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**HOW THE UNIFORM COMMERCIAL CODE APPLIES TO NATURAL RESOURCES TRANSACTIONS**

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**§ 5.01   Introduction**

The article of the Uniform Commercial Code (UCC or Code)[[1]](#footnote-2)1 applying to sales of goods applies to natural resources transactions if the mineral has already been severed from the ground or if it is to be severed by the seller- This includes ***oil*** and gas.

Problems arise when the Code is applied to natural resource transactions. Generally, the sales article was designed to deal with one-time, single delivery sales of widgets. However, the forms and terms of art for contracts for the sale of minerals and ***oil*** and gas developed from businesses and attorneys specializing in natural resources law. Meanings and usages are far different from those developed by the wholesalers, distributors, and commercial attorneys for whom the Code sales provisions were created. So difficulties arise when the Code is applied to natural resources transactions. Even more tension arises when the Code's sales provisions must be applied to something like the continuous sale of undefined quantities of natural gas over contract periods as long as 20 years. All these problems are more difficult when, as at the present, market fluctuations are causing a great deal of contract litigation.[[2]](#footnote-3)2

The purpose of this paper is to examine the ways in which the Uniform Commercial Code applies to natural resources sales transactions- Emphasis is given to the way in which the Code has been construed in litigation.

**§ 5.02   Application of the UCC to Natural Resources Transactions**

The sales article of the Uniform Commercial Code has applied to natural resources transactions since its inception because of section 2-107(1), which provides that: "A contract for the sale of timber, minerals, or the like (including ***oil*** and gas)...is a contract for the sale of goods within this article if they are to be severed by the seller...."[[3]](#footnote-4)3 Despite this clear language, and the early adoption of the UCC by most states, the courts were slow to apply it to natural resources transactions- The Federal Power Commission, predecessor of the Federal Energy Regulatory Commission, admonished practitioners to begin considering the effects of the Code.[[4]](#footnote-5)4 The courts agreed that the Code should apply.[[5]](#footnote-6)5 Gradually most reported natural resources decisions have begun applying the Code where applicable-

It is not so easy to say exactly which natural resources transactions are controlled by the UCC. ***Oil*** and gas leases are not covered,[[6]](#footnote-7)6 nor are transactions of things other than natural resources, such as sale of a refinery, just because natural resources are tangentially involved-[[7]](#footnote-8)7 The untested provisions of section 2-107(2) apply the sales article to materials to be severed by the seller or by the buyer, if the parties can sufficiently identify the material before severance. Although by its strict terms section 2-207(2) might apply to something like sale of a right to enter and mine a vein, it has not yet been applied in that way.

In any event, the sales article of the Code will apply broadly to sales of the severed mineral or ***oil*** or gas or minerals to be severed by the seller.

**§ 5.03   Formation of Contracts**

The basic change in the way contracts may be formed is that a great deal less formality is required under the Code than under common law. Section provides that a contract may come into being without a written agreement, from conduct alone.[[8]](#footnote-9)8 However, generally the Code retains a semblance of a statute of frauds- A contract for the sale of natural resources of a value greater than $500 is unenforceable unless evidenced by a sufficient writing signed by the party to be charged. The writing is much less than was required by common law. Under section 2-201(1), all that is necessary is that a writing demonstrate that some sort of agreement was reached between the parties. Omission of an agreed-upon term is not fatal, for, as will be seen, the courts may supply such terms.[[9]](#footnote-10)9

There is an important special mechanism for the formation of contracts without a writing signed by the party against whom enforcement is sought. Code section 2-201 provides that as between "merchants,"[[10]](#footnote-11)10 one party may send a "confirmatory memorandum" to another- That second party then has the duty to reject the memorandum *in writing within ten days*. If the second party fails to make such a rejection, he becomes bound even though he never signed any kind of writing. In the *Apex* ***Oil***[[11]](#footnote-12)11 case, two parties orally discussed spot market sales of ***oil***. The would-be buyer then sent a short telex to the seller, saying that the proposed sale was confirmed and reciting the price and quantity. The Second Circuit held that this was sufficient to constitute a confirmatory memorandum. Although the court emphasized the sophisticated nature of the parties and the prior history of dealing between them, section 2-201(2) makes no such requirement. It says only that the parties must be "merchants."

It is also possible that one may become unwittingly bound to additional terms of a contract. An acceptance of an offer may be effective even though it contains new or additional terms.[[12]](#footnote-13)12 Between merchants, the new or additional terms are deemed accepted and become a part of the contract if the party receiving them does not object within a reasonable time-[[13]](#footnote-14)13

With more frequent spot market transactions in natural gas, and existing spot markets in ***oil*** and in some minerals, these considerations mean that care is necessary lest one unexpectedly become bound to a very informal contract. Merchants dare not ignore receipt of some document talking about sale for fear it might be held to be a confirmatory memorandum. To reiterate, conduct alone may form a contract.

Similar informality applies also to amendment of existing contracts. Contrary to the common law in many states, an amendment or modification to an existing contract requires no new consideration.[[14]](#footnote-15)14 Under section 2-209(3), an amendment of a contract originally within the statute of frauds must be in writing- Even if an attempted modification is not in writing, it may nevertheless be effective as a waiver.[[15]](#footnote-16)15 Finally, even if nothing occurs which one would call an amendment, the means of construction or interpretation of a contract put sufficient emphasis on conduct during performance that a contract may be effectively changed in that way.[[16]](#footnote-17)16

Parties to a contract may also agree to modify or suspend the effect of provisions of the Code-[[17]](#footnote-18)17

The degree of formality required by the Code for making or amending a contract is far less than that to which many in the natural resources field may be accustomed.

**§ 5.04   Interpretation of Contracts**

**[1]   Statutory Hierarchy of Categories of Evidence Admissible to Interpret**

Market fluctuations have necessarily been accompanied by protracted litigation over contract interpretation. Again, the Code brings new considerations to questions of contract construction or interpretation. Gone is the rule that a court should confine its inquiry, at least initially, to matters within the "four corners" of the contract.[[18]](#footnote-19)18 The Code permits admission of a great deal of evidence extrinsic to the contract itself- The Code establishes a sort of hierarchy, in which one category of evidence prevails over a lower-ranking category.

First: The contract. Evidence of the contract terms themselves is of course always admissible.

Second: The commercial context. Comment 1 to Code section 1-205 states in part that "[t]he measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing." This comment is taken from the introductory article of the Code, and not from the sales article. It seems not to have found its way into many decisions. Nevertheless, it suggests that "commercial context" may always be admissible, and thus is a harbinger of the broad admissibility of extrinsic evidence in contract interpretation cases.

Third: Course of performance. "Course of performance" refers to the way the parties have demonstrated their understanding of a contract's meaning after its execution and during its performance. It is almost like a form of estoppel. Put another way, the courts are not likely to permit a party to interpret a contract in one way for the first half of the term, and then try to argue for a different meaning during the latter part of the term. Course of performance, or the parties' own behavior in performing, has been called the "best evidence" of what the parties intended their agreement to mean.[[19]](#footnote-20)19 Course of performance is also like estoppel in that it may consist of mere acquiescence in the conduct of the other party "without objection-" Consequently, it now is really necessary for a party to establish systems to monitor what is happening under its existing contracts.

Fourth: Course of dealing. Course of dealing refers to the way parties have interacted prior to the execution of the contract in question. For example, as an aid to interpretation of an existing contract, a court might look to a prior series of similar contracts or transactions between the same parties.

