured, non-Code law must be consulted on issues of subrogation, claims against an insured carrier and disputes between insurance companies.*[22]

*2. Revisions in § 2-509.*

***Rec. A2.5 (6).***

***Several minor revisions are recommended in the text of § 2-509.***

*Interpretation of Shipment Term. As noted earlier, clarification is required on when "the contract requires or authorizes the seller to ship the goods by carrier," § 2-509(1).*

***(A) We renew our recommendation that the presumption favoring an "F.O.B. point of shipment" contract, now found in Comment 5 to § 2-503, be elaborated in the text of § 2-319(1) or § 2-503. See Rec. A2(5)(3)(A).***

*Thus, if the seller is expected to ship the goods by carrier but is not clearly required to deliver them to a particular destination, an F.O.B. point of shipment contract is presumed and the risk of loss passes when they are "duly delivered" to the carrier. § 2-509(1).*

*Definition of Carrier. The word "carrier" in § 2-509(1) is not defined. Suppose the contract requires the seller to ship the goods to the buyer and contains an "F.O.B. the place of shipment" term. Does risk pass to the buyer when the seller loads the goods on a truck or airplane which is owned by the seller or a subsidiary of the seller?*

***(B) With some dissent, we recommend that the comment be revised to clarify that, unless otherwise agreed, "carrier" does not include a wholly owned subsidiary, operating division or agent of***

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*21. The risk of loss provisions in the Convention on Contracts for the International Sale of Goods, §§ 66-70, are difficult to capture in a few sentences. For a good summary, see Roth, The Passing of Risk, 27 Am. J. Comp. L. 291 (1979). See also, Berman & Ladd, Risk of Loss or Damage in Documentary Transactions Under the Convention on the International Sale of Goods, 21 Cornell Int'l L.J. 423, 426-31 (1988).*

*22. See, e.g., R. Keeton & A. Widiss, Insurance Law §§ 3.10-3.11 (2d ed. 1988).*

*the seller.[23] If the vehicle or airplane is not a "carrier," the contract should be interpreted as if the seller was required to deliver the goods to a particular destination. § 2-509(1)(b).*

*Bailee Issues.*

***(C) We recommend that the phrase "to the buyer" be inserted after the word "bailee" in § 2-509(2)(b). We agree with Judge Posner's analysis and result in the Jason's Foods decision.[24] A similar revision was recommended for § 2-503(4)(b).***

*The word "bailee" in § 2-509(2)(b) is not defined in Article 2. This suggests that it may have a broader or more conventional meaning than that in Article 7.[25] Thus, it is possible for a seller, with the buyer's agreement, to retain possession after tender of delivery and become a bailee of the goods.[26] Can this seller-bailee pass the risk of loss under § 2-509(2)(b) simply by acknowledging the buyer's right to possession even though the risk would not pass under either § 2-509(1) or (3)?*

***(D) We think that the answer should be no, and recommend that the Drafting Committee consider how better to define who is a bailee for the purpose of the risk of loss policies in § 2-509(2). A possible solution might state that unless the parties have otherwise allocated the risk, § 2-509(4), a seller cannot be a bailee for purposes of § 2-509(2) where the conditions of either § 2-509(1) or 2-509(3) have not been satisfied.***

*Risk and the Non-merchant Seller. In § 2-509(3), a distinction is drawn between a merchant and a non-merchant seller: In the former case, risk of loss passes upon receipt of the goods by the buyer, in the latter case risk passes upon tender of delivery. There is no evidence, however, that the buyer's ability to insure is better when the seller is a non-merchant. We assume that the non-merchant seller in possession will be in a much better position than the buyer to obtain insurance.*

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*23. Both CISG §§ 31 & 67(1) and the 1980 INCO Terms support the conclusion that "carrier" does not include transport facilities, such as delivery trucks, operated by the parties. See Honnold at 235-37, 374-76. The converse problem is how far the definition of carrier should be extended. White and Summers suggest that it should include the U.S. Mail. White & Summers at 220.*

*24. Jason's Foods Inc. v. Peter Eckrich & Sons, Inc., 774 F.2d 214 (7th Cir. 1985).*

*25. For purposes of Article 7, "bailee" is defined as a "person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them." § 7-102(1)(a). Document of title is defined in § 1-201(15).*

*26. This should be distinguished from the case where the seller of a horse is requested, after the sale, to stable the horse for a stated period of time until the buyer can take possession. In the latter case, the seller may be a bailee.*

*(C) Subject to that assumption, we recommend that the distinction be abolished and a uniform rule that risk passes upon the buyer's "receipt" of the goods be adopted for § 2-509(3).*

[TASK FORCE - 2-509]

SECTION 2-509

The Task Force agrees with the Study Group's conclusion that the general policy of this section should not be altered. The section's general policy is that, because it has the best opportunity to and most likely has insured the goods, the party in control of the goods should bear the risk of loss, unless otherwise agreed.[328]

Section 2-509(1) does not define the word "carrier." The question posed is whether, in a shipment contract, the risk passes to the buyer when the seller loads the goods on a truck, airplane or other vehicle owned by the seller. With some dissent, the Report recommends, therefore, that the term "carrier" be defined in the comments to make clear that it does not include a wholly owned subsidiary, operating division, or agent of the seller.

To the degree that this recommendation is consistent with the general assumptions about which party is likely to be insured, it is sound. There is some concern among Task Force members, however, about whether this presumption of insurance is valid based only on the fact that the seller controls the carrier. Further inquiry may be in order.

In section 2-509(3), which governs sales where the goods are neither authorized to be shipped nor held by a bailee, the Code specifies separate rules for merchants and non-merchants.[329] The Report suggests that "[t]here is no evidence, however, that the buyer's ability to insure is better when the seller is a non-merchant. We assume that the non-merchant seller in possession will be more likely to have the buyer obtain insurance."[330]

To the extent that this assumption is correct, the proposal to abolish the distinction between a merchant seller and a non-merchant seller will bring this section in accord with the overarching

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328 Prelim. Rpt., Part 5, *supra* p. 1149.

329 "In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery." U.C.C. § 2-509(3) (1990).

330 Prelim. Rpt., Part 5, *supra* p. 1151.

policy of section 2-509: to place the risk of loss on the party in the best situation to insure. The remaining issue is whether this assumption is correct. A merchant seller probably will have insured the inventory. The fact patterns of sales by non-merchants, however, do not have enough common factors to clearly justify this assumption. There are simply too many possible variables to make such a broad assumption.

*[PRELIMINARY REPORT - 2-510]*

*K. EFFECT OF BREACH ON RISK OF LOSS: § 2-510.*

*Rec. A2.5 (7).*

***The Study Group recommends that § 2-510 be repealed. Given the tenuous nature of the reallocation policy in § 2-510, the effort required to redraft the statute for clarity in application is not justified. If repeal is rejected, § 2-510 should be revised to insure a link between the breach and casualty to the goods. If the breach is not the substantial cause of the loss, there should be no reallocation of the usual risk of loss outcome.***

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

*Even if the reallocation were plausible,[27] § 2-510 is complex, incomplete and difficult to apply. For example:*

*(1) § 2-510(1) applies where a tender of delivery would pass the risk but for the non-conformity. The prototype case is an FOB point of shipment contract where the seller tenders delivery under § 2-504. § 2-509(1)(a). But if the goods were destroyed in the carrier's possession and they were not inspected at the point of shipment, how is it determined whether the buyer had a right of rejection and who has what burden of proof?*

*Perhaps the burden in these cases should be on the seller to prove that the goods conformed to the contract when they were delivered to the carrier.*

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

*(2) Even though the buyer had a rejection right, § 2-510(1) provides that the risk remains on the seller only "until cure or acceptance." Section 2-510(2), however, provides that if the buyer "rightfully revokes acceptance," presumably before the loss,[28] "he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning." What does this mean?*

*Suppose at the time of the loss that the contract price was $100, the market value of the goods with defects was $75 and the buyer was insured up to $50 per unit. What is the deficiency in "effective" coverage, $25 or $50? (Probably $25.) What is the buyer's relief from that deficiency? Since he does not owe the price, § 2-608(3), it is not a price offset. Since the buyer is now just a bailee of the seller's goods, he does not have any ownership interest to insure. § 2-401(4). Does the buyer get to keep the proceeds (a windfall) or must he remit them to the seller? And what about the buyer's insurance company?*

*No answers are provided by the statute or the comments.*

*(3) § 2-510(3) covers the case where the seller identifies goods to the contract (risk still on seller), buyer breaches (risk still on seller) and then the goods are destroyed. Here, the seller "may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time." Let's suppose that the goods were worth $100 and the seller was insured up to $50. Does § 2-510(3) permit the seller to sue the buyer for the deficiency as if it were a suit for the price under § 2-709(1)(a)? This seems plausible, but the answer is not clear.*

[TASK FORCE - 2-510]

SECTION 2-510

Section 2-510 confuses and complicates questions of risk of loss by mixing them with questions regarding the consequences of breach. Because the general risk of loss rules (section 2-509) operate on presumptions of insurance, which are considerations separate from the risks attendant to breach, there is no clear policy guidance or general principle running throughout section 2-510 to pull the section together and make it coherent. A majority of Task Force members therefore agree with the recommendation to repeal section

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*28. If the goods were destroyed before the attempt, revocation of acceptance would not be available. § 2-608(2).*

2-510. Those members who do not support repeal agree with the Study Group's alternate recommendation to revise section 2-510 to assure a causal link between the breach and the casualty to the goods.

