

## RISK OF LOSS UNDER THE UNIFORM COMMERCIAL CODE

### I. INTRODUCTION

The wide variety of ways in which goods can be damaged, destroyed, or lost after parties have contracted for the sale of those goods creates the need for a simple and workable set of legal rules allocating risk of loss between the contracting parties. The complexity of modern commercial practices underscores this need. A common example illustrates the problem. A men's clothing dealer in New York sends a purchase order for three hundred custom shirts to a manufacturer in Indiana. The manufacturer fills the order and ships the shirts by truck to the buyer in New York. However, before delivery can be made, the shirts are totally destroyed by a fire at a truck terminal.

Who bears the risk of loss in this situation? The question is of direct monetary interest to both of the contracting parties, for if the seller bears the risk of loss, he is liable in damages for nondelivery.<sup>1</sup> The buyer is liable for the price if the risk of loss falls on the buyer.<sup>2</sup> The Uniform Commercial Code (UCC) has noticeably changed the law of risk of loss as it existed under the common law and the Uniform Sales Act. This note presents an explanation of the manner in which risk of loss is allocated between contracting parties pursuant to the UCC and examines problems which have arisen and may arise by application of the UCC's risk of loss provisions.<sup>3</sup>

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<sup>1</sup>UNIFORM COMMERCIAL CODE [hereinafter cited as UCC] § 2-713.

<sup>2</sup>*Id.* § 2-709; see *Park County Implement Co. v. Craig*, 397 P.2d 800, 802-03 (Wyo. 1964).

<sup>3</sup>See generally 2 R. ANDERSON, UNIFORM COMMERCIAL CODE 101-15 (1971); 1 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 1.23, at 131-44 (1964); R. NORDSTROM, HANDBOOK OF THE LAW OF SALES §§ 130-36 (1970); J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 5, at 134-66 (1972); 6B W. WILLIER & F. HART, BENDER'S UNIFORM COMMERCIAL CODE SERVICE 489-94 (1973); Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 561, 581-84 (1950); Comment, *Risk of Loss and the Uniform Commercial Code: The Unlamented Passing of Title*, 13 KAN. L. REV. 565 (1965); Comment, *Commercial Transactions: Risk of Loss: What Does the Code Mean by Bailee?*, 21 OKLA. L. REV. 310 (1968); Comment, *The Status of the Concept of Title in Article II of the Uniform Commercial Code*, 37 ST. JOHN'S L. REV. 178 (1962).

Codifying the common law,<sup>4</sup> the Uniform Sales Act put the risk of loss on the party having legal title to the goods.<sup>5</sup> Thus, if title had not yet passed to the buyer, the seller bore the risk of loss.<sup>6</sup> If title had passed to the buyer, he was liable for the price and thus bore the risk of loss. The passage of risk of loss with the passage of title allowed the risk of loss to shift to the buyer under circumstances in which the seller remained in possession of the goods.<sup>7</sup> The inequity caused by allowing passage of title to determine the risk of loss was apparent since the risk could fall upon the party least likely to have prepared against such loss. In addition, the uncertainty in the law relating to title prompted needless litigation under the Uniform Sales Act's risk of loss provision.<sup>8</sup>

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<sup>4</sup>R. BRAUCHER & A. SUTHERLAND, *COMMERCIAL TRANSACTIONS* 187-88 (4th ed. 1968); L. VOLD, *HANDBOOK OF THE LAW OF SALES* § 38, at 225 (2d ed. 1959); *see, e.g.*, *California State Automobile Ass'n Inter-Ins. Bureau v. Dearing*, 259 Cal. App. 2d 717, 66 Cal. Rptr. 852 (1968).

<sup>5</sup>Section 22 of the Uniform Sales Act provided the general rules as to risk of loss. Section 22 provided in full:

Section 22.—[Risk of Loss.] Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer the goods are at the buyer's risk whether delivery has been made or not, except that—

(a) Where delivery of the goods has been made to the buyer, or to a bailee for the buyer, in pursuance of the contract and the property in the goods has been retained by the seller merely to secure performance by the buyer of his obligation under the contract, the goods are at the buyer's risk from the time of such delivery.

(b) Where delivery has been delayed through the fault of either buyer or seller the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

<sup>6</sup>One exception to the general rule resulted when the parties acted under a security agreement, such as a conditional sales contract, by which the seller retained title for security purposes, while the buyer obtained beneficial ownership. Here, risk of loss shifted to the buyer with the passage of beneficial ownership. *UNIFORM SALES ACT* § 22(a). The second exception to the general rule placed the risk of loss on the party in fault when the delivery of goods was delayed through the fault of either the buyer or the seller. *Id.* § 22(b).

<sup>7</sup>The Uniform Sales Act provided that under an unconditional sales contract, title to specific goods passed when the contract was made. Time of payment and delivery were immaterial. *Id.* § 19, Rule 1.

<sup>8</sup>*See, e.g.*, *Parish & Parish Mining Co. v. Serodino, Inc.*, 52 Tenn. App. 196, 372 S.W.2d 433 (1963).

The Code's approach to risk of loss does not depend upon the inadequate principle of passage of title.<sup>9</sup> Rather, the drafters of the Code state that "[t]he underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the 'property' in the goods. . . ."<sup>10</sup> The basic policy behind the Code's risk of loss provisions is that the risk of loss should fall upon the party most likely to have insured or otherwise taken precautions against such loss. This general policy manifests itself in provisions in which the allocation of risk of loss turns upon such factors as which party has possession of the goods or which party retains the most control over the goods. The application of this general policy is logically sound. For example, one provision of the UCC places the risk of loss on the party having possession of the goods.<sup>11</sup> Assume a merchant-seller has contracted to sell specific goods, but retains possession. Most likely, the merchant-seller's insurance policy covers all goods on his premises. By placing the risk of loss on the party having possession of the goods, the merchant-seller, the Code has placed the burden on the party most likely to have insured against the loss. By fashioning rules around this basic policy, the drafters provide for the allocation of risk of loss in a simple, clear manner which is workable in today's complex commercial setting.

## II. SECTION 2-509—RISK OF LOSS IN THE ABSENCE OF BREACH

### A. *General Application*

Section 2-509 sets forth the method of determining whether the buyer or the seller bears the risk of loss when neither party has breached the contract. This section is strictly confined to the

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<sup>9</sup>UCC § 2-401 specifically provides in part:

Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchaser or other third parties applies irrespective of title to the goods except where the provision refers to such title.