Fifth: Usage of trade. Usage of trade means any "practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question."[[20]](#footnote-21)20 The scope of the meaning of usage of trade is broadened by the Code's statement that actual knowledge of the usage is not required- A sort of constructive notice is enough for the party to be bound by a usage of trade of which he "should be aware...."[[21]](#footnote-22)21 So usage of trade is a very broad category. It even goes so far as to include customs in a particular "place." That puts a great burden on those who travel to different areas to make deals, or even enter into contracts without ever getting near a particular locality. Moreover, the Code specifically provides that as to performance, the usage of trade in the place where "any part of performance is to occur..." is controlling in interpreting the agreement as to that part of performance. Again, one may be bound by trade usages in different and unfamiliar localities.[[22]](#footnote-23)22

All these factors form a specific hierarchy- In theory, when one category of evidence cannot be construed consistently with another, then the express terms of the contract prevail over inconsistent course of performance; course of performance controls both course of dealing and usage of trade.[[23]](#footnote-24)23 Between course of dealing and usage of trade, the former controls the latter,[[24]](#footnote-25)24 section 1-205(4), except that some blurring between the two is again possible-

This hierarchy is as far as the Code goes in stating when evidence above and beyond the contract itself is admissible. When is parol evidence admissible, either when it consists of parts of this hierarchy or when it is not even mentioned in the hierarchy?

**[2]   Parol or Extrinsic Evidence**

Comment 1(c) to section 2-202 says that the UCC "definitely rejects" the requirement that a condition precedent to the admissibility of evidence of course of dealing, course of performance, or usage of trade is any "determination by the court that the [contract] language used is ambiguous."[[25]](#footnote-26)25 This language makes it appear that such evidence is always admissible, although the order of the hierarchy still applies to determine whether one controls over another if differences cannot be reconciled-[[26]](#footnote-27)26

What of other kinds of extrinsic evidence? The only major category of extrinsic evidence that is not likely to fall within the Code hierarchy is that of testimony as to subjective intent. The courts have split on admissibility of subjective intent.

One statement is that extrinsic evidence of subjective intent will not be allowed unless and until the court makes a specific finding of the existence of ambiguity after looking at the entire package of the contract itself (presumably including commercial context), course of performance, course of dealing, and trade usage.[[27]](#footnote-28)27

However, the courts generally emphasize they will be very liberal in admitting extrinsic evidence- One court said that all evidence reasonably consistent with the terms of the contract should be admitted, and adopted a "clearly erroneous" standard to review the trial court's treatment of extrinsic evidence.[[28]](#footnote-29)28

However, probably typical of the difficulty the courts are encountering in this area is the Tenth Circuit's decision in Amoco Production Co. v. Western Slope Gas Co.[[29]](#footnote-30)29 The court said that "[o]nly if in light of the circumstances and purposes of the contract the judge finds it unambiguous should he or she prohibit parol evidence to explain its meaning-"[[30]](#footnote-31)30 By itself, this statement does not seem unreasonable. It implies, as a sort of corollary to comment 1(c) to 2-202, *supra*, that a court must make a finding that a contract is unambiguous as a condition precedent to denying admissibility of extrinsic evidence. The problem with *Amoco*, however, is that the extrinsic evidence admitted seems to have included evidence of subjective intent.[[31]](#footnote-32)31 If the Tenth Circuit is saying that evidence of subjective intent should be admitted in all cases except when the court is able to find as a matter of law that the contract is unambiguous on its face, that would be unfortunate indeed-

As a general matter, courts should be highly reluctant to admit evidence of subjective intent. The crystal clarity of hindsight always shows just what a party wanted a contract to mean when the time comes to go to the courtroom. Allowing testimony as to subjective intent detracts from the contract language, and the contract language ought to be paramount. This is even more true because the cases allowing testimony of subjective intent do not require that intent to have been disclosed to the other party to the contract, so a sort of "secret side intent" becomes admissible. A purpose of the Code is to let all parties to a contract know from the outset what their rights and duties are. With commercial stability at stake, it is unfortunate to let one party later testify what his undisclosed intent was. Furthermore, the intent of the parties is to be determined "by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances."[[32]](#footnote-33)32 The contract and the Code hierarchy of other admissible evidence provide many tools for a court construing a contract- Courts should view testimony of subjective intent with great caution, and admit it only with great reluctance.

**[3]   The Importance of Retaining Documents**

A final and very important conclusion may be drawn from the variety of categories of evidence the Code admits into evidence for the purpose of construing a document. The introduction to this paper noted that the Code's sales article was really designed for a one-time sale of widgets. A natural gas contract, however, not atypically will have a contract term of as long as 20 years. If difficulties arise, a breach or a dispute over contract meaning could occur within months after execution. But it could also occur in the eighteenth year of the twenty-year contract term. At that time, or whenever after that the case gets to trial, a party may be seeking evidence of all of the factors for interpretation discussed in this paper. Those factors can include such extrinsic evidence as intermediate drafts in the negotiations leading up to the final contract. Relevant evidence can include course of dealing, the things that were done during performance of contracts *prior* to the existing twenty-year contract. The courts have said that course of performance, the way the parties themselves have performed the existing contract during its term, is the best evidence of what the parties meant. That means that events during any of the hypothetical eighteen years of the twenty-year term may be relevant. The implications for company document retention and destruction policies are obvious. Contract documents should be retained for *at least* as long as the contract term. Furthermore, organization of documents is important. The way in which a contract evolved from prior contracts may be important, as is the way a party performed or interpreted similar contracts with the same or possibly even other parties. With the microfilm or electronic retention of documents, and the computer access to those documents, made possible by modern technology, there is no excuse not to retain documents in such a way that they may will be conveniently accessible. Having the documents may win a case; the easy access may save large sums in costs of litigation.

**§ 5.05   The UCC "Gap Filler" Provisions**

**[1]   The Purpose: Stability of Commercial Relationships**

As is already apparent, the UCC goes to great length to give binding effect to agreements that might have been defective under the common law. Efforts are made to prevent failure of a contract the parties intend to be binding merely for want of some term. One of the most innovative parts of the Code is a statutory procedure by which the courts can supply missing terms to contracts.

The "gap filler" provisions provide a means to fill in absent provisions for price, place for delivery, time for delivery, contract term, and time for payment. If one or more of these terms were not agreed upon by buyer and seller, but the contract is otherwise complete, then the Code provides ways to determine the open terms. After all, the Code's intent is that "[*e]ven though one or more terms are left open, a contract for sale does not fail for indefiniteness* if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy."[[33]](#footnote-34)33 Consequently, the Code provides mechanisms to fill in the terms left open-

**[2]   "Automatic" Gap Fillers**

Certain open terms are filled in automatically by operation of the Code without the immediate intervention of a court. Quantity is one term that *cannot* be filled in by a court under the gap filler provisions. The statute of frauds provision says that a contract is not enforceable beyond the quantity of goods shown in the contract.[[34]](#footnote-35)34 So quantity is one item drafters should be sure to include in contracts-

Two exceptions exist. An output contract, defining quantity as the total output of the seller, or a requirements contract, defining quantity as the total requirements of the buyer, means actual output or actual requirements as reached in good faith, but no quantity can be unreasonably disproportionate to a stated estimate or normal or comparable prior output or requirements.[[35]](#footnote-36)35 Second, an exclusive dealing contract means the seller shall use his best efforts to supply all needed goods, or that a buyer shall use his best efforts to resell the goods-[[36]](#footnote-37)36 With these two exceptions, quantity must be specified in one way or another.

**[3]   Open Price Term**

The gap filler provision usually regarded as most significant is the one related to price. At common law, presumably a contract would fail for want of an essential term if price was not agreed upon. Under the Code the contract need not necessarily fail. Section 2-305 provides that a contract may be valid although the price is not settled. The price term may be entirely absent; or the contract may require the parties to agree, but they then cannot agree; or the price is to be fixed by some standard, such as by a journal reporting market prices or a government agency establishing ceilings, and that standard ceases to exist. In any of these situations the contract may be valid. If so, the price will be a "reasonable price at the time for delivery...."[[37]](#footnote-38)37 The courts will set that price based upon a number of factors-[[38]](#footnote-39)38

If, however, the parties to the contract do not intend that the contract continue in effect if the price is not fixed or mutually agreed to, then section 2-305 will not fill the gap and the contract will fail.[[39]](#footnote-40)39 These provisions may seem to be a boon to parties who have inadvertently left out a price term- The provisions may also apply in the situation that seems to be appearing in spot natural gas markets, where delivery is made and the parties later work out the price. However, examination of all the factors that may come into play in a court determination of "reasonable price" means any such litigation will be lengthy and expensive, necessitating review of evidence of all the factors and retention of a number of experts.[[40]](#footnote-41)40 So parties should make every effort to see that contracts set price or provide for a definite means to establish price according to standards that will always be available. Court determination of a dollar figure for "reasonable price" should be avoided at all costs.

