Title and Risk of Loss Under the UCC

Parties to a sales contract will usually agree on the obvious details of a sales transaction—the nature of goods, the price, and the delivery time, as discussed in the next chapter. But there are two other issues of importance lurking in the background of every sale:

1. When does the title pass to the buyer? This question arises more in cases involving third parties, such as creditors and tax collectors. For instance, a creditor of the seller will not be allowed to take possession of goods in the seller's warehouse if the title has already passed to the buyer.
2. If goods are damaged or destroyed, who must bear the loss? The answer has obvious financial significance to both parties. If the seller must bear the loss, then in most cases he must pay damages or send the buyer another shipment of goods. A buyer who bears the loss must pay for the goods even though they are unusable. In the absence of a prior agreement, loss can trigger litigation between the parties.

Transfer of Title

Why It Is Important When Title Shifts

There are three reasons why it is important when title shifts from seller to buyer—that is, when the buyer gets title.

It Affects Whether a Sale Has Occurred

First, a sale cannot occur without a shift in title. You will recall that a sale is defined as a "transfer of title from seller to buyer for a price." Md. Code Ann., Com. Law § 2-106. Thus if there is no shift of title, there is no sale. And there are several consequences to there being no sale, one of which is— concerning a merchant-seller—that no implied warranty of merchantability arises. (An implied warranty provides that when a merchant-seller sells goods, the goods are suitable for the ordinary purpose for which such goods are used.) In a lease, of course, title remains with the lessor.

Creditors' Rights

Second, title is important because it determines whether creditors may take the goods. If Creditor has a right to seize Debtor's goods to satisfy a judgment or because the parties have a security agreement (giving Creditor the right to repossess Debtor's goods), obviously it won't do at all for Creditor to seize goods when Debtor doesn't have title to them—they are somebody else's goods, and seizing them would be conversion, a tort (the civil equivalent of a theft offense).

Insurable Interest

Third, title is related to who has an **insurable interest**. A buyer cannot legally obtain insurance unless he has an insurable interest in the goods. Without an insurable interest, the insurance contract would be an illegal gambling contract. For example, if you attempt to take out insurance on a ship with which you have no connection, hoping to recover a large sum if it sinks, the courts will construe the contract as a wager you have made with the insurance company that the ship is not seaworthy, and they will refuse to enforce it if the ship

should sink and you try to collect. Thus this question arises: under the UCC, at what point does the buyer acquire an insurable interest in the goods? Certainly a person has insurable interest if she has title, but the UCC allows a person to have insurable interest with less than full title. The argument here is often between two insurance companies, each *denying* that its insured had insurable interest as to make it liable.

Goods Identified to the Contract

The Identification Issue

Section 2-401 provides that "title to goods cannot pass under a contract for sale prior to their identification to the contract." Md. Code Ann., Com. Law § 2-401. In a lease, of course, title to the leased goods does not pass at all, only the right to possession and use for some time in return for consideration. Md. Code Ann., Com. Law § 2A-103(1)(j). So identification to the contract has to happen before title can shift. Identification to the contract here means that the seller in one way or another picks the goods to be sold out of the mass of inventory so that they can be delivered or held for the buyer.

When are goods "identified"? There are two possibilities as to when identification happens.

Parties May Agree

Section 2-501(1) says "identification can be made at any time and in any manner explicitly agreed to by the parties." Md. Code Ann., Com. Law § 2-501(1).

UCC Default Position

If the parties do not agree on when identification happens, the UCC default kicks in. Section 2-501(1) says identification occurs

1. when the contract is made if it is for the sale of goods already existing and identified;
2. if the contract is for the sale of future goods other than those described in paragraph 3 below, when goods are shipped, marked, or otherwise identified by the seller as goods to which the contract refers;
3. when crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young (livestock) to be born within twelve months after contract or for the sale of corps to be harvested within twelve months or the next normal harvest seasons after contracting, whichever is longer. Md. Code Ann., Com. Law § 2-501.

Thus if Very Fast Food Inc.'s purchasing agent looks at a new type of industrial sponge on Delta Sponge Makers' store shelf for restaurant supplies, points to it, and says, "I'll take it," identification happens then, when the contract is made. But if the purchasing agent wants to purchase sponges for her fast-food restaurants, sees a sample on the shelf, and says, "I want a gross of those"—they come in boxes of one hundred each—identification won't happen until one or the other of them chooses the gross of boxes of sponges out of the warehouse inventory.

When Title Shifts

Parties May Agree

Assuming identification is done, when does title shift? The law begins with the premise that the agreement of the parties governs. Section 2-401(1) of the UCC says that, in general, "title to goods passes from the seller to

the buyer in any manner and on any conditions explicitly agreed on by the parties." Md. Code Ann., Com. Law § 2-401(1). Many companies specify in their written agreements at what moment the title will pass; here, for example, is a clause that appears in sales contracts of Dow Chemical Company: "Title and risk of loss in all goods sold hereunder shall pass to Buyer upon Seller's delivery to carrier at shipping point." Thus Dow retains title to its goods only until it takes them to the carrier for transportation to the buyer.

Because the UCC's default position (discussed later in this section) is that title shifts when the seller completed delivery obligations, and because the parties may agree on delivery terms, they also may, by choosing those terms, effectively agree when title shifts (again, they also can agree using any other language they want). So it is appropriate to examine some delivery terms at this juncture. There are three possibilities: shipment contracts, destination contracts, and contracts where the goods are not to be moved.

Shipment Contracts

In a shipment contract, the seller's obligation is to send the goods to the buyer, but not to a particular destination. The typical choices are set out in Section 2-319:

- F.O.B. [place of shipment] (the place from which the goods are to be shipped goes in the brackets, as in "F.O.B. Seattle"). F.O.B. means "free on board"; the seller's obligation, according to Section 2-504, is to put the goods into the possession of a carrier and make a reasonable contract for their transportation, to deliver any necessary documents so the buyer can take possession, and promptly notify the buyer of the shipment. Md. Code Ann., Com. Law § 2-319(1).
- F.A.S. [named port] (the name of the seaport from which the ship is carrying the goods goes in the brackets, as in "F.A.S. Long Beach"). F.A.S means "free alongside ship"; the seller's obligation is to at his "expense and risk deliver the goods alongside the vessel in the manner usual in that port" and to provide the buyer with pickup instructions. Md. Code Ann., Com. Law § 2-319(2).
- C.I.F. and C. & F. These are actually not abbreviations for delivery terms, but rather they describe who pays insurance and freight. "C.I.F" means "cost, insurance, and freight"—if this term is used, it means that the contract price "includes in a lump sum the cost of the goods and the insurance and freight to the named destination." "C. & F." means that "the price so includes cost and freight to the named destination." Md. Code Ann., Com. Law §§ 2-319, 2-320.

Destination Contracts

In a destination contract, the seller's obligation is to see to it that the goods actually arrive at the destination. Here again, the parties may employ the use of abbreviations that indicate the seller's duties. See the following from Section 2-319:

- F.O.B. [destination] means the seller's obligation is to "at his own expense and risk transport the goods to that place and there tender delivery of them" with appropriate pickup instructions to the buyer. Md. Code Ann., Com. Law § 2-319(1).
- Ex-ship "is the reverse of the F.A.S. term." Md. Code Ann., Com. Law § 2-322. It means "from the carrying vessel"—the seller's obligation is to make sure the freight bills are paid and that "the goods leave the ship's tackle or are otherwise properly unloaded."
- No arrival, no sale means the "seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the non-arrival." Md. Code Ann., Com. Law § 2-324. If the goods don't arrive, or if they are damaged or deteriorated through no fault of the seller, the

buyer can either treat the contract as avoided, or pay a reduced amount for the damaged goods, with no further recourse against the seller. Md. Code Ann., Com. Law § 2-613.

Goods Not to Be Moved

It is not uncommon for contracting parties to sell and buy goods stored in a grain elevator or warehouse without physical movement of the goods. There are two possibilities:

1. Goods with documents of title. A first possibility is that the ownership of the goods is manifested by a document of title—"bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers." Md. Code Ann., Com. Law § 1- 201(15). In that case, Section 2-401(3)(a), says that title passes "at the time when and the place where" the documents are delivered to the buyer. Md. Code Ann., Com. Law § 2-401(3)(a).
2. Goods without documents of title. If there is no physical transfer of the goods and no documents to exchange, then Section 2-401(3)(b), provides that "title passes at the time and place of contracting." Md. Code Ann., Com. Law § 2-401(3)(b).

Here are examples showing how these concepts work.

Suppose the contract calls for Delta Sponge Makers to "ship the entire lot of industrial grade Sponge No. 2 by truck or rail" and that is all that the contract says about shipment. That's a "shipment contract," and the UCC, Section 2-401(2)(a), says that title passes to Very Fast Foods at the "time and place of shipment." At the moment that Delta turns over the 144 cartons of 1,000 sponges each to a trucker— perhaps Easy Rider Trucking comes to pick them up at Delta's own factory—title has passed to Very Fast Foods.

