

RIGHTS AND OBLIGATIONS OF BUYERS
WITH RESPECT TO GOODS IN THEIR POSSESSION
AFTER RIGHTFUL REJECTION OR JUSTIFIABLE
REVOCATION OF ACCEPTANCE

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INTRODUCTION

One of the more frequently litigated questions arising under article 2 of the Uniform Commercial Code¹ ("the Code") concerns what a buyer of goods may do with the goods in his possession after he has notified the seller that they do not conform to the contract and that he desires to return them to the seller and cancel the contract. If the seller agrees to retake possession of the goods and restores to the buyer any payments made under the contract, the contract is cancelled.² Frequently, however, the seller claims that the goods conform to the contract and refuses to retake possession of the goods. At this point, the buyer is faced with a number of Code provisions requiring him to do certain things with respect to the goods and prohibiting him from doing others. These provisions are drafted in very broad language and the attorney advising a buyer of his rights and obligations must resort to the case law construing these provisions. Unfortunately, courts interpreting these provisions have not developed a coherent or consistent analysis, which has resulted in essentially irreconcilable results and an almost total lack of predictability.

This article will explore the rights and obligations of buyers with respect to goods in their possession after they have "rightfully" rejected those goods or have "justifiably" revoked acceptance.³ After a brief discussion of the historical development of these rights and obligations at common law and

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1. All references to the Uniform Commercial Code are to the 1978 official text, unless otherwise indicated.

2. Although "cancellation" puts an end to the contract, the buyer still retains any remedy for breach, U.C.C. § 2-106(4), including the right to sue for damages under § 2-712 or § 2-713. 3A R. DUESENBERG & L. KING, BENDER'S UNIFORM COMMERCIAL CODE SERVICE § 14.02[1], at 14-7 (1985).

3. For a discussion of these curious adjectives, see J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 7-3 (2d ed. 1980) [hereinafter cited as WHITE & SUMMERS].

under the Uniform Sales Act,⁴ the article will discuss the applicable provisions of the Code dealing with the buyer's remedies of rejection and revocation of acceptance. The initial discussion will deal with the obligations of buyers who do not have a security interest in the rejected goods. The bulk of this discussion will deal with the question of what a buyer may do with rejected goods in his possession without forfeiting his claim that he has rejected the goods or revoked his acceptance of them. The remainder of the article will deal with the rights and obligations of a buyer who has a security interest in rejected 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."⁵

I. PRE-CODE LAW

A. *Common Law*

At common law, a buyer of nonconforming goods could inspect them and, if the nonconformity was discovered by such inspection, either return the goods to the seller or hold them for a reasonable time subject to the order of the seller.⁶ If the buyer was unable to discover the nonconformity until after some prolonged use of the goods, most American jurisdictions allowed the buyer the remedy of rescission,⁷ a cancellation of the contract which was intended to return both the buyer and the seller to the pre-contract status quo.⁸ Where rescission was sought, several courts held that the buyer's continued use of the goods after discovery of the nonconformity amounted to a waiver of the right to rescind.⁹ Many of these courts noted that the buyer's continued use of the goods after discovery of the nonconformity had necessarily resulted in a deterioration of the value of the goods, thus making impossible a return to the pre-contract status quo.¹⁰ Nevertheless, rescission was also denied in cases where the duration of the use and the nature of the goods made it extremely unlikely that there was any deterio-

4. The Uniform Sales Act, the forerunner of article 2 of the Uniform Commercial Code, was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and was ultimately enacted in 37 states.

5. U.C.C. § 2-711(3).

6. C. TIEDEMAN, *THE LAW OF SALES* 293 (1891).

7. *Id.* at 296.

8. *E.g.*, *Wall v. Zynda*, 283 Mich. 260, 265, 278 N.W. 66, 68 (1938); 17 AM. JUR. 2D *Contracts* § 512 (1964); Note, *Buyer's Continued Use of Goods After Revocation of Acceptance Under the Uniform Commercial Code*, 24 WAYNE L. REV. 1371 (1978).

9. *E.g.*, *The Venezuela*, 173 F. 834 (W.D.N.Y. 1909); *America Theater Co. v. Siegel, Cooper & Co.*, 221 Ill. 145, 77 N.E. 588 (1906); *Noel & McGinnis v. Kaufman Buggy Co.*, 32 Ky. 576, 106 S.W. 237 (1907). See generally Annot., 41 A.L.R.2D 1173 (1955) (supplementing Annot., 77 A.L.R. 1165 (1932)).

10. *E.g.*, *Twin City Motor Co. v. Pettit*, 177 So. 814 (La. Ct. App. 1937); *Hughes v. Wm. F. V. Neumann & Sons*, 253 Mich. 386, 235 N.W. 192 (1931).

ration in value.¹¹ Other courts held that any use of the goods by the buyer after discovery of their nonconformity negated any attempted rescission on the theory that the buyer was a bailee solely for the benefit of the seller and hence should not use the goods for his own benefit,¹² on the theory that continued use by the buyer constituted an election to accept the goods despite their nonconformity,¹³ or on the theory that any subsequent use was inconsistent with the revesting of title in the seller at the time notice of rescission was received by the seller.¹⁴

There were some exceptions to this general rule in situations where the seller had authorized or requested the buyer to continue to use the goods,¹⁵ where the seller was attempting to repair the goods,¹⁶ where the use was for a very short period of time with no discernible depreciation in the value of the goods,¹⁷ or where the seller had previously refused the buyer's tender of the goods.¹⁸ Despite these exceptions, a buyer who made even the slightest use of goods after giving notice of rescission did so at his peril.

B. *The Uniform Sales Act*

Under the Uniform Sales Act, a buyer of nonconforming goods who sought to return the goods and cancel the contract was also granted the remedy of rescission. The Uniform Sales Act provided that the buyer could

[r]escind the contract to sell or the sale and refuse to receive the goods, or if the goods have already been received, return them or offer to return them to the seller and recover the price or any part thereof which has been paid.¹⁹

11. *E.g.*, *Fox v. Wilkinson*, 133 Wis. 337, 113 N.W. 669 (1907) (use of engine for one-and-one-half days); *Palmer v. Banfield*, 86 Wis. 441, 56 N.W. 1090 (1893) (use of harvester for one day).

12. *E.g.*, *Sturgis v. Whisler*, 145 Mo. App. 148, 130 S.W. 111 (1910).

13. *E.g.*, *Fred W. Wolf Co. v. Monarch Refrigerating Co.*, 252 Ill. 491, 96 N.E. 1063 (1911).

14. *E.g.*, *Comer v. Franklin*, 169 Ala. 573, 53 So. 797 (1910).

15. *E.g.*, *Laumeier v. Dolph*, 145 Mo. App. 78, 130 S.W. 360 (1910), *aff'd on rehearing*, 171 Mo. App. 81, 153 S.W. 510 (1913).

16. *Crabtree v. Potts*, 108 Ill. App. 627 (1902).