**[4]   Other Gap Fillers**

Section 2-307 says that unless otherwise specified, all goods contracted to be sold must be delivered in a single delivery. This section is another example of how the sales article was designed for one-time delivery of widgets and not for delivery of a supply of minerals over a period of months or years, nor for a continuous flow of natural gas for a period of years. Although the context of the natural resources contract will usually show that more than one delivery is contemplated, perhaps some care should be taken in reviewing contracts to make sure that the contract expressly provides for multiple deliveries.

Section 2-308(a) says that unless otherwise provided, the place for delivery will be the seller's place of business or, if he has no place of business, his residence. Obviously points of delivery should be specified in the contract to avoid absurdities. A broker would not like to be awaiting pickup of coal or ***oil*** from his office or home.

The contract must provide specific times for delivery and for duration of the contract. Otherwise, the time for shipment or delivery shall be a "reasonable time," and one would not like to leave that to definition by a court.[[41]](#footnote-42)41 Similarly, if a specific contract termination date is omitted, the contract is valid for a reasonable time but may be terminated at *any* time by either party-[[42]](#footnote-43)42 Once again, the results reached by operation of law under the Code's statutory provisions could be so undesirable that these terms simply cannot be left open in contracts.

Other provisions deal with time of payment. As noted above, the place of delivery can be the buyer's place of business or residence under section 2-308(a). Regardless, absent agreement to the contrary, payment is due when the goods are actually received by the buyer.[[43]](#footnote-44)43 This rule leads to a probably unintended result in mineral transactions; it leads to a ridiculous result when the buyer is continuously receiving ***oil*** or natural gas-

Code section 2-311 deals with open terms concerning details of performance. The section establishes somewhat complicated rules for filling in these gaps as to performance. First, it specifically validates contracts in which details of the performance are left to be set by one party, assuming that the contract is otherwise sufficient. A party with the power to set such details must do so in good faith and with commercial reasonableness.[[44]](#footnote-45)44 Second, if the parties do not agree who has the power to fill a term, only the choice of assortment of goods is left to the buyer, something of little relevance in most natural resources transactions- "[S]pecifications or arrangements relating to shipment" are left to the seller, which may give some substantial power to the seller.[[45]](#footnote-46)45 Finally, if one of the parties is given the power to fill in the gaps but fails to do so in a timely manner, remedies are given the other party by section 2-311(3). The various rules of section 2-311, and the paucity of decisions construing it, particularly as to natural resources, again mean that care must be taken to leave few or no gaps when drafting the contract.

**[5]   Warranties**

UCC warranties are not usually described as gap fillers. Nevertheless, the sales article does make certain warranties a part of a contract by operation of law. Obviously, specific guarantees or any "affirmation of fact or promise" made by the seller[[46]](#footnote-47)46 becomes an express warranty as to all the minerals or ***oil*** or gas covered by the contract-[[47]](#footnote-48)47 Furthermore, any description of the natural resources being sold or any sample which "is made part of the basis of the bargain"[[48]](#footnote-49)48 also becomes an express warranty that all of the natural resources sold under the contract "shall conform" to the description or sample-[[49]](#footnote-50)49 Finally, in order to form an effective warranty it is not necessary to use the words "warrant" or "guarantee" nor even to have a specific intention to make a warranty.[[50]](#footnote-51)50

Of course, the Code also contains implied warranties- Assuming the seller is a "merchant,"[[51]](#footnote-52)51 every contract for the sale of natural resources includes an implied warranty of merchantability. That includes the following specific warranties:

**1.   The mineral or *oil* or gas must "pass without objection in the trade under the contract description";**[[52]](#footnote-53)52

**2-   If fungible (which nearly all subjects of natural resources contracts should be), it must be of "fair average quality within the description";**[[53]](#footnote-54)53

**3.   It must be fit for the ordinary purposes for which such goods are used;**[[54]](#footnote-55)54

**4-   Within the variations permitted by contract, it must "run...of even kind, quality, and quantity within each unit and among all units involved";**[[55]](#footnote-56)55 **and**

**5.   It must be adequately "contained" and "labeled" as the contract may require.**[[56]](#footnote-57)56

The warranties do not end there- Section 2-314(3) also provides that warranties may arise from course of dealing, the prior transactions between the parties. Warranties may also arise from usage of trade. As discussed earlier in this paper, usage of trade may include customs even in a particular locality, so this latter implied warranty could be extremely dangerous. Finally, if at the time the contract is made the seller knows that the ***oil*** or gas or mineral will be used for a particular purpose, and the buyer is relying on the seller's skill or judgment to select or supply "suitable" goods, there is an implied warranty that the material sold is fit for that particular purpose.[[57]](#footnote-58)57

Every personal injury lawyer or products liability lawyer knows the Code provisions about express and implied warranties by heart. Probably every household appliance, every automobile, and every child's toy sold in America contains boilerplate language to the effect that all warranties are excluded except the specific guarantees described on the label or on a separate sheet. The author has never seen any such language in any natural resources contract. When prices drop, these implied warranties may give a buyer who wishes to avoid a contract many ways to find fault with performance. Even without that, breach of warranties may lead to massive consequential damages. The Code permits exclusion or limitation of warranties[[58]](#footnote-59)58 in section 2-316, and limitations on damages for breach of warranty or for consequential damages generally, in sections 2-316(4), 2-718, and 2-719- Any attorney or representative negotiating an agreement for a seller should be at pains to include the broadest possible limitations of warranties and liabilities. A buyer, for the same reasons, may wish to resist such limitations, particularly on the right to seek consequential damages.

**§ 5.06   Defenses to Breach of Contract Actions**

Nothing in the Code in and of itself precludes the use of common law defenses.[[59]](#footnote-60)59 Some parts of the Code adopt and modify common law defenses-[[60]](#footnote-61)60 Two defenses are worth discussing separately, i.e., the Code defenses of unconscionability and frustration of purpose of contract.

**[1]   Unconscionability**

The defense of unconscionability is specifically adopted and codified in section 2-302.[[61]](#footnote-62)61 As a practical matter, it will usually apply in consumer situations and rarely, if ever, in commercial contexts- It is narrowly limited by the fact that it applies only if it is found to be unconscionable at the time it is made, not because later conditions like large price changes make application of the contract harsh. Furthermore, comment 1 says the purpose is to prevent "oppression and unfair surprise," not to remedy the effects of "superior bargaining power." However, if a contract clause is indeed held to be unconscionable, then section 2-302 gives the court broad power to refuse to enforce the contract, to refuse to enforce the offending clause, or to limit the effect of the clause.

**[2]   Frustration of Purpose**

A defense which parties attempt to invoke much more often is that of frustration of purpose, codified in section 2-615. This section should be read to include the former common law doctrines of impossibility of performance and commercial impracticability as well as frustration of purpose.[[62]](#footnote-63)62 If performance is truly impossible, that is obviously a defense because section 2-615 makes lesser difficulties a defense- The section creates a defense for late delivery and for partial or complete nonperformance. It may be invoked when the contracted-for performance becomes "impracticable" by the occurrence of a contingency "the nonoccurrence of which was a basic assumption on which the contract was made...." This means that if occurrence of the contingency was foreseeable, section 2-615 should not apply at all. After all, the purpose of the Code is to promote commercial stability and favor the performance of contracts, and if the contingency was foreseeable, the parties will be deemed to have allocated the risk of failure of the contingency in the contract in one way or another.