Suppose the contract calls for Delta to "deliver the sponges on June 10 at the Maple Street warehouse of Very Fast Foods Inc." This is a destination contract, and the seller "completes his performance with respect to the physical delivery of the goods" when it pulls up to the door of the warehouse and tenders the cartons. Uniform Commercial Code, Section 2-401(2)(b). "Tender" means that the party—here Delta Sponge Makers—is ready, able, and willing to perform and has notified its obligor of its readiness. When the driver of the delivery truck knocks on the warehouse door, announces that the gross of industrial grade Sponge No. 2 is ready for unloading, and asks where the warehouse foreman wants it, Delta has tendered delivery, and title passes to Very Fast Foods.

Suppose Very Fast Foods fears that the price of industrial sponges is about to soar; it wishes to acquire a large quantity long before it can use them all or even store them all. Delta does not store all of its sponges in its own plant, keeping some of them instead at Central Warehousing. Central is a bailee, one who has rightful possession but not title. (A parking garage often is a bailee of its customers' cars; so is a carrier carrying a customer's goods.) Now assume that Central has issued a warehouse receipt (a document of title that provides proof of ownership of goods stored in a warehouse) to Delta and that Delta's contract with Very Fast Foods calls for Delta to deliver "document of title at the office of First Bank" on a particular day. When the goods are not to be physically moved, that title passes to Very Fast Foods "at the time when and the place where" Delta delivers the document.

Suppose the contract did not specify physical transfer or exchange of documents for the purchase price. Instead, it said, "Seller agrees to sell all sponges stored on the north wall of its Orange Street warehouse,

namely, the gross of industrial Sponge No. 2, in cartons marked B300–B444, to Buyer for a total purchase price of $14,000, payable in twelve equal monthly installments, beginning on the first of the month beginning after the signing of this agreement." Then title passes at the time and place of contracting—that is, when Delta Sponge Makers and Very Fast Foods sign the contract.

So, as always under the UCC, the parties may agree on the terms they want when title shifts. They can do that directly by just saying when—as in the Dow Chemical example—or they can indirectly agree when title shifts by stipulating delivery terms: shipment, destination, goods not to be moved. If they don't stipulate, the UCC default kicks in.

UCC Default Provision

If the parties do not stipulate by any means when title shifts, Section 2-401(2) of the UCC provides that "title passes to the buyer at the time and place at which seller completes his performance with reference to the physical delivery of the goods." And if the parties have no term in their contract about delivery, the UCC's default delivery term controls. It says "the place for delivery is the seller's place of business or if he has none his residence," and delivery is accomplished at the place when the seller "put[s] and hold[s] conforming goods at the buyer's disposition and give[s] the buyer any notification reasonably necessary to enable him to take delivery." Uniform Commercial Code, Sections 2-308 and 2-503.

Title from Nonowners

The Problem of Title from Nonowners

We have examined when title transfers from buyer to seller, and here the assumption is, of course, that seller had good title in the first place. But what title does a purchaser acquire when the seller has no title or has at best only a voidable title? This question has often been difficult for courts to resolve. It typically involves a type of eternal triangle with a three-step sequence of events, as follows (see Figure 13 "Sales by Nonowners"): (1) The nonowner obtains possession, for example, by loan or theft; (2) the nonowner sells the goods to an innocent purchaser for cash; and (3) the nonowner then takes the money and disappears, goes into bankruptcy, or ends up in jail. The result is that two innocent parties battle over the goods, the owner usually claiming that the purchaser is guilty of conversion (i.e., the unlawful assumption of ownership of property belonging to another) and claiming damages or the right to recover the goods.

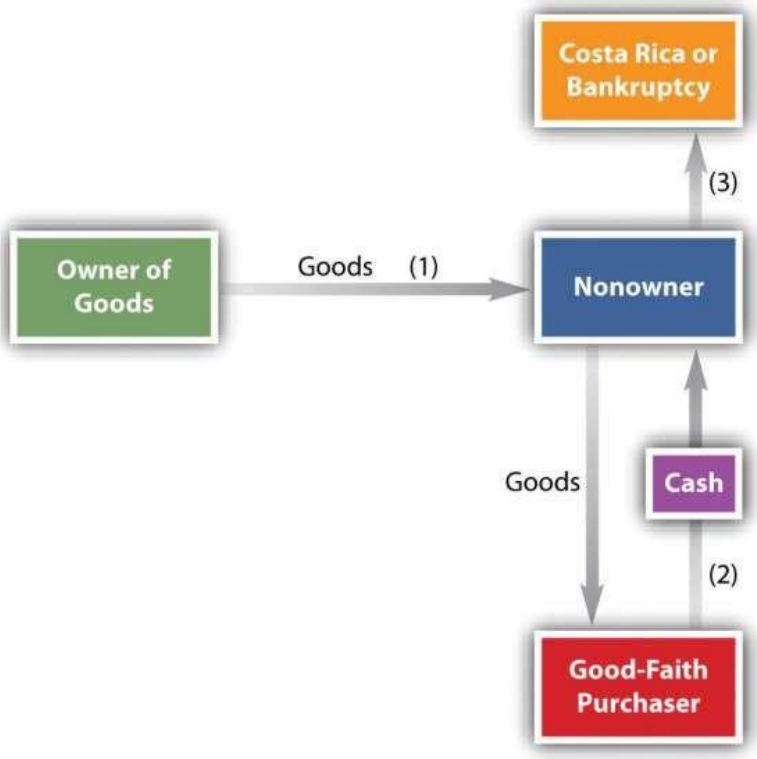


Figure 12 Sales by Nonowners

The Response to the Problem of Title from Nonowners The Basic Rule

To resolve this dilemma, we begin with a basic policy of jurisprudence: a person cannot transfer better title than he or she had. (This policy is noted in Sections 2-403, 2A-304, and 2A-305.) This policy would apply in a sale-of-goods case in which the non-owner had a void title or no title at all. For example, if a non-owner stole the goods from the owner and then sold them to an innocent purchaser, the owner would be entitled to the goods or to damages. Because the thief had no title, he had no title to transfer to the purchaser. A person cannot get good title to goods from a thief, nor does a person have to retain physical possession of her goods at all times to retain their ownership—people are expected to leave their cars with a mechanic for repair or to leave their clothing with a dry cleaner.

If thieves could pass on good title to stolen goods, there would be a huge increase in the trafficking of stolen property; that would be unacceptable. In such a case, the owner can get her property back from whomever the thief sold it to in a civil action called replevin (an action to recover personal property unlawfully taken). On the other hand, when a buyer in good faith buys goods from an apparently reputable seller, she reasonably expects to get good title, and that expectation cannot be dashed with impunity without faith in the market being undermined. Therefore, as between two innocent parties, sometimes the original owner does lose, on the theory that (1) that person is better able to avoid the problem than the downstream buyer, who had absolutely no control over the situation, and (2) faith in commercial transactions would be undermined by allowing original owners to claw back their property under all circumstances.

So the basic legal policy that a person cannot pass on better title than he had is subject to a number of exceptions. Likewise, the law governing the sale of goods contains exceptions to the basic legal policy. These usually fall within one of two categories: sellers with voidable title and entrustment.

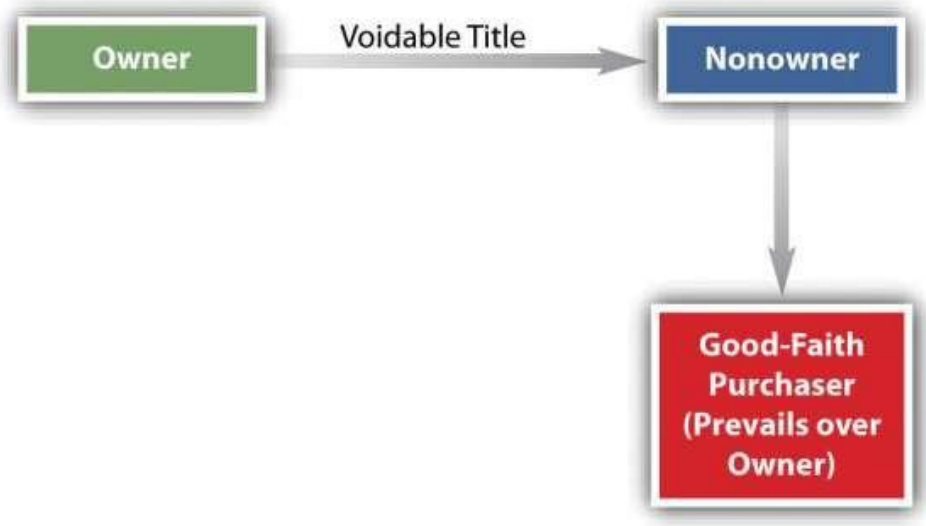
The Exceptions

Sellers with a Voidable Title

Under the UCC, a person with a voidable title has the power to transfer title to a good-faith purchaser for value (see Figure 14 "Voidable Title"). The UCC defines *good faith* as “honesty in fact in the conduct or transaction concerned.” Md. Code Ann., Com. Law § 1-201(19). A “purchaser” is not restricted to one who pays cash; any taking that creates an interest in property, whether by mortgage, pledge, lien, or even gift, is a purchase for purposes of the UCC. And “value” is not limited to cash or goods; a person gives value if he gives any consideration sufficient to support a simple contract, including a binding commitment to extend credit and security for a preexisting claim. Recall from the section in Contract Law on "The Agreement" that a “voidable” title is one that, for policy reasons, the courts will cancel on application of one who is aggrieved. These reasons include fraud, undue influence, mistake, and lack of capacity to contract. When a person has a voidable title, title can be taken away from her, but if it is not, she can transfer better title than she has to a good-faith purchaser for value.