*[PRELIMINARY REPORT - 2-511]*

*L. TENDER OF PAYMENT BY BUYER; PAYMENT BY CHECK: § 2-511.*

***No revisions are recommended in the text of § 2-511.***

*Assuming that the buyer's duty to tender arises first, § 2-511(1) states, unless otherwise agreed, that "tender of payment is a condition to the seller's duty to tender and complete any delivery." If the seller tenders first, see § 2-507(1), the buyer now has a duty to accept and pay for the goods. Presumably, the buyer must tender payment under § 2-511(1) before the seller is obligated to "complete" the earlier tender of delivery.*

*See Rec. A2.5(4)(A), where the Study Group recommended that unless otherwise agreed the seller should have the obligation to tender first.*

***Rec. A2.5 (8).***

***These clarifications and the proposed revision to § 2-507(1) should be included in a comment to § 2-511.***

*No problems of importance have arisen in determining when a tender of payment is "sufficient," § 2-511(2), and the consequences of dishonor, § 2-511(3).*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-512]*

*M. PAYMENT BY BUYER BEFORE INSPECTION: § 2-512.*

***No revisions are recommended in § 2-512.***

*The buyer normally has a right to inspect the goods "before payment and acceptance." § 2-513(1). The parties, however, may agree otherwise, such as by an agreement for delivery C.O.D. or for payment "against documents of title." § 2-513(3). In these cases, § 2-512(1) states when the buyer must pay even if the goods are non-conforming and § 2-512(2) states that such payment is not an acceptance[29] and does not impair the*

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*29. Payment coupled with other conduct satisfying § 2-606, however, may constitute an acceptance. Tonka Tours, Inc. v. Chadima, 372 N.W.2d 723 (Minn. 1985).*

*buyer's subsequent right to inspect the goods or "any of his remedies."*

*No problems of importance have arisen under § 2-512.*[30]

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-513]*

*N. BUYER'S RIGHT TO INSPECTION OF GOODS: § 2-513.*

***No revisions are recommended in the text of § 2-513.***

*Unless otherwise agreed, § 2-513(1) provides that the buyer, after the seller's tender or identification of the goods, has a "right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner." In shipment contracts, the time may be "after their arrival."*

*Section 2-513 also allocates the expenses of inspection, § 2-513(2), states when the buyer is not entitled to inspect before payment, § 2-513(2), and covers problems that might arise when the "place or method of inspection" is fixed by the parties. § 2-513(4). These rules are subject to contrary agreement of the parties and are influenced by trade practice and prior course of dealing.*[31] *There is no litigation of importance under § 2-513 and we are aware of no significant problems in practice.*[32]

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-514]*

*O. WHEN DOCUMENTS DELIVERABLE ON ACCEPTANCE; WHEN ON PAYMENT: § 2-514.*

***No revisions are recommended in the text of § 2-514.***

*This specialized provision should be incorporated into any revision that integrates all sections dealing with documentary transactions.*

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*30. Section 2-512 frequently applies in documentary transactions. § 2-512(1)(a) states that "where the contract requires payment before inspection non-conformity of the goods does not excuse the buyer from so making payment unless (a) the non-conformity appears without inspection. . . ." Clearly, the "unless" clause refers to the "non-conformity" of the goods rather than any non-conformity in the documents. In the latter case, the buyer could reject the tender under § 2-601.*

*As a practical matter, the "unless" in § 2-512(1)(a) will not arise where the goods are not available for inspection at the time of the demand for payment.*

*31. See, e.g. D.C. Leathers, Inc. v. Gelmart Industries, Inc., 509 N.Y.2d 161 (App.Div. 1986), where trade usage and past practices between the parties were invoked to support the reasonableness of an inspection.*

*32. The probabilities are that many buyers discover non-conformities in the goods after acceptance, i.e., where they had a "reasonable opportunity to inspect" the goods and failed to make an effective rejection. § 2-606(1)(b). If so, this suggests that many buyers are not fully utilizing a right that is clearly and reasonably afforded them in § 2-513.*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-515]*

*P. PRESERVING EVIDENCE OF GOODS IN DISPUTE: § 2-515.*

***No revisions are recommended in § 2-515.***

*Here is another provision of potential importance over which there has been little or no litigation. The inspection right arises after a dispute over quality has arisen. At least one court has held that it must be exercised to further the adjustment of any claim or dispute rather than as a device for discovery after a law suit has been filed.[33] In any event, the right is available without regard to who has what burden to prove either the existence or the breach of a warranty.*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-601]*

## *ARTICLE 2, PART 6: BREACH, REPUDIATION AND EXCUSE*

*A. OVERVIEW.*

*Article 2, Part 6 deals with two somewhat distinct sets of problems. The first, covered in §§ 2-601 through 2-612, concerns the power of and procedures necessary for the buyer to reject a tender of delivery, the buyer's duties with regard to rejected goods, acceptance and the consequences of acceptance, revocation of acceptance, adequate assurance of due performance, repudiation and retraction of a repudiation and installment contracts. The second, covered in §§ 2-613 through 2-616, deals with the grounds and procedures for claiming excuse for a failure to perform as agreed and some of the remedial consequences.*

*B. BUYER'S RIGHTS ON IMPROPER DELIVERY: §2-601.*

***Rec. A2.6 (1)***

***A majority of the Study Group recommends minor revisions in § 2-601 and the comments.***

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*33. A magistrate's opinion in Massachussetts. See 39 U.C.C. Rep. Serv. 1263 (1984).*

*Because of the potential for abuse by the buyer, the "perfect tender" rule is a matter of some controversy.[1] The image of a buyer rejecting a trivial non-conformity to take advantage of a rapidly falling market price is frequently invoked.[2] Also, the "perfect tender" rule has been rejected for commercial reasons by CISG in international sales.[3] One might expect, therefore, a recommendation to adopt a substantial impairment test in § 2-601.*

***(A) The Study Group, however, recommends that § 2-601 be maintained as currently drafted, except that the phrase "if acting in good faith" should be inserted after "the buyer" and before "may." Further, the comments and cross-references should be revised to (1) collect in one place all of the limitations upon § 2-601 and (2) clarify the importance of agreement in defining the standards for performance to which the goods or the tender must perfectly conform.***

*Arguably, the image of buyers engaging in strategic behavior under § 2-601 is illusory. Certainly, that image is not strengthened by the cases, most of which show rejections for reasons consistent with a substantial impairment rather than bad faith.[4] Further, a statutory requirement of substantial impairment emerges indirectly from the limitations imposed upon § 2-601 and the reality that many buyers will accept the goods without discovering the nonconformity and will have to establish "substantial impairment" to revoke acceptance under § 2-608.*

*Although the current statutory scheme is not very tidy, additional clarity could be achieved by listing in the statutory cross-references all of the limitations on § 2-601 that are not contained in the statute itself, such as §§ 2-508, 2-504, 2-614 and, when an acceptance has occurred, § 2-608.*

***(B) An alternative proposal, supported by some commentators and some members of the Study Group, requires that § 2-601 be revised to condition rejection upon a nonconformity that "substan-***

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*1. For a timeless analysis attacking the rule, see Honnold, Buyer's Right of Rejection-A Study of the Impact of Codification Upon a Commercial Problem, 97 U. Pa. L. Rev. 1123 (1949). See also, Lawrence, The Prematurely Reported Demise of the Perfect Tender Rules, 35 U. Kan. L. Rev. 557 (1987); Schmitt & Frisch, The Perfect Tender Rule—An Acceptable Interpretation, 13 U. Tol. L. Rev. 1375 (1982).*

*2. Such a rejection may be in bad faith. See Neumiller Farms, Inc. v. Cornett, 368 So.2d 272 (Ala. 1979). This problem was explored in an early article, Eno, Price Movement and Unstated Objections to the Defective Performance of Sales Contracts, 44 Yale L.J. 782 (1935).*

*3. Article 46(2).*

*4. See, e.g., Carbontex Trading Co. Ltd. v. Phibro Energy, Inc., No. 87-1767 (E.D. La., Sept. 12, 1989)(under New York law, facts justifying rejection under § 2-601 also constituted a substantial impairment).*

*tially impairs the value of the performance to the buyer."[5] This revision is consistent with the practical effect of current § 2-601, yet, in its "subjective" aspects, provides protection to particular expectations of the buyer. A primary purpose here is to increase the chances that a seller will be able to "cure" before the buyer cancels the contract.[6]*

[TASK FORCE - 2-601]