See *Silver v. Sloop Silver Cloud*, 259 F. Supp. 187, 192 (S.D.N.Y. 1966); *William F. Wilke, Inc. v. Cummins Diesel Engines, Inc.*, 252 Md. 611, 250 A.2d 886, 889 (1969); *Hayward v. Postma*, 31 Mich. App. 720, 188 N.W.2d 31, 32 (1971); *Park County Implement Co. v. Craig*, 397 P.2d 800, 802 (Wyo. 1964); Carrington, *Uniform Commercial Code Section: The Passage of Title*, 14 WYO. L.J. 17, 25 (1959); Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 561, 581 (1950); Comment, *The Status of the Concept of Title in Article II of the Uniform Commercial Code*, 37 ST. JOHN'S L. REV. 178 (1962).

<sup>10</sup>UCC § 2-509, Comment 1.

<sup>11</sup>*Id.* § 2-509(3).

no-breach situation,<sup>12</sup> although actions by either party or defects in the goods which do not constitute a breach would fall within the application of this section.<sup>13</sup> Section 2-509<sup>14</sup> classifies the no-breach situation into three basic categories: (1) When the parties have entered into a contract calling for goods to be shipped by carrier, subsection (1) applies; (2) Subsection (2) allocates the risk of loss under circumstances in which the goods are held by a bailee to be delivered without being moved; (3) If the contract contains no provision as to delivery, the residuary provision, subsection (3), determines who bears the risk of loss. Significantly, the parties may avoid the Code's allocation of risk of loss by entering into a specific contractual agreement with respect to risk of loss. Section 2-509(4) provides in part that "[t]he provisions of this section are subject to contrary agreement of the parties . . . ."<sup>15</sup> Thus, assuming the contractual provision is sufficiently clear to be valid,<sup>16</sup> the parties may themselves determine the specifics of who bears the risk of loss.

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<sup>12</sup>*Id.* § 2-509, Comment 1 explains the drafters' intent as to the application of this section:

The scope of the present section, therefore, is limited strictly to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

*Cf.* *Sunbury Wire Rope Mfg. Co. v. United States Steel Corp.*, 129 F. Supp. 425 (E.D. Pa. 1955).

<sup>13</sup>See R. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 132, at 399-400 (1970).

<sup>14</sup>For a case discussing the general application of section 2-509 and the distinctions among its subsections, see *Mercanti v. Pearson*, 160 Conn. 468, 280 A.2d 137 (1971).

<sup>15</sup>UCC § 2-509(4); *cf.* *Consolidated Bottling Co. v. Jaco Equip. Corp.*, 442 F.2d 660 (2d Cir. 1971). UCC § 2-509, Comment 5 supports the contrary agreement rule and also states:

"Contrary" is in no way used as a word of limitation and the buyer and seller are left to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or course of dealing or performance.

Note that section 2-509(4) also provides that the provisions of this section do not apply to a sale on approval.

<sup>16</sup>It should be emphasized that an agreement determining the allocation of risk of loss must contain language which clearly and unequivocally calls for that result. For example, in *Hayward v. Postma*, 31 Mich. App. 720, 188

B. Section 2-509(1)

1. Delivery Terms

In order to understand the Code's allocation of risk of loss when the parties have contracted for shipment of the goods, common delivery terms must be examined. These shorthand terms were developed by merchants to distinguish between "shipment" and "destination" contracts. In short, a shipment contract requires only that the seller place the goods in the hands of the carrier in order to shift the risk of loss to the buyer. On the other hand, a destination contract places the risk of loss on the seller until the carrier actually delivers the goods to the buyer. The Code adopts these common delivery terms<sup>17</sup> and allocates risk of loss according to whether the parties have agreed to a shipment or destination contract.<sup>18</sup>

Pursuant to section 2-320, both "C.I.F." (cost, insurance, and freight) and "C.F." (cost and freight) contracts are considered shipment contracts, requiring the seller to bear the expense and risk of loss of putting the goods into the possession of the carrier.<sup>19</sup> The price of a C.I.F. contract includes the cost of the goods plus the cost of insurance and freight to the specified destination, while the price of a C.F. contract includes the cost of the goods plus freight.<sup>20</sup> The C.I.F. delivery term logically indicates a shipment

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N.W.2d 31 (1971), the Michigan Court of Appeals held that a provision in a security agreement by which the buyer was to keep the goods fully insured at all times was not a contrary agreement to which section 2-509(4) would apply.

<sup>17</sup>See, e.g., UCC §§ 2-319 to -324.

<sup>18</sup>*Id.* § 2-509(1).

<sup>19</sup>*Id.* § 2-320(2). *Id.* § 2-320, Comment 1 states in part:

The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title". . . .

See also *York-Shipley, Inc. v. Atlantic Mut. Ins. Co.*, 474 F.2d 8 (5th Cir. 1973).

<sup>20</sup>UCC § 2-320(1); see *Amco Transworld, Inc. v. M/V Bambi*, 257 F. Supp. 215 (S.D. Tex. 1966); *Continental Ore Corp. v. United States*, 423 F.2d 1248 (Ct. Cl. 1970). Unless otherwise agreed, the C.I.F. delivery term imposes the obligation on the seller, at his expense and risk, to (1) put the goods in the carrier's possession and obtain a negotiable bill of lading on the shipment, (2) load the goods and obtain a paid freight receipt, (3) obtain

contract because the buyer has specifically contracted to insure against the risk of loss on the goods. However, a less obvious, but more practical reason underlies the classification of the C.F. delivery term as a shipment contract. The buyer usually has a blanket insurance policy covering all shipments made by or to him.<sup>21</sup> These rules support the drafter's intent to place the risk of loss on the party most likely to have insured against the loss.

The delivery terms "F.O.B." (free on board) and "F.A.S." (free alongside) may indicate either shipment or destination contracts. Pursuant to section 2-319,<sup>22</sup> by using the delivery term

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the policy or certificate of insurance of the usual kind and amount, (4) prepare an invoice and any other necessary documents, (5) forward and tender those documents with commercial promptness and with necessary indorsements to the buyer. UCC § 2-320(2). These same obligations fall upon a seller under a C.F. delivery term, except that the C.F. term imposes no insurance obligation. *Id.* § 2-320(3).

<sup>21</sup>UCC § 2-320, Comment 16.

<sup>22</sup>*Id.* § 2-319 provides in full:

(1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this Article (section 2-504) and bear the expense and risk of putting them into the possession of the carrier; or

(b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this Article (section 2-503);

(c) when under either (a) or (b) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this Article on the form of bill of lading (section 2-323).