Rita, sixteen years old, sells a video game to her neighbor Annie, who plans to give the game to her nephew. Since Rita is a minor, she could rescind the contract; that is, the title that Annie gets is voidable: it is subject to be avoided by Rita’s rescission. But Rita does not rescind. Then Annie discovers that her nephew already has that video game, so she sells it instead to an office colleague, Donald. He had no notice that Annie bought the game from a minor and has only a voidable title. He pays cash. Should Rita— the minor—subsequently decide she wants the game back, it would be too late: Annie transferred good title to Donald even though Annie’s title was voidable. *See Inmi-Etti v. Aluisi*, 63 Md. App., 492 A.2d 917 (1985) (voidable title can only arise from a voluntary transaction).

Figure 13 Voidable Title



Suppose Rita was an adult and Annie paid her with a check that later bounced, but Annie sold the game to Donald before the check bounced. Does Donald still have good title? The UCC says he does, and it identifies three other situations in which the good-faith purchaser is protected: (1) when the original transferor was deceived about the identity of the purchaser to whom he sold the goods, who then transfers to a good-faith purchaser; (2) when the original transferor was supposed to but did not receive cash from the intermediate purchaser; and (3) when "the delivery was procured through fraud punishable as larcenous under the criminal law." Md. Code Ann., Com. Law §§ 2-403(1), 2A-304, 2A-305.

This last situation may be illustrated as follows: Dimension LLC leased a Volkswagen to DK Inc. The agreement specified that DK could use the Volkswagen solely for business and commercial purposes and could not sell it. Six months later, the owner of DK, Darrell Kempf, representing that the Volkswagen was part of DK's used-car inventory, sold it to Edward Seabold. Kempf embezzled the proceeds from the sale of the car and disappeared. When DK defaulted on its payments for the Volkswagen, Dimension attempted to repossess it. Dimension discovered that Kempf executed a release of interest on the car's title by forging the signature of Dimension's manager. The Washington Court of Appeals, applying the UCC, held that Mr. Seabold should keep the car. The car was not stolen from Dimension; instead, by leasing the vehicle to DK, Dimension transferred possession of the car to DK voluntarily, and because Seabold was a good-faith purchaser, he won. *Dimension Funding, L.L.C. v. D.K. Associates, Inc.*, 191 P.3d 923, 927 (Wash. Ct. App. 2008).

Entrustment

A merchant who deals in particular goods has the power to transfer all rights of one who entrusts to him goods of the kind to a "buyer in the ordinary course of business" (see Figure 4 "Entrustment"). Md. Code Ann., Com. Law §§ 2-403(2), 2A-304(2), 2A-305(2). The UCC defines such a buyer as a person who buys goods in an ordinary transaction from a person in the business of selling that type of goods, as long as the buyer purchases in "good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods." Md. Code Ann., Com. Law § 1-201(9).

Bess takes a pearl necklace, a family heirloom, to Wellborn's Jewelers for cleaning; as the entrustor, she entrusted the necklace to an entrustee, Wellborn's. The owner of Wellborn's—perhaps by mistake—sells the necklace to Clara, a buyer, in the ordinary course of business. Bess cannot take the necklace back from Clara,

although Bess has a cause of action against Wellborn's for conversion. As between the two innocent parties, Bess and Clara (owner and purchaser), the latter prevails. Notice that the UCC only says that the entrustee can pass *whatever title the entrustor had* to a good-faith purchaser, not necessarily good title. If Bess's cleaning woman borrowed the necklace, soiled it, and took it to Wellborn's, which then sold it to Clara, Bess could get it back because the cleaning woman had no title to transfer to the entrustee, Wellborn's.

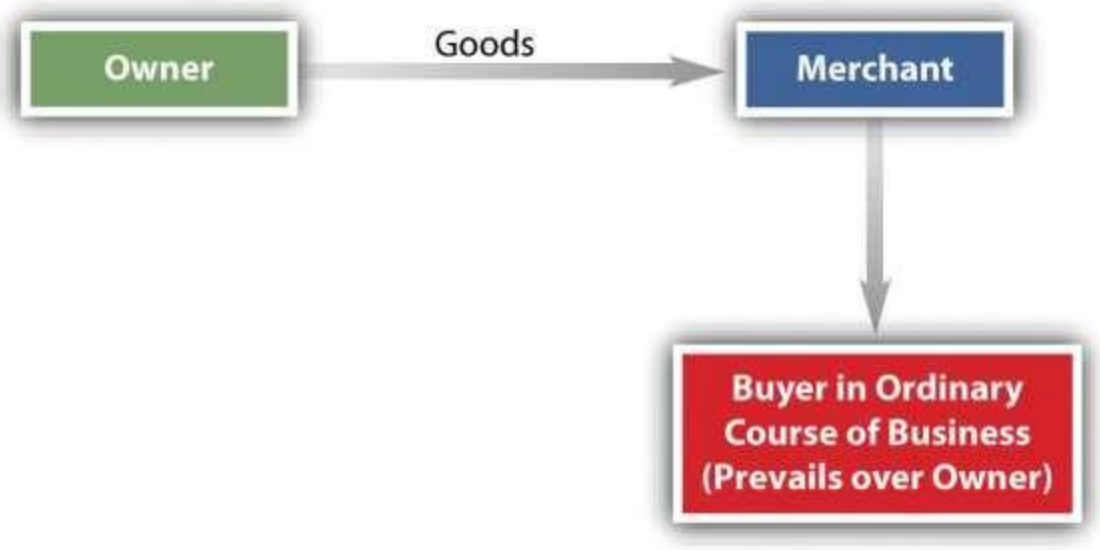


Figure 14 Entrustment

Entrustment is based on the general principle of estoppel: "A rightful owner may be estopped by his own acts from asserting his title. If he has invested another with the usual evidence of title, or an apparent authority to dispose of it, he will not be allowed to make claim against an innocent purchaser dealing on the faith of such apparent ownership." *Zendman v. Harry Winston, Inc.*, 111 N.E. 2d 871 (N.Y. 1953).

Risk of Loss

Why Risk of Loss Is Important

"Risk of loss" means who has to pay—who bears the risk—if the goods are lost or destroyed *without the fault of either party*. It is obvious why this issue is important: Buyer contracts to purchase a new car for $35,000. While the car is in transit to Buyer, it is destroyed in a landslide. Who takes the $35,000 hit?

When Risk of Loss Passes

The Parties May Agree

Just as title passes in accordance with the parties' agreement, so too can the parties fix the risk of loss on one or the other. They may even devise a formula to divide the risk between themselves. Md. Code Ann., Com. Law § 2-303.

Common terms by which parties set out their delivery obligations that then affect when title shifts (F.O.B., F.A.S., ex-ship, and so on) were discussed earlier in this section. Similarly, parties may use common terms to set out which party has the risk of loss; these situation arise with trial sales. That is, sometimes the seller will permit the buyer to return the goods even though the seller had conformed to the contract. When the goods are intended primarily for the buyer's use, the transaction is said to be "sale on approval." When they are intended primarily for resale, the transaction is said to be "sale or return." When the "buyer" is really only a sales agent for the "seller," it is a consignment sale. Md. Code Ann., Com. Law §§ 2-326, 2-327.

Sale on Approval

Under a sale-on-approval contract, risk of loss (and title) remains with the seller until the buyer accepts, and the buyer's trial use of the goods does not in itself constitute acceptance. Md. Code Ann., Com. Law § 2-327(1)(a). If the buyer decides to return the goods, the seller bears the risk and expense of return, but a merchant buyer must follow any reasonable instructions from the seller. Very Fast Foods asks Delta for some sample sponges to test on approval; Delta sends a box of one hundred sponges. Very Fast plans to try them for a week, but before that, through no fault of Very Fast, the sponges are destroyed in a fire. Delta bears the loss.

Sale or Return

The buyer might take the goods with the expectation of reselling them—as would a women's wear shop buy new spring fashions, expecting to sell them. Md. Code Ann., Com. Law § 2-326. But if the shop doesn't sell them before summer wear is in vogue, it could arrange with the seller to return them for credit. In contrast to sale-on-approval contracts, sale-or-return contracts have risk of loss (and title too) passing to the buyer, and the buyer bears the risk and expense of returning the goods. Md. Code Ann., Com. Law § 2-327. Occasionally the question arises whether the buyer's other creditors may claim the goods when the sales contract lets the buyer retain some rights to return the goods. The answer seems straightforward: in a sale-on-approval contract, where title remains with the seller until acceptance, the buyer does not own the goods—hence they cannot be seized by his creditors—unless he accepts them, whereas they are the buyer's goods (subject to his right to return them) in a sale-or-return contract and may be taken by creditors if they are in his possession.