ARTICLE 2 - PART 6

SECTION 2-601

The issue of whether to adopt a rule of perfect tender or a rule of substantial performance as a prerequisite to the buyer's right of rejection was debated numerous times over more than a decade during the drafting of Article 2.[331]

The drafters rejected the substantial performance rule for several reasons: "[F]irst, that the buyer should not be required to

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*5. Karl N. Llewllyn's contention that the right to rejection should be limited to a material breach was supported by the New York Law Revision Commission. See Report of the Law Revision Commission to the Legislature Relating to the Uniform Commercial Code 44 (1956). See also, Wiseman, The Limits of Vision: Karl Llewellyn and the Merchant Rules, 100 Harv. L. Rev. 465, 510-21 (1987)(discussing legislative history). Peters agreed. See Roadmap at 215-16.*

*6. A direct revision might limit rejection to a non-conformity which "substantially impairs the value of the contract to the buyer," the test now required to revoke acceptance, § 2-608(1). The burden would then be on the parties to contract "into" rather than out of the "perfect tender" rule. If adopted, other sections now limiting § 2-601 should be reviewed for consistency.*

*Under this revision, a plausible statutory scheme might look like this: (1) The power to reject and the power to revoke acceptance would be the same. Both would be subject to notice conditions, but the revocation power would still have some of the conditions now contained in § 2-608; (2) The seller's power to cure would be broadened in § 2-508 and extended to both rejection and revocation of acceptance; (3) The buyer's power to cancel would be conditioned upon the seller's unwillingness or inability to cure; and (4) Problems associated with the buyer's possession of goods rejected or revoked could be treated in the same sections. For an elaboration, see Sebert, Rejection, Revocation and Cure Under Article 2 of the UCC: Some Modest Proposals, 84 Nw. U. L. Rev. #2 (1990)(forthcoming).*

331 N.C.C.U.S.L., Consideration in Committee of the Whole of the First Tentative Draft of the Amendments to the Uniform Sales Act 7-17 (1940), *reprinted in* N.C.C.U.S.L. Archives Publications, microfiche 32.0-A (Hein, 1983); N.C.C.U.S.L., Consideration in Committee of the Whole of the Revised Uniform Sales Act 62-66 (1941) [hereinafter 1941 Annual Conference Transcript], *reprinted in* N.C.C.U.S.L. Archives Publications, microfiche 32.0-B (Hein, 1983); Malcolm, *Hearing Before Enlarged Editorial Board January 27-29, 1951*, 6 BUS. LAW.

guess at his peril whether a breach is material; second, that proof of materiality would sometimes require disclosure of the buyer's private affairs such as secret formulas or processes.''[332] In the earlier debates on substantial performance, fear was expressed that such a rule would result in a flood of litigation due to the uncertainty inherent in such a rule.[333]

In 1956, the Article 2 Subcommittee of the Editorial Board resisted recommendations by the New York Law Revision Commission that the substantial performance rule be adopted. The Subcommittee report to the Law Revision Commission, after reciting the reasons against the rule quoted above, declared, "Individual members of this subcommittee retain their views that the LRC [New York Law Revision Commission] proposal states a better policy than the Code text, but they do not recommend that the matter be reopened now.''[334]

The Drafting Committee should reconsider whether to adopt a substantial performance test, as some members of the Study Group recommend.[335] The Drafting Committee should carefully consider the benefits and costs of such a rule. In particular, it should consider whether the adoption of rules permitting a tribunal composed of merchants to decide the substantial performance issue would be a workable solution.[336]

*[PRELIMINARY REPORT - 2-602]*

*C. MANNER AND EFFECT OF RIGHTFUL REJECTION: § 2-602.*

***Rec. A2.6 (2)***

***A major restructuring is recommended for § 2-602. Section 2-602(1) should be combined with § 2-605 to create a new section***

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164, 194-95 (1951) (editorial board votes to reconcile 2-601 with 2-612); Editorial Board, Uniform Commercial Code, Report No. 5 of the Subcommittee on Art. 2. at 103a (Jan. 18, 1956) in the Braucher Papers, file 26-2 (located in the Harvard Law School Library) [hereinafter Report No. 5 of the Art. 2 Subcommittee].

332 Report No. 5 of the Art. 2 Subcommittee, *supra* note 331.

333 1941 Annual Conference Transcript, *supra* note 331, at 64.

334 Report No. 5 of the Art. 2 Subcommittee, *supra* note 331.

335 Prelim. Rpt., Part 6, Rec. A2.6(1)(B), *supra* p. 1158-59.

336 Revised Uniform Sales Act, Second Draft. Comment on § 11-A, at 101 (Dec. 1941), *reprinted in* 1 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 381 (1983); 1941 Annual Conference Transcript, *supra* note 331.

*numbered § 2-602 and entitled "Manner, Effect and Form of Rightful Rejection." Section 2-602(2) should then be combined with § 2-603 to create a new section numbered § 2-603 and entitled "Buyer's Duties as to Rightfully Rejected Goods" and covering the duties of both merchant and non-merchant buyers.*

*1. Form, Method and Time of Rejection.*

*Assuming that the power to make a rightful rejection exists under § 2-601, § 2-602(1) conditions an "effective" rejection upon action within a reasonable time and upon "seasonable" notice to the seller. The failure to make an "effective" rejection is an acceptance, § 2-606(1)(b), which "precludes rejection of the goods accepted. . . ." § 2-607(2). Is an attempt to reject after acceptance a "wrongful" rejection, and thus a breach by the buyer, see § 2-602(3), or is the buyer simply limited to a possible revocation of acceptance under § 2-608? The latter is apparently correct, see Comment 3 to § 2-602 and the cross-references.*

***(A) We recommend that the Comments and cross-references be reviewed for clarity, since the interrelationship among these sections is not always apparent.***

*§ 2-602(1) does not prescribe the form of an effective rejection. Section 2-605, however, deals with the consequences of a failure by the buyer to state a particular defect "in connection with rejection." This section is not cited in either the comments or the cross-references to § 2-602.*

***(B) We recommend that after a review for clarity, § 2-605 be moved to § 2-602. As revised and integrated, § 2-602 would deal only with the manner, effect and form of a rejection otherwise rightful.***

*2. Duties with regard to Rightfully Rejected Goods.*

*§ 2-602(2) deals with the some of the buyer's rights and duties with regard to rejected goods. Sections 2-603 and 2-604 provide other duties and rights and § 2-711(3) grants the buyer a security interest in goods in its possession upon "rightful" rejection.*

***(C) We recommend that § 2-602(2) be combined with § 2-603 to provide in one section all of the buyer's rights and duties with regard to "rightfully" rejected goods. That section (§ 2-603) also would govern the obligations of a buyer who is in possession of goods after a justifiable revocation of acceptance under § 2-608. See § 2-608(3)***

***In addition, the same rights and duties, to the extent appropriate, should apply where the buyer is in possession after a justifiable revocation of acceptance.***

*In this integration, care must be given to achieve consistency in terminology and accurate captions. The following clarifications and questions should be considered.*

*(a) What are the buyer's duties with regard to goods in its possession after a "wrongful" rejection? Section 2-602(3) deals with the seller's remedial rights after a wrongful rejection, but what about the buyer's duties? Are they those of a common bailee or are they governed by § 2-602(2)(b)?*[7]

*(b) It should be clear that "rightful" rejection, as used in §§ 2-602(2), 2-603 and 2-604, means a proper rejection under § 2-601 and an effective rejection under § 2-602(1), and that all rejections governed by those sections are "rightful" rejections. If the rejection is "wrongful," it is a breach of contract. If it is proper under § 2-601 but not effective under § 2-602(1) the buyer has accepted the goods and is subject to § 2-607.*

*(c) New § 2-603 should deal clearly with the effect of an "exercise of ownership" by the buyer over goods in its possession after a rightful rejection or a justifiable revocation of acceptance. Section 2-602(2)(a) makes a pass at this for the former and, presumably, this also covers a revocation. But § 2-602(2)(a) simply states that an exercise of ownership is "wrongful as against the seller" without spelling out the consequences. To further complicate matters, § 2-606(1)(c) states that an act "inconsistent" with the seller's ownership is an acceptance, but if the act is "wrongful" against the seller, the seller must ratify to have an acceptance.*

*An attempt should be made to differentiate three post-rejection or post-revocation "use" situations: (1) Cases where use of the goods imposed a duty to pay for the use but did not impair the validity of the rejection or revocation;*[8] *(2) Cases where the use either constituted acceptance of the goods or waived the revocation, but was not wrongful against the seller; and (3) Cases where the use or conduct was wrongful, giving the seller a choice between enforcing the contract or bringing an action in tort for conversion.*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-603]*

*D. MERCHANT BUYER'S DUTIES AS TO RIGHTFULLY REJECTED GOODS: § 2-603.*

***Rec. A2.6 (3).***

***As discussed under § 2-602, a major restructuring is recommended for § 2-603. Section 2-603 should be expanded to cover the duties of all buyers in possession of rightfully rejected or justifiably***