17. *Hudson v. Roos*, 76 Mich. 173, 42 N.W. 1099 (1899) (mirrors placed in buyer's store for a day or two before buyer could notify seller of his intention to rescind). In *Fox v. Wilkinson*, 133 Wis. 337, 341, 113 N.W. 669, 671 (1907), the court said:

Doubtless there may be situations where some use of an article after unsatisfactoriness is fully established is unavoidable to protect the purchaser from injury or serious inconvenience resulting from the very predicament in which he is thrown by making the trial, as for example, one who discovers defects in the trial drive of a horse, and who merely continues the use to return to the starting point. In such case the continued use might well fail to evince any intent to retain the article.

18. *Schwartz v. Church of the Holy Cross*, 60 Minn. 183, 62 N.W. 266 (1895) (use by church of one of several altars to celebrate mass after frequent refusals by seller to remove the altars).

19. UNIF. SALES ACT § 69(1)(d) (1906) (act superseded by Uniform Commercial Code 1952).

If the seller refused to retake the goods after the buyer's tender, the buyer was "deemed to hold the goods as bailee for the seller,"²⁰ subject to the buyer's lien to secure repayment of any portion of the purchase price which had been paid.²¹

In order for a buyer successfully to rescind the contract for sale, the buyer had to notify the seller of his intention to rescind within a reasonable time and was required to return, or offer to return, the goods to the seller in substantially as good condition as they were in when the buyer received them.²² If a buyer elected to pursue the remedy of rescission, it was generally held that the remedy was exclusive and precluded the buyer from bringing an action for damages.²³

The requirements that the buyer return the goods to the seller in substantially as good condition as when he received them and that the buyer hold the goods as the bailee for the seller placed serious limitations on what the buyer could do with the goods after giving notice of rescission to the seller. Most courts construing the Uniform Sales Act agreed with the pre-Act cases that any substantial use of the goods by the buyer after giving notice of rescission constituted a waiver of the buyer's right to rescind the contract.²⁴ Also, where a buyer who purchased goods for resale continued to offer the goods for sale and to sell them to its customers after giving the seller notice of rescission, the courts held that the buyer had waived its right to rescission.²⁵ Likewise, the buyer of nonconforming goods who leased the goods to a lessee after discovering the nonconformity was prevented from invoking the remedy of rescission.²⁶ However, some courts allowed the buyer to rescind where the buyer's continued use after rescission was "slight."²⁷ With this narrow exception, however, a buyer who continued to use the goods after giving notice of rescission was almost universally denied rescission.

II. THE CODE'S REMEDIES OF REJECTION AND REVOCATION OF ACCEPTANCE

A. Introduction

The drafters of the Code consciously chose to abandon the use of the term "rescission" when describing the buyer's remedies with respect to

20. *Id.* § 69(5).

21. *Id.*

22. *E.g.*, Fuller v. Fried, 57 N.D. 824, 224 N.W. 668 (1928).

23. 3 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT § 612, at 362 & n.4 (rev. ed. 1948). Some courts allowed recovery of expenses incurred in acquiring or using the goods, apparently under a restitutionary theory. *Id.* § 612(a), at 365-66.

24. *E.g.*, Modern Home Utils. v. Garrity, 121 Conn. 651, 186 A. 639 (1936); Advance-Rumley Thresher Co. v. Wharton, 211 Iowa 264, 233 N.W. 673 (1930); Powers v. Rosenbloom, 143 Me. 361, 62 A.2d 531 (1948); Alexander Carpet Co. v. Worms, 269 A.D. 665, 53 N.Y.S.2d 4 (1944); Knudsen Music Co. v. Masterson, 121 Utah 252, 240 P.2d 973 (1952); Hall v. Hodgdon, 114 Vt. 63, 39 A.2d 195 (1944).

25. Reno Sales Co. v. Pritchard Indus., 178 F.2d 279 (7th Cir. 1949) (applying Illinois law).

26. Peterson Oven Co. v. Guarino, 221 A.D. 146, 223 N.Y.S. 107 (1927).

27. Gottsman v. Jeffrey-Nichols Co., 268 Mass. 10, 167 N.E. 229 (1929).

nonconforming goods. This omission is explained in comment 1 to section 2-608:

The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract.²⁸

Instead, the Code refers to a buyer's remedies as "rejection" and "revocation of acceptance." While there are procedural and substantive differences between rejection and revocation of acceptance, which are discussed below, the effect of the two remedies is essentially the same: the buyer is relieved of his obligation to pay the unpaid contract price²⁹ and is entitled to recover any payments made to the seller.³⁰ It is also important to note the economic consequences of a rightful rejection or justifiable revocation of acceptance. When the buyer properly exercises these remedies, any loss resulting from depreciation of the goods is thrown back on the seller.³¹ The position of buyers who have rejected nonconforming goods or revoked their acceptance of such goods should be contrasted with buyers who have accepted the goods and sue for damages for breach. The latter buyers can recover "the loss resulting in the ordinary course of events from the seller's breach"³² and, in the event of a breach of warranty, the measure of damages is usually "the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted."³³ However, a buyer who has accepted the goods and sues for damages is not entitled to recover damages for any depreciation or decline in the market value of the goods which did not result from the alleged nonconformity.

Thus, the remedies of rejection and revocation of acceptance are of considerable utility to a buyer of nonconforming goods. That is the good news for the buyer; the bad news is that the rejecting or revoking buyer must be careful to follow the procedures required by the Code for the exercise of these remedies, or forfeit his right to invoke them. Hence, a brief discussion

28. U.C.C. § 2-608 comment 1. There is some question whether the pre-Code remedy of rescission remains a viable remedy for the buyer of nonconforming goods. Professors White and Summers conclude that, absent mistake, fraud, duress, or the like, the Code preempts the field and the buyer's only remedies in regard to return of the goods are those specified in article 2. WHITE & SUMMERS, *supra* note 3, § 8-1, at 295. *Accord* Koperski v. Husker Dodge, Inc., 208 Neb. 29, 302 N.W.2d 655, 31 U.C.C. Rep. Serv. 113 (1981). *Contra* Sarnecki v. Al Johns Pontiac, 56 Luz. Leg. Reg. Reports 293, 3 U.C.C. Rep. Serv. 1121 (Pa. Ct. C.P. 1966). A number of courts have suggested that the nomenclature of the remedy is irrelevant. *E.g.*, Gilson v. Twin Trailer Sales of Sharon, Inc., 53 Pa. D. & C.2d 311, 10 U.C.C. Rep. Serv. 120 (Pa. C.P. 1971).

29. WHITE & SUMMERS, *supra* note 3, § 8-1, at 294.

30. U.C.C. § 2-711(1).

31. WHITE & SUMMERS, *supra* note 3, § 8-1, at 294-95.

32. U.C.C. § 2-714(1).

33. U.C.C. § 2-714(2).

of the required procedures for a rightful rejection or justifiable revocation of acceptance follows.

B. Procedural Requirements for Rightful Rejection

The general requirements governing the manner and effect of rightful rejection are set forth in section 2-602 of the Code. That section contains two principal procedural requirements for a rightful rejection: timeliness and notice.