In practice, the section has not proved to be of much help to a party claiming frustration of purpose, in large part because of comment 4:

Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover.

This comment foretold the failure of parties injured by extreme price fluctuations in minerals or ***oil*** or gas to get any relief from this section. The courts have almost without exception been unwilling to excuse performance on such grounds.[[63]](#footnote-64)63

However, the courts have been more sympathetic when the difficulties are caused by things other than market fluctuations- Section 2-615 also excuses delay of performance when that is caused by compliance with a governmental regulation. The case of *International Minerals v. Llano*[[64]](#footnote-65)64 actually was construing the force majeure clause of a sales contract, but the court read that clause to be coextensive with section 2-615. The problem was that a buyer of natural gas had been unable to use it for a period of time because New Mexico state environmental regulations had precluded the use of certain furnaces. The court was unimpressed with the seller's contention that it had not become impossible for the defendant buyer to *buy* the gas, but only unlawful to *use* the gas in a particular way. It held that supervening governmental regulations were a sufficient defense.

The conclusion is that price fluctuations or even market collapse will not be sufficient as a defense. Unforeseen change in laws or other factors making a commodity unusable may well be a defense, at least if those factors are truly unforeseeable.

**§ 5.07   Remedies for Breach of Contract**

The Uniform Commercial Code also codifies both the damages and other remedies to which a wronged party may be entitled, as well as establishing just when breach occurs.

**[1]   Acts Amounting to Breach**

**[a]   In General**

Breach of a contract does not always occur from conduct which might have amounted to a breach at common law. For example, section 2-614 gives a specific mandate to "substituted performance." If an agreed-upon form of delivery becomes either impossible or commercially impracticable, and there is a commercially reasonable substitute, there is no breach. The seller is under a duty to use the alternative form of delivery; the buyer is under a duty to accept that form of delivery.

Another example is that a breach arising from some sort of defect in the commodity may be waived unless the buyer describes the particular shortcoming to the seller so that the seller has a chance to remedy a curable defect.[[65]](#footnote-66)65 Since the Code attempts to maintain commercial stability, it attempts to avoid a breach situation when a remedial method short of outright breach is available-

In any situation in which one believes a breach exists and he has a right to take advantage of appropriate remedies, the Code should be checked carefully for curative or ameliorative provisions such as these. It would be unfortunate for a wronged party to become the wrongdoer for failure to comply with the substituted delivery or notice provisions.

However, the important thing here is to recognize three specific ways in which the Code recognizes breach situations differently than does the common law.

**[b]   Anticipatory Repudiation**

The first of these is the common law doctrine of anticipatory repudiation, codified by the UCC but perhaps not changed that much from the common law. Section 2-610 specifically recognizes the doctrine of anticipatory repudiation and describes its effect. No definition is given for repudiation, for, as will be seen, the Code gives relief to a party who is unsure whether or not the other party has repudiated. However, the Code does make one limitation on the doctrine of anticipatory repudiation which may not have existed at common law in *haec verba*. Under section 2-610 anticipatory repudiation may exist only if the repudiation is of a future performance, the loss of which performance "will substantially impair the value of the contract" to the non-repudiating party. Accordingly, the repudiation cannot be one with an inconsequential effect on the non-repudiating party.[[66]](#footnote-67)66

When an anticipatory repudiation occurs, the aggrieved party has a choice of remedies- The Code, with its purpose of maintaining commercial relationships, will not force him to declare the repudiation to be an immediate breach; he may await performance for "a commercially reasonable" time.[[67]](#footnote-68)67 Even though he has waited, or has urged the repudiating party to withdraw the repudiation, he may still immediately avail himself of any of the Code's remedies for breach.[[68]](#footnote-69)68 Finally, he may suspend his own performance-[[69]](#footnote-70)69

The Code takes one further step to attempt to continue in force an existing contractual relationship. Even when an anticipatory repudiation has occurred, the repudiating party still has the option of retracting his repudiation. Section 2-611 gives that right to the repudiating party unless his next performance is actually due or unless the aggrieved party has elected to cancel the contract or materially changed his position. Allowances are made for injury caused the aggrieved party by delay, and the repudiating party must also give any guarantee of performance "justifiably" requested by the aggrieved party.

**[c]   The Right to Demand Adequate Assurance of Performance**

A new and important right created by the Code is the right to demand adequate assurance of performance. To maintain commercial stability, the Code permits a party who fears a future breach by the other party to clarify and crystallize the situation. A new implied covenant is effectively created. Section 2-609 declares that "[a] contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired." So a party is entitled not only to performance, but to freedom from reasonable fears of nonperformance.[[70]](#footnote-71)70

Section 2-609 provides that when a party has reasonable grounds for insecurity about a possible breach, he may make a written request for "adequate assurance" of timely performance- The assurance requested could take many forms, ranging from something as simple as a written explanation to something as serious as a performance bond. If adequate assurance is properly requested, the other party must give that adequate assurance within a reasonable time not to exceed thirty days. Obviously in some situations, such as a supply of gas or coal to heat a hospital or the sale of a critical ingredient for a plant, the reasonable time for response would be much less than thirty days.

*If adequate assurance is not timely provided, the contract is deemed repudiated*. An immediate breach exists, and the aggrieved party may take any of the remedies for anticipatory repudiation, such as suing for damages or cancelling the contract.

The Code's adequate assurance situation is clearly intended to apply to two different situations. One is where there are ambiguous statements by one party which may or may not amount to an anticipatory repudiation. If a party to a contract makes statements to the effect that he believes it will be difficult to live up to the contract and would like to renegotiate it, the attorney for the other party need no longer guess whether the statements are enough to legally constitute a repudiation. He simply asks for adequate assurances. The other situation is where one has cause to suspect the other party may be unable to perform. For example, one might hear rumors that a buyer is about to suffer a strike, or that a supplier's vein of ore is about finished. Again, the remedy is to request adequate assurances.

Obviously, the party from whom adequate assurance is requested may respond in several ways. He may ignore the request or refuse it, claiming that there were no reasonable grounds for insecurity. In an appropriate situation, an unreasonable request for assurances might operate as an anticipatory repudiation or at least as grounds for the party to respond with his own request for assurances. He may respond but claim that the specific kind of assurance requested is unnecessarily burdensome. Or, of course, he can give the assurance requested.

Section 2-609 obviously cuts in more than one way. On the one hand, the drafters put it in the Code to continue to seek that goal of commercial stability. If one doesn't know whether or not he can get supplies, he can request adequate assurances. If there is to be a breach, he can discover that in the present without waiting, and can take immediate steps to protect himself by securing alternative sources of supply and also by suing immediately. On the other hand, recurring paper trails of requests for assurances are not the best way to promote commercial harmony between parties to a contract. And the doctrine may create a new burden for the innocent party. At common law one may have had no duty to begin action to mitigate his damages just because of a feared breach, at least short of an actual repudiation. Now, however, one has the tool of the Code request for adequate assurance. If one fails to use the tool, it may be argued that he has failed to mitigate his damages.

The new concept of request for adequate assurance is clearly a powerful tool. Practitioners should also be aware of the new burden it may create.

**[d]   Insolvency of Buyer**

Finally, the Code establishes a specific remedy when a seller discovers that a buyer is insolvent. The seller is allowed to refuse to deliver except for payment in cash for present deliveries and everything already delivered. He may stop delivery. He gains certain rights of reclamation.[[71]](#footnote-72)71 And a reasonable fear of insolvency of a buyer (and sometimes of a seller) may be grounds to invoke reasonable requests for assurance-

**[2]   Damages**

The UCC provisions for damages appear quite complex. Actually, they become much more comprehensible if they are viewed as an attempt to incorporate and codify common law mitigation principles. The sections dealing with calculation of money damages consist primarily of efforts to force the innocent party whose contract has been breached to take steps immediately to sell to someone else or buy from someone else. If he fails to do so, his damages will be restricted to what they would have been if he had mitigated.