(2) Unless otherwise agreed the terms F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must

(a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within subsections (1) (a) or (c) or subsection (2) the buyer must seasonably

“F.O.B. place of shipment,” the seller is obligated under the shipment contract to bear the expense and risk of loss of putting the goods in the possession of the carrier, and he must comply with the requirements of section 2-504.<sup>23</sup> On the other hand, when the delivery term “F.O.B. place of destination” is used, the seller is obligated to bear the risk of loss to the place of destination, and he must comply with the requirements of section 2-503.<sup>24</sup> Similarly, the risk of loss passes at the named destination under a “F.A.S.” contract.<sup>25</sup> The delivery term “ex-ship” also denominates a destination contract.<sup>26</sup>

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give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this Article (section 2-311). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

<sup>23</sup>*Id.* § 2-319(1)(a). Section 2-504 provides that under a shipment contract the seller must (1) place the goods in the possession of a carrier and, with regard to the nature of the goods and other circumstances of the case, make a reasonable transportation contract, (2) obtain and deliver the proper documents of title, and (3) promptly notify the buyer of the shipment. *See* Permalum Window & Awning Mfg. Co. v. Permalum Window Mfg. Corp., 412 S.W.2d 863 (Ky. Ct. App. 1967). However, section 2-504 also states that failure to notify pursuant to paragraph (a) constitutes grounds for rejection only in the case of material delay or loss.

<sup>24</sup>UCC § 2-319(1)(b). Section 2-503 provides that for a destination contract the seller must make a proper tender of delivery. More specifically, the seller is required to tender conforming goods and give the buyer any notification reasonably necessary to enable him to take delivery. *Id.* § 2-503(1). Although the manner, time, and place of tender are determined by the contract of the parties, the seller is required to make tender at a reasonable hour and to keep the goods available for delivery for a reasonable period. *Id.* § 2-503(1)(a). The buyer, unless otherwise agreed, must provide delivery facilities reasonably suited for the receipt of the goods. *Id.* § 2-503(1)(b). The seller is further obligated to tender the proper documents of title. *Id.* § 2-503(3).

<sup>25</sup>*Id.* § 2-319(2).

<sup>26</sup>*Id.* § 2-322. Under the “ex-ship” term, the seller has the obligation to deliver by ship to the named destination, to discharge all liens against the goods, and to remove the goods from the ship’s tackle. *Id.*

## 2. Allocation of Risk of Loss

Adopting the common delivery terms used by merchants, section 2-509(1) allocates the risk of loss when the parties are operating under a transportation contract according to whether the parties have agreed to a shipment or a destination contract. Subsection (1) states:

Where the contract requires or authorizes the seller to ship goods by carrier

- (a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505); but
- (b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable buyer to take delivery.<sup>27</sup>

Thus, when the parties are operating under a transportation contract which requires or authorizes the seller to ship the goods by carrier, paragraph (a) passes the risk of loss when the goods are duly delivered to the carrier if the parties have agreed to a shipment contract. If, on the other hand, a destination contract is involved, paragraph (b) provides that the risk of loss does not pass until the goods are so tendered to the buyer that he may take delivery.

A definitional problem exists with regard to the use of the term "carrier" since the term is not defined by the Code. However, the implication of the Code is that carrier is used in its normal sense to mean an enterprise in the business of transporting the goods of others for commercial gain.<sup>28</sup> Thus, subsection (1) would not apply to a seller shipping goods by means of his own vehicles. An interpretative problem is created under a transportation contract which does not explicitly state whether it is a shipment or

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<sup>27</sup>*Id.* § 2-509(1).

<sup>28</sup>*See* R. NORDSTROM, *HANDBOOK OF THE LAW OF SALES* § 132, at 396-97 (1970); J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 5-2, at 143-44 (1972). *See also* *Mercanti v. Pearson*, 160 Conn. 468, 280 A.2d 137, 139 (1971).

a destination contract.<sup>29</sup> Forseeing this problem, the drafters intended that there be a presumption in favor of shipment contracts. Accordingly, unless the parties explicitly provide for a destination contract, the contract will be construed as a shipment contract. Stated differently, all ambiguous transportation contracts will be construed as shipment contracts.<sup>30</sup>

Under a shipment contract, pursuant to section 2-509(1) (a), the risk of loss passes to the buyer when the goods are "duly delivered." The term "duly delivered" is not defined by the UCC. But, again, the drafters' intent is clear. In Comment 2 to section 2-509, the drafters state:

In order that the goods be "duly delivered to the carrier" under paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender.<sup>31</sup>

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<sup>29</sup>UCC § 2-503, Comment 5 provides in part:

[U]nder this Article the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

See also *id.* § 2-509, Comment 2.

The courts have followed the drafters' intent and have held that there is a presumption in favor of shipment contracts. In *Electric Regulator Corp. v. Sterling Extruder Corp.*, 280 F. Supp. 550 (D. Conn. 1968), a Connecticut seller contracted to sell and ship goods to a New Jersey buyer. The district court construed the "F.O.B. Norwalk, Conn." delivery term as a shipment contract by using the shipment contract presumption. *Id.* at 558; *accord*, *Ninth St. E., Ltd. v. Harrison*, 5 Conn. Cir. 597, 259 A.2d 772 (1968); *Dana Debs, Inc. v. Lady Rose Stores, Inc.*, 65 Misc. 2d 697, 319 N.Y.S.2d 111 (Civ. Ct. 1970).

<sup>30</sup>*Ninth St. E., Ltd. v. Harrison*, 5 Conn. Cir. 597, 259 A.2d 772 (1968); *Dana Debs, Inc. v. Lady Rose Stores, Inc.* 65 Misc. 2d 697, 319 N.Y.S.2d 111 (Civ. Ct. 1970); *Lumber Sales, Inc. v. Brown*, 469 S.W.2d 888 (Tenn. Ct. App. 1971).

In *Electric Regulator Corp. v. Sterling Extruder Corp.*, 280 F. Supp. 550, 557 (D. Conn. 1968), the district court stated, "Thus, an F.O.B. term must be read to indicate the point at which delivery is to be made unless there is a specific agreement otherwise. . . ."

<sup>31</sup>UCC § 2-509, Comment 2. This interpretation is also supported by the fact that paragraph (a) of section 2-319(1), which deals with shipment

The requirements of shipment by the seller are contained in section 2-504, which provides that the seller must: (1) place the goods in the possession of a carrier, and, with regard to the nature of the goods and other circumstances of the case, make a reasonable transportation contract, (2) obtain and deliver the proper documents of title, and (3) promptly notify the buyer of the shipment.<sup>32</sup> Thus, goods are "duly delivered" pursuant to section 2-509(1)(a) if they conform to the contract, and if the requirements of section 2-504 are met by the seller.