The rejection must occur within a reasonable time after the goods are delivered or tendered.³⁴ What constitutes a reasonable time depends on the nature, purpose and circumstances of the transaction.³⁵ The parties to the sales contract may, by agreement,³⁶ fix a time within which rejection must occur, and such agreement will be given effect if it is not "manifestly unreasonable."³⁷ Nevertheless, the Code provides that the buyer does not accept goods by failing to make an effective rejection until the buyer has had a "reasonable opportunity" to inspect the goods.³⁸

In addition to the right to a reasonable opportunity to inspect the goods, the reasonableness of the time of rejection may also be extended by the seller's promises to cure a defect which would otherwise give rise to a right to reject. In *Jones v. Abriani*,³⁹ buyers purchased a mobile home which failed to conform to the contract in various ways, both apparent and hidden. The buyers sought to refuse delivery, but were told by the seller's agent that they would forfeit their down payment if they refused delivery. Having taken possession of the mobile home, the buyers made numerous complaints to the seller, who repeatedly assured the buyers that the defects in the mobile home would be cured. About one year after first taking possession, the buyers filed an action seeking to rescind the contract. The court held that this one-year period was a reasonable time in which to reject.⁴⁰ The court noted that the buyers were entitled to "try out" the goods to discover defects in the mobile home for a reasonable period before acceptance occurred⁴¹ and that this was especially true where the seller had assured the buyer that any defects would be remedied.⁴² Most other courts which have addressed

34. U.C.C. § 2-602(1).

35. U.C.C. § 1-204(2).

36. U.C.C. § 1-201(3) defines the term "agreement." In determining the reasonableness of the time of rejection, course of dealing, usage of trade, and course of performance are relevant. U.C.C. § 1-204 comment 2.

37. U.C.C. § 1-204(1). Comment 1 to this section provides that the parties may fix "any time which is not obviously unfair as judged by the time of contracting."

38. U.C.C. § 2-606(1)(b).

39. 169 Ind. App. 556, 350 N.E.2d 635, 19 U.C.C. Rep. Serv. 1102 (1976).

40. *Id.* at 568, 350 N.E.2d at 643-44, 19 U.C.C. Rep. Serv. at 1112-13.

41. *Id.*, 350 N.E.2d at 643, 19 U.C.C. Rep. Serv. at 1112.

42. *Id.*, 19 U.C.C. Rep. Serv. at 1112-13.

the issue agree that a seller's promise to repair extends the time in which a rejection will be found to be reasonable.⁴³

In addition to the requirement that rejection occur within a reasonable time after tender or delivery, section 2-602 requires that the buyer seasonably notify the seller of the rejection. At the outset, it should be noted that the content of the notification of rejection requires more of the buyer than does the notice of breach required to preserve the buyer's claim for damages pursuant to section 2-607 of the Code. Under section 2-607, notice of breach need only "be sufficient to let the seller know that the transaction is still troublesome and must be watched."⁴⁴ Generally, however, the Code does not require a rejecting buyer to specify the nonconformity unless a merchant seller makes a written demand on a merchant buyer for such particulars pursuant to section 2-605(1)(b), or unless the defect could have been cured by the seller if stated seasonably. An official comment to section 2-605 indicates that this section is designed to permit the buyer to give "quick and informal notice of defects in a tender without penalizing him for omissions in his statement"⁴⁵ unless the seller has been prejudiced by a misleading statement designed to prevent his opportunity to cure.⁴⁶

Despite this seemingly lenient view of what type of notice is required, a number of early cases under the Code found several types of notice to be insufficient. Some courts held that the notice of rejection had to be in writing.⁴⁷ Other courts held that an offer by the buyer to return the goods was not sufficient notice.⁴⁸ Several courts took the view that the notice of rejection must be "clear and unambiguous."⁴⁹

More recent cases, however, have demanded considerably less formality in the buyer's notice of rejection. In *Western Conference Resorts, Inc. v. Pease*,⁵⁰ the court held that telephone calls from the buyers of an airplane to the seller's agent, which included the statement, "I don't think I want this airplane," constituted sufficient notice of rejection. In *Kabco Equipment Specialists v. Budgetel, Inc.*,⁵¹ the buyer of a commercial washing machine

43. *E.g.*, *Tiger Motor Co. v. McMurtry*, 284 Ala. 283, 224 So. 2d 638, 6 U.C.C. Rep. Serv. 608 (1969); *Lanners v. Whitney*, 247 Or. 223, 428 P.2d 398, 4 U.C.C. Rep. Serv. 369 (1967).

44. U.C.C. § 2-607 comment 4. *Cf.* *Solar Kinetics Corp. v. Joseph T. Ryerson & Son, Inc.*, 488 F. Supp. 1237, 29 U.C.C. Rep. Serv. 85 (D. Conn. 1980); *Allis-Chalmers Corp. v. Sygitowicz*, 18 Wash. App. 658, 571 P.2d 224, 22 U.C.C. Rep. Serv. 1151 (1977).

45. U.C.C. § 2-605 comment 1.

46. *Id.*

47. *E.g.*, *Julian C. Cohen Salvage Corp. v. Eastern Elec. Sales Co.*, 205 Pa. Super. 26, 206 A.2d 331, 2 U.C.C. Rep. Serv. 432 (1965). *Contra* *Melms v. Mitchell*, 266 Or. 208, 512 P.2d 1336, 13 U.C.C. Rep. Serv. 223 (1973) (oral notice sufficient).

48. *E.g.*, *Grossman v. D'Or*, 98 Ill. App. 2d 198, 240 N.E.2d 266 (1968); *Akron Brick & Block Co. v. Moniz Eng'g Co.*, 365 Mass. 92, 310 N.E.2d 128, 14 U.C.C. Rep. Serv. 563 (1974).

49. *E.g.*, *Shreve v. Castro Trailer Sales, Inc.*, 150 W. Va. 669, 149 S.E.2d 238, 31 U.C.C. Rep. Serv. 796 (1966).

50. 668 P.2d 973, 36 U.C.C. Rep. Serv. 131 (Colo. Ct. App. 1983).

51. 2 Ohio App. 3d 58, 440 N.E.2d 611, 35 U.C.C. Rep. Serv. 140 (1981).

was deemed to have given sufficient notice of rejection when it filed suit against the seller seeking return of the purchase price. Finally, in *Steinmetz v. Robertus*,⁵² a buyer of a defective irrigation pump was deemed to have given sufficient notice of rejection when he twice called the seller and complained that the pump was not working properly, when he complained to the seller's agent three times about unsuccessful attempts at repair, and when he refused to pay any part of the purchase price for a period of several months after the sale.

Although this liberalizing trend has its advantages, particularly in recognizing the validity of oral notices of rejection,⁵³ the substance of the notices in these cases is troubling. The act of rejection is one that significantly affects the relative rights and obligations of both buyers and sellers. The principal virtue of rejection is that the buyer can cancel his contractual obligations and throw the goods back on the seller. Thus, at a minimum, the notice of rejection should clearly indicate that the buyer views his contractual obligations as having been terminated due to the nonconformity of the goods and that the buyer does not wish to keep the goods.⁵⁴ Merely complaining about the quality of the goods, without more, does not adequately inform the seller that the buyer does not wish to retain the goods.