If a seller becomes victim of a breach of contract, he must attempt to resell on the market.[[72]](#footnote-73)72 Suppose he is successful in reselling, but at a lower price than what the buyer was contractually obligated to pay- Under section 2-706(1), the jilted seller is then entitled to recover

Contract price

- Actual resale price

   Seller's damages

On the other hand, suppose the jilted seller fails to mitigate by reselling immediately. Section 708(1) will then limit recovery to

Contract price

- Market price at time of delivery

   Seller's damages[[73]](#footnote-74)73

Note the effect of this second formula- If the jilted seller has failed to resell by selling at market at the time he was scheduled to make delivery, the second formula will let him recover no more than the market price at that time. If the seller waits to resell, and market prices go farther down, he still can recover no more than the contract price less the market price at the contracted-for time of delivery.

Similar provisions govern the jilted buyer. The Code creates a new concept of "cover." Under section 2-712(2), the jilted buyer must "cover" by buying replacements for his needs. His damages then become

Price paid to "cover"

-    Contract price

   Buyer's damages

This is, after all, exactly what the buyer has lost, the replacement cost less the contract price. Suppose, however, the jilted buyer fails to cover by buying replacement goods. Under section 2-713(1), his recovery will be limited to Market price at the time of breach

- Contract price

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Buyer's damage

So the buyer is left in the same position as if he had mitigated by covering as soon as he learned of the breach.[[74]](#footnote-75)74 If he does not cover, and the price of the commodity goes up, he still will be able to recover no more than if he had covered immediately- And there is another consequence to the jilted buyer. Ordinarily the buyer is entitled to recover foreseeable consequential damages. In other words, if a buyer is taking cobalt to make into steel, and the contract is broken, the buyer may recover not only the market price less contract price differential, but also consequential damages such as lost profits because the steel could not be made. But section 2-715(2)(a) permits recovery of only those consequential damages which could not have been avoided by covering, by finding a replacement supply. This is only fair. If our steel fabricator could have bought the cobalt from another supplier, it is only fair not to give him lost profits if he failed to do so.

The sales article of the Code never mentions mitigation of damages. Nevertheless, it is obvious just how basic mitigation principles are to the entire damage scheme. If the aggrieved party fails to mitigate by reselling, or by covering by buying a replacement supply, he will be put in the same position as if he had done so.

Both buyer and seller are also allowed incidental damages, such as transportation charges or commissions involved in resale at market.[[75]](#footnote-76)75

There are certain problems implicit in these formulas, and those problems may well crop up in natural resources situations-

Initially, the remedies for both buyer and seller impliedly require the aggrieved party to resell or cover. Reselling or covering is easy in the case of a small firm which is selling or buying only a small amount of a particular commodity. It would be easy in the case of a sales transaction for a number of specially fabricated widgets. But suppose the firm is a large one, making many sales or purchases at different prices in a short period of time. A seller would like to claim that the lowest price of any lot sold is the resale price to be used in the formula. Subtracting that lowest price from the contract price would allow the greatest difference and the greatest damages. A buyer forced to cover, on the other hand, would like to select the lot it bought with the highest price, thus giving itself the greatest damages for the cover price less the contract price. When an injured party is making many trades for many lots in a short period of time, how is one to tell which price to use? The reasonable answer that appears to be emerging is that the courts will give the aggrieved party considerable latitude to select the transaction the price of which is to be employed in the formula.[[76]](#footnote-77)76 That party, after all, is the innocent party which did not breach the contract-

Another anomalous result may follow from strict application of the formulas. The purpose of the damage calculations is to force resale or cover and, if that is not done, to restrict seller or buyer to the amount of damages he would have suffered if he had resold or covered at about the time of the breach. However, suppose a seller chooses not to resell, believing the price of, say, gold will go up sharply in the future. Blind application of the damage formula would permit the seller to recover the difference between a low market price at the time of breach and the contract price.[[77]](#footnote-78)77 However, by retaining the gold, the supposedly injured seller would achieve double recovery by later selling at a much higher market price- Here the answer is not so clear. One part of the sales article does permit adjustment of damages in the case of a buyer where the remedy under the formula appears inadequate.[[78]](#footnote-79)78 The courts have read this section to evidence some intent to permit flexibility. In the situation described, or a similar one with a buyer, the courts would probably act to prevent the windfall of double recovery.[[79]](#footnote-80)79

**[3]   The Lost Volume Seller**

However, there is one problem, not unique to natural resources, but which is likely to arise whenever the breach is by a seller buying from a first level seller who is producing the ***oil*** or gas or mining the mineral. Suppose the seller cannot resell at market because, in a depressed natural resource industry, there *is* no market. Then there is no chance to resell and no market price to plug into the damage formula. But the problem is greater yet. If the seller is allowed to recover damages akin to the sales price, there may be something of a windfall, for the seller will still retain the ***oil*** or gas or mineral in place in the ground, with at least some hope of selling it later.

This is the problem of the "lost volume seller," involving not a seller who is left with some unique fabricated product which cannot be resold, but a seller who simply can sell only a lesser volume at present because of the breach.[[80]](#footnote-81)80 Presumably he will sell all the mineral later, or all the ***oil*** or gas, at least absent drainage or reservoir damage- How are damages to be measured for this seller?

Section 2-708(2) provides that:

If the measure of damages [provided by the formula]...is inadequate to put the seller in as good a position as performance would have done, then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this article section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

So the remedy provided when the formula does not work is loss of net profit.

Obviously, that is not a total answer, because the seller may be able to make a profit at some time in the future because the ***oil*** or gas or mineral is still in the ground to be sold at some future time. That is ameliorated by the concluding words of the subsection, requiring that proceeds of resale be taken into account. That may not help the buyer who is being sued, for in a weak market resale may not have occurred by the time of trial. However, the seller, who had expected a present profit, clearly is entitled to some remedy. It is difficult to see just what a better remedy might be.

In one Seventh Circuit case,[[81]](#footnote-82)81 the court appears to have said, in dictum, that the measure of damages was contract price less cost of production, or net profits- This appears to be consistent with the remedy described in section 2-708(2).

However, what may be the only case to confront the problem of the lost volume seller in a natural resources context is *Commonwealth Edison Co. v. Decker Coal Co*.[[82]](#footnote-83)82 Because of a sharp decline in the price of coal, the buyer deliberately breached a contract for the purchase of coal that was to run over a period of years- Although the court purported to be following the Code, it ignored section 2-708(2). Instead, it allowed the seller to recover the full contract price, without even any deduction for the cost of mining the coal. Allowing recovery of the gross price, as opposed to the net profit, is in itself a departure from 708(2). But the court went on to take notice of the possible windfall to the seller by allowing recovery of gross contract price while keeping the coal. It let the breaching buyer have the right to go in and mine the coal at its own expense, but only during the balance of the contract term. This is another approach to avoiding a windfall double recovery by the seller, but not a good one. The *Commonwealth Edison v. Decker Coal* solution overlooks the difficulty with policing the mining of coal by the breaching buyer on the seller's property. Furthermore, if the buyer was economically efficient at mining coal, presumably it would already be engaged in that business. There is no reason to prefer the jury-rigged solution of this case to that of section 2-708(2).

**[4]   Equitable Remedies**[[83]](#footnote-84)83

The Code generally is not concerned with whether or not injunctions are proper- However, it does deal with the related area of specific performance. Section 2-716(1) allows specific performance to be granted only to buyers, and then only "where the goods are unique or in other proper circumstances." This is in keeping with the general equitable consideration that relief at equity may not be had if there is an adequate remedy at law. In theory, a seller of ***oil*** or gas or minerals will always have an adequate remedy at law-a suit for monetary damages. Accordingly, following the Code, equitable relief in the nature of injunctions or specific performance is usually not allowed to sellers.