Consignment Sales

In a consignment situation, the seller is a bailee and an agent for the owner who sells the goods for the owner and takes a commission. This is considered a sale or return, thus the consignee (at whose place the goods are displayed for sale to customers) is considered a buyer and has the risk of loss and title. Md. Code Ann., Com. Law § 2-326(3). Whether or not the consignee's creditors may seize goods depends on if the consignee has perfected a security interest in the goods. Md. Code Ann., Com. Law § 9-319. Space precludes a detailed discussion of secured transactions and perfected security interests (students interested in further studies on secured transactions should consider taking MNGT 141, Business Law II).

The UCC Default Position

If the parties fail to specify how the risk of loss is to be allocated or apportioned, the UCC again supplies the answers. A generally applicable rule, though not explicitly stated, is that risk of loss passes when the seller has completed obligations under the contract. Notice this is *not* the same as when title passes: title passes when seller has completed *delivery* obligations under the contract, risk of loss passes when *all* obligations are completed. (Thus a buyer could get good title to nonconforming goods, which might be better for the buyer than not getting title to them: if the seller goes bankrupt, at least the buyer has something of value.)

Risk of Loss in Absence of a Breach

If the goods are *conforming*, then risk of loss would indeed pass when delivery obligations are complete, just as with title. This is because delivery of conforming goods completes the seller's obligations. The analysis here would be the same as we looked at in examining shift of title.

A shipment contract. The contract requires Delta to ship the sponges by carrier but does not require it to deliver them to a particular destination. In this situation, risk of loss passes to Very Fast Foods when the goods are delivered to the carrier.

A destination contract. If the destination contract agreement calls for Delta to deliver the sponges by carrier to a particular location, Very Fast Foods assumes the risk of loss only when Delta's carrier tenders them at the specified place.

Goods not to be moved. If Delta sells sponges that are stored at Central Warehousing to Very Fast Foods, and the sponges are not to be moved, Section 2-509(2) of the UCC sets forth three possibilities for transfer of the risk of loss:

The buyer receives a negotiable document of title covering the good. A document of title is negotiable if by its terms goods are to be delivered to the bearer of the document or to the order of a named person.

The bailee acknowledges the buyer's right to take possession of the goods. Delta signs the contract for the sale of sponges and calls Central to inform it that a buyer has purchased 144 cartons and to ask it to set aside all cartons on the north wall for that purpose. Central does so, sending notice to Very Fast Foods that the goods are available. Very Fast Foods assumes risk of loss upon receipt of the notice.

When the seller gives the buyer a nonnegotiable document of title or a written direction to the bailee to deliver the goods and the buyer has had a reasonable time to present the document or direction. Md. Code Ann., Com. Law § 2-509.

All other cases. In any case that does not fit within the rules just described, the risk of loss passes to the buyer only when the buyer actually receives the goods if seller is a merchant; otherwise it passes on tender of delivery. Md. Code Ann., Com. Law § 2-509(3). Cases that come within this section generally involve a buyer who is taking physical delivery from the seller's premises. A merchant who sells on those terms can be expected to insure his interest in any goods that remain under his control. The buyer is unlikely to insure goods not in his possession. The case of *Ramos v. Wheel Sports Center*, 409 N.Y.S.2d 505 (N.Y. Civ. Ct. 1978) demonstrates how this risk-of-loss provision applies when a customer pays for merchandise but never actually receives his purchase because of a mishap. "Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains on him until actual receipt by the buyer, even though full payment has been made and the buyer notified that the goods are at his disposal. The underlying theory is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them." *Id*. at 506.

Risk of Loss Where Breach Occurs

The general rule for risk of loss was set out as this: risk of loss shifts when seller completed its obligations under the contract. We said if the goods are conforming, the only obligation left is delivery, so then risk of loss would shift upon delivery. But if the goods are nonconforming, then the rule would say the risk doesn't shift. And that's correct, though it's subject to one wrinkle having to do with insurance. Let's examine the two possible circumstances: breach by seller and breach by buyer.

First, suppose the *seller* breaches the contract by proffering nonconforming goods, and the buyer *rejects* them—never takes them at all. Then the goods are lost or damaged. Under Section 2-510(1) of the UCC, the loss falls on seller and remains there until seller cures the breach or until buyer accepts despite the breach. Md. Code Ann., Com. Law § 2-510(1). Suppose Delta is obligated to deliver a gross of industrial No.

2 sponges; instead it tenders only one hundred cartons or delivers a gross of industrial No. 3 sponges. The risk of loss falls on Delta because Delta has not completed its obligation under the contract and Very Fast Foods doesn't have possession of the goods. Or suppose Delta breached the contract by tendering to Very Fast Foods a defective document of title. Delta cures the defect and gives the new document of title to Very Fast Foods, but before it does so the sponges are stolen. Delta is responsible for the loss.

Now suppose that a seller breaches the contract by proffering nonconforming goods and that the buyer, not having discovered the nonconformity, *accepts* them—the nonconforming goods are in the buyer's hands. The buyer has a right to revoke acceptance, but before the defective goods are returned to the seller, they are destroyed while in the buyer's possession. The seller breached, but here's the wrinkle: the UCC says that the seller bears the loss only to the extent of any deficiency in the buyer's insurance coverage. Md. Code Ann., Com. Law § 2-510(2). Very Fast Foods had taken delivery of the sponges and only a few days later discovered that the sponges did not conform to the contract. Very Fast has the right to revoke and announces its intention to do so. A day later its warehouse burns down and the sponges are destroyed. It then discovers that its insurance was not adequate to cover all the sponges. Who stands the loss? The seller does, again, to the extent of any deficiency in the buyer's insurance coverage.

Second, what if the *buyer* breaches the contract? Here's the scenario: Suppose Very Fast Foods calls two days before the sponges identified to the contract are to be delivered by Delta and says, "Don't bother; we no longer have a need for them." Subsequently, while the lawyers are arguing, Delta's warehouse burns down and the sponges are destroyed. Under the rules, risk of loss does not pass to the buyer until the seller has delivered, which has not occurred in this case.

Nevertheless, responsibility for the loss here has passed to Very Fast Foods, to the extent that the seller's insurance does not cover it. Section 2-510(3) permits the seller to treat the risk of loss as resting on the buyer for a "commercially reasonable time" when the buyer repudiates the contract before risk of loss has passed to him. Md. Code Ann., Com. Law § 2-510(3). This transfer of the risk can take place only when the goods are identified to the contract. The theory is that if the buyer had taken the goods as per the contract, the goods would not have been in the warehouse and thus would not have been burned up.

Insurable Interest

Why It Matters

We noted at the start of this chapter that who has title is important for several reasons, one of which is because it affects who has an insurable interest. (You can't take out insurance in something you have no interest in: if you have no title, you may not have an insurable interest.) And it was noted that the rules on risk of loss are affected by insurance. (The theory is that a businessperson is likely to have insurance, which is a cost of business, and if she has insurance and also has possession of goods—even nonconforming ones—it is reasonable to charge her insurance with loss of the goods; thus she will have cause to take care of them in her possession, else her insurance rates increase.) So in commercial transactions insurance is important, and when goods are lost or destroyed, the frequent argument is between the buyer's and the seller's insurance companies, neither of which wants to be responsible. They want to deny that their insured had an insurable interest. Thus it becomes important who has an insurable interest.

Insurable Interest of the Buyer

It is not necessary for the buyer to go all the way to having title in order for him to have an insurable interest. The buyer obtains a "special property and insurable interest in goods by identification of existing goods as goods to which the contract refers." Md. Code Ann., Com. Law § 2-501(1). We already discussed how "identification" of the goods can occur. The parties can do it by branding, marking, tagging, or segregating them—and they can do it at any time. We also set out the rules for when goods will be considered identified to the contract under the UCC if the parties don't do it themselves.

Insurable Interest of the Seller

As long as the seller retains title to or any security interest in the goods, he has an insurable interest. Md. Code Ann., Com. Law § 2-501(2).

Other Rights of the Buyer

The buyer's "special property" interest that arises upon identification of goods gives the buyer rights other than that to insure the goods. For example, under Section 2-502, the buyer who has paid for unshipped goods may take them from a seller who becomes insolvent within ten days after receipt of the whole payment or the first installment payment. ." Md. Code Ann., Com. Law § 2-502. Similarly, a buyer who has not yet taken delivery may sue a third party who has in some manner damaged the property.

UCC Performance & Remedies

The parties often set out in their contracts the details of performance. These include price terms and terms of delivery—where the goods are to be delivered, when, and how. If the parties fail to list these terms, the rules studied in this chapter will determine the parties' obligations: the parties may agree; if they do not, the UCC rules kick in as the default. In any event, the parties have an obligation to act in good faith.