C. Requirements for Justifiable Revocation of Acceptance

In order for a revocation of acceptance to be "justifiable," the nonconformity must substantially impair the value of the goods to the buyer.⁵⁵ Whether such substantial impairment of value exists is generally a question of fact.⁵⁶ In addition to the requirement of substantial impairment, the buyer's acceptance must have been based on either the reasonable assumption that the nonconformity would be cured and it has not been seasonably cured, or the buyer must have accepted the goods without discovery of the nonconformity and his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.⁵⁷

52. 196 Mont. 311, 637 P.2d 31, 32 U.C.C. Rep. Serv. 1441 (1981).

53. Section 2-602 does not, by its terms, require written notice. Section 1-201(26) provides: "A person 'notifies' or 'gives' a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it." When the drafters of article 2 intended to require written notice, they made such intent clear. *E.g.*, U.C.C. §§ 2-605(1)(b) (written request for a full and final statement of defects), 2-607(5)(a) (written notice of litigation by buyer seeking to "vouch in" a seller), 2-609(1) (written request for adequate assurance of due performance), 2-616(1) (written notification from buyer to seller claiming excuse due to impracticability).

54. *E.g.*, *Connecticut Investment Casting Corp. v. Made-Rite Tool Co.*, 382 Mass. 603, 416 N.E.2d 966, 31 U.C.C. Rep. Serv. 531 (1981).

55. U.C.C. § 2-608(1).

56. *Erling v. Homera, Inc.*, 298 N.W.2d 478, 481, 30 U.C.C. Rep. Serv. 181, 186 (N.D. 1980); *Frontier Mobile Home Sales, Inc. v. Trigleth*, 256 Ark. 101, 103-04, 505 S.W.2d 516, 517, 14 U.C.C. Rep. Serv. 411, 414 (1974).

57. U.C.C. § 2-608(1)(a), (b).

In order to be "justifiable," a revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it,⁵⁸ and the revocation is not effective until the buyer notifies the seller of the revocation.⁵⁹ Thus, notice must be given within a reasonable time after the buyer discovers or should have discovered the nonconformity. Essentially the same standards of timeliness and content of the notice apply to revocation of acceptance as to rejection,⁶⁰ except that the reasonableness of the time of notice of revocation is usually longer due to the assumption that the parties will usually spend some time seeking an adjustment of the dispute before revocation of acceptance occurs.⁶¹ A failure to give notice of the revocation within a reasonable time means that there has been no justifiable revocation of acceptance, and thus the buyer has accepted the goods and must pay the contract price.⁶² The buyer, however, retains an action for damages with regard to any nonconformity of the accepted goods.⁶³ Assuming that the prerequisites for a justifiable revocation of acceptance have occurred, the buyer has the same rights and duties with respect to the goods as if he had rejected them.⁶⁴

The remainder of this article proceeds on the premise that the buyer of nonconforming goods has complied with all of the procedures for a rightful rejection or a justifiable revocation of acceptance. Furthermore, it will be assumed that the rejection or revocation of acceptance was also substantively justified—that is, in the case of rejection, the goods failed to conform to the contract and, in the case of revocation of acceptance, the nonconformity substantially impaired the value of the goods to the buyer. The remainder of the article will focus on the buyer's rights and obligations with respect to the goods after the rejection or revocation of acceptance.

III. THE OBLIGATION TO HOLD THE GOODS WITH REASONABLE CARE AT THE SELLER'S DISPOSITION

Section 2-602(2)(b) of the Code provides that a buyer of goods who has physical possession of them, but who does not have a security interest in the goods pursuant to section 2-711(3),⁶⁵ "is under a duty after rejection to

58. U.C.C. § 2-608(2).

59. *Id.*

60. *See supra* text accompanying notes 34-54.

61. U.C.C. § 2-608 comment 4.

62. U.C.C. § 2-607(1).

63. U.C.C. § 2-607(2). *See* U.C.C. § 2-714.

64. U.C.C. § 2-608(3). The remainder of this article will employ the term "rejecting buyer" to describe both a buyer who has rightfully rejected nonconforming goods and a buyer who has justifiably revoked his acceptance of such goods. If the rights or obligations of a buyer vary depending on whether he rejected the goods or revoked his acceptance of them, such differences will be noted.

65. For a discussion of the rights and obligations of buyers who do not have such a security interest in goods, see *infra* text accompanying notes 203-346.

hold them with reasonable care . . . for a time sufficient to permit the seller to remove them."⁶⁶ This section disposes with the Uniform Sales Act's requirement that a buyer seeking to rescind a sales contract must tender the goods back to the seller.⁶⁷ As one court put it, the seller has "delivered the goods and . . . he should remove them or let them remain at his peril."⁶⁸ Even a post-rejection promise by the buyer to return the goods to the seller has been held to be unenforceable as being purely gratuitous.⁶⁹

The obligation to hold the goods with reasonable care does not extend indefinitely, but is imposed on the buyer only for a time sufficient to allow the seller to remove them.⁷⁰ At the expiration of that time, it appears that even a casualty to the goods directly resulting from the buyer's negligence would not prejudice the buyer's ability to claim a rightful rejection or a justifiable revocation of acceptance. In *Askco Engineering Corp. v. Mobil Chemical Co.*,⁷¹ the buyer of defective polyethylene, who had stored the goods for nine months after giving notice of rejection and then buried the goods, was held to have complied with the obligations imposed under section 2-602(2)(b), although the court did point out that the polyethylene was "worthless" at the time of the burial.

What actions constitute reasonable care is purely a factual question,⁷² but the cases do provide some guidance about appropriate conduct. A buyer of a defective boat who stored the boat in a marina and procured an insurance policy on the boat was held to have exercised reasonable care with respect

66. U.C.C. § 2-602(2)(b). Because a buyer who revokes his acceptance has the same rights and duties with respect to the goods as if he had rejected them, U.C.C. § 2-608(3), § 2-602(2)(b) also imposes this duty on revoking buyers.

67. See UNIF. SALES ACT § 69(3) (1906) (act superseded by Uniform Commercial Code 1952). See, e.g., *Mobile Home Sales Management, Inc. v. Brown*, 115 Ariz. App. 11, 562 P.2d 1378, 21 U.C.C. Rep. Serv. 1040 (1977); *Frank's Maintenance & Eng'g, Inc. v. C.A. Roberts Co.*, 86 Ill. App. 3d 980, 408 N.E.2d 403, 30 U.C.C. Rep. Serv. 163 (1980); *Art Hill, Inc. v. Heckler*, 547 N.E.2d 242, 37 U.C.C. Rep. Serv. 697 (Ind. Ct. App. 1983); *Arkin Imports, Inc. v. Dorothy's Exclusive Fashions, Inc.*, 12 U.C.C. Rep. Serv. 871 (N.Y. Civ. Ct. 1973); *Campbell v. Pollack*, 101 R.I. 223, 221 A.2d 615, 3 U.C.C. Rep. Serv. 703 (1966). But see *Underwood v. Monte Asti Buick Co.*, 73 Pa. D. & C.2d 773, 20 U.C.C. Rep. Serv. 657 (Pa. C.P. 1976).

68. *Garfinkel v. Lehman Floor Covering Co.*, 60 Misc. 2d 72, 302 N.Y.S.2d 167, 6 U.C.C. Rep. Serv. 915 (1969).