However, there is growing evidence in the area of natural gas that courts are becoming weary of deliberate breaches by buyers motivated only by market collapse and uneconomic contract prices.[[84]](#footnote-85)84 Furthermore, under appropriate circumstances a seller may have no adequate remedy at law- That may be true if a buyer has agreed to buy the entire output of a well or field, and the amounts are hard to estimate, or if irreparable injury may be caused by damage to shut-in reservoirs or by drainage by competing wells. In these circumstances courts have begun granting injunctive relief in the nature of specific performance.[[85]](#footnote-86)85

A buyer is entitled to specific performance if the mineral is unique or in other "appropriate circumstances."[[86]](#footnote-87)86 It probably is a rare circumstance when a mineral may be said to be "unique-" However, specific performance may be granted in other appropriate circumstances, and considerations of supply may well make natural gas or even ***oil*** or a mineral "unique" in a sense. If an area is served only by one pipeline, the gas carried by that pipeline becomes irreplaceable.

Obviously, the irreparable harm suffered by a hospital or even consumers in winter might constitute both irreparable harm and appropriate circumstances under the Code to grant specific performance. It is a remedy that should always be considered for a buyer.

Finally, section 2-719 says that a contract may provide for remedies in addition to or in substitution for the remedies specified by the Code. Many natural resources sales contracts provide for specific performance by either party. It remains to be seen whether the courts will view this provision as requiring them to exercise their equitable powers when they would not have done so at common law.

**[5]   Conditions Precedent**

One cannot leave a discussion of remedies under the Code without noting in passing the conditions precedent to obtaining those remedies.

In any number of situations, a party may be compelled to take certain steps before particular rights under the Code become available to him. As has been noted, a seller must attempt to resell in the event of breach, and notice must usually be given the buyer.[[87]](#footnote-88)87 If a seller wishes to avail himself of the defense of frustration of purpose of contract, he must give timely notice to the buyer-[[88]](#footnote-89)88 Of course, any action by a buyer for breach of an implied or express warranty must be preceded by timely notice of the defect.[[89]](#footnote-90)89

There are many other examples of notices that must be given under the Code- It is essential that in any situation of breach or anticipated breach the parties be at pains to carefully review all pertinent Code provisions, and to do so very early.

**§ 5.08   Conclusion**

Application of the Uniform Commercial Code to ***oil***, gas, and mineral transactions is new. Because the Code was not really written to be applied to natural resources in place, nor to long-term contracts, difficulties may arise in its application. Even greater difficulties can befall those who rely only on the interpretations of contracts and ***oil*** and gas or mining law developed by time in those specialties. Instead, all must be fully aware of the Code and the changes it makes. Because time is very much of the essence in complying with notice requirements or making other decisions under the Code, early review of and familiarity with its terms are necessary.

In addition to this, certain specific steps are desirable:

**1.   All those who administer or negotiate contracts should be aware of Code provisions relevant to their work.**

**2.   In appropriate circumstances, attention should be paid to usage of trade in each specific "place."**

**3.   Some means of monitoring "course of performance" should be established, because acceptance of any particular kind of performance may be binding, or may operate as a waiver.**

**4.   Record retention systems should be revised so that all records are retained for the entire life of a contract, including notes of the negotiation and records of course of performance.**

**5.   In situations where there is uncertainty as to whether the adverse party can, or is willing to, continue performance, liberal use should be made of the UCC right to adequate assurance of performance.**

**6.   Mechanisms should be established to allow quick action in reselling or covering in case of breach, to avoid the mitigation formulas implicit in Code damage provisions.**

**7.   Care should be taken to comply with warranties, or to exclude implied warranties from contracts.**

**8.   In breach situations, care must be taken to act with commercial reasonableness and to comply with all Code provisions, particularly those of notice.**

Because there will be different levels of familiarity with the Code within a particular business, the most important point is that preventative law and corporate audit systems be established to ensure compliance with these steps in particular and with the Code in general.

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**End of Document**

1. 1The Uniform Commercial Code has now been adopted by all fifty states and the District of Columbia. However, when Louisiana, the last state to adopt the Code, enacted it, it specifically did *not* adopt article 2, the sales article. *See* La. Rev. Stat. Ann. §§ 10:1-101 *et seq*. (West 1983). So all of what is said in this paper unfortunately does not apply to Louisiana, a major ***oil*** and gas producer, except to the extent that that state's courts might find the Code and cases under it to be persuasive authority. [↑](#footnote-ref-2)
2. 2For an excellent general discussion of difficulties in times of market collapse, see Marks & Martin, "Minerals Supply Contracts When the Market Goes South or North-Enforcement, Avoidance, and Renegotiation," 32 *Rocky Mt. Min. L. Inst*. 5-1 (1986)[hereinafter cited as "Marks & Martin"]. [↑](#footnote-ref-3)
3. 3The original text of the Code did not include the parenthesized phrase "(including ***oil*** and gas)." In 1972 the Code revisors suggested addition of this phrase, and most states have done so. However, courts have applied the Code to ***oil*** and gas transactions even in the absence of the parenthesized phrase, and the author is aware of no decision declining to apply article 2 of the Code to ***oil*** and gas transactions for want of the parenthesized phrase. Accordingly, it seems safe to presume the application of the Code in all states except, as pointed out in note 1 *supra*, Louisiana. All sections of the Uniform Commercial Code referred to herein are from the original 1958 text, with the exception of the 1972 amendment to UCC § 107[1]. [↑](#footnote-ref-4)
4. 4*E.g*., Philadelphia Electric Co., 58 F.P.C. 88 (1977). [↑](#footnote-ref-5)
5. 5The first example is Pennzoil v. FERC, 645 F.2d 360, 387 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). [↑](#footnote-ref-6)
6. 6*E.g*., Casper v. Neubert, 489 F.2d 543, 546 (10th Cir. 1973); Piney Woods Country Life School v. Shell ***Oil*** Co., 726 F.2d 225 (5th Cir. 1984), *cert. denied*, 105 S. Ct. 1868 (1985). [↑](#footnote-ref-7)
7. 7McClanahan v. American Gilsonite Co., 494 F. Supp. 334 (D. Colo. 1980). [↑](#footnote-ref-8)
8. 8Troy Mining Co. v. Itmann Coal Co., 346 S.E.2d 749 (W. Va. 1986), deals with such oral agreements or modifications. Of course, nothing in the Code precludes application of the doctrine of promissory estoppel from *Restatement of Contracts* § 45 or the common law. [↑](#footnote-ref-9)
9. 9See discussion of courts' power to "fill in gaps" in text accompanying note 37 *infra*. [↑](#footnote-ref-10)
10. 10"Merchant" is rather broadly defined. A university might be a merchant of heating ***oil*** if its purchasing department made regular purchases. Comment 3 to U.C.C. § 2-104. [↑](#footnote-ref-11)
11. 11Apex ***Oil*** Co. v. Vanguard ***Oil*** & Service Co., 760 F.2d 417 (2d Cir. 1985). [↑](#footnote-ref-12)
12. 12U.C.C. § 2-207(1). [↑](#footnote-ref-13)
13. 13*Id*. § 2-207(2)(c). [↑](#footnote-ref-14)
14. 14*Id*. § 2-209(1).