Performance by the Seller

The Seller's Duty in General

The general duty of the seller is this: to make a timely delivery of conforming goods. Md. Code Ann., Com. Law § § 2-301, 2-309.

Analysis of the Seller's Duty

Timing

By agreement or stipulation, the parties may fix the time when delivery is to be made by including statements in contracts such as "Delivery is due on or before July 8" or "The first of 12 installments is due on or before July 8." Both statements are clear.

If the parties do not stipulate in their contract when delivery is to occur, the UCC fills the gap. Section 2- 309 of the UCC says, "The time for shipment or any other action under a contract if not provided for in this Article or agreed upon shall be a reasonable time." Md. Code Ann., Com. Law § 2-309. And what is a "reasonable time" is addressed by comment 1 to this section: It thus turns on the criteria as to "reasonable time" and on good faith and commercial standards set forth in Sections 1-202, 1-203 and 2-103. It…depends on what

constitutes acceptable commercial conduct in view of the nature, purposes and circumstances of the action to be taken. *Id.* at cmt. 1.

Delivery

The parties may agree as to how delivery shall be accomplished; if they do not, the UCC fills the gap. "Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot." Md. Code Ann., Com. Law § 2-307.

By Agreement

The parties may use any language they want to agree on delivery terms.

If There Is No Agreement

If the parties do not stipulate delivery terms or if their agreement is incomplete or merely formulaic, the UCC describes the seller's obligations or gives meaning to the formulaic language. (Because form contracts are prevalent, formulaic language is customary.) As we will cover in Title and Risk of Loss, title to goods shifts when the seller has completed delivery obligations under the contract. The contract may be either a *shipment* contract, a *destination* contract, or a contract where the *goods are not to be moved* (being held by a bailee). In any case, unless otherwise agreed, the delivery must be at a reasonable time and the tender (the offer to make delivery) must be kept open for a reasonable time; the buyer must furnish facilities "reasonably suited to the receipt of the goods." Md. Code Ann., Com. Law § 2-503.

In a shipment contract, the seller has four duties: (1) to deliver the goods to a carrier; (2) to deliver the goods with a reasonable contract for their transportation; (3) to deliver them with proper documentation for the buyer; and (4) to promptly notify the buyer of the shipment. Md. Code Ann., Com. Law § 2-504. The contract may set out the seller's duties using customary abbreviations, and the UCC interprets those: "F.O.B [insert place where goods are to be shipped from]" means "free on board"—the seller must see to it that the goods are loaded on the vehicle of conveyance at the place of shipment. "F.A.S. [port of shipment inserted here]" means the seller must see to it that the goods are placed along the ship on the dock ready to be loaded. Md. Code Ann., Com. Law § 2-319. Price terms include "C.I.F.," which means the sale price includes the cost of the goods, insurance, and freight charges, and "C. & F.," which means the sales price includes the cost of the goods at a cheaper unit price and freight but not insurance. Md. Code Ann., Com. Law § 2-320. If it is clear from the contract that the seller is supposed to ship the goods (i.e., the buyer is not going to the seller's place to get them) but not clear whether it is a shipment or a destination contract, the UCC presumes it is a shipment contract. Md. Code Ann., Com. Law § 2-503(5).

If it is a destination contract, the seller has two duties: to get the goods to the destination at the buyer's disposal and to provide appropriate documents of delivery. Md. Code Ann., Com. Law § 2-503. The contract language could be "F.O.B. [place of destination inserted here]," which obligates the seller to deliver to that specific location; "ex-ship," which obligates the seller to unload the goods from the vehicle of transportation at the agreed location (e.g., load the goods onto the dock); or it could be "no arrival, no sale," where the seller is not liable for failure of the goods to arrive, unless she caused it. Md. Code Ann., Com. Law §§ 2-319, 2-322, 2-324.

If the goods are in the possession of a bailee and are not to be moved—and the parties don't stipulate otherwise—Section 2-503 says delivery is accomplished when the seller gives the buyer a negotiable document of title, or if none, when the bailee acknowledges the buyer's right to take the goods. Md. Code

Ann., Com. Law § 2-503(4). If nothing at all is said about delivery, the place for delivery is the seller's place of business or his residence if he has no place of business. Md. Code Ann., Com. Law § 2-308.

Conforming Goods

As always, the parties may put into the contract whatever they want about the goods as delivered. If they don't, the UCC fills the gaps.

By Agreement

The parties may agree on what "conforming goods" means. An order will specify "large grade A eggs," and that means something in the trade. Or an order might specify "20 gross 100-count boxes No. 8 × 3/8 × 32 Phillips flathead machine screws." That is a screw with a designated diameter, length, number of threads per inch, and with a unique, cruciform head insert to take a particular kind of driver. The buyer might, for example, agree to purchase "seconds," which are goods with some flaw, such as clothes with seams not sewed quite straight or foodstuffs past their pull date. The parties may also agree in the contract what happens if nonconforming goods are delivered.

If There Is No Agreement

If nothing is said in the contract about what quality of goods conform to the contract, then the UCC default rule kicks in. The seller is to make a perfect tender: what is delivered must in every respect conform to the contract. Md. Code Ann., Com. Law § 2-601. And if what is delivered doesn't conform to the contract, the buyer is not obligated to accept the goods.

Installment Contracts

Unless otherwise agreed, all goods should be delivered at one time, and no payment is due until tender. But where circumstances permit either party to make or demand delivery in lots, Section 2-307 of the UCC permits the seller to demand payment for each lot if it is feasible to apportion the price. Md. Code Ann., Com. Law § 2-307. What if the contract calls for delivery in installment, and one installment is defective—is that a material breach of the whole contract? No. Section 2-612 of the UCC says this:

- The buyer may reject any installment which is non-conforming if the non-conformity substantially impairs the value of that installment and cannot be cured or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.
- Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole contract.

Md. Code Ann., Com. Law § 2-612.

Cure for Improper Delivery

Failure to make a perfect tender, unless otherwise agreed, is a material breach of the sales contract. However, before the defaulting seller is in complete default, she has a right to cure.

- Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.
- Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

Md. Code Ann., Com. Law § 2-508.

Buyer orders Santa Claus candles deliverable November 5; on October 25 the goods are delivered, but they're not right: they're Christmas *angel* candles instead. But the seller still has eleven days to cure, and the buyer must allow that. Buyer places an order exactly the same as the first order, and the order arrives on November 5 in the original manufacturer's packaging, but they're not right. "Well," says the seller, "I thought they'd be OK right out of the package. I'll get the correct ones to you right away." And the buyer would have a duty to allow that, if "right away" is a "further reasonable time."

The seller's duty is to make a timely delivery of conforming goods. Let's take a look now at the buyer's duties.

Performance by Buyer

General Duties of Buyer

The general duty of the buyer is this: inspection, acceptance, and payment. Md. Code Ann., Com. Law §§ 2-301, 2-513. But the buyer's duty does not arise unless the seller tenders delivery.

Inspection

Under Sections 2-513(1) and (2), the buyer has a qualified right to inspect goods. Md. Code Ann., Com. Law § 2-513. That means the buyer must be given the chance to look over the goods to determine whether they conform to the contract. If they do not, he may properly reject the goods and refuse to pay. The right to inspect is subject to three exceptions:

1. The buyer waives the right. If the parties agree that payment must be made before inspection, then the buyer must pay (unless the nonconformity is obvious without inspection). Payment under these circumstances does not constitute acceptance, and the buyer does not lose the right to inspect and reject later.
2. The delivery is to be made C.O.D. (cash on delivery).
3. Payment is to be made against documents of title.

If the buyer fails to inspect, or fails to discover a defect that an inspection would have revealed, he cannot later revoke his acceptance, subject to some exceptions.

Acceptance

Acceptance is clear enough: it means the buyer takes the goods. But the buyer's options on improper delivery need to be examined, because that's often a problem area.

The buyer may accept goods by words, silence, or action. Section 2-606(1) of the UCC defines acceptance as occurring in any one of three circumstances:

1. **Words.** The buyer, after a reasonable opportunity to inspect, tells the seller either that the goods conform or that he will keep them despite any nonconformity.
2. **Silence.** The buyer fails to reject, after a reasonable opportunity to inspect.
3. **Action.** The buyer does anything that is inconsistent with the seller's ownership, such as using the goods (with some exceptions) or selling the goods to someone else.

Once the buyer accepts, she is obligated to pay at the contract rate and loses the right to reject the goods. Md. Code Ann., Com. Law § 2-607. In short, she is stuck, subject to some exceptions set forth in Section 2-608.

Payment

The parties may specify in their contract what *payment* means and when it is to be made. If they don't, the UCC controls the transaction. Md Code Ann., Com. Law §§ 2-511, 2-512.

Section 2-511:

"(1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this Act on the effect of an instrument on an obligation (Section 3-802), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment."

Md. Code Ann., Com. Law § 2-511.

Section 2-512 states:

"(1) 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; or
- (b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this Act (see Md. Code Ann., Com. Law § 5-114).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies."

Md. Code Ann., Com. Law § 2-512.