69. *Presto Mfg. Co. v. Formetal Eng'g Co.*, 46 Ill. App. 3d 7, 360 N.E.2d 510, 21 U.C.C. Rep. Serv. 1299 (1977). One commentator has suggested that such a promise should be enforceable as a modification of the contract, even absent consideration, pursuant to § 2-209. Whaley, *Tender, Acceptance, Rejection and Revocation—The U.C.C.'s "Tarr"-Baby*, 24 DRAKE L. REV. 52, 67 n.67 (1974). However, because a buyer rejecting goods or revoking his acceptance of goods is exercising his right of cancellation, thereby terminating contractual obligations, it would seem that there is no contract to modify. Yet, if the contract of sale itself contains a provision requiring the buyer to return the goods, it would be enforceable under § 2-719, absent other considerations such as the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Pub. L. No. 93-637, 88 Stat. 2183 (1975).

70. *Graybar Elec. Co. v. Shook*, 17 N.C. App. 81, 193 S.E.2d 392, 11 U.C.C. Rep. Serv. 1189 (1972), *aff'd*, 283 N.C. 213, 195 S.E.2d 514, 12 U.C.C. Rep. Serv. 681 (1973).

71. 535 S.W.2d 893, 19 U.C.C. Rep. Serv. 1119 (Tex. Civ. App. 1976).

72. Whaley, *supra* note 69, at 66.

to the boat.⁷³ A buyer of a car who parked it in front of his home after giving notice of rejection has been deemed to have exercised reasonable care.⁷⁴ Thus, it appears that storage of goods in a customary place constitutes the exercise of reasonable care.

If the seller fails or refuses to pick up the goods or fails to give reasonable instructions to a merchant buyer within a reasonable time after notification of rejection or revocation of acceptance, "the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in [section 2-603]."⁷⁵ The Code specifically provides that the buyer's exercise of these options is neither an acceptance of the goods nor a conversion of them.⁷⁶ The options apply regardless of whether the buyer is a merchant.⁷⁷ Although the official comment to section 2-604 states that these three options are "intended to be not exhaustive but merely illustrative," courts have taken differing views of a buyer's exercising other options with respect to rejected goods. For example, in *Frank's Maintenance & Engineering, Inc. v. C.A. Roberts Co.*,⁷⁸ a buyer of steel tubing which was chipped, marred, and allegedly worthless scrapped the entire shipment sixty days after sending notice of rejection to the seller. The seller alleged that the buyer's scrapping the steel tubing was not authorized by section 2-604 and constituted an acceptance of the goods under section 2-606(1)(c). The court disagreed and noted that the three options listed in section 2-604 are not exclusive and that a "rule of reasonableness" should apply.⁷⁹

However, in *Bowen v. Young*,⁸⁰ the buyer of a defective mobile home continued to live in the mobile home for a year after sending the seller notice of revocation of acceptance and spent about \$600 to make the furnace conform to the contract. The court noted that the buyer had failed to exercise any of the three options listed in section 2-604 and found the buyer's occupancy and repair of the mobile home were acts inconsistent with the seller's ownership constituting an acceptance of the mobile home under section 2-606.⁸¹ Thus, the court strongly implied that a buyer may only

73. *Werner v. Montana*, 117 N.H. 721, 378 A.2d 1130, 22 U.C.C. Rep. Serv. 894 (1977).

74. *Colonial Dodge, Inc. v. Miller*, 116 Mich. App. 78, 322 N.W.2d 549, 34 U.C.C. Rep. Serv. 123 (1982), *vacated*, 121 Mich. App. 466, 328 N.W.2d 678, 35 U.C.C. Rep. Serv. 438 (1983), *rev'd*, 420 Mich. 452, 362 N.W.2d 704, 40 U.C.C. Rep. Serv. 1 (1984); *Yates v. Clifford Motors, Inc.*, 283 Pa. Super. 293, 423 A.2d 1262, 30 U.C.C. Rep. Serv. 967 (1980).

75. U.C.C. § 2-604.

76. *Id.*

77. The official comment to § 2-604 states: "This is not a 'merchant's' section and the options are pure options given to merchant and non-merchant buyers alike." *Id.*, comment.

78. 86 Ill. App. 3d 980, 408 N.E.2d 403, 30 U.C.C. Rep. Serv. 163 (1980).

79. *Id.* at 986-87, 408 N.E.2d at 408, 30 U.C.C. Rep. Serv. at 171. *See also Askco Eng'g Corp. v. Mobil Chem, Corp.*, 535 S.W.2d 893, 19 U.C.C. Rep. Serv. 1119 (Tex. Civ. App. 1976) (buyer's burial of defective polyethylene after seller refused to accept a reshipment not an acceptance of the goods).

80. 507 S.W.2d 600, 14 U.C.C. Rep. Serv. 403 (Tex. Civ. App. 1974).

81. *Id.* at 603-05, 14 U.C.C. Rep. Serv. at 407-09.

exercise one of the three options listed in section 2-604 and that any other action with respect to the goods constitutes an acceptance. At least one commentator agrees that these three alternatives are exclusive and goes even further to suggest that a buyer *must* do one of these three things.⁸² This view cannot be reconciled with the language of the official comment to section 2-604 that the three listed options are “not exhaustive”;⁸³ it is also inconsistent with the language of section 2-602(2)(c) that, aside from the buyer’s obligation to hold the goods with reasonable care at the seller’s disposition for a time sufficient to permit the seller to remove them, “the buyer has no further obligations with regard to goods rightfully rejected.”⁸⁴ Finally, the view that a buyer must exercise one of these three options ignores the fact that section 2-604 uses the permissive “may” while the immediately preceding section placing additional obligations on certain merchant buyers uses the mandatory phrase “[the] buyer . . . is under a duty . . . to follow any reasonable instructions.”⁸⁵ Thus, where the drafters of the Code intended to impose mandatory duties on buyers, they had no difficulty making this intention quite clear.

Nor is the former view, that any “reasonable” action taken with regard to the goods is proper, a particularly satisfactory way to analyze these cases. First, if the drafters had intended to utilize a standard of reasonableness as a required standard of conduct, one suspects they would have done so explicitly.⁸⁶ Moreover, courts following this “rule of reasonableness” have failed to articulate what facts ought to be considered in making the reasonableness determination.

A more appropriate analysis would be to recognize that a buyer is not limited to the three options listed in section 2-604, but also to recognize that some actions by a buyer are so inconsistent with the remedy of rejection or revocation of acceptance as to preclude a buyer from claiming that the goods were nonconforming. Viewed in this light, cases like *Frank’s Maintenance* make sense. A buyer who claims the goods to be worthless and destroys them is not acting inconsistently with his claim that the goods are nonconforming. However, where a buyer continues to use the goods for their intended purpose after rejection, such action may be inconsistent with the claim that the goods are nonconforming.

If a buyer does choose to exercise one of the three options listed in section 2-604—storage, reshipment, or resale—the buyer is entitled to reimbursement for his reasonable expenses in storing,⁸⁷ reshipping,⁸⁸ or reselling the goods,

82. 3A B. DUESENBERG & L. KING, *supra* note 2, § 14.02(1)(c)(i), at 14-19 (1985).