Under a destination contract, pursuant to section 2-509(1)(b), the risk of loss shifts to the buyer at the place of destination if the goods are "duly so tendered as to enable the buyer to take delivery."<sup>33</sup> A parallel reading with paragraph (a) would require the seller to comply with the requirements of shipment under a destination contract as set forth in section 2-503.<sup>34</sup> To make a proper tender of delivery pursuant to this section, the seller is required to tender conforming goods and to give the buyer any notification reasonably necessary to enable buyer to take delivery.<sup>35</sup> Although the manner, time, and place of tender are determined by the contract of the parties, the seller is required to make tender at a reasonable hour and to keep the goods available for delivery for a reasonable period.<sup>36</sup> The seller is further obligated to tender the proper documents of title.<sup>37</sup>

In a sense, the application of subsection (1) produces a somewhat consistent result under either a shipment or a destination contract. In both cases the seller initially begins with the risk of loss. Through compliance with the requirements of tender under the applicable Code provisions, the seller may shift the burden of the risk of loss. The difference in results stems from the distinction between a shipment and a destination contract—a distinction created by merchants themselves. For parties operating pur-

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contracts under the F.O.B. delivery terms, specifically requires the seller to comply with section 2-504. *See* note 23 *supra*.

<sup>32</sup>UCC § 2-504.

<sup>33</sup>*Id.* § 2-509(1)(b).

<sup>34</sup>This interpretation is supported by section 2-509, Comment 2, and by section 2-319(1)(b). *See* note 24 *supra*.

<sup>35</sup>UCC § 2-503(1).

<sup>36</sup>*Id.* § 2-503(1)(a).

<sup>37</sup>*Id.* § 2-503(3).

suant to a shipment contract, the burden passes upon delivery to the carrier, while under the destination contract the burden does not shift until delivery to the buyer at the place of destination.

The New York Civil Court case of *Dana Debs, Inc. v. Lady Rose Stores, Inc.*,<sup>38</sup> properly illustrates the application of subsection (1). The plaintiff, a dress and suit manufacturer in New York City, received an order for certain garments from the defendant buyer on buyer's printed form. Defendant's firm was located in Long Island. Shipment terms on the bill of sale were "Terms, F.O.B., N.Y.C." Plaintiff sued for the price of the garments after the shipment was lost by the carrier. Plaintiff's recovery thus turned on who bore the risk of loss after the goods were delivered to the carrier. The court, holding that the parties had agreed to a shipment contract, allowed the plaintiff to recover.<sup>39</sup> The court reasoned that the parties had not explicitly agreed to a destination contract. Therefore, a shipment contract was presumed.<sup>40</sup> The court supported its position by pointing out that the seller was located in New York City, while the buyer was located outside New York City. The "F.O.B., N.Y.C." term thus indicated an F.O.B. place of shipment term, which denominated a shipment contract.<sup>41</sup> Accordingly, the risk of loss passed to the buyer when the seller properly tendered the goods to the carrier.

### C. Section 2-509(2)

#### 1. Bailment Terms

It has been a common business practice for the owner of goods to place those goods in the possession of a third party who has the obligation to return the goods or dispose of them as the owner directs. This common business practice is defined in the law as a "bailment,"<sup>42</sup> the owner of the goods being the bailor and the third party in whose possession the goods are placed, the bailee. Of great legal consequence is the fact that the bailor retains

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<sup>38</sup>65 Misc. 2d 697, 319 N.Y.S.2d 111 (Civ. Ct. 1970). See also *Electric Regulator Corp. v. Sterling Extruder Corp.*, 280 F. Supp. 550 (D. Conn. 1968); *Ninth St. E., Ltd. v. Harrison*, 5 Conn. Cir. 597, 259 A.2d 772 (1968); *Sternheim v. Silver Bell, Inc.*, 66 Misc. 2d 726, 321 N.Y.S.2d 965 (N.Y.C. City Ct. 1971).

<sup>39</sup>65 Misc. 2d at 698, 319 N.Y.S.2d at 112.

<sup>40</sup>*Id.*

<sup>41</sup>*Id.* at 699, 319 N.Y.S.2d at 113.

<sup>42</sup>See, e.g., *In re George L. Nadell & Co.*, 294 Mich. 150, 292 N.W. 684, 686 (1940); *Hardin v. Grant*, 54 S.W.2d 189, 190 (Tex. Civ. App. 1932).

ownership of the goods, while the bailee retains possession. This division of ownership and possession would create difficulty for the bailor who, desiring to sell the bailed goods or to borrow using the bailed goods as collateral, does not want to physically move those goods.

Fortunately, possible difficulties arising from the division of ownership and possession in bailed goods have been minimized by the legal concept of "documents of title." Simply stated a document of title is a piece of paper which represents title to specific goods.<sup>43</sup> Accordingly, the bailor may sell or borrow on bailed goods by simply transferring the document of title without physically moving the goods. Documents of title may either be negotiable or nonnegotiable. To be negotiable, a document of title must contain order or bearer language.<sup>44</sup> Any other document of title is nonnegotiable.<sup>45</sup>

When the bailor of goods<sup>46</sup> places those goods in the possession of the bailee,<sup>47</sup> called a warehouseman,<sup>48</sup> under a bailment agreement, the warehouseman often issues a document of title called a "warehouse receipt," which may either be negotiable or non-

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<sup>43</sup>UCC § 1-201(15) defines a document of title and alludes to the bailment concept:

"Document of title" includes 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. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

See also *id.* § 1-201, Comment 15.

<sup>44</sup>*Id.* § 7-104(1) (a).

<sup>45</sup>*Id.* § 7-104(2).

<sup>46</sup>"Goods" means all things which are treated as movable for the purposes of a contract of storage or transportation." *Id.* § 7-102(1) (f).

<sup>47</sup>

"Bailee" means the person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them.

*Id.* § 7-102(1) (a).

<sup>48</sup>"Warehouseman" is a person engaged in the business of storing goods for hire." *Id.* § 7-102(1) (h).

negotiable. When a negotiable document of title is issued, the Code imposes special obligations on both the holder of the document and the bailee. More specifically, the holder

must surrender for cancellation or notation of partial deliveries any outstanding negotiable document covering the goods, and the bailee must cancel the document or conspicuously note the partial delivery thereon or be liable to any person to whom the document is duly negotiated.<sup>49</sup>

No such obligation arises under the Code with the issuance of a nonnegotiable document of title. For this reason, the negotiable document is the only document of title which represents true and absolute title to the goods.<sup>50</sup>

Since the bailor is not obligated to surrender a nonnegotiable document and since the bailee is not obligated to demand surrender of a nonnegotiable document in order to release the goods in his possession,<sup>51</sup> another document, "the delivery order,"<sup>52</sup> is commonly used in transactions involving a nonnegotiable document of title. The delivery order is a written order from the bailor to the bailee which directs the bailee to surrender the goods and states to whom the goods are to be delivered.<sup>53</sup> It is evident that goods may have been delivered under a delivery order while one or several nonnegotiable documents remain outstanding since the bailee is not required to demand the surrender of a nonnegotiable document in order to deliver the goods.<sup>54</sup>

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<sup>49</sup>*Id.* § 7-403(3). For other obligations placed on the bailee, see *id.* § 7-403(1).