A Buyer's Right on Nonconforming Delivery

Obviously if the delivery is defective, the disappointed buyer does not have to accept the goods: the buyer may (a) reject the whole, (b) accept the whole, or (c) accept any commercial unit and reject the rest or (d)—in two situations—revoke an acceptance already made. Md. Code Ann., Com. Law §§ 2-601, 2A-509.

Rejection and a Buyer's Duties after Rejection

Rejection is allowed if the seller fails to make a perfect tender. Md. Code Ann., Com. Law § 2-601. The rejection must be made within a reasonable time after delivery or tender. Once it is made, the buyer may not act as the owner of the goods. If he has taken possession of the goods before he rejects them, he must hold them with reasonable care to permit the seller to remove them. If the buyer is a merchant, then the buyer has a special duty to follow reasonable instructions from the seller for disposing of the rejected goods; if no instructions are forthcoming and the goods are perishable, then he must try to sell the goods for the seller's account and is entitled to a commission for his efforts. Whether or not he is a merchant, a buyer may store the goods, reship them to the seller, or resell them—and charge the seller for his services—if the seller fails to send instructions on the goods' disposition. Such storage, reshipping, and reselling are not acceptance or conversion by the buyer.

Acceptance of a Nonconforming Delivery

The buyer need not reject a nonconforming delivery. She may accept it with or without allowance for the nonconformity.

Acceptance of Part of a Nonconforming Delivery

The buyer may accept any commercial unit and reject the rest if she wants to. A commercial unit means "such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine), a set of articles (as a suite of furniture or an assortment of sizes), a quantity (as a bale, gross, or carload), or any other unit treated in use or in the relevant market as a single whole." Md. Code Ann., Com. Law §§ 2-105 and 2A103(1).

Installment Sales

A contract for an installment sale complicates the answer to the question, "What right does the buyer have to accept or reject when the seller fails to deliver properly?" (An installment contract is one calling for delivery of goods in separate lots with separate acceptance for each delivery.) The general answer is found in Section 2-612, which permits the buyer to reject any nonconforming installment if the nonconformity cannot be cured if it substantially impairs the value of that particular installment. Md. Code Ann., Com. Law § 2-612. However, the seller may avoid rejection by giving the buyer adequate assurances that he will cure the defect, unless the particular defect substantially impairs the value of the whole contract. *Id.*

Suppose the Corner Gas Station contracts to buy 12,000 gallons of regular gasoline from Gasoline Seller, deliverable in twelve monthly installments of 1,000 gallons on the first of each month, with a set price payable three days after delivery. In the third month, Seller is short and can deliver only 500 gallons immediately and will not have the second 500 gallons until midmonth. May Corner Gas reject this tender? The answer depends on the circumstances. The nonconformity clearly cannot be cured, since the contract calls for the full 1,000 on a particular day. But the failure to make full delivery does not necessarily impair the value of that installment; for example, Corner Gas may know that it will not use up the 500 gallons until midmonth. However, if the failure will leave Corner Gas short before midmonth and unable to buy from another supplier unless it agrees to take a full 1,000 (more than it could hold at once if it also took Seller's 500 gallons), then Corner Gas is entitled to reject Seller's tender.

Is Corner Gas entitled to reject the entire contract on the grounds that the failure to deliver impairs the value of the contract as a whole? Again, the answer depends on whether the impairment was substantial. Suppose other suppliers are willing to sell only if Corner Gas agrees to buy for a year. If Corner Gas needed the extra

gasoline right away, the contract would have been breached as whole, and Corner Gas would be justified in rejecting all further attempted tenders of delivery from Seller. Likewise, if the spot price of gasoline were rising so that month-to-month purchases from other suppliers might cost it more than the original agreed price with Seller, Corner Gas would be justified in rejecting further deliveries from Seller and fixing its costs with a supply contract from someone else. Of course, Corner Gas would have a claim against Seller for the difference between the original contract price and what it had to pay another supplier in a rising market (as you'll see later in this section).

Revocation

A revocation of acceptance means that although the buyer has accepted and exercised ownership of the goods, he can return the goods and get his money back. There are two circumstances in which the buyer can revoke an acceptance if the nonconformity "substantially impairs its value to him." Md. Code Ann., Com. Law § 2-608.

1. if the buyer reasonably thought the nonconformity would be cured and it is not within a reasonable time; or
2. without discovery of such nonconformity if his acceptance was reasonably induced by the difficulty of discovery before acceptance or by the seller's assurances. *Id.*

Consider two examples illustrated in the next paragraph. The first deals with item 1 and the second deals with item 2.

In August 1983, the Borsages purchased a furnished mobile home on the salesperson's assertion that it was "the Cadillac of mobile homes." But when they moved in, the Borsages discovered defects: water leaks, loose moldings, a warped dishwasher door, a warped bathroom door, holes in walls, defective heating and cooling systems, cabinets with chips and holes, furniture that fell apart, mold and mildew in some rooms, a closet that leaked rainwater, and defective doors and windows. They had not seen these defects at the time of purchase because they looked at the mobile home at night and there were no lights on in it. The Borsages immediately complained. Repairmen came by but left, only promising to return again. Others did an inadequate repair job by cutting a hole in the bottom of the home and taping up the hole with masking tape that soon failed, causing the underside of the home to pooch out. Yet more repairmen came by but made things worse by inadvertently poking a hole in the septic line and failing to fix it, resulting in a permanent stench. More repairmen came by, but they simply left a new dishwasher door and countertop at the home, saying they didn't have time to make the repairs. *North River Homes, Inc., v. Borsage, Mississippi,* 594 So.2d 1153 (Miss. 1992).

In June 1984, the Borsages provided the seller a long list of uncorrected problems; in October they stopped making payments. Nothing happened. In March 1986—thirty-one months after buying the mobile home—they told the seller to pick up the mobile home: they revoked their acceptance and sued for the purchase price. The defendant seller argued that the Borsages' failure to move out of the house for so long constituted acceptance. But they were repeatedly assured the problems would be fixed, and moreover they had no place else to live, and no property to put another mobile home on if they abandoned the one they had. The court had no problem validating the Borsages' revocation of acceptance, under the section noted earlier, if they ever had accepted it. The seller might have a right to some rental value, though. *Id.* at 1161-1162.

In April 1976, Clarence Miller ordered a new 1976 Dodge Royal Monaco station wagon from plaintiff Colonial Dodge. The car included a heavy-duty trailer package with wide tires. The evening of the day the Millers picked up the new car, Mrs. Miller noticed that there was no spare tire. The following morning, the defendant notified the plaintiff that he insisted on a spare tire, but when he was told there were no spare tires available (because of a labor strike), Mr. Miller told the plaintiff's salesman that he would stop payment on the check he'd given them and that the car could be picked up in front of his house. He parked it there, where it remained until the temporary registration sticker expired and it was towed by the police to an impound yard. Plaintiff sued for the purchase price, asserting that the missing spare tire did not "substantially impair the value

of the goods to the buyer." On appeal to the Michigan Supreme Court, the plaintiff lost. "In this case the defendant's concern with safety is evidenced by the fact that he ordered the special package which included spare tires. The defendant's occupation demanded that he travel extensively, sometimes in excess of 150 miles per day on Detroit freeways, often in the early morning hours.…He was afraid of a tire going flat…at 3 a.m. Without a spare, he would be helpless until morning business hours. The dangers attendant upon a stranded motorist are common knowledge, and Mr. Miller's fears are not unreasonable." The court observed that although he had accepted the car before he discovered the nonconformity, that did not preclude revocation: the spare was under a fastened panel, concealed from view. *Colonial Dodge v. Miller*, 362 N.W.2d 704 (Mich. 1984).

Remedies

General Policy

The general policy of the Uniform Commercial Code (UCC) is to put the aggrieved party in a good position as if the other party had fully performed—as if there had been a timely delivery of conforming goods. The UCC provisions are to be read liberally to achieve that result if possible. Thus the seller has a number of potential remedies when the buyer breaches, and likewise the buyer has a number of remedies when the seller breaches.

Specifying Remedies

We have emphasized how the UCC allows people to make almost any contract they want (as long as it's not unconscionable). Just as the parties may specify details of performance in the contract, so they may provide for and limit remedies in the event of breach. Md. Code Ann., Com. Law §§ 2-719(1), 2A-503(1). The following would be a typical limitation of remedy: "Seller's sole obligation in the event goods are deemed defective by the seller is to replace a like quantity of nondefective goods." A remedy is optional unless it is expressly agreed that it is the exclusive remedy. Md. Code Ann., Com. Law §§ 2-719(1)(b), 2A-503(2).

But the parties are not free to eliminate all remedies. As the UCC comment to this provision puts it, "If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract." *Id.* at cmt. 1. In particular, the UCC lists three exemptions from the general rule that the parties are free to make their contract up any way they want as regards remedies:

1. When the circumstances cause the agreed-to remedy to fail or be ineffective, the default UCC remedy regime works instead. Md. Code Ann., Com. Law §§ 2-719(2), 2A-503(2).

2. Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable, but limitation of damages where the loss is commercial is not. Md. Code Ann., Com. Law §§ 2-719(3), 2A-503(2).