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*7. See § 2-401(4)(title revests in seller after an unjustified rejection).*

*8. A variation of this is where the use neither impaired validity nor imposed a duty to pay.*

*revoked goods, with clarifications on the nature and effect of subsequent use and the nature and effect of any post-rejection or post-revocation use.*

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-604]*

*E. BUYER'S OPTIONS AS TO SALVAGE OF RIGHTFULLY REJECTED GOODS: § 2-604.*

***No revisions are recommended in § 2-604.***

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-605]*

*F. WAIVER OF BUYER'S OBJECTIONS BY FAILURE TO PARTICULARIZE: § 2-605.*

***Rec. A2.6 (4).***

***Section 2-605 should be integrated with § 2-602(1) to create a new section, entitled "Manner, Effect and Form of Rightful Rejection."***

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-606]*

*G. WHAT CONSTITUTES ACCEPTANCE OF GOODS: § 2-606.*

***No revisions are recommended in § 2-606.***

*Section 2-606(1)(c) raises the question discussed under § 2-602: To what extent can a buyer, after rejection or revocation, use the goods without either impairing the remedies in § 2-601 and 2-608 or committing a tort? The need for such use might arise because of delay by the seller in effecting a "cure" or delays in covering. An appropriate answer is that, in these circumstances, the buyer should be able to make use of the goods for a reasonable time upon the payment of reasonable compensation. This limited use should be distinguished from other acts inconsistent with the seller's*

*ownership. Again, additional clarity in the lines to be drawn is required.*[9]

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-607]*

*H. EFFECT OF ACCEPTANCE; NOTICE OF BREACH; BURDEN OF ESTABLISHING BREACH AFTER ACCEPTANCE; NOTICE OF CLAIM OR LITIGATION TO PERSON ANSWERABLE OVER: § 2-607.*

***Rec. A2.6 (5).***

***Some revisions in the text of § 2-607 are recommended, as noted below.***

*Section 2-607 collects in one place some important and sometimes controversial consequences of acceptance. In most cases, they place increased burdens on a buyer who has failed, after a reasonable opportunity to inspect, to make an effective rejection. § 2-606(1)(b).*

*1. Some important burdens of acceptance include: (a) The buyer must pay for the goods at the contract rate. § 2-607(1). This is consistent with § 2-709(1)(a); (b) The buyer cannot reject the goods and, if acceptance was made with knowledge of a non-conformity, it may lose the right to revoke acceptance under § 2-608. § 2-607(2); (c) The burden "to establish any breach with respect to the goods" is placed on the buyer. § 2-607(4).*

***No revisions are recommended in these subsections.***

*(2) A controversial burden of acceptance is the notice condition in § 2-607(3)(a).*[10] *A buyer is "barred from any remedy" if it fails "within a reasonable time after he discovers or should have discovered any breach" to "notify the seller of breach." This subsection operates on the assumption that notice is important to the seller to effect a cure, or to facilitate an effort to negotiate a settlement, or to gather and preserve evidence for possible litigation. All of these are laudable purposes.*

*One problem is that the buyer is penalized for failing to give notice within a reasonable time after it "should" have discovered the breach. Compare § 2-608(2). Thus, the buyer could lose any remedy even though it had no knowledge of the breach. Compare § 2-725(1). This concern is*

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*9. Three other questions to be answered are: (1) Can ordinary use of the goods be distinguished from an "act inconsistent with the seller's ownership," § 2-606(1)(c); (2) Should § 2-606(1)(c) also provide that the buyer must have a "reasonable opportunity to inspect" before the use or act; and (3) Should the buyer be obligated to the seller for any depreciation of the goods during use?*

*10. See Reitz, Against Notice: A Proposal to Restrict the Notice of Claims Rule in U.C.C. 2-607(3)(a), 73 Cornell L. Rev. 534 (1988).*

*softened by the fact that the buyer is given a "reasonable opportunity" to inspect the goods before acceptance and by the importance of prompt and adequate information to efficient dispute resolution.*

*A more important problem is the content of otherwise timely notice. Section 2-607(3)(a) says that the buyer must "notify the seller of breach." Comment 4, however, states, on the one hand, that the "content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched" and, on the other hand, that the "notification which saves the buyer's rights under this Article need only be such as informs the seller that the transaction is claimed to involve a breach. . . ." Some courts, taking a literal approach, have faulted a notice of problems that would arise if a breach occurred and a notice that identified existing problems without claiming a breach.*

***(A) Literal interpretations of the notice requirement should be rejected. Either the text of § 2-607(3)(a) or the comments should be revised to require only that the notice inform the seller that problems have arisen or continue to exist with regard to the accepted goods. Also, the comments should clarify that the buyer has no obligation to notify for breaches of which it has no knowledge.***

*3. The remaining parts of § 2-607 deal with a "vouching in" procedure in breach of warranty claims, § 2-607(5)(a), and special notice and vouching rules where claims of infringement are asserted under § 2-312.*

***(B) The Drafting Committee should consider whether the "vouching" procedure is constitutional and, if so, whether it is needed in light of improvements in third party practice and changes in the scope of the privity defense.***

[TASK FORCE - 2-607]

SECTION 2-607

The Task Force disagrees with the suggestion that the buyer has no obligation to notify the seller for breaches of which it has no knowledge. Admittedly, there may be cases in which the time for notice begins to run before the buyer learns of the breach, but for several reasons, it is believed that they do not justify a change from the "should have discovered any breach" language of the section. In the first place, the time when the breach should have been discovered is already the benchmark for judging the timeliness

of the buyer's actions under other sections of the Code.[337] It would be anomalous to say that the buyer's right to revoke has expired or that the statute of limitations has run, but that the time for reasonable notice under section 2-607 has not expired.

Second, the Task Force suggests that the penalty provision of section 2-607 be changed from an absolute bar of "any remedy" to a loss of remedy conditioned on the defendant showing that it was in some way prejudiced by reason of the failure to receive timely notice. Such a change would, in many instances, reduce the impact that the existing "discovery" rule would otherwise have on the unknowing buyer.

Finally, the notice requirement as now written reflects the importance of the buyer's right of inspection.[338] The change recommended by the Study Group would weaken the incentive to inspect carefully because the notice requirement is waived for an unknowing buyer.

An issue not dealt with by the Study Group is whether notice must be given when the suit is brought against a remote seller by a buyer claiming third party beneficiary status under U.C.C. section 2-318 or otherwise. It seems that there has been sufficient case law[339] and non-uniform amendments[340] to section 2-607 to justify statutory clarification. The Task Force sees no reason why notice should not be required in all cases, provided that where suit is against a remote seller, the time for giving notice does not begin to run until the seller's identity is or should have been discovered by the buyer.

One final matter considered by the Task Force was the constitutionality of the "vouching" procedure. Based solely on *Asahi Metal Industry Co. v. Superior Court*,[341] the following hypothetical would clearly bring vouching-in into conflict with due process: A

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337 *See, e.g.*, U.C.C. §§ 2-608(2), 2-725(2) (1990).

338 *See* U.C.C. § 2-513 (1990) (providing a right to inspect goods).

339 *Compare* Simmons v. Clemco Indus., 368 So. 2d 509, 513 (Ala. 1979) (claimant who contracted silicosis due to defective sandblasting hoods supplied by employer not required to give notice to manufacturer) *with* Parrillo v. Giroux Co., 426 A.2d 1313, 1317 (R.I. 1981) (bartender injured by exploding bottle of grenadine was required to give notice to manufacturer within reasonable time).

340 *See* ME. REV. STAT. ANN. tit. 11, § 2-607 (1966 & Supp. 1990) (notice requirement not applicable to personal injury); S.C. CODE ANN. § 36-2-607(3)(a) (Law. Co-op. 1976) (no notice of personal injury to seller of consumer good is required).

341 480 U.S. 102 (1987).

manufactures tire valves in limited numbers. He sells a few to B, who makes tires and puts the valves in tires. A and B are located in Delaware. A does not know where B sells tires. A does not ask. B sells some of the tires at his branch store in Los Angeles. P buys a tire from B and is injured, allegedly because of a defect in the valve, while riding in California. P sues B, who vouches-in A, in California.

There is an argument, however, that this longstanding procedure[342] might be compared to other so-called "traditional" (non-minimum contacts-based) bases of jurisdiction. For example, the Supreme Court has clearly continued to allow world-wide jurisdiction in true *in rem* cases, as per the discussion in *Shaffer v. Heitner*.[343] Likewise, jurisdiction through service while in the state survives *Shaffer*.[344] A tradition-based argument could be made for vouching-in, although it is probably less established (in a jurisdictional context) than *in rem* proceedings and in-hand service of process.

A stronger argument in favor of the constitutionality of applying the statute in the above mentioned hypothetical, and one which is endorsed by the Task Force, is premised on a contractual waiver of personal jurisdiction rights.[345] If the statute is interpreted as implying the right to vouch-in as one of the terms of the contract, it might constitute an enforceable waiver of the constitutional objection. A re-wording of section 2-607 to make the waiver explicit is suggested.