<sup>50</sup>The nonnegotiable document of title is merely written evidence of the contract between the bailor and the bailee, and usually states the obligations of that contract upon the bailee.

<sup>51</sup>See note 49 *supra* & accompanying text. See also UCC § 7-504(2).

<sup>52</sup>UCC § 7-102(1)(d) defines the delivery order as follows:

"Delivery order" means a written order to deliver goods directed to a warehouseman, carrier or other person who in the ordinary course of business issues warehouse receipts or bills of lading.

<sup>53</sup>Note that Comment 3 to section 102 states in part:

When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the ordinary obligation of contract which the bailee may have assumed to the depositor of the goods.

<sup>54</sup>Note also that the rights of a holder of a nonnegotiable document may be defeated by creditors of the seller, other buyers from the seller, or the bailee. UCC § 7-504(2).

## 2. Allocation of Risk of Loss

Section 2-509 (2) allocates the risk of loss under circumstances in which goods are held by a bailee to be delivered without being moved. Subsection (2) provides:

Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer

- (a) on his receipt of a negotiable document of title covering the goods; or
- (b) on acknowledgement by the bailee of the buyer's right to possession of the goods; or
- (c) after his receipt of a non-negotiable document of title or other written direction to deliver, as provided in subsection (4) (b) of Section 2-503.<sup>55</sup>

The basic principle underlying subsection (2) is that the risk of loss falls upon the party who has control over the bailee. This principle is based upon, or is at least consistent with, the principle underlying all the Code's risk of loss provisions that the risk of loss should fall upon the party most likely to have insured or taken precautions against such loss.<sup>56</sup>

The rule of section 2-509(2) (a) regarding passage of risk of loss when a negotiable document<sup>57</sup> covers the goods is simply that "the risk of loss passes to the buyer on his receipt of a negotiable document of title covering the goods."<sup>58</sup> The bailee is obligated to surrender the goods in this situation, and the buyer is likely to have obtained insurance covering the goods. The rule governing risk of loss after the issuance of a nonnegotiable document of title<sup>59</sup> is by nature more complex. Indeed, section 2-509 (3) specifically mandates that risk of loss will pass to the buyer after

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<sup>55</sup>*Id.* § 2-509(2).

<sup>56</sup>*See* note 10 *supra* & accompanying text. *See also* UCC § 2-509, Comment 3.

<sup>57</sup>*See* note 44 *supra* & accompanying text.

<sup>58</sup>UCC § 2-509(2) (a). Although receipt of a negotiable document of title is not defined by the Code, receipt with regard to goods is defined as the taking of actual possession of the goods. *See id.* § 2-103(1)(c). Consistency would demand a similar definition with regard to documents of title.

<sup>59</sup>*See* note 45 *supra* & accompanying text.

his receipt of the nonnegotiable document or other written direction to deliver, such as a delivery order,<sup>60</sup> according to the rule of section 2-503(4)(b). Pursuant to section 2-503(4)(b),

*risk of loss of the goods and any failure by the bailee to honor the non-negotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.*<sup>61</sup>

Thus, when a nonnegotiable document of title covers the goods, risk of loss does not pass with receipt of the document as in the case of a negotiable document. Instead, the buyer has a reasonable time to present the bailee with the nonnegotiable document or delivery order.<sup>62</sup> Because the bailee may refuse to deliver the goods upon the surrender of a nonnegotiable document, section 2-503(4)(b) further provides that the bailee's refusal defeats the tender of the document and thus defeats passage of risk of loss. The latter provision of paragraph (b) protects the buyer for a practical reason, *i.e.*, the buyer who holds a nonnegotiable document can lose his rights to creditors of the seller, to the bailee, or to other purchasers from the seller from whom the bailee has previously accepted other documents and to whom the bailee has delivered the goods.<sup>63</sup>

The possibility exists that the bailee will not issue a document of title when the bailed goods are placed in his possession. Similarly, the bailor may not issue a direction for the bailee to deliver the goods to the buyer. When no document of title or direction to deliver is involved, and goods are held by a bailee

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<sup>60</sup>See note 52 *supra* & accompanying text.

<sup>61</sup>UCC § 2-503(4)(b) (emphasis added).

<sup>62</sup>

Paragraph (b) of subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

*Id.* § 2-503, Comment 6.

<sup>63</sup>*Id.* § 7-504(2). See also note 49 *supra* & accompanying text.

to be delivered without being moved, section 2-509(2)(b) provides that "the risk of loss passes to the buyer on acknowledgement by the bailee of the buyer's right to possession of the goods."<sup>64</sup> After acknowledgement by the bailee, the buyer has complete control over the goods and is likely to have procured insurance covering those goods. Thus, risk of loss should logically pass to him after the bailee's acknowledgement of the buyer's rights in the goods.

One possible drafting defect in section 2-509(2) which presents a litigable issue arises from the fact that the subsection does not place a limitation upon who may be considered a bailee.<sup>65</sup> Consider a situation in which a seller remains in possession of goods previously sold to a buyer. The seller agrees to store the goods until delivery to the buyer, but the goods are destroyed while in the seller's possession. In this situation, the seller might contend that he is a bailee under subsection (2), that he acknowledged the buyer's rights in the goods, and that section 2-509(2)(b) thus mandates placing risk of loss on the buyer. Such a contention seems erroneous. Indeed, including the seller as a bailee under subsection (2) would be contrary to the basic policy underlying the Code's risk of loss provisions, for the merchant-seller is likely to have insurance which covers goods remaining in his possession. It is also arguable that the drafters did not intend such an interpretation of the term bailee under subsection (2).<sup>66</sup>

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<sup>64</sup>UCC § 2-509(2)(b). In *Whately v. Tetrault*, 5 UCC REP. SERV. 838 (Mass. App. 1964), a boat and trailer held by a bailee were sold by the owner, and the buyer subsequently made arrangements with the bailee to take possession of the boat. The court held that the making of arrangements for the buyer to take possession of the boat and trailer was an acknowledgment by the bailee of the buyer's rights in the goods sufficient to shift the risk of loss to the buyer pursuant to section 2-509(2)(b). *Id.* at 840.

<sup>65</sup>Note, *Commercial Transactions: Risk of Loss: What Does the Code Mean by Bailee?*, 21 OKLA. L. REV. 310, 313-15 (1968).