3. The parties may agree to liquidated damages: "Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty." Md. Code Ann., Com. Law §§ 2-718. The Code's equivalent position on *leases* is interestingly slightly different. Section 2A-504(1) says damages may be liquidated "but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused" by the breach.

Md. Code Ann., Com. Law § 2A-504(1). It leaves out anything about difficulties of proof or inconvenience of obtaining another adequate remedy.

Statute of Limitations

The UCC statute of limitations for breach of any sales contract is four years. Md. Code Ann., Com. Law § 2-725. The parties may "reduce the period of limitation to not less than one year but may not extend it." Md. Code Ann., Com. Law § 2-725. Section 2A-506(1) for leases is similar, but omits the prohibition against extending the limitation. Article 2-725(2) goes on: "A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered." Md. Code Ann., Com. Law § 2-725.

Seller's Remedies

Article 2 in General

Per section 2-703, where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract, then also with respect to the whole undelivered balance, the aggrieved seller may:

- withhold delivery of such goods;
- stop delivery by any bailee;
- identify to the contract conforming goods not already identified;
- reclaim the goods on the buyer's insolvency;
- resell and recover damages;
- recover damages for non-acceptance or repudiation;
- in a proper case recover the price;
- cancel.

Items (1)–(4) address the seller's rights to deal with the goods; items (5)–(7) deal with the seller's rights as regards the price, and item (8) deals with the continued existence of the contract.

To illustrate the UCC's remedy provision, in this and the following section, we assume these facts: Howard, of Los Angeles, enters into a contract to sell and ship one hundred prints of a Pieter Bruegel painting, plus the original, to Bunker in Dallas. Twenty-five prints have already been delivered to Bunker, another twenty-five are en route (having been shipped by common carrier), another twenty-five are finished but haven't yet been shipped, and the final twenty-five are still in production. The original is hanging on the wall in Howard's living room. We will take up the seller's remedies if the buyer breaches and if the buyer is insolvent.

Remedies on Breach

Bunker, the buyer, breaches the contract. He sends Howard an e-mail stating that he won't buy and will reject the goods if delivery is attempted. Howard has the following cumulative remedies; election is not required.

Withhold Further Delivery

Howard may refuse to send the third batch of twenty-five prints that are awaiting shipment. Md. Code Ann., Com. Law § 2-703(a).

Stop Delivery

Howard may also stop the shipment. If Bunker is insolvent, and Howard discovers it, Howard would be permitted to stop any shipment in the possession of a carrier or bailee. Md. Code Ann., Com. Law §§ 2-702, 2-703(b). If Bunker is not insolvent, the UCC permits Howard to stop delivery only of carload, truckload, planeload, or larger shipment. Md. Code Ann., Com. Law § 2-705. The reason for limiting the right to bulk shipments in the case of non-insolvency is that stopping delivery burdens the carrier and requiring a truck, say, to stop and the driver to find a small part of the contents could pose a sizeable burden.

Identify to the Contract Goods in Possession

Howard could "identify to the contract" the twenty-five prints in his possession. Section 2-704(1) permits the seller to denote conforming goods that were not originally specified as the exact objects of the contract, if they are under his control or in his possession at the time of the breach. Md. Code Ann., Com. Law §§ 2-703(c), 2-704(1). Assume that Howard had five hundred prints of the Bruegel painting. The contract did not state which one hundred of those prints he was obligated to sell, but once Bunker breached, Howard could declare that those particular prints were the ones contemplated by the contract. He has this right whether or not the identified goods could be resold. Moreover, Howard may complete production of the twenty-five unfinished prints and identify them to the contract, too, if in his "reasonable commercial judgment" he could better avoid loss—for example, by reselling them. If continued production would be expensive and the chances of resale slight, the seller should cease manufacture and resell for scrap or salvage value.

Resell

Howard could resell the seventy-five prints still in his possession as well as the original. Md. Code Ann., Com. Law § 2-703(d). As long as he proceeds in good faith and in a commercially reasonable manner, per Section 2-706(2) and Section 2A-527(3), he is entitled to recover the difference between the resale price and the contract price, plus incidental damages (but less any expenses saved, like shipping expenses). Md. Code Ann., Com. Law §§ 2-706, 2A-527. "Incidental damages" include any reasonable charges or expenses incurred because, for example, delivery had to be stopped, new transportation arranged, storage provided for, and resale commissions agreed on.

The seller may resell the goods in virtually any way he desires as long as he acts reasonably. He may resell them through a public or private sale. If the resale is public—at auction—only identified goods can be sold, unless there is a market for a public sale of futures in the goods (as there is in agricultural commodities, for example). In a public resale, the seller must give the buyer notice unless the goods are perishable or threaten to decline in value speedily. The goods must be available for inspection before the resale, and the buyer must be allowed to bid or buy.

The seller may sell the goods item by item or as a unit. Although the goods must relate to the contract, it is not necessary for any or all of them to have existed or to have been identified at the time of breach. The seller does not owe the buyer anything if resale or re-lease results in a profit for the seller. Md. Code Ann., Com. Law §§ 2-706(6), 2A-527.

Recover Damages

The seller may recover damages equal to the difference between the market price (measured at the time and place for tender of delivery) and the unpaid contract price, plus incidental damages, but less any expenses saved because of the buyer's breach. Md. Code Ann., Com. Law § 2-703(e), 2-708. Suppose Howard's contract price was $100 per print plus $10,000 for the original and that the market price on the day Howard was to deliver the seventy-five prints was $75 (plus $8,000 for the original). Suppose too that the shipping costs (including insurance) that Howard saved when Bunker repudiated were $2,000 and that to resell them Howard would have to spend another $750. His damages, then, would be calculated as follows: original contract price ($17,500) less market price ($13,625) = $3,875 less $2,000 in saved expenses = $1,875 plus $750 in additional expenses = $2,625 net damages recoverable by Howard, the seller.

If the formula would not put the seller in as good a position as performance under the contract, then the measure of damages is lost profits—that is, the profit that Howard would have made had Bunker taken the original painting and prints at the contract price (again, deducting expenses saved and adding additional expenses incurred, as well as giving credit for proceeds of any resale). Md. Code Ann., Com. Law §§ 2-708(2), 2A-528(2). This provision becomes especially important for so-called lost volume sellers. Howard may be able to sell the remaining seventy-five prints easily and at the same price that Bunker had agreed to pay. Then why isn't Howard whole? The reason is that the second buyer was not a *substitute* buyer but an *additional* one; that is, Howard would have made that sale even if Bunker had not reneged on the contract. So Howard is still short a sale and is out a profit that he would have made had Bunker honored the contract.

Recover the Price

Howard—the seller—could recover from Bunker for the price of the twenty-five prints that Bunker holds. Md. Code Ann., Com. Law §§ 2-703(e), 2-709. Or suppose they had agreed to a shipment contract, so that the risk of loss passed to Bunker when Howard placed the other prints with the trucker and that the truck crashed en route and the cargo destroyed. Howard could recover the price. Or suppose there were no market for the remaining seventy- five prints and the original. Howard could identify these prints to the contract and recover the contract price. If Howard did resell some prints, the proceeds of the sale would have to be credited to Bunker's account and deducted from any judgment. Unless sold, the prints must be held for Bunker and given to him upon his payment of the judgment.

Cancel the Contract

When Bunker repudiated, Howard could declare the contract cancelled. This would also apply if a buyer fails to make a payment due on or before delivery. Cancellation entitles the non-breaching party to any remedies for the breach of the whole contract or for any unperformed balance. That is what happens when Howard recovers damages, lost profits, or the price. Md. Code Ann., Com. Law §§ 2-703(f), 2A-524(1)(a).

Note again that these UCC remedies are cumulative. That is, Howard could withhold future delivery *and* stop delivery en route, *and* identify to the contract goods in his possession, *and* resell, *and* recover damages, *and* cancel.

Remedies on Insolvency

The remedies apply when the buyer *breaches* the contract. In addition to those remedies, the seller has remedies when he learns that the buyer is insolvent, even if the buyer has not breached. Md. Code Ann., Com. Law § 2-702. Insolvency results, for example, when the buyer has "ceased to pay his debts in the ordinary course of business," or the buyer "cannot pay his debts as they become due." Md. Code Ann., Com. Law § 1-201(23).

Upon learning of Bunker's insolvency, Howard could refuse to deliver the remaining prints, unless Bunker pays cash not only for the remaining prints but for those already delivered. If Howard learned of Bunker's insolvency within ten days of delivering the first twenty-five prints, he could make a demand to reclaim them. Md. Code Ann., Com. Law § 2-702(2). If within three months prior to delivery, Bunker had falsely represented that he was solvent, the ten- day limitation would not cut off Howard's right to reclaim. *Id.* If he does seek to reclaim, Howard will lose the right to any other remedy with respect to those particular items. However, Howard cannot reclaim goods already purchased from Bunker by a customer in the ordinary course of business. The customer does not risk losing her print purchased several weeks before Bunker has become insolvent. Md. Code Ann., Com. Law § 2-702 (3).