As an alternative to the above, the Drafting Committee should consider a construction of the statute which limits it to that which is constitutionally permissible. Those who wish to save the existing statute at the expense of giving up the jurisdictional aspect might favor a minor addition ("to the extent permitted by the constitution of this state and of the United States") to clarify the constitutional issue.

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342 *See generally* Degnan & Barton, *Vouching to Quality Warranty: Case Law and Commercial Code*, 51 CALIF. L. REV. 471 (1963).

343 433 U.S. 186 (1977).

344 *See* Burnham v. Superior Court, 110 S. Ct. 2105 (1990) (finding that a California court had personal jurisdiction over New Jersey resident who was served with process while temporarily in California for activities unrelated to the lawsuit).

345 Contractual waiver of jurisdiction is well established. *See* National Equip. Rental v. Szukhent, 375 U.S. 311 (1964).

*[PRELIMINARY REPORT - 2-608]*

## *I. REVOCATION OF ACCEPTANCE IN WHOLE OR IN PART: § 2-608.*

***Rec. A2.6 (6).***

***The following revisions in the text or comments of § 2-608 are recommended.***

*1. Section 2-608 permits a buyer to "revoke" an acceptance under limited circumstances. A proper revocation gives the buyer "the same rights and duties with regard to the goods involved as if he had rejected them." § 2-608(3). Section 2-608, however, does not set forth the effect of a "wrongful," i.e., unjustified, revocation. Clearly, it is a breach of contract, § 2-703, and, presumably, otherwise a nullity.*[11]

***(A) The comments should clarify that unless otherwise agreed, a wrongful rejection is still an acceptance and that the buyer's duties and the seller's remedies are controlled by §§ 2-607 and 2-703.***

*2. There are four types of limitations on revocation of acceptance, all of which must be satisfied under § 2-608: (a) The non-conformity must substantially impair the value to the buyer of a lot or commercial unit (the so-called subjective approach); (b) The failure to act upon or to discover the nonconformity at the time of acceptance must be excusable, see § 2-608(1); (c) Notice of the revocation must be timely; and (d) Revocation must occur before "any substantial change in condition of the goods which is not caused by their own defects." § 2-608(2).*

***No revisions in the four limitations in § 2-608 are recommended. The Comments, however, should elaborate when use of the goods should bar revocation under § 2-608(2).***

*3. Does the seller have the right to "cure" a non-conformity after a rightful revocation of acceptance? The right is not provided in § 2-608, and § 2-508, literally construed, is limited to rejections.*

***(B) The Study Group recommends that §§ 2-608 and 2-508(1) be revised to insure that the seller shall have a right to cure where acceptance is rightfully revoked and the time for performance has not yet expired. The right to cure, however, shall not be available thereafter.***

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*11. See Roadmap at 240; Comment 5, § 2-709. But see, Wilbur, Wrongful Revocation: An Action For the Price or Damages, 16 W. St. U.L. Rev. 649 (1989).*

*4. To what extent should the buyer be permitted to use goods in its possession after a rightful revocation? This question, which also arises after a rightful rejection, has been litigated with uncertain results.*[12]

*In theory, the buyer is a bailee only and should seek substitute conforming goods through cover. In practice, cover may not be readily available or the seller may delay in making a promised repair or giving appropriate instructions.*

***(C) As previously noted, we recommend that § 2-603 be revised to state clearly in one place the buyer's rights and duties with regard to goods in its possession after either a rightful rejection or revocation of acceptance. In revised § 2-603, the power of the buyer, if any, to use the goods without prejudicing the remedies of rejection and revocation should be stated, along with the compensation that should be paid for use.***

*5. Under § 2-719(1), the parties have power to agree upon a sole and exclusive remedy for breach of contract. This agreement for limited remedies may exclude both rejection and revocation of acceptance. Section 2-719(2), however, provides that where "circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." Assuming such failure of essential purpose and unless otherwise agreed, the remedy of revocation of acceptance should still be available if the conditions of § 2-608 can be satisfied.*

***(D) A Comment clarifying that the remedy of revocation survives the failure of an agreed, limited remedy should be prepared.***

[TASK FORCE - NONE]

*[PRELIMINARY REPORT - 2-609]*

*J. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE: § 2-609.*

***No revisions are recommended in the text of § 2-609.***

*The text of § 2-609 consists, mainly, of standards that must be particularized in each case. Certainty and predictability do not reside therein. Nevertheless, the "adequate assurance" process, when invoked, provides important opportunities for communication and clarification between the parties and can facilitate agreed dispute resolution. Despite disagreements*

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*12. See Robertson, Rights and Obligations of Buyers With Respect to Goods in their Possession After Rightful Rejection or Justifiable Revocation of Acceptance, 60 Ind. L. J. 663, 679-94 (1985).*

*over interpretation, there is no evidence that § 2-609 has failed its intended objectives.*

[TASK FORCE - 2-609]

SECTION 2-609

Contrary to the Study Group's recommendation, the Task Force is of the opinion that there are two areas in which problems might be avoided by certain revisions in the text of section 2-609. First, while the section explicitly requires that the demand for assurances be in writing, some courts have followed the Restatement (Second) of Contracts[346] and have held that no writing is required.[347] For the sake of uniformity, the Task Force favors dropping the writing requirement. Furthermore, to require an insecure party who is satisfied with an oral assurance of performance to make his demand in writing might not always be appropriate. A formal demand for assurance might be viewed as excessive in light of the party's prior relationship, particularly when that relationship has been continuous and friendly.

The second problem area involves excessive demands. Some courts have held that even though there are reasonable grounds for insecurity, an insecure party who makes excessive demands is not entitled to any assurances in return, and may instead find himself in breach for suspending performance while awaiting assurances.[348] This is clearly erroneous. Once the threshold of reasonable grounds for insecurity has been met, the right to demand unconditionally assurances unconditionally accrues to the insecure

346 RESTATEMENT (SECOND) OF CONTRACTS § 251 (1979).

347 *See, e.g.*, AMF, Inc. v. McDonald's Corp., 536 F.2d 1167, 1171, 19 U.C.C. Rep. Serv. (Callaghan) 801, 807 (7th Cir. 1976) (plaintiff's "failure to make a written demand was excusable" because the defendant had a "clear understanding" that the plaintiff had "suspended performance until it should receive adequate assurance of due performance"); Kunian v. Development Corp. of Am., 165 Conn. 300, 334 A.2d 427, 12 U.C.C. Rep. Serv. (Callaghan) 1125 (1973) (oral demand for assurances at a meeting between parties was equivalent to a written demand); Toppert v. Bunge Corp., 60 Ill. App. 3d 607, 377 N.E.2d 324 (1978) (oral demand at meeting asking for payment was a demand for adequate assurances under the purposes and policies of the Code).

348 *See, e.g.*, United States v. Great Plains Gasification Assocs., 819 F.2d 831 (8th Cir. 1987); Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572, 18 U.C.C. Rep. Serv. (Callaghan) 931 (7th Cir. 1976).

party. While a party should not have to respond to any unreasonable demands, a party from whom a justified demand is sought must provide "adequate assurances," to the extent they are required under section 2-609.[349] A clarification of this in the text of the section is desirable.

*[PRELIMINARY REPORT - 2-610]*

*K. ANTICIPATORY REPUDIATION: § 2-610.*

***Rec. A2.6 (7).***

***The following revisions in the text of or comments to § 2-610 are recommended.***

*1. Except for § 2-609(4), Article 2 does not define when a party "repudiates the contract with respect to a performance not yet due." § 2-610. An attempt at definition is made in the comments, but there are some inconsistencies, especially where conduct is claimed as a repudiation.*

***(A) We recommend that the comments be revised to define repudiation in a style consistent with § 250 of the Restatement, Second. It should be harder rather than easier to establish a repudiation, especially where conduct is involved.[13] A tighter definition encourages the use of § 2-609 and expands the availability of a "safe harbor" against cancellation when there is a good faith dispute over contractual obligations.[14]***

*2. A repudiation of a future performance is not actionable unless the "loss. . .will substantially impair the value of the contract to the other." Under this subjective test, if the contract is 90% performed or only the next installment is repudiated, see § 2-612, the uncertainty over whether a*

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349 *Cf. In re* Luce Indus., Inc., 8 Bankr. 100, 108 (Bankr. S.D.N.Y. 1980) (the assurance provided does not have to be that which is requested; "[s]o long as the assurance is adequate, it will satisfy [11 U.S.C. § 356]").