<sup>66</sup>For example, UCC § 2-509, Comment 3 states in part:

The underlying theory of this rule 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. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

The implication of this comment is that the drafters did not intend a seller to escape the obligation of bearing the risk of loss for goods remaining in his possession by interpreting section 2-509(2) to include the seller as a bailee.

D. Section 2-509(3)

The residuary or catch-all provision<sup>67</sup> of section 2-509, subsection (3), enounces the general rule of risk of loss in the absence of breach and applies to situations not specifically covered by subsections (1) or (2). Subsection (3) provides:

In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.<sup>68</sup>

Thus, if the seller is a merchant,<sup>69</sup> the general rule is that risk of loss passes to the buyer on his actual receipt of the goods. Receipts of goods, as defined by the Code, means taking physical possession.<sup>70</sup> On the other hand, when the seller is not a merchant, risk of loss passes to the buyer on the seller's tender of delivery.

The application of section 2-509(3) is aptly illustrated by the case of *Ellis v. Bell Aerospace Corp.*<sup>71</sup> Plaintiff Ellis contracted

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<sup>67</sup>In *Hayward v. Postma*, 31 Mich. App. 720, 188 N.W.2d 31 (1971), the Court of Appeals of Michigan, speaking of section 2-509(3), stated:

The general approach of Article 2 of the code is that freedom of contract prevails; the greater part of it is concerned with detailing what happens where the contract is silent on a particular point. Such is the purpose of § 2-509(3). This provision was meant to cover the common situation where the parties have not agreed on who shall bear the risk of loss.

*Id.* at 723, 188 N.W.2d at 32. See also *Diefenbach v. Gorney*, 93 Ill. App. 2d 51, 234 N.E.2d 813 (1968).

<sup>68</sup>UCC § 2-509(3).

<sup>69</sup>Merchant is defined by section 2-104(1) as follows:

"Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

<sup>70</sup>UCC § 2-103(1)(c). When the seller had installed a television antenna and tower at buyer's home under a conditional sales contract, the court held these goods had been "received" so as to shift risk of loss to buyer pursuant to subsection (3) of section 2-509. The antenna and tower were held by the court to have been received inspite of the fact that seller agreed to maintain the system and could remove the system upon a payment deficiency. *Lair Distrib. Co. v. Crump*, 48 Ala. App. 72, 261 So. 2d 904 (1972).

<sup>71</sup>315 F. Supp. 221 (D. Ore. 1970).

to purchase a new helicopter from defendant Bell. The purchase price was paid when assembly of the helicopter was completed. Because there was a space shortage at Bell, the helicopter was stored at an airport. While Ellis was taking flight instructions from Bell employees at the airport, the aircraft crashed and burned. The district court applied section 2-509(3) with the view that Bell had never technically delivered to Ellis since Bell had not sufficiently relinquished dominion and control over the helicopter. The court stated that under section 2-509(3), "a merchant seller cannot transfer risk of loss to the buyer until the buyer actually receives the merchandise."<sup>72</sup> This rule applies "even though the buyer has paid the full price and has been notified that the goods are at his disposal."<sup>73</sup> The court, stating that an insurable interest is not synonymous with receipt of the goods, held for the buyer in spite of the fact that the buyer had obtained insurance on the aircraft.<sup>74</sup>

Subsection (3) usually applies to a situation in which the buyer is to pick up goods at the seller's place of business. Subsection (3) also applies when the seller is to deliver the goods other than by carrier, for example, when the seller ships via his own truck fleet.<sup>75</sup>

### III. SECTION 2-510—EFFECT OF BREACH ON RISK OF LOSS

#### A. General Application

Section 2-510 determines the effect of either party's breach of contract on allocation of risk of loss. Section 2-510<sup>76</sup> classifies

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<sup>72</sup>*Id.* at 224.

<sup>73</sup>*Id.*

<sup>74</sup>*Id.* In *Mercanti v. Pearson*, 160 Conn. 468, 280 A.2d 137 (1971), the defendant boat builder contracted to build a mast for the plaintiff buyer. The court stated that the application of section 2-509(3) would place the risk of loss on the defendant seller since the plaintiff had not received the goods and the defendant had not tendered delivery. *Id.* at 471-73, 280 A.2d at 140. However, since plaintiff had misled the defendant in the course of the transaction, the court, using the doctrine of estoppel, refused to apply section 2-509(3) and found for the defendant. *Id.* at 477-79, 280 A.2d at 142. *See also* *Deitch v. Shamash*, 56 Misc. 2d 875, 290 N.Y.S.2d 137 (N.Y.C. Civ. Ct. 1968), in which the court applied section 2-509(3) to a contract for the sale of real estate because the sale included a bronze sculpture.

<sup>75</sup>*See* R. NORDSTROM, *HANDBOOK OF THE LAW OF SALES* § 131, at 395 (1970); J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 5-1, at 139 (1972).

<sup>76</sup>*See* *Portal Galleries, Inc. v. Tomar Prods., Inc.*, 60 Misc. 2d 523, 302 N.Y.S.2d 871 (Sup. Ct. 1969).

the breached contract situation into three basic categories: (1) Subsection (1) applies to a breach by the seller which gives the buyer the right of rejection; (2) If the buyer accepts the goods, but later rightfully revokes his acceptance due to the seller's breach, subsection (2) allocates the risk of loss between the parties; (3) Subsection (3) determines who bears the risk of loss when the buyer repudiates or otherwise breaches before the risk of loss passes to him under section 2-509.

The general rule of section 2-510 is that the party who breaches the contract bears the risk of loss. In some cases, however, the breaching party bears the risk of loss only to the extent not covered by the nonbreaching party's insurance. This general rule has been severely criticized by the commentators<sup>77</sup> for sound reasons. The general policy behind the Code's approach to risk of loss is to place that risk on the party most likely to have insured or prepared against the loss. This general policy is applied by putting the risk on the party having possession or control over the goods. But, placing the risk on the breaching party is inconsistent with this general policy since there is usually no correlation between whether a party breaches a contract and whether he insures against risk of loss.

Furthermore, if the Code's drafters intended to simplify the area of commercial law which deals with risk of loss, they clearly failed to achieve that intent with section 2-510. As even a cursory reading of section 2-510 reveals, the section is dominated by complexities and is difficult to apply. As will be seen from the discussion which follows, subsection (3) contains a number of conditions which make it commercially impractical to apply. Indeed, the shortcomings of section 2-510 seem unnecessary in light of the simple and workable manner in which section 2-509 was drafted.

