

Title, insurable interest, and risk of loss

Commercial transactions class

Lecture 2.01

Introduction

Setting

- Title is the legal term for a claim of ownership to property
- The sale of goods involves the transfer of title from a seller to a buyer
- There is a lapse of time between contract execution and acquiring title
- Who bears the risk of loss during this time?

Objective

- In this lecture we study three concepts: Title, Risk of Loss, and Insurable Interest. After this lecture, you should be able to answer the following questions:
 1. What is the concept of title?
 2. How does it pass?
 3. What is risk of loss?
 4. What is insurable interest?
 5. What are the different kinds of sales contracts, and how does each type affect title passing, risk of loss, and insurable interest?

Passing of title

When the goods exist and are identified in the contract, title may pass to the buyer

- The UCC states that title may pass in any manner on which the parties agree
- If the parties do not specify when title passes, the UCC provides the default rules

Default rule possibilities regarding passing of title

- If the goods are to be shipped, title passes to the buyer once the seller meets its obligations to ship the goods as specified in the contract (i.e., when the seller delivers the goods to the common freight carrier)
- If the goods are not shipped and remained stored, title passes when the seller delivers a document of title (e.g., warehouse receipt or bill of lading) to the buyer
- If the contract does not require shipping or delivery of the documents of title, title passes to the buyer when the contract is made effective and the goods are identified to the contract

Good faith buyers

- The UCC has a rule regarding when a good faith buyer can acquire valid title to improperly obtained goods
- A good faith buyer is someone who acts honestly and provides reasonable value for the goods

- A good faith buyer must not know or suspect that the goods were obtained improperly

There are three kinds of title

- Good title: acquired from someone who owns goods, free and clear
- Void title: acquired from someone with stolen goods
- Voidable title: acquired from a purchase of goods through fraud or deceit

A seller has voidable title if the goods it is selling were

- obtained by fraud or deceit,
- paid for with a dishonored check,
- purchased from a minor, or
- purchased on credit when the seller was insolvent

A good faith buyer acquires valid title so long as the seller obtained a voidable title

- A void title involves property obtained through theft
- The acquisition of stolen property, even by a good faith purchaser, results in the stolen property being returned to its rightful owner
- If the property was acquired through fraud or deceit, a good faith buyer may keep the property and retain valid title

Imperfect title creates problems for those who attempt to sell or lease

- A seller who has void title cannot transfer good title
- A seller whose title is voidable has the power to transfer valid title to a good faith purchaser
- General Rule: If third party purchaser makes good-faith purchase for value, it gets good title (not void/voidable title)

Entrusting goods to a merchant gives the merchant the right to transfer title

- If an owner entrusts the possession of goods to a merchant,
- the merchant can transfer all rights in the goods to a buyer in the ordinary course of business.

Passing of title requires identification

The UCC requires the following to occur before title to goods passes from the seller to the buyer

- Goods must actually exist
- Goods must be identified to the contract as the ones which will specifically be sold to the buyer
 - For example, vehicle identification numbers or specific lot numbers
 - Parties may agree on any method they desire to identify the goods to the contract

Identification

- For title to pass from seller to buyer, goods must be distinguished from similar goods
- Identification gives a buyer
 - a right to obtain insurance on goods and
 - to recover from third parties who damage the goods

The point at which identification occurs varies depending on the nature of the good

1. Existing goods - If the contract calls for the sale or lease of goods that already exist in their final form, then identification occurs at the time the contract is made
2. Future goods - If the contract calls for the sale or lease of goods that have yet to be completed or modified in accordance with the contract, identification occurs when the goods are shipped, marked, or otherwise designated by the seller or lessor for delivery
3. Fungible goods - Identification of these goods occurs when the goods are shipped, marked, or otherwise designated by the seller or lessor for delivery to the buyer or lessee

Insurable interest

A party will protect itself from risk of loss by obtaining insurance

- Insurance companies will not insure property unless the party seeking insurance has an insurable interest
- An insurable interest exists when loss or damage to something or someone causes a person to suffer a financial or other kind of recognizable loss
- **Insurable interest:** A property interest in sold or leased goods that is sufficiently substantial to permit a party to insure against damage to the goods identified to the sale or lease contract

Title creates an insurable interest

- The UCC recognizes that the buyer may want to insure the goods before acquiring title
- The UCC allows the buyer to obtain an insurable interest in goods without title if the goods are identified in the contract

Both the buyer and the seller may have insurable interests in the same goods if the title has not yet passed

- A buyer has an insurable interest once the goods are identified to the contract
- A seller has an insurable interest as long as it retains title to the goods

Risk of loss

The UCC allocates risk of loss from an accident, mishandling, or theft

- Risk of loss is the term describing which party should bear the burden of risk for damage occurring to goods after the sale has been completed, but before delivery has occurred
- Risk of loss is separate from title
- In any transaction, the parties will allocate risk of loss

Who bears the risk of loss—the seller or the buyer? In every contract, this matter arises

- By agreement, parties can generally control when risk of loss passes from seller to buyer
- If the contract does not specify when risk passes, the UCC will supply the applicable rules
- The UCC allocates risk of loss based on whether an agreement is categorized as a shipment contract or a destination contract

Under the Uniform Commercial Code (UCC), there are risk of loss rules

1. Agreement - the agreement of the parties controls
2. Delivery by common carrier other than by seller
3. Breach - the breaching party is liable for any uninsured loss even though breach is unrelated to the problem

Delivery by common carrier other than by seller

1. Risk of loss shifts from seller to buyer at the time that seller completes its delivery obligations
2. If it is a shipment contract, risk passes when the goods are placed in the hands of the first carrier
3. If it is a destination contract, then risk of loss remains with the seller until the goods reach the buyer

Risk of loss and carrier contracts

Shipment contracts require the seller to use a carrier to deliver the goods

- Contracts for the sale of goods are considered shipment contracts unless the parties have agreed otherwise
- Seller completes performance by placing the goods in the hands of the carrier
- The seller bears the risk of loss until the seller delivers the goods to the carrier
- Risk of loss transfers when goods are placed in the hands of the first carrier

Destination contracts require the seller to deliver the goods to a specified destination

- Seller completes performance when the goods have been delivered at the specified destination
- Risk of loss is allocated to the buyer at the time of tender if the goods are conforming
- If goods are damaged while in the hands of the carrier, the seller bears the risk of loss

Risk of loss and breach of contract

Seller breaches by failing to deliver conforming goods

- Buyer may accept nonconforming goods "as is", or reject goods (subject to seller's right to "cure")
- Risk of loss remains with seller until buyer accepts goods or until deficiencies are corrected
- Non-Conforming Goods: If goods are so nonconforming that a buyer rejects them, risk of loss does not pass until the defects are cured

Seller breaches and buyer accepts non-conforming goods (despite defects)

- If a buyer accepts and then later discovers the defect, the buyer may revoke its acceptance

Buyer breach (buyer refuses to accept conforming goods, goods later lost or damaged)

- Risk of loss depends on type of contract between buyer and seller
- In the absence of contractual language, the risk of loss immediately shifts to the buyer
- The buyer only bears the risk of loss for a commercially reasonable time

Conclusion

What did we learn today?

- Understanding title starts with understanding identification
- Commercial transactions require knowing when an insurable interest exists
- Determining the point at which title and risk of loss passes depends on the contract