    Section 2-209(2) says that a signed agreement forbidding modification or rescission without writing is effective. The degree of informality the Code permits in modifications suggests that such a provision is desirable for drafters to include in agreements. [↑](#footnote-ref-15)
15. 15*Id*. § 2-209(3). [↑](#footnote-ref-16)
16. 16See text accompanying note 19 *infra*. [↑](#footnote-ref-17)
17. 17U.C.C. § 1-102(3). However, § 1-102(3) provides that the obligations of "good faith, diligence, reasonableness and care" in the Code may not be modified, and certain sections contain specific prohibitions against modification by agreement. For discussion of interpretation of an alleged modification of the effect of the Code, see Commonwealth Propane Co. v. Petrosol International, Inc., 818 F.2d 522 (6th Cir. 1987), as to whether a contract had altered the UCC provision for risk of loss of propane stored under the contract. [↑](#footnote-ref-18)
18. 18*E.g*., Amendment of Commission's Interim Regulations, 7 F.E.R.C. ¶ 61,152 at p.61,372 (1984). [↑](#footnote-ref-19)
19. 19*E.g*., Paragon Resources, Inc. v. National Fuel Gas Distribution Corp., 695 F.2d 991, 997 (5th Cir. 1983); United Gas Pipeline Co., 27 F.E.R.C. ¶ 61,199 at p. 61,372 (1984). [↑](#footnote-ref-20)
20. 20U.C.C. § 1-205(2). [↑](#footnote-ref-21)
21. 21*Id*. § 1-205(3). [↑](#footnote-ref-22)
22. 22One caveat is in order to the litigator who seeks to introduce evidence of a usage of trade. U.C.C. § 1-204(6) requires that a party give the adverse party such notice as a court deems reasonable before the evidence can be admitted. Because of a possible blurring of the distinction between usage of trade and other factors such as commercial context, perhaps one should err on the side of caution in giving notice of particular evidence. [↑](#footnote-ref-23)
23. 23*Id*. § 4-208(2). [↑](#footnote-ref-24)
24. 24*Id*. § 1-205(4). [↑](#footnote-ref-25)
25. 25See the general discussion in J. White & R. Summers, *Uniform Commercial Code* §§ 2-9 & -10 at 75-89 (2d ed. 1980)[hereinafter cited as "White & Summers"]. [↑](#footnote-ref-26)
26. 26Although this result seems compelled by the language, it is hardly desirable. When the finder of fact is a jury, this would mean: (a) letting all evidence in and instructing the jury to disregard evidence lower down in the hierarchy if it is inconsistent with evidence higher up; or (b) involving the court in making rulings excluding evidence depending upon conclusions of fact and law which really are for the jury. [↑](#footnote-ref-27)
27. 27Paragon Resources, Inc. v. National Fuel Gas Corp., 723 F.2d 419, 422 (5th Cir. 1984). [↑](#footnote-ref-28)
28. 28***Kern*** ***Oil*** & Refining Co. v. Tenneco ***Oil*** Co., 792 F.2d 1380, 1383-84 (9th Cir. 1986). [↑](#footnote-ref-29)
29. 29754 F.2d 303 (10th Cir. 1985). [↑](#footnote-ref-30)
30. 30*Id*. at 308. [↑](#footnote-ref-31)
31. 31*Id*. at 309-10. The court even noted that there had been testimony of what one person thought another person knew! *Id*. at 310. [↑](#footnote-ref-32)
32. 32Comment 1 to U.C.C. § 1-205. [↑](#footnote-ref-33)
33. 33U.C.C. § 2-204(3) (emphasis added). [↑](#footnote-ref-34)
34. 34The statute of frauds provision of the Code even provides that contracts are not enforceable beyond the quantity specified in the writing. *Id*. § 2-201(1). [↑](#footnote-ref-35)
35. 35*Id*. § 2-306(1). [↑](#footnote-ref-36)
36. 36*Id*. § 2-306(2). [↑](#footnote-ref-37)
37. 37*Id*. § 2-305(1). [↑](#footnote-ref-38)
38. 38*See, e.g*., Piney Woods Country Life School v. Shell ***Oil*** Co., 726 F.2d 225, 238-42 (5th Cir. 1984), *cert. denied*, 105 S. Ct. 1868 (1985); North Central Airlines, Inc. v. Continental ***Oil*** Co., 574 F.2d 582 (D.C. Cir. 1978); Hollimon, "The Volatile Area of Market Value Gas Royalty Litigation," 13 *St. Mary's L.J*. 1 (1981). The cases among them list a dozen or more factors to be considered. [↑](#footnote-ref-39)
39. 39U.C.C. §§ 2-305(1) and (4). [↑](#footnote-ref-40)
40. 40It is important to note that the price to be filled into the contractual gap is "reasonable price," not "market price." A seller should be able to show that "reasonable price" under the particular contract is higher than market because of such factors as the buyer wishing to secure a guaranteed long-term source of supply. Other factors may apply to both parties. U.C.C. § 2-724 makes "reports in official publications or trade journals or in newspapers or periodicals of general circulation" admissible on the issue of determining "prevailing price or value" of materials sold in an established commodity market. However, nothing in the Code establishes the weight to be given such reports, and obviously they were not intended to be of conclusive weight. Comment to § 2-724. [↑](#footnote-ref-41)
41. 41U.C.C. § 2-309(1). [↑](#footnote-ref-42)
42. 42*Id*. § 2-309(2). [↑](#footnote-ref-43)
43. 43*Id*. § 2-310(a). [↑](#footnote-ref-44)
44. 44*Id*. § 2-311(1). [↑](#footnote-ref-45)
45. 45*Id*. § 2-311(2). [↑](#footnote-ref-46)
46. 46The Code drafters obviously had in mind the parol evidence rule, which generally excludes from a contract, statements or writings made prior to or contemporaneously with the execution of the contract which do not become a part of the final, integrated contract. However, that is not quite the way the Code states the proposition. Instead, for that "affirmation of fact or promise" to become an express warranty, it must be one which "becomes part of the basis of the bargain". *Id*. § 2-313(1)(a). That is not quite the same thing as saying that the warranty becomes part of the integrated contract, and just what it does mean is not altogether clear. [↑](#footnote-ref-47)
47. 47*Id*. § 2-313(1)(a). [↑](#footnote-ref-48)
48. 48The language "is made part of the basis for the bargain" is slightly different from the language "becomes part of the basis for the bargain" in U.C.C. § 2-313(1)(a) discussed in note 46, *supra*. The reason for and effect of the difference is not clear. [↑](#footnote-ref-49)
49. 49U.C.C. §§ 2-313(1)(b) and (c). [↑](#footnote-ref-50)
50. 50*Id*. § 2-313(2). [↑](#footnote-ref-51)
51. 51It should be remembered that the Code's definition of "merchant" is sweeping and may encompass many who would not be thought to be merchants in any lay sense. See note 10 *supra*. [↑](#footnote-ref-52)
52. 52U.C.C. § 2-314(2)(a). [↑](#footnote-ref-53)
53. 53*Id*. § 2-314(2)(b). [↑](#footnote-ref-54)
54. 54*Id*. § 2-314(2)(c). [↑](#footnote-ref-55)
55. 55*Id*. § 2-314(2)(d). [↑](#footnote-ref-56)
56. 56*Id*. § 2-314(2)(e). [↑](#footnote-ref-57)
57. 57*Id*. § 2-315. [↑](#footnote-ref-58)
58. 58The cited sections contain many limitations on the way warranties are excluded or modified, such as the necessity for clarity of the language. Furthermore, it is important to make sure that any modification or exclusion is not held unreasonable. Not only does the Code contain specific references to that requirement, but also obviously this is an area in which the courts will carefully scrutinize the conduct of the parties. [↑](#footnote-ref-59)
59. 59In reading all parts of the Code, one should keep in mind the provisions of § 1-103 that principles of law and equity "supplement" provisions of the Code unless "displaced" by particular provisions. That section goes on to specifically list as "supplementing" the Code, the common law affirmative defenses of lack of capacity to contract, estoppel, fraud, misrepresentation, duress, coercion, mistake, or bankruptcy. [↑](#footnote-ref-60)
60. 60For example, as noted in the discussion of damages at section 5.07[2] *infra*, the author believes that the Code's damages provisions can best be understood as an attempt to codify common law principles of mitigation of damages. [↑](#footnote-ref-61)
61. 61For a general discussion of unconscionability under the UCC, see Reese, "The Uniform Commercial Code: Its Impact on Natural Gas Contract Litigation," 2 *Natural Gas* 16 (1985). [↑](#footnote-ref-62)
62. 62*See* Comment 1 to U.C.C. § 2-615. [↑](#footnote-ref-63)
63. 63*E.g*., Gulf ***Oil*** Corp. v. FPC, 563 F.2d 588 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978); Northern Illinois Gas Co. v. Energy Cooperative, Inc., 122 Ill. App. 3d 940, 461 N.E.2d 1049 (1984); Sunflower Electric Cooperative, Inc. v. Tomlinson ***Oil*** Co., 7 Kan. App. 2d 131, 638 P.2d 963 (1981). Publicker Industries Inc. v. Union Carbide Corp., 17 U.C.C. Rep. Serv. 989 (E.D. Pa. 1975), reviewed authorities and concluded that nothing less than a 100% increase in costs had been sufficient to be a defense. However, the courts are now upholding contracts involving far greater price fluctuations in ***oil*** or gas contracts.