## B. Seller's Breach

### 1. Buyer's Remedies for Breach

Under the Code's "perfect tender rule,"<sup>78</sup> if the goods or the tender of delivery<sup>79</sup> fails *in any respect* to conform to the contract,

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<sup>77</sup>See, e.g., R. NORDSTROM, *supra* note 75, § 136, at 416-17; J. WHITE & R. SUMMERS, *supra* note 75, § 5-5, at 146-47.

<sup>78</sup>UCC § 2-601. For a pre-Code case illustrating the application of the perfect tender rule, see *Mitsubishi Goshi Kaisha v. J. Aron & Co.*, 16 F.2d 185 (2d Cir. 1926).

<sup>79</sup>Section 2-503 sets forth the requirements for the seller's tender of delivery. See note 24 *supra*.

the buyer may reject<sup>80</sup> the whole, accept the whole, or accept any commercial units and reject the rest. The perfect tender rule, which is codified in section 2-601, thus gives the buyer the right to reject any goods when those goods or the tender of delivery fails in any respect to conform to the contract. The installment contract provides an exception to the perfect tender rule.<sup>81</sup> Under an installment contract, the buyer may reject any nonconforming installment if the nonconformity substantially impairs the value of that installment,<sup>82</sup> and may reject the whole if the nonconformity substantially impairs the value of the whole.<sup>83</sup> In summary, the buyer under a contract may reject the goods if the goods or the tender fail to conform to the contract in any respect, while the buyer under an installment contract may reject the goods only if the nonconformity substantially impairs its value.

“Acceptance”<sup>84</sup> of goods precludes rejection of those goods.<sup>85</sup> However, even after the buyer has accepted the goods, he may “revoke acceptance,” which has the same effect as rejection. Revocation of acceptance is permitted pursuant to section 2-608 if the nonconformity of the goods substantially impairs the value

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<sup>80</sup>Rejection of the goods must be within a reasonable time after delivery and is ineffective unless the buyer seasonably notifies the seller. UCC § 2-602.

<sup>81</sup>Section 2-601 specifically excepts installment contracts from the application of the perfect tender rule.

<sup>82</sup>UCC § 2-612(2). However, subsection (2) further provides that if the nonconformity does not substantially impair the value of the whole and the seller gives adequate assurance of cure, the buyer must accept that installment. *Id.*

When the seller has reasonable grounds to believe the nonconforming goods would be acceptable or when the time for performance has not yet expired, the seller has the right to cure the defect upon seasonable notification to the buyer. *Id.* § 2-508.

<sup>83</sup>*Id.* § 2-612(3). Subsection (3) further provides that the aggrieved party reinstates the contract if he accepts the nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect to past installments or demands performance as to future installments. *Id.*

<sup>84</sup>The buyer accepts the goods if he (1) notifies the seller that the goods are conforming or that he will retain them in spite of their nonconformity after the buyer has had a reasonable opportunity to inspect the goods, (2) fails to make an effective rejection pursuant to section 2-602(1) after a reasonable opportunity to inspect, or (3) does an act inconsistent with the seller's ownership. *Id.* § 2-606.

<sup>85</sup>*Id.* § 2-607(2).

of the contract to the buyer who has accepted the goods on the reasonable assumption that the nonconformity would be cured and it has not been seasonably cured, or if the buyer did not discover a nonconformity before acceptance and the nonconformity was difficult to discover.<sup>86</sup>

## 2. Allocation of Risk of Loss

Subsections (1) and (2) of section 2-510 apply to allocate the risk of loss when the seller breaches the contract of the parties. Subsection (1) provides:

Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.<sup>87</sup>

The rule thus evolves that when the seller has breached the contract by a nonconformity<sup>88</sup> of tender or delivery of goods so as to give the buyer a right of rejection, the risk of loss remains on the seller until either the buyer accepts or the seller cures.<sup>89</sup> Simply stated, as long as the buyer has the right of rejection, the risk of loss remains on the seller because, according to subsection (1), the risk cannot pass until the buyer accepts or the seller cures. As previously explained, the buyer may reject goods under the perfect tender rule if the goods or the tender fail to conform to the contract *in any respect*. The exception is the buyer under

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<sup>86</sup>*Id.* § 2-608(1); see *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 240 A.2d 195 (1968). Compare *Hays Merchandise, Inc. v. Dewey*, 78 Wash. 2d 343, 474 P.2d 270 (1970), with *Campbell v. Pollack*, 101 R.I. 223, 221 A.2d 615 (1966). Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the nonconformity and before any substantial change in the condition of the goods, not due to the nonconformity, occurs. UCC § 2-608(2). Revocation of acceptance is not effective until the buyer notifies the seller. *Id.*

<sup>87</sup>UCC § 2-510(1).

<sup>88</sup>

Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

*Id.* § 2-106(2).

<sup>89</sup>

Under subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

*Id.* § 2-510, Comment 1.

an installment contract, who may reject only if the nonconformity substantially impairs the value of the contract.<sup>90</sup>

The application of section 2-510(1) is well illustrated by the case of *William F. Wilke, Inc. v. Cummins Diesel Engines, Inc.*<sup>91</sup> Having contracted to supply a diesel-powered generator, Wilke in turn contracted to purchase such a generator from Cummins. Cummins delivered the engine without batteries and maintenance and operating instructions. When Wilke attempted to start the generator, employees discovered that the engine had been severely damaged by the freezing of water in the cooling system. Wilke notified Cummins of the damages. The issue of whether the risk of loss had passed with delivery to the buyer, Wilke, arose when Cummins presented Wilke with a sizeable bill for repair of damages to the engine. The court correctly applied subsection (1) on the theory that Cummins had breached the contract by delivering an engine which could not be started and thus did not conform to the contract.<sup>92</sup> Applying subsection (1), the court concluded that the risk of loss remained on Cummins and that Wilke was not liable for the cost of repairing damages to the engine while Cummins retained the risk of loss.<sup>93</sup>

As previously explained, even after the buyer has accepted, he may revoke his acceptance under the conditions specified by section 2-608.<sup>94</sup> Subsection (2) of section 2-510 applies to the situation in which the seller has breached the contract, but the buyer has revoked his prior acceptance of the goods. Subsection (2) provides:

Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.<sup>95</sup>

Thus, when the buyer responds to the seller's breach by revocation of acceptance, subsection (2) works to throw the risk of loss back

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<sup>90</sup>See text accompanying notes 78, 79, 80 *supra*.

<sup>91</sup>252 Md. 611, 250 A.2d 886 (1969). See also *McKnight v. Bellamy*, 248 Ark. 27, 449 S.W.2d 706 (1970); *Portal Galleries, Inc. v. Tomar Prods., Inc.*, 60 Misc. 2d 523, 302 N.Y.S.2d 871 (Sup. Ct. 1969).

<sup>92</sup>252 Md. at 617-18, 250 A.2d at 890.