*13. Under § 250, a "repudiation is (a) a statement by the obligor to the obligee indicating that the obligor will commit a. . .total breach. . .,or (b) a voluntary affirmative act which renders the obligor unable or apparently unable to perform without such a breach."*

*14. The courts and commentators agree that the test for repudiation is objective and that one form of repudiation occurs when a party, without justification, states that he will not perform a material part of the future performance unless the other party agrees to a modification of the contract. See E. A. Farnsworth, Contracts §§ 8.20 & 8.21 (1982). There is less agreement whether withholding future performance until resolution of a good faith dispute arising under the contract is a repudiation. Given the importance of agreed dispute resolution and preserving the contract, there should be some room for a "safe harbor" in this setting and the boundary should be made clearer. For a suggestive analysis, see Rosett, Partial, Qualified, and Equivocal Repudiation of Contract, 81 Colum. L. Rev. 93 (1981).*

*cancellation is justified may induce the aggrieved party to invoke the "adequate assurance" mechanism in § 2-609.*

***(B) We support the subjective test and recommend that it be used in other sections, e.g., §§ 2-608(1) and 2-612, where the substantial impairment requirement is contained.***

*3. If the elements of repudiation and "substantial impairment" are satisfied, § 2-610 gives the aggrieved party several remedial options.*

*First, it may await performance by the repudiating party "for a commercially reasonable time. . . .," § 2-610(a), and "suspend his own performance." § 2-610(c).[15] A buyer who follows this course of action takes the risk that the repudiator may retract the repudiation. § 2-611.[16] What is the effect, however, of waiting for more than a commercially reasonable time? Does the aggrieved party waive the power to cancel the contract or lose the implied right to perform under the contract and seek damages? Or, does the suspended duty to perform now become a breach? Or, may the aggrieved party still "resort to any remedy for breach?" § 2-610(b). The latter solution appears to be sound, although the text is not clear.[17]*

***(C) We recommend revisions in the comments to clarify these relationships.***

*Second, unlike § 2-612(3), § 2-610(b) appears to give a party aggrieved by a repudiation more latitude to urge action inconsistent with cancellation without losing the power to cancel. Section 2-610(b), for example, states that the aggrieved party may resort to any remedy "even though he has notified the repudiating party that he would await the latter's performance and has urged retraction." Presumably, if the aggrieved party continued to perform the repudiated contract or sued for specific performance, the power to cancel would be waived. Conversely, if the aggrieved party canceled the contract for breach, the power subsequently to treat the contract as in force would be terminated.[18]*

***(D) Again, the comments should be revised to clarify what conduct is sufficiently inconsistent with a repudiation that the power to cancel is waived.***

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*15. The aggrieved party's discretion to wait a "commercially reasonable time" preserves remedial options but does not provide a measure of damages. See §§ 2-708(1) & 2-713 and the recommended revisions at Rec. A2(7)(11)(A). infra.*

*16. Leary and Frisch argue that the power of the repudiator under § 2-611 to unilaterally reinstate the contract is unsound and should be reexamined. Revision at 463-65.*

*17. See Rec. A27(11)(A), infra, for discussion of the relationship between § 2-610(a) and the damage formula in §§ 2-708(1) and 2-713.*

*18. See Peters, Roadmap at 263-67, who worries through some of these problems.*

*Third, the relationship between the remedial options provided in § 2-610 and the power to cancel the contract given in § 2-703 and § 2-711(1) is not always clear. "Cancellation" is defined in § 2-106(4), but Article 2 does not state what action constitutes cancellation or what procedures or notice should be invoked to effect it.*

***(E) Assuming that an aggrieved party has power to cancel all or part of the remaining contract under § 2-610 and either § 2-703 or § 2-711(1), we recommend that the Drafting Committee consider whether the content of and procedures for cancellation should be more fully elaborated.***

[TASK FORCE - NONE][350]

*[PRELIMINARY REPORT - 2-611]*

*L. RETRACTION OF ANTICIPATORY REPUDIATION: § 2-611.*

***No revisions are recommended in the text of § 2-611.***

[TASK FORCE - NONE]

*[PRELIMINARY REPORT- 2-612]*

*M. "INSTALLMENT CONTRACT": BREACH: § 2-612.*

***Rec. A2.6 (8).***

***We recommend several revisions in the text of and the comments to § 2-612.***

*1. No major problems exist in the definition of an installment contract. Transactions such as "take or pay" contracts are installment contracts under § 2-612(1) because the bargain "authorizes" delivery of goods in separate lots even though the buyer may decide always to pay and never to take.*[19]

*2. Section 2-612(2) deals with the buyer's power to reject a non-conforming installment. A non-conformity in goods must "substantially impair the value of that installment and cannot be cured." There is no persuasive reason why a substantial impairment test should be invoked for*

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350 *But see infra* text accompanying notes 389-93 (discussing problems with purely subjective test for total breach).

*19. But see Roadmap at 223-24, where Peters suggests that the result is not so clear.*

*rejection of a single installment, although there is a stronger justification for a broader power by the seller to cure in an installment contract.*

***(A) A majority of the Study Group[20] recommends the following revisions in § 2-612(2) or the comments: (a) The "perfect tender" rule should be available to the buyer or seller when an installment fails to conform "in any respect to the contract"; (b) In a continuing relationship, the seller should have power to "cure" the nonconformity which is as broad as that granted in § 2-508(1), even though the time for performance of that installment has passed; and (c) The comments should clarify when the failure to the seller to cure the non-conformity justifies cancellation of the entire contract.[21]***

*3. § 2-612(3) states when a breach with regard to one or more installments "is a breach of the whole" and, assuming that such a breach has occurred, when certain inconsistent conduct by the aggrieved party "reinstates the contract."*

*(a) Since a "breach of the whole" gives the aggrieved party power to cancel the contract, one question involves the test for substantial impairment. Unlike § 2-610 and § 2-608(1), § 2-612(3) appears to exact an objective test: The non-conformity must "substantially impair the value of the whole contract" to a reasonable person, not simply impair the value of the whole contract "to him." Thus, it is harder to cancel an installment contract (presumably there is a policy to preserve these contracts) and more incentive to use the adequate assurance mechanism in § 2-609.*

***(B) The Study Group, with one dissent, recommends that the "subjective" test of substantial impairment be adopted for § 2-612(3). This achieves consistency in the statement of that test without undue risk to the security of installment contracts and without undercutting the utility of § 2-609.***

*(b) The second sentence of § 2-612(3) provides that an aggrieved party "reinstates the contract" if, after a breach of the whole, it engages in inconsistent conduct, such as demanding "performance as to future installments." A more accurate statement is that the aggrieved party "waives the power to cancel" by such conduct, not "reinstates" a contract that has not yet been canceled.*

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*20. This recommendation assumes that the "perfect tender" rule is preserved in § 2-601.*

*21. Section 2-612(2) now provides, in essence, that if the default in one installment is insufficient to justify cancellation of the entire contract, § 2-612(3), and the seller gives "adequate assurance of its cure," the buyer "must accept that installment." The text, however, does not say what happens if the seller fails to cure or to give "adequate assurance" of cure. A preferred answer is that, after the seller's failure, the buyer should invoke § 2-609 and demand adequate assurance with regard to the entire contract.*

*(C) We recommend that § 2-612(3) be revised to this effect. Also, we recommend that the Drafting Committee consider whether an indication in the text of what conduct under § 2-610 "waives" the power to cancel is necessary. Ideally, a single subsection dealing with the "waiver" issue for all breaches of the whole makes sense.*

*(D) The comments should be revised to clarify that the remedy of revocation of acceptance should be available under § 2-612, subject to the seller's right to cure under § 2-508(1).*[22]

*In 1963, Professor Peters, after suggesting that § 2-612 was a "law professor's delight," recommended revisions that would "apply evenhandedly to both buyers and sellers."*[23] *Her analysis should be carefully considered by the Drafting Committee. In addition, the concept of "material" breach expressed in §§ 2-608, 2-610 and 2-612 should be carefully reviewed.*[24]

[TASK FORCE - 2-612]

SECTION 2-612

This section contains special rules applicable to "installment contracts," as that term is defined in subdivision 2-612(1).

1. *Subdivision 2-612(1): Definition of "Installment Contract"*

The Study Group finds that no major problems exist with the definition of "installment contract." Consequently, the Study Group does not recommend any changes. The Preliminary Report does, however, note that Justice (then Professor) Peters did raise a problem with the definition.[351]

Peters' concern was that the definition is ambiguous when applied to a contract permitting deliveries, but not payments, to be made in installments, if it is not feasible to apportion the price for each installment. Peters concluded that such a contract would be within the subdivision 2-612(1) definition.[352]

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*22. For an excellent analysis, see Patterson, UCC Section 2-612(3): Breach of an Installment Contract and a Hobson's Choice for the Aggrieved Party, 48 Ohio St. L.J. 177 (1987).*

*23. Roadmap at 223-27.*

*24. See Andersen, A New Look at Material Breach in the Law of Contracts, 21 U.C.D. L. Rev. 1073 (1988).*

351 Prelim. Rpt., Part 6 n.19, *supra* p. 1173.

352 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, 223-24 (1963).