83. U.C.C. § 2-604 comment.

84. U.C.C. § 2-602(2)(c).

85. U.C.C. § 2-603(1).

86. A number of Code sections specifically make reasonableness a standard of conduct. *E.g.*, U.C.C. §§ 1-102(3), 2-206(1)(a), 2-206(2), 2-513(1), 2-515(a), 2-602(2)(b), 2-603(1).

87. *Pacific Marine Schwabcher, Inc. v. Hydroswift Co.*, 525 P.2d 615, 15 U.C.C. Rep. Serv. 354 (Utah 1974).

88. *Askco Eng’g Co. v. Mobil Chem. Co.*, 535 S.W.2d 893, 19 U.C.C. Rep. Serv. 1119 (Tex. Civ. App. 1976).

including, in the case of resale, a sales commission such as is usual in the trade or, if there is no customary sales commission, a reasonable commission not to exceed ten percent of the gross proceeds of such resale.⁸⁹

A buyer who resells nonconforming goods pursuant to section 2-604 does not, apparently, have to comply with the requirements of section 2-706 governing resale of goods by a seller after a buyer's breach, which are made applicable to rejecting buyers who have a security interest in the goods pursuant to section 2-711(3).⁹⁰ Thus, the buyer need not give notice to the seller of his intention to resell,⁹¹ and he may resell at a public or private sale using his sole discretion and is not bound to comply with the standard that every aspect of the resale must be commercially reasonable. The sole apparent limitation on the buyer's conduct in reselling the goods is that the resale must be in good faith.⁹²

However, because the buyer must resell "for the seller's account," it should be incumbent on the buyer to remit to the seller the proceeds of the sale, less expenses and commissions to which the buyer is entitled. A buyer who fails to do this, or who fails to keep adequate records of the resale, runs the risk of a court concluding that the sale was for the buyer's account, an act which most courts have found to be inconsistent with the seller's ownership and thus an acceptance of the goods pursuant to section 2-606(1)(c).⁹³

IV. ADDITIONAL OBLIGATIONS OF MERCHANT BUYERS TO FOLLOW REASONABLE INSTRUCTIONS AND TO SELL PERISHABLE GOODS

Section 2-603(1) of the Code provides:

Subject to any security interest in the buyer (subsection (3) of Section 2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instruction to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.⁹⁴

89. U.C.C. § 2-603(2).

90. U.C.C. § 2-711(3). For a discussion of the rights and obligations of buyers who do have a security interest in such goods, see *infra* text accompanying notes 203-346.

91. At least one court has assumed that the requirements of § 2-706 apply to reselling buyers under § 2-604. *North Am. Steel Co. v. Siderius*, 75 Mich. App. 391, 403, 254 N.W.2d 899, 905, 22 U.C.C. Rep. Serv. 62, 69 (1977).

92. The text of § 2-604 makes no reference to the good-faith standard, but the official comment refers to buyers who have "taken steps towards realization on or preservation of the goods in good faith." U.C.C. § 2-604 comment (emphasis added).

93. See *infra* text accompanying notes 187-94.

94. U.C.C. § 2-603(1).

The term "merchant" is defined in section 2-104(1) as "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"⁹⁵ An official comment to section 2-104 provides that the use of the term "merchant" in section 2-603 is meant to apply "to persons who are merchants under either the 'practices' or 'goods' aspect of the definition of merchant."⁹⁶ Thus, the buyers subject to the duties of section 2-603 are not limited to persons who deal in goods of the kind involved in the sale.

No reported case has confronted the question of who is encompassed within the phrase "merchant buyer" under section 2-603 and a detailed discussion of when a person may be deemed a "merchant" is beyond the scope of this article.⁹⁷ However, the prudent attorney should keep in mind that the definition of "merchant" relates to a person who has specialized knowledge of *either* the practices or goods involved in the transaction. Thus, in a recent case involving the timeliness of a buyer's notice of breach, the court held that a joint venture of experienced sewer contractors was a "merchant" because it had specialized knowledge of business practices in the construction industry, even though it had no specialized knowledge of the particular good purchased.⁹⁸

Assuming that the buyer is a "merchant," the buyer's additional duties under section 2-603 only arise when "the seller has no agent or place of business in the market of rejection."⁹⁹ The Code provides that general principles of agency supplement its terms,¹⁰⁰ and the reported cases have disclosed no difficulty arising from agency questions. However, the term "market of rejection" is not defined. Two problems could arise from the use of this term: (1) what is the size of the "market of rejection"?; and (2) what is the location of the "market of rejection"?

There are two reported cases giving some guidance on the question of the size of the "market of rejection." In *Traynor v. Walters*,¹⁰¹ sellers located in Pennsylvania shipped nonconforming Christmas trees to a merchant buyer in New York City. The court concluded that the merchant buyer was subject

95. U.C.C. § 2-104(1).

96. U.C.C. § 2-104 comment 2.

97. The literature in this area is voluminous. See generally Dolan, *The Merchant Class of Article 2: Farmers, Doctors & Others*, 1977 WASH. U.L.Q. 1; Henkel & Shedd, *Article 2 of the Uniform Commercial Code: Is a Farmer a "Merchant" or a "Tiller of the Soil"?*, 18 AM. BUS. L.J. 323 (1980); Newell, *The Merchant of Article 2*, 7 VAL. U.L. REV. 307 (1973); Note, *A County as a Merchant Under the Uniform Commercial Code*, 1980 WIS. L. REV. 194; Comment, *The Farmer in the Sales Article of the U.C.C.: "Merchant" or "Tiller of the Soil"?*, 1976 S. ILL. U.L.J. 237; Comment, *The U.C.C. Merchant Sections: Reasonable Standards of Fair Dealing in the Trades*, 14 TULSA L.J. 190 (1978).

98. *K & M Joint Venture v. Smith Int'l, Inc.*, 669 F.2d 1106, 1115, 33 U.C.C. Rep. Serv. 1, 13-14 (6th Cir. 1981).

99. U.C.C. § 2-603(1).

100. U.C.C. § 1-103.

101. 342 F. Supp. 455, 10 U.C.C. Rep. Serv. 965 (M.D. Pa. 1972).

to the requirements of section 2-603 because the sellers had no agent or place of business in New York City.¹⁰² Conversely, in *Arkin Imports, Inc. v. Dorothy's Exclusive Fashions, Inc.*,¹⁰³ where both the buyer and seller were located in New York City,¹⁰⁴ the court concluded that the buyer was not subject to the requirements of section 2-603.¹⁰⁵ Hence, the size of the market of rejection seems to be at least an area encompassing a single city.

There are no reported cases addressing the question of the location of the "market of rejection." This is not surprising because in the normal situation of a buyer who has only one place of business the "market of rejection" would clearly be the location of the buyer's place of business. However, some problems could arise in determining the location of the "market of rejection" in the situation where the buyer has more than one place of business. For example, assume that both buyer and seller have corporate headquarters in New York City. They agree upon a sale of goods to be delivered to the buyer's place of business in Chicago. The goods are delivered and found to be nonconforming. The buyer's agents in Chicago notify their superiors in New York City of the nonconformity and the buyer's agents in New York City give notice of rejection to the seller. Is the buyer subject to the requirements of section 2-603? A literal reading of the term "market of rejection" might lead a court to answer in the negative because a rejection is not effective until the buyer seasonably notifies the seller¹⁰⁶ and because this notice was given by the buyer in New York City where the seller does have a place of business. However, this interpretation overlooks the clear purpose of the additional requirements placed on merchant buyers under section 2-603, which is to require the merchant buyer to follow reasonable instructions from the seller in a situation where the seller is not in a position to take possession or control of the goods. Thus, the term "market of rejection" should be interpreted as meaning the market where the buyer is holding the rejected goods.