<sup>93</sup>*Id.*

<sup>94</sup>See note 86 *supra* & accompanying text.

<sup>95</sup>UCC § 2-510(2).

on the seller to the extent the loss or damage is not covered by the buyer's insurance.<sup>96</sup>

Significantly, the buyer must "rightfully" revoke acceptance in order to throw the risk of loss back on the seller.<sup>97</sup> Since section 2-608 requires the buyer to make the revocation of acceptance before any substantial change in the condition of the goods occurs, the risk of loss would not shift back to the seller if the buyer attempted to revoke acceptance after the goods have been damaged or destroyed by a cause other than a defect in the goods. Note also that the burden of the risk of loss placed on the seller by subsection (2) is limited to any deficiency in the buyer's effective insurance coverage. The drafters point out that the "effective insurance coverage" language was used to protect the aggrieved party in the event of the supervening insolvency of his insurer.<sup>98</sup> The drafter's inserted the term "deficiency" in order to prevent subrogation.<sup>99</sup> Accordingly, subsection (2) shifts risk of loss back to the seller when damage to the goods occurs after acceptance and before a rightful revocation of acceptance, but only to the extent the damage is not covered by the buyer's insurance.

### C. Buyer's Breach

Subsection (3) of section 2-510 applies to allocate the risk of loss when the buyer breaches the contract of the parties. The construction of subsection (3) is similar to subsection (2) in that it shifts risk of loss only to the extent that damages exceed effective insurance coverage. Section 2-510(3) reads as follows:

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<sup>96</sup>The drafters stated their intent as to the operation of the subsection as follows:

In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by his insurance falls upon the contract breaker under subsections (2) and (3) rather than upon him. . . .

UCC § 2-510, Comment 3.

<sup>97</sup>The buyer rightfully revokes acceptance by complying with section 2-608. As previously discussed, the buyer may revoke acceptance if the nonconformity of the goods substantially impairs the value of the contract to him and if he accepted the goods on the reasonable assumption that the nonconformity would be cured and it has not been cured, or if he had not discovered a nonconformity before acceptance and the nonconformity was difficult to discover. *Id.* § 2-608(1); see note 86 *supra* & accompanying text.

<sup>98</sup>UCC § 2-510, Comment 3.

<sup>99</sup>*Id.*

Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.<sup>100</sup>

When the buyer repudiates<sup>101</sup> or otherwise breaches the contract, the risk of loss will shift to him by operation of subsection (3) if five conditions are present. First, the goods must "conform" to the contract. Goods conform to the contract when they are in accordance with the obligations under the contract.<sup>102</sup> Thus, if goods fail in any respect to conform to the contract, subsection (3) will not apply. Rather, subsection (1) will place the risk of loss on the seller to the full extent. That the goods must be "identified" to the contract constitutes the second condition imposed by subsection (3). In order to identify goods to the contract, the goods must be "shipped, marked or otherwise designated by the seller as goods to which the contract refers."<sup>103</sup> The third condition is that the goods must be "already" identified to the contract. The use of the word already requires that identification precede the occurrence of the loss or damage to the goods. Fourthly, the breach or repudiation must occur prior to the risk of loss passing to the buyer. If the breach or repudiation occurs after the buyer has the risk of loss, the buyer bears the risk of loss to the full extent under section 2-509. Lastly, the loss must occur within a "commercially reasonable time." The agreement of the parties and all the facts and circumstances of the case would determine what constitutes a commercially reasonable time.

Again, assuming these conditions are present, subsection (3) shifts the risk of loss to the buyer only to the extent that the damage or loss exceeds the seller's effective insurance coverage. Subsection (3) is so burdened with conditions that it is difficult to understand and can seldom be applied. An attempted statement of the rule of subsection (3) readily reveals the difficulty of its application: if the buyer repudiates or otherwise breaches

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<sup>100</sup>*Id.* § 2-510(3).

<sup>101</sup>Although the Code does not specifically define repudiation, the use of the term in sections 2-610, 2-611, 2-703, and 2-711 indicates that repudiation means anticipatory breach.

<sup>102</sup>UCC § 2-106(2).

<sup>103</sup>*Id.* § 2-501(1)(b). *See also id.* § 2-704.

the contract before risk of loss passes to him under some other Code provision as to goods identified to the contract before the occurrence of damage to the goods, subsection (3) shifts the risk of loss to the buyer for a commercially reasonable time to the extent that the damage exceeds the seller's effective insurance coverage.

#### IV. CONCLUSION

Under the Uniform Sales Act, allocation of risk of loss depended on the legal concept of passage of title. Recognizing the inadequacies of this concept, the drafters of the UCC developed rules based upon a more logical and workable principle. The general principle of the UCC's risk of loss provisions is to place the risk of loss on the party who is most likely to have insured or otherwise taken precautions against damage to the goods.

Section 2-509 sets forth the method of allocating the risk of loss when neither party breaches the contract. When the parties have contracted for the transportation of goods under a shipment contract, risk of loss passes to the buyer when the goods are duly delivered to the carrier. If a destination contract is involved, the risk of loss shifts when the goods are duly tendered so as to allow the buyer to take delivery. The basic rule covering the bailment situation is that the party having control over the bailee bears the burden of the risk of loss. When neither a transportation contract nor a bailment contract is involved, the general rule for the merchant-seller shifts the risk to the buyer when the buyer actually receives the goods. However, for the nonmerchant-seller, tender of delivery shifts the risk to the buyer. Significantly, the parties may avoid the application of section 2-509 altogether by contractually agreeing to their own method of risk of loss allocation.

Section 2-510 can be criticized for failing to adhere to the Code's general policy relating to risk of loss and for unnecessary complexity. The general rule of section 2-510 is that the risk of loss falls upon the breaching party. If the seller breaches by a nonconformity of tender or delivery of goods so as to give the buyer a right of rejection, the risk of loss remains on the seller until either the buyer accepts or the seller cures. If the buyer accepts nonconforming goods, but later rightfully revokes his acceptance, the burden of risk shifts back to the seller to the extent not covered by the buyer's insurance. On the other hand, if the buyer repudiates or otherwise breaches before the risk of loss passes to him, he suffers the risk to the extent not covered by the seller's insurance.

Overall, the Code's approach to the complicated commercial area of risk of loss marks a vast improvement over the prior law. The Code's rules are, for the most part, refreshingly simple. Furthermore the Code's approach to risk of loss is based upon sound, practical commercial policies. One provision, section 2-510, seems clearly deficient, partly because of its apparent inconsistency with the principle that the risk of loss should fall on the party most likely to have taken precautions against such loss. Hopefully, that provision will be amended to provide a more commercially sound approach.

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