The drafting history of section 2-612 demonstrates that Peters' conclusion is correct. In 1954, the relevant portion of subdivision 2-612(1) read, "An 'installment contract' is one which requires or authorizes the delivery of goods in separate lots to be separately accepted and paid for . . . ."[353] The New York Law Revision Commission recommended that the words "and paid for" be deleted.[354] The Editorial Board's Article 2 Subcommittee initially resisted the change on the grounds that the text "follows Uniform Sales Act Section 45(2) and seems not to have caused difficulty."[355]

In response to the Subcommittee report, Professor John Honnold, writing in his personal capacity, implored the Subcommittee to give further consideration to a number of sections, including subdivision 2-612(1).[356] He reasoned that, under the existing definition, a contract calling for separate deliveries but one payment would be excluded from section 2-612. Honnold asserted that such contracts are even more a unit and are more appropriate for coverage by section 2-612 than contracts that call for separate shipment and separate payment.[357] The Editorial Board subsequently adopted this recommendation and deleted the words.[358]

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353 U.C.C., Official Draft, Text and Comments Ed., 1952, With Changes and Modifications Approved by the Enlarged Editorial Board at Meetings Held on December 29, 1952, February 16, 1953, May 21, 1953, and December 11, 1953, at 211, *reprinted in* 16 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 243 (1983).

354 1956 N.Y. State Law Revision Comm'n Report 393 (No. 65). The reason for recommending the deletion presumably was the one advanced by Professor John Honnold, then a Research Consultant to the Law Revision Commission: "[T]he right to demand payment separately for each lot relates to the remedy and is not properly a part of the definition of an installment contract." *See* 1-1955 N.Y. State Law Revision Comm'n Report 543 ("There seems to be no apparent reason why rights to cancel, or obligation to accept defective installment, should turn on whether installments are to be separately . . . paid for.").

355 Uniform Commercial Code, Report to the Editorial Board of the Subcommittee on Article 2, Status of Sections and Answers to Unaccepted Recommendations 11 (Sept. 4, 1956) in the A.L.I. Archives, Drawer 198 [hereinafter Sept. 4, 1956, Article 2 Subcommittee Report].

356 J. Honnold, Comments on the September 4, 1956, Report of the ALI Subcommittee on Article 2 of the Uniform Commercial Code at 7 (Oct. 3, 1956) (available in the A.L.I. Archives, Box 697).

357 *Id. See also* Honnold, *Buyer's Right of Rejection, A Study in the Impact of Codification Upon a Commercial Problem*, 97 U. PA. L. REV. 457, 477 (1949) (stating that "[i]t would be startling to conclude that the special rules which apply because separate deliveries are embraced by a single contract may not also apply when the deliveries are even more closely linked by common payment").

358 1956 Recommendations of the Editorial Board for the U.C.C. 69 (1957), *reprinted in* 18 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 93 (1983).

Thus, it is clear that a contract permitting separate deliveries but not separate payments is an installment contract under subdivision 2-612(1).

### 2. *Subdivision 2-612(2): When a Non-Conforming Installment Can Be Rejected*

#### a. *Standard for Rejection of Single Installment*

Subdivision 2-612(2) permits a buyer to reject a non-conforming installment only if the non-conformity substantially impairs the value of the installment and cannot be cured, or if the non-conformity is a defect in the required documents. Contrary to present subdivision 2-612(2), a majority of the Subcommittee recommends (assuming that the perfect tender rule is retained for rejection under subdivision 2-601) that the perfect tender rule be available to the buyer or seller when an installment fails to conform to the contract in any respect.[359] Presumably, this means that the buyer or seller should have the right to reject an installment for any non-conformity, even one that is immaterial. The reason given for this recommendation is that "[t]here is no persuasive reason why a substantial impairment test should be invoked for rejection of a single installment, although there is a stronger justification for a broader power by the seller to cure in an installment contract."[360]

The proposal to provide a perfect tender rule for rejection of installments was made several times during the drafting history of Article 2.[361] It was rejected each time by the drafters in favor of the rule now contained in section 2-612(2). The drafters gave the following reason for limiting the buyer's right to reject an installment: "The fact of a continuing relationship normally justifies a less rigid standard for installment contracts than for contracts for

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359 Prelim. Rpt., Part 6, Rec. A2.6(8)(A), *supra* p. 1174.

360 Prelim. Rpt., Part 6, *supra* p. 1173-74.

361 *See, e.g.*, Memorandum of Task Group of the Special Committee of the Commerce and Industry Association of New York, Inc. on the U.C.C. on Article 2, Sales and Article 6, Bulk Transfers, *reprinted in* 1-1954 N.Y. Law Revision Comm'n Report (No. 65) at 104. *See also* 1-1954 N.Y. Law Revision Comm'n Report at 635.

a single delivery, covered by section 2-601.''[362] In addition, Llewellyn asserted several times that the limitations on the buyer's right to reject an installment were reflected in case law and mercantile practice.[363] Yet, Peters asserts that pre-Code law permitted the buyer to reject an installment for minor defaults.[364] At the very least, before any changes are made, this apparent conflict ought to be resolved.[365]

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362 Supplement No. 1 to the 1952 Official Draft of Text and Comments of the U.C.C. 106 (Jan. 1955), *reprinted in* 17 A.L.I. and N.C.C.U.S.L., U.C.C. Drafts 424 (1983).

Grant Gilmore described the drafting history in typically colorful fashion:

> There was a considerable controversy in the early days of the Code as to why the Code had, apparently, although stating the strong substantial performance role in § 2-612 with respect to installment contracts, restated what many people considered this exploded theory of perfect tender in § 2-601. I think at that point few people realized how much substantial performance there was buried in other, apparently unrelated, sections of the Code to cut back § 2-601. There was considerable tendency in the academic discussions of the problem in law review articles to say that § 2-601 was all wrong and what the draftsman ought to have done was to have adopted a straight substantial performance rule all the way through.
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> I remember hearing Professor Llewellyn discuss this problem once. He put it this way: He said that one of his advisers in the early years of drafting the sales article had been a Mr. Hiram Thomas of Boston, a Boston lawyer, for whom Llewellyn had great admiration, indeed reverence. Llewellyn said there was one meeting at which Hiram Thomas explained why it was that the perfect tender rule of § 2-601 was right with respect to ordinary contracts and the substantial performance rule of § 2-612 was right with respect to installment contracts. Anyone who heard Mr. Thomas that day, said Llewellyn, would be in no doubt that both sections were right. Unfortunately, said Llewellyn, he had since forgotten exactly what it was that Mr. Thomas said, and Mr. Thomas had since died, so that there was no way of reconstructing just why it was that § 2-601 was a good section of its type and § 2-612 was a good section its type. But Professor Llewellyn was adamant that they were both right and that Mr. Thomas had once known the reason. (Laughter)

A.L.I. and A.B.A., Advanced ALI-ABA Course of Study on Banking and Secured Transactions Under the Uniform Commercial Code 145 (1968). *See also* Honnold, *supra* note 357, at 477-88.

363 Informal Appendix to Revised Uniform Sales Act, Third Draft, 1943, Tentative Sketch of Material for Comments 45-46 (1943) (available in the A.L.I. Archives, Drawer 202). *See also* 21 A.L.I., *Proceedings* 191, 197 (1944).

364 Peters, *supra* note 352, at 224-25.

365 Preliminary research favors Llewellyn's view. *See* 1 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT 578 (rev. ed. 1948); 2 *id.* 701 at n.19, 729 at n.8, 730 at n.15, 776 at n.2 & 780.

In any event, in an installment contract, the buyer should be required to accept non-conforming installments if the seller gives adequate assurance of cure.[366] This result will maximize the opportunities for the deal to continue and for each side to get that for which they bargained. In effect, this rule requires the buyer and seller to cooperate to resolve non-conformities.[367] If the non-conformity is insubstantial, Llewellyn believed that money allowance would always suffice.[368] If the non-conformity is substantial, it should be cured. But the concept of cure in this section should be and is more flexible than under section 2-508. Under section 2-508, the cure must conform to the contract; that is, the buyer may insist on exact compliance with the literal terms of the contract[369] and he need not accept the goods until they conform. Under subdivision 2-612(2), however, the seller is not held to exact compliance with the literal terms.[370] Deficiencies in quantity or quality commonly are made up in later installments. Money allowance is permissible here,[371] but not under 2-508.[372] Additionally, under subdivision 2-612(2), the buyer is required to accept the installment if the seller gives assurance of cure.

The rule, supported by a majority of the Study Group, which would permit the buyer to reject for any defect and require a precisely conforming retender by the seller, increases the likelihood that the deal will break down. It is a rule that will tend to "snowball" partial breaches into total breaches. This result can only

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366 This discussion assumes that the non-conformity does not substantially impair the value of the whole contract under U.C.C. § 2-612(3) (1990).

367 *Cf.* Selected Comments to Uniform Revised Sales Act, General Comment on Parts II and IV. Formation and Construction 15 (1948) in the Llewellyn Papers, file J(IX)(2)(a) [hereafter General Comment] (reproduced in App. A); U.C.C. § 2-612 comment 5 (1990) (requiring reasonable action by buyer to facilitate cure by seller); Comment on Section 7-9 (S 101) Breach in Installment Contracts 10-11 (1948) in the Llewellyn Papers, file J(IX)(2)(b) [hereinafter Comment on Section 7-9] (reproduced in App. F).