The question of what instructions from a seller are "reasonable" is one of fact. Section 2-603 does provide that "[i]nstructions are not reasonable if on demand indemnity for expenses is not forthcoming."¹⁰⁷ The section implies that more than a mere promise for indemnity is required. However, just because indemnity is forthcoming does not make instructions from the seller reasonable. In *Buckeye Trophy, Inc. v. Southern Bowling & Billiard Supply Co.*,¹⁰⁸ the seller asked the buyer to reship the rejected goods and

102. *Id.* at 460, 10 U.C.C. Rep. Serv. at 973.

103. 12 U.C.C. Rep. Serv. 871 (N.Y. Civ. Ct. 1973).

104. According to the court, the seller was located in "the bustling, competitive, hard street of Seventh Avenue" and the buyer in "the chic east side uptown of the Drake Hotel." *Id.* at 872.

105. *Id.* at 873.

106. U.C.C. § 2-602(1).

107. U.C.C. § 2-603(1).

108. 3 Ohio App. 3d 32, 443 N.E.2d 1043, 35 U.C.C. Rep. Serv. 140 (1982).

offered to pay the freight costs, but the buyer refused to comply. The court found that the buyer did not have to comply with the instructions, citing evidence that there were substantial costs in preparing the goods for shipment, that the seller refused to provide a final credit to the buyer, and that the buyer feared that damage to the goods in transit would force the buyer to "piecemeal any set-off due to the non-conformity."¹⁰⁹

Where the instructions from the seller are reasonable, yet the merchant buyer refuses to follow them, the question becomes this: to what remedy is the seller entitled? The official comment to section 2-603 says that "a buyer who fails to make a salvage sale when it is his duty to do so . . . is subject to damages pursuant to the section on liberal administration of remedies."¹¹⁰ Likewise, one would assume that a merchant buyer who fails to comply with reasonable instructions given by the seller would likewise be liable in damages to the seller. However, in *Borges v. Magic Valley Foods, Inc.*,¹¹¹ a buyer of nonconforming potatoes was instructed by the seller to blend the potatoes with others of a higher grade in an effort to make the potatoes meet the required grade standard. Instead, the buyer processed the potatoes into flakes and sold them to a third party. The court held that the buyer's failure to follow the reasonable instructions of the seller, coupled with the resale of the potatoes in the ordinary course of the buyer's business, constituted an acceptance of the goods by the buyer and thus rendered the buyer's rejection ineffective.¹¹²

The holding in *Borges* should not be broadly construed as precluding the effectiveness of the merchant buyer's rejection or revocation of acceptance just because the merchant buyer has failed to follow instructions from the seller. *Borges* involved a substantial alteration of the condition of the goods as well as a resale of the goods in the ordinary course of the buyer's business, acts which many courts have held to preclude rejection or revocation of acceptance.¹¹³ In the case where the buyer merely fails to follow instructions from the seller, the seller should be sufficiently protected by an award of damages for the buyer's breach of his statutory duty based either on the deterioration in value of the goods or the loss of use of the goods by the seller.

If all the above requirements are met, and if the seller fails to give reasonable instructions and the goods are perishable or threaten to decline in value speedily, then the buyer must make reasonable efforts to sell the

109. *Id.* at 34, 443 N.E.2d at 1046, 35 U.C.C. Rep. Serv. at 143. Although the court did not elaborate on the meaning of buyer's argument, it appears that the buyer contended that it would be difficult to apportion any damages to the goods resulting from accidents in transit and damages to the goods resulting from their original nonconformity.

110. U.C.C. § 2-603 comment 5. See U.C.C. § 1-106.

111. 101 Idaho 494, 616 P.2d 273, 29 U.C.C. Rep. Serv. 1282 (1980).

112. *Id.* at 497, 616 P.2d at 276, 29 U.C.C. Rep. Serv. at 1286.

113. See *infra* text accompanying notes 172-94.

goods for the seller's account.¹¹⁴ Courts have been very lenient toward buyers accused of failing to sell such goods, holding that so long as the buyer proceeds in a good-faith exercise of reasonable business judgment, his decision whether to sell will not subject him to liability.¹¹⁵

V. THE OBLIGATION TO REFRAIN FROM EXERCISING OWNERSHIP OF THE GOODS

By far the most perplexing of the obligations placed on a buyer of goods after rejection or revocation of acceptance is the obligation to refrain from exercising "ownership" of the goods. The term "ownership" is not defined in the Codè,¹¹⁶ and, theoretically at least, virtually any exercise of dominion over the goods could constitute an exercise of "ownership."¹¹⁷

In addition to the ambiguity of the term "ownership," a more significant problem involves the determination of the seller's remedy when the buyer is deemed to have exercised "ownership" over the goods. Two sections of the Code are relevant here: sections 2-602(2)(a) and 2-606(1)(c). Section 2-602(2)(a) provides that "after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller."¹¹⁸ Section 2-606(1)(c) provides that an acceptance of goods occurs when the buyer "does any act inconsistent with the seller's ownership, but if such act is wrongful as against the seller it is an acceptance only if ratified by him."¹¹⁹

As the following discussion will illustrate, courts have not developed any satisfactory theory to explain their decisions that some acts of dominion may constitute an acceptance of the goods precluding rejection or revocation of acceptance while other acts of dominion do not. After examining the different approaches used by the courts to determine whether a buyer's continued use of the goods after rejection or revocation of acceptance constitutes an acceptance of the goods, this article will suggest an alternative approach to analyzing that question and will then apply that approach to questions relating to other acts of dominion over the goods.

A. Possession of the Goods

It is clear that "mere" possession does not constitute an "exercise of ownership" because the buyer is under a duty to "hold" rejected goods at the seller's disposition.¹²⁰

114. U.C.C. § 2-603(1).

115. *Sullivan Island Seafood Co. v. Island Seafood Co.*, 390 So. 2d 113, 30 U.C.C. Rep. Serv. 982 (Fla. Dist. Ct. App. 1980).

116. The question of what might constitute acts of "ownership" by a buyer should not be determined based on considerations of title, insofar as article 2 rights and obligations are not affected by passage of title unless a specific provision refers to title. U.C.C. § 2-401 & comment 1.