In the lease situation, of course, the goods belong to the lessor—the lessor has title to them—so the lessor can repossess them if the lessee defaults. Md. Code Ann., Com. Law § 2A-525(2).

Buyer's Remedies

In this section, let us assume that Howard, rather than Bunker, breaches, and all other circumstances are the same. That is, Howard had delivered twenty-five prints, twenty-five more were en route, the original painting hung in Howard's living room, another twenty-five prints were in Howard's factory, and the final twenty-five prints were in production.

In General

Where the seller fails to make delivery or repudiates, or the buyer rightfully rejects or justifiably revokes, then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract, the buyer may

- cancel the contract, and
- recover as much of the price as has been paid; and
- "cover" and get damages; and
- recover damages for non-delivery.

Md. Code Ann., Com. Law § 2-711(1).

Where the seller fails to deliver or repudiates, the buyer may also:

- if the goods have been identified recover them; or
- in a proper case obtain specific performance or
- replevy the goods.

Md. Code Ann., Com. Law § 2-711(2).

On rightful rejection or justifiable revocation of acceptance, a buyer:

- has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller.

Md. Code Ann., Com. Law § 2-711(3)

If the buyer has accepted non-conforming goods and notified seller of the non-conformity, buyer can

- recover damages for the breach; Md. Code Ann., Com. Law § 2-714

and in addition the buyer may

- recover incidental damages and
- recover consequential Md. Code Ann., Com. Law § 2-715

Thus the buyer's remedies can be divided into two general categories: (1) remedies for goods that the buyer does not receive or accept, when he has justifiably revoked acceptance or when the seller repudiates, and (2) remedies for goods accepted. Md. Code Ann., Com. Law §§ 2-711 – 2-716.

Goods Not Received

The UCC sets out buyer's remedies if goods are not received or if they are rightfully rejected or acceptance is rightfully revoked.

Cancel

If the buyer has not yet received or accepted the goods (or has justifiably rejected or revoked acceptance because of their nonconformity), he may cancel the contract and—after giving notice of his cancellation— he is excused from further performance. Md. Code Ann., Com. Law §§ 2-711(1), 2-106, 2A-508(1)(a), and 2A-505(1).

Recover the Price

Whether or not the buyer cancels, he is entitled to recover the price paid above the value of what was accepted.

Cover

In the example case, Bunker—the buyer—may "cover" and have damages: he may make a good-faith, reasonable purchase of substitute goods. Md. Code Ann., Com. Law § 2-712. He may then recover damages from the seller for the difference between the cost of cover and the contract price. This is the buyer's equivalent of the seller's right to resell. Thus Bunker could try to purchase seventy-five additional prints of the Bruegel from some other manufacturer. But his failure or inability to do so does not bar him from any other remedy open to him.

Sue for Damages for Nondelivery

Bunker could sue for damages for nondelivery. Under Section 2-713 of the UCC, the measure of damages is the difference between the market price at the time when the buyer learned of the breach and the contract price (plus incidental damages, less expenses saved). Md. Code Ann., Com. Law § 2-713. Suppose Bunker could have bought seventy- five prints for $125 on the day Howard called to say he would not be sending the rest of the order. Bunker would be entitled to $1,875—the market price ($9,375) less the contract price ($7,500). This remedy is available even if he did not in fact purchase the substitute prints. Suppose that at the time of breach, the original painting was worth $15,000 (Howard having just sold it to someone else at that price). Bunker would be entitled to an additional $5,000, which would be the difference between his contract price and the market price.

For leases, Section 2A-519(1), provides the following: "the measure of damages for non-delivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default." Md. Code Ann., Com. Law § 2A-519(1).

Recover the Goods

If the goods are unique—as in the case of the original Bruegel—Bunker is entitled to specific performance—that is, recovery of the painting. This section is designed to give the buyer rights comparable to the seller's right to the price and modifies the old common-law requirement that courts will not order specific performance except for unique goods. It permits specific performance "in other proper circumstances," and these might include particular goods contemplated under output or requirements contracts or those peculiarly available from one market source. Md. Code Ann., Com. Law §§ 2- 716(1), 2A-521(1).

Even if the goods are not unique, the buyer is entitled to *replevy* them if they are identified to the contract and after good-faith effort he cannot recover them. Replevin is the name of an ancient common-law action for recovering goods that have been unlawfully taken; in effect it is not different from specific performance, and the UCC makes no particular distinction between them in Section 2-716. Section 2A-521 holds the same for leases. Md. Code Ann., Com. Law §§ 2-716, 2A-521. In our case, Bunker could replevy the twenty-five prints identified and held by Howard.

Bunker also has the right to recover the goods should it turn out that Howard is insolvent. Under Section 2-502, if Howard were to become insolvent within ten days of the day on which Bunker pays the first installment of the price due, Bunker would be entitled to recover the original and the prints, as long as he tendered any unpaid portion of the price. Md. Code Ann., Com. Law § 2-502.

For security interest in goods rightfully rejected, if the buyer rightly rejects nonconforming goods or revokes acceptance, he is entitled to a security interest in any goods in his possession. Md. Code Ann., Com. Law § 2-711(3). In other words, Bunker need not return the twenty-five prints he has already received unless Howard reimburses him for any payments made and for any expenses reasonably incurred in their inspection, receipt, transportation, care, and custody. If Howard refuses to reimburse him, Bunker may resell the goods and take from the proceeds the amount to which he is entitled. Md. Code Ann., Com. Law §§ 2-711(3), 2-706, 2A-508(5), 2A- 527(5).

Goods Accepted

The buyer does not have to reject nonconforming goods. She may accept them anyway or may effectively accept them because the time for revocation has expired. In such a case, the buyer is entitled to remedies as long as she notifies the seller of the breach within a reasonable time. Md. Code Ann., Com. Law §§ 2-714(1) and 2A-519(3). In our example, Bunker can receive three types of damages, all of which are outlined here.

Compensatory Damages

Bunker may recover damages for any losses that in the ordinary course of events stem from the seller's breach. Suppose Howard had used inferior paper that was difficult to detect, and within several weeks of acceptance the prints deteriorated. Bunker is entitled to be reimbursed for the price he paid.

Consequential Damages

Bunker is also entitled to consequential damages. Md. Code Ann., Com. Law §§ 2-714(3), 2-715, and 2A-519(3). These are losses resulting from general or particular requirements of the buyer's needs, which the seller had reason to know and which the buyer could not reasonably prevent by cover or otherwise. Suppose Bunker is about to make a deal to resell the twenty-five prints that he accepted, only to discover that Howard used inferior ink that faded quickly. Howard knew that Bunker was in the business of retailing prints and therefore he knew or should have known that one requirement of the goods was that they be printed in long-lasting ink. Because Bunker will lose the resale, he is entitled to the profits he would have made. (If Howard had not wished to take the risk of paying for consequential damages, he could have negotiated a provision limiting or excluding this remedy.) The buyer has the burden of proving consequential damages, but the UCC does not require mathematical precision. Suppose customers come to Bunker's gallery and sneer at the faded colors. If he can show that he would have sold the prints were it not for the fading ink (perhaps by showing that he had sold Bruegels in the past), he would be entitled to recover a reasonable estimate of his lost profits.

In *De La Hoya v. Slim's Gun Shop,* 146 Cal. Rptr. 68 (Cal. App. Dep't Super. Ct. 1978), the plaintiff purchased a handgun from the defendant, a properly licensed dealer. While the plaintiff was using it for target shooting, he was questioned by a police officer, who traced the serial number of the weapon and determined that— unknown to either the plaintiff or the defendant—it had been stolen. The plaintiff was arrested for possession of stolen property and incurred, in 2010 dollars, $3,000 in attorney fees to extricate himself from the criminal charges. He sued the defendant for breach of the implied warranty of title and was awarded the amount of the attorney fees as consequential damages. On appeal the California court held it foreseeable that the plaintiff would get arrested for possessing a stolen gun, and "once the foreseeability of the arrest is established, a natural and usual consequence is that the [plaintiff] would incur attorney's fee." *Id.* at 72.

Incidental Damages

Section 2-715 allows incidental damages, which are "damages resulting from the seller's breach including expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach." Md. Code Ann., Com. Law § 2-715. Section 2A-520(1) of the UCC is similar for leases.

Excuses for Non-Performance

In contracts for the sale of goods, as in common law, things can go wrong. What then?

Casualty to Identified Goods

As always, the parties may agree what happens if the goods are destroyed before delivery. The default is Sections 2-613 and 2A-221(a) "where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer,…then (a) if the loss is total the contract is avoided; and (b) if the loss is partial the buyer may nevertheless accept them with due allowance for the goods' defects." Md. Code Ann., Com. Law §§ 2-613, 2A-221(a). Thus if Howard ships the original Bruegel to Bunker but the painting is destroyed, through no fault of either party, before delivery occurs, the parties are discharged. If the frame is damaged, Bunker could, if he wants, take the painting anyway, but at a discount.

The UCC's Take on Issues Affecting "Impossibility"