    The topic has been the subject of much writing. *E.g*., Marks & Martin, *supra* note 2, at § 5.04[3]; Tannenbaum, "Commercial Impracticability Under the UCC: Natural Gas," 20 *Hous. L. Rev*. 771 (1982); Turner, "Natural Gas-Impact of Deregulation or Reregulation on Sales Contracts," 29 *Rocky Mt. Min. L. Inst*. 501 (1983). [↑](#footnote-ref-64)
64. 64International Minerals & Chemical Corp. v. Llano, 770 F.2d 879 (10th Cir. 1985), *cert. denied*, 106 S. Ct. 1196 (1986). [↑](#footnote-ref-65)
65. 65U.C.C. § 2-605. [↑](#footnote-ref-66)
66. 66A single delivery of a natural resource sufficiently out of conformity with the contract to constitute a breach does *not* necessarily constitute an anticipatory repudiation. U.C.C. § 2-612 provides specific remedies in the case of a nonconforming shipment of an installment contract. Comment 1 to U.C.C. § 2-610 makes it clear that such difficulties are not to be treated as an anticipatory repudiation. [↑](#footnote-ref-67)
67. 67U.C.C. § 2-610(a). [↑](#footnote-ref-68)
68. 68*Id*. § 2-610(b). [↑](#footnote-ref-69)
69. 69*Id*. § 2-610(c).

    However, care must be taken when one suspends performance. In Columbia Gas Transmission Corp. v. Wright, 443 F. Supp. 14 (S.D. Ohio 1977), Wright was selling natural gas to Columbia. Columbia discovered that it was being overcharged because the meters had been tampered with, although there was no proof as to who had done the tampering. Furthermore, Wright was in default on the long-term financing Columbia had provided to cover start-up costs. Columbia informed Wright that it was going to continue taking the gas without payment until the arrearages were made up. When Wright refused to deliver any more gas to Columbia and began selling the contracted-for gas to others, the court denied Columbia any injunctive relief. The court felt bound to the Code's standards of commercial reasonableness, and believed it commercially unreasonable to expect Wright to stay in business with *no* incoming payments. The case is very important to remember in deciding on one's actions in a breach situation. [↑](#footnote-ref-70)
70. 70See the lengthy discussion of the right to adequate assurances in United States v. Great Plains Gas Associates, 819 F.2d 831 (8th Cir. 1987), in which the federal government announced by press release and otherwise that it did not intend to continue with a gas synthesis project. [↑](#footnote-ref-71)
71. 71U.C.C. § 2-702. [↑](#footnote-ref-72)
72. 72There are severe limitations on the manner of resale. The seller may use the actual resale price in the formula only if the sale has been consummated in a "commercially reasonable manner." *Id*. § 2-706(1). If the sale is private, notice must be given the buyer, and, in general, there are a number of provisions that must be complied with. *Id*. §§ 2-706(2), (3) and (4). [↑](#footnote-ref-73)
73. 73Nobs Chemical, U.S.A. Inc. v. Koppers Co., 616 F.2d 212 (5th Cir. 1980), deals with an interesting problems of the damage formula of U.C.C. § 2-708(1). Defendant Koppers breached a contract to buy cumene from Plaintiff Nobs Chemical. However, because of the breach Nobs, a "middleman," never bought the cumene it was to resell to Koppers. At the time of breach, the price of cumene had dropped, so under § 2-708(1) Nobs would have recovered the difference between the contract price and the price at which it had arranged to buy, *plus* the additional amount by which the market price had dropped. It would have received a windfall. The court denied this windfall and allowed Nobs only the profit it would have made if the contract had been carried out. After all, U.C.C. § 1-106(1) says the purpose of the Code is to return the aggrieved party to the position it would have been in had performance occurred. Following this principle, the court applied the lost profit rule of U.C.C. § 2-708(2) instead of mechanically following § 2-708(1). The case stands for the principle that the courts will adjust the Code damage formulas where strict application would result in injustice. [↑](#footnote-ref-74)
74. 74The critical time here is not the actual time of the breach, but when the buyer *learns there has been a breach*. U.C.C. § 2-713(1). After all, it would be unfair to hold the jilted buyer to the market price at the time of a breach he had not yet heard of, so that he could not be expected to go out on the market and cover. [↑](#footnote-ref-75)
75. 75*Id*. §§ 2-710, 2-715. [↑](#footnote-ref-76)
76. 76*E.g*., Milwaukee Valve Co. v. Mishawaka Brass Mfg., Inc., 107 Wisc. 2d 164, 319 N.W.2d 885 (Wisc. App. 1982). [↑](#footnote-ref-77)
77. 77*See Nobs Chemical, supra* note 73. [↑](#footnote-ref-78)
78. 78U.C.C. § 2-708(2), discussed at section 5.07[3] *infra* in connection with the consideration of the lost volume seller. [↑](#footnote-ref-79)
79. 79*See Nobs Chemical, supra* note 73. [↑](#footnote-ref-80)
80. 80*See generally* White & Summers, *supra* note 25, § 7-9 at 274-78; Jackson, "'Anticipatory Repudiation' and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Case of Prospective Nonperformance," 31 *Stan. L. Rev*. 69 (1978). [↑](#footnote-ref-81)
81. 81Northern Indiana Public Service Co. v. Carbon County Coal Co., 799 F.2d 265, 279 (7th Cir. 1986). [↑](#footnote-ref-82)
82. 82653 F. Supp. 841 (N.D. Ill. 1987). [↑](#footnote-ref-83)
83. 83*See* the general discussion of equitable and declaratory relief in Marks & Martin, *supra* note 2, at § 5.04[2][a]; White & Summers, *supra* note 25, § 6-6 at 235-40. [↑](#footnote-ref-84)
84. 84Recall that Comment 4 to the commercial frustration section, discussed in the text accompanying note 63 *supra*, says that even market collapse is not a defense, for that is a risk inherent in fixed price business contracts. *See, e.g*., Stack v. Tenneco, Inc., 641 F. Supp. 199 (S.D. Miss. 1986)(denying specific performance but ordering payment of all monies due to date); Sid Richardson Carbon & Gas Co. v. Inter North, Inc., 595 F. Supp. 497 (N.D. Tex. 1984); Howell Pipeline Co. v. Terra Resources, Inc., 454 So.2d 1353 (Ala. 1984). [↑](#footnote-ref-85)
85. 85*E.g*., Sea Robin Pipeline Co. v. Pogo Producing Co., 493 So.2d 909 (La. App.), *writ denied* 487 So.2d 310 (La. 1986); Equitable Petroleum Corp. v. Central Transmission, Inc., 431 So.2d 1084, 1089 (La. App. 1983); Coquina ***Oil*** Corp. v. Transwestern Pipeline Co., No. 86-562-M (U.S.D.C., D.N.M., Aug. 19, 1986); *See also* Big Horn Fractionation Co. v. MIGC, Inc., No. C84-B-0028 (U.S.D.C., D. Wyo., Feb. 6, 1985)(injunction granted to compel transportation but not to compel purchase). [↑](#footnote-ref-86)
86. 86U.C.C. § 2-716(1). [↑](#footnote-ref-87)
87. 87*Id*. § 2-706(2) and (3)(b). [↑](#footnote-ref-88)
88. 88*Id*. § 2-615(c). [↑](#footnote-ref-89)
89. 89*Id*. § 2-607(3)(a). [↑](#footnote-ref-90)