368 21 A.L.I., *Proceedings* 197 (1944). *Cf.* U.C.C. § 2-612 comment 5 (1990) ("Cure of non-conformity of an installment in the first instance can usually be afforded by an allowance against the price . . . .").

369 *See supra* notes 306-07 and accompanying text (discussing § 2-508).

370 Compare the treatment of defects in required documents where the perfect tender rule for rejection does apply, but the seller has the right to make a timely conforming retender of documents. *See infra* notes 373-75 and accompanying text.

371 U.C.C. § 2-612 comment 5 (1990).

372 *See supra* notes 317-18 and accompanying text (discussing § 2-508).

serve to aid the party who wants to cancel for reasons having nothing to do with the asserted non-conformity.

The Study Group's recommendation of a perfect tender rule for rejection of an installment is coupled with the recommendation that the seller have a right to cure "as broad as that granted in section 2-508(1) even though the time for performance of that installment has passed."[373] This statement indicates that the Study Group may not have properly understood the scope of the seller's respective rights to cure under sections 2-508 and 2-612.

The seller's right to cure a defect in an installment under subdivision 2-612(2) is broader than the seller's right to cure under subdivision 2-508(1).[374] The differences between these subsections is illustrated by the disparate treatment in subdivision 2-612(2) of defects in goods compared with defects in documents. Defects in goods are governed by the installment contract rules of subdivision 2-612(2). Defects in documents are expressly excluded from the coverage of that subdivision because, in documentary sales, the rule is that the documents must strictly comply with the contract.[375] Nevertheless, cure of defective documents can be accomplished under section 2-508 if appropriate documents are readily available.[376]

b. *Effect of Seller's Failure to Cure or to Give Assurance of Cure*

The Study Group recommends that the comments to section 2-612 be revised to clarify when the failure to cure a non-conformity justifies cancellation of the entire contract.[377] The Preliminary Report suggests in a footnote that if the seller fails to cure or to give adequate assurance of cure, the buyer should be able to invoke section 2-609 and demand adequate assurance as to the entire contract.[378]

This suggestion is a proper solution only if the failure to cure or to give assurance of cure impairs the buyer's expectation of receiving due performance of future installments. Thus, if the seller

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373 Prelim. Rpt., Part 6, Rec. 2.6(8)(A), *supra* p. 1174.

374 *See supra* notes 368-72 and accompanying text.

375 General Comment, *supra* note 367, at 4-5; U.C.C. § 2-508 comment 2 (1990).

376 U.C.C. § 2-612 comment 5 (1990).

377 Prelim. Rpt., Part 6, Rec. A2.6(8)(A), *supra* p. 1174.

378 Prelim. Rpt., Part 6 n.21, *supra* p. 1174.

were to insist that the installment in question was not defective and that he would continue to deliver in like fashion, the buyer's expectation of proper future performance would be impaired. In this case, resort to section 2-609 is proper.

In some instances, however, the seller's inability does not impair the buyer's expectation of future performance. Suppose, for example, that part of the installment had been damaged enroute to the buyer, and that replacement goods were not readily available. If the seller had sufficient undamaged goods on hand to fulfill future installments, the buyer's expectation of future performance would not be impaired. In these circumstances, the buyer's right to cancel would depend on whether the present breach, the damage to the delivered installment, was so great as to substantially impair the value of the whole contract. This question does not involve section 2-609. Therefore, the Subcommittee's suggestion that the buyer can invoke section 2-609 if the seller fails to cure is not entirely correct.

The matter seems to be sufficiently covered in comment 6 to section 2-612. Therefore, unless the case law demonstrates a problem, there is no need to revise the comments in the fashion suggested.

### 3. *Subdivision 2-612(3): Substantial Impairment of the Whole Contract*

The drafters intended to carry forward the policy of the Uniform Sales Act (U.S.A.) section 45(2) in regard to breaches of the whole contract.[379] That policy essentially weighed the interest of the aggrieved party against the interest of the breaching party.[380]

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379 *Compare* Comment on Section 7-9, *supra* note 367, at 6 (section follows test of Helgar Corp. v. Warner's Features Inc., 222 N.Y. 449, 119 N.E. 113 (1918)) *with* 2 WILLISTON, *supra* note 365, at 752-53 (endorsing *Helgar* analysis as consistent with U.S.A. § 45(2) (1950)).

380 U.S.A. § 45(2) (1950) provided, in pertinent part:

> [I]t depends in each case on the terms of the contract and the circumstances of the case, whether the breach of contract is so material as to justify the injured party in refusing to proceed further and suing for damages for breach of the entire contract, or whether the breach is severable, giving rise to a claim for compensation but not to a right to treat the whole contract as broken.

Williston, the drafter of the U.S.A. and the Restatement of Contracts, saw this test as requiring a weighing of interests. *See* 2 WILLISTON, *supra* note 365, at 752-53 (endorsing the *Helgar* analysis). *See also* RESTATEMENT OF CONTRACTS § 275 (1932).

Judge Cardozo authored the most popular statement of this test. Speaking of when failure to pay for an installment constituted a material breach under U.S.A. section 45(2), he wrote:

> We must know the cause of the default, the length of the delay, the needs of the vendor, and the expectations of the vendee. If the default is the result of accident or misfortune, if there is a reasonable assurance that it will be promptly repaired, and if immediate payment is not necessary to enable the vendor to proceed with performance, there may be one conclusion. If the breach is willful, if there is no just ground to look for prompt reparation, if the delay has been substantial, or if the needs of the vendor are urgent so that continued performance is imperiled, in these, and in other circumstances, there may be another conclusion.[381]

This analysis was endorsed by Williston, the Code drafters, and practically every other commentator who discussed breaches of the whole.[382] The Code drafters adopted it for subdivision 2-612(3).[383]

The reason for using terminology different from the U.S.A. in subdivision 2-612(3) results from the drafting decision to cover only present breaches of the whole in subdivision 2-612(3).[384] Future breaches of the whole, that is, anticipatory total breaches (repudiation), are governed by section 2-610.

a. *Subdivision 2-612(3) Covers only Present Breaches of the Whole*

Breaches of the whole are of two types: (1) present total breaches, and (2) anticipatory total breaches or repudiation. Subdivision 2-612(3) deals with present total breaches. These are situations in which the default in the installment(s) then due is so great as to justify immediate cancellation of the whole contract on the basis of the present default alone.[385] Thus, for example, suppose a seller failed to deliver the second of four equal installments

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381 Helgar Corp., 222 N.Y. at 454, 119 N.E. at 114.
382 *See supra* note 380 (discussing relevant authority).
383 Comment on Section 7-9, *supra* note 367, at 6.
384 *Id.* at 5-6, 6-7.
385 *Cf.* 2 WILLISTON, *supra* note 365, at 776-77.

because the goods had been destroyed under circumstances in which the seller is not excused and where the seller is unable to procure substitute goods. Here, the buyer likely would be permitted to cancel the entire contract under subdivision 2-612(3), even though the seller was willing and able to deliver the remaining installments.

Anticipatory total breaches are covered by section 2-610 and section 2-609. Thus, if a seller were to repudiate its obligation to deliver the second installment before delivery became due, the buyer could cancel the rest of the contract. This right to cancel, however, arises under section 2-610, not subdivision 2-612(3).[386]

Particularly troublesome under pre-Code law was the situation where present conduct or breach indicated possible breach of future installment obligations, but was equivocal and, thus, not a repudiation. The solution under section 2-609 is to permit a party whose expectation of future performance has been impaired to force a clarification of the matter. Thus, if the buyer has legitimate doubts about the seller's ability to deliver future installments, his remedy is to proceed under section 2-609.[387] It is even possible that a present breach that does that not substantially impair the value of the whole contract might impair the buyer's expectation of future performance, thereby justifying resort to section 2-609.[388]

In sum, subdivision 2-612(3) applies to present breaches, not anticipatory breaches.

b. *"Subjective" versus "Objective" Substantial Impairment*

The Study Group recommends that a "subjective" test of substantial impairment be adopted for subdivision 2-612(3).[389] Presumably, this recommendation would be effected by adding words to the text to make it read, "substantially impairs the value of the whole contract *to the aggrieved party* . . . ."

This textual change is probably consistent with the drafting intent. It was intended that the general test of subdivision 2-612(3) be similar to that for section 2-610.[390] The latter section contains

386 *Cf.* Comment on Section 7-9, *supra* note 367, at 5-6.

387 U.C.C. § 2-612 comment 6; Comment on Section 7-9, *supra* note 367, at 5-6, 6-7.

388 W. HAWKLAND, SALES AND BULK SALES 117-18 (A.L.I. 1958).

389 Prelim. Rpt., Part 6, Rec. A2.6(8)(B), *supra* p. 1174. Presumably the Study Group would recommend that the standard for rejection of an installment under § 2-612(2) also be judged subjectively.

390 U.C.C. § 2-610 comment 3. *See* Comment on Section 7-9, *supra* note 367, at 5.