117. Cf. *WHITE & SUMMERS*, *supra* note 3, § 8-2, at 298.

118. U.C.C. § 2-602(2)(a).

119. U.C.C. § 2-606(1)(c).

120. U.C.C. § 2-602(2)(b).

B. Inspection and Testing of the Goods

A buyer is entitled to inspect or test the goods to see if they conform to the contract without thereby accepting the goods. Even under the restrictive common law requirements for rescission of a contract for sale, a buyer was entitled to inspect or test goods to determine their conformity to the contract without fear that he would be deemed to have waived his right of rescission.¹²¹ The courts reasoned that inspection or testing is often necessary to determine whether the goods conform to the contract and that, because nonconformity is a prerequisite to rescission, inspection or testing is not a waiver of the remedy of rescission. The same result occurred in cases arising under the Uniform Sales Act.¹²²

Under the Code, the right of a buyer to inspect goods without foregoing his right to reject the goods is recognized in section 2-606(1)(b), which provides that acceptance occurs when a buyer "fails to make an effective rejection . . . , but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect [the goods]."¹²³ A typical case is *Askco Engineering Co. v. Mobil Chemical Corp.*¹²⁴ where the court held that a buyer of polyethylene did not exercise "ownership" within the meaning of section 2-606(2)(a) when it tested the polyethylene to see if it conformed to the seller's representations.¹²⁵

C. Use of the Goods

A recurring problem which plagues buyers who are in possession of goods following rejection or revocation of acceptance is whether continued "use" of the goods after discovery of their nonconformity will be deemed an acceptance of the goods or a waiver of the right to reject or revoke acceptance. Initially, it should be pointed out that the use of the goods prior to discovery of the nonconformity by the buyer should not affect the ability of the buyer to revoke his acceptance of the goods.¹²⁶ This view is consistent with the notion that a buyer has a "reasonable opportunity to inspect" the goods before he is deemed to have accepted them. It is also consistent with

121. *E.g.*, *Boles v. Merrill*, 173 Mass. 491, 53 N.E. 894 (1899); *Rhind v. Freedley*, 74 N.J.L. 138, 64 A. 963 (1906); *Walter A. Wood Mowing & Reaping Mach. Co. v. Calvert*, 89 Wis. 640, 62 N.W. 532 (1895). *See generally* Annot., 77 A.L.R. 1165, 1184-86 (1932).

122. *E.g.*, *Robinson v. Main*, 227 Iowa 1195, 290 N.W. 539 (1940); *Middlesboro Black Gem Coal Co. v. Capps*, 297 Ky. 600, 180 S.W.2d 567 (1944).

123. U.C.C. § 2-606(1)(b).

124. 535 S.W.2d 893, 19 U.C.C. Rep. Serv. 1119 (Tex. Civ. App. 1976).

125. *Id.* at 897, 19 U.C.C. Rep. Serv. at 1124.

126. *Yates v. Clifford Motors, Inc.*, 283 Pa. Super. 293, 310, 423 A.2d 1262, 1271, 30 U.C.C. Rep. Serv. 967, 978 (1980); *La Villa Fair v. Lewis Carpet Mills, Inc.*, 219 Kan. 395, 548 P.2d 825, 19 U.C.C. Rep. Serv. 120 (1976); *Franz Lithographic Servs., Inc. v. Sun Chem. Co.*, 38 U.C.C. Rep. Serv. 485 (E.D. Pa. Mar. 26, 1984). *See WHITE & SUMMERS, supra* note 3, § 8-2, at 298-99.

section 2-602(2)(a), which provides that any exercise of ownership by the buyer is "wrongful as against the seller" but which applies only "after rejection." Hence, the only concern here is with a buyer's use of the goods after discovery of the nonconformity and his attempt to invoke the remedies of rejection or revocation of acceptance.

The Code does not contain any provision dealing specifically with continued use after rejection or revocation of acceptance, but the drafters clearly sought to remove some of the restrictive requirements of the pre-Code remedy of rescission by abandoning that term in favor of the term "revocation of acceptance."¹²⁷ By so doing, the drafters cleared up certain pre-Code problems involving the ambiguity of this term and also specifically rejected any notion that the remedy of cancellation involved any sort of an election of remedies.¹²⁸

Although the Code drafters specifically ceased use of the term "rescission," this omission did not clearly signify any change from pre-Code law relating to the buyer's continued use of goods after rejection. Indeed, under a straightforward reading of section 2-602(2)(a), the buyer's continued use of the goods after rejection clearly constitutes an "exercise of ownership" which is "wrongful as against the seller." Furthermore, under a literal reading of section 2-606(1)(c), continued use of goods after rejection would certainly seem to be an "act inconsistent with the seller's ownership" and thus an acceptance or reacceptance of the goods. In fact, many early cases and a substantial number of more recent cases have taken the view that any use of the goods subsequent to rejection or revocation of acceptance is wrongful as against the seller and thus, ipso facto, an acceptance of the goods barring the buyer from invoking the remedies of rejection or revocation of acceptance.¹²⁹

However, in the early 1970's, some courts departed from the rule that any significant use of the goods following rejection or revocation of acceptance amounted to an act inconsistent with the seller's ownership and thus barred rejection or revocation of acceptance.¹³⁰ Many of these cases involved the sale of a mobile home where the buyer continued to occupy the home after he had given notice of rejection or revocation of acceptance. One of the earliest of such cases to hold that continued occupancy of the

127. U.C.C. § 2-608 comment 1.

128. *Id.*

129. *E.g.*, *Waltz v. Chevrolet Motor Div.*, 307 A.2d 815, 12 U.C.C. Rep. Serv. 874 (Del. Super. Ct. 1973); *Cooper v. Mason*, 14 N.C. App. 472, 188 S.E.2d 653, 10 U.C.C. Rep. Serv. 1128 (1972); *Fablok Mills, Inc. v. Cocker Mach. & Foundry Co.*, 120 N.J. Super. 350, 294 A.2d 62, 11 U.C.C. Rep. Serv. 59 (Law Div. 1972), *rev'd*, 125 N.J. Super. 251, 310 A.2d 491, 13 U.C.C. Rep. Serv. 449 (App. Div. 1973); *Bassman v. Manhattan Dodge Sales*, 5 U.C.C. Rep. Serv. 128, 129 (N.Y. Sup. Ct. 1968) (buyer's "continued use of the automobile controverted the claim of 'revocation of acceptance' as indicated in § 2-608" of the Code); *F.W. Lang Co. v. Fleet*, 193 Pa. Super. 365, 165 A.2d 258, 1 U.C.C. Rep. Serv. 177 (1960) (use of compressor for two years following sale constituted an acceptance precluding rescission by buyer).

130. *See infra* note 137.

mobile home after revocation of acceptance did not impair the buyer's revocation was *Minsel v. El Rancho Mobile Home Center, Inc.*¹³¹ In *Minsel*, the buyers purchased a mobile home and subsequently discovered numerous defects. About six weeks after moving into the mobile home, and after the seller's failure to remedy the defects, the buyers gave notice that they were revoking their acceptance of the mobile home. The buyers were unable to find alternative housing for a six-week period following notice of revocation and continued to occupy the mobile home for that period of time. When the buyers vacated the mobile home, they left it in a clean condition and continued to pay the utilities and rent on the lot for four-and-one-half months after notice of revocation; it was at this point that the seller retook possession. The buyers sued for rescission, return of their down payment, and incidental damages. After a judgment for the buyers, the seller appealed and contended that the buyers' continued occupancy of the mobile home amounted to an acceptance of the home pursuant to section 2-606(1)(c). The Michigan Court of Appeals rejected the seller's contention and affirmed the judgment for the buyers.¹³² The court noted that the buyers were under a duty to protect and care for the mobile home for a reasonable period pursuant to section 2-602(2)(b).¹³³ The court held that the buyers' act of "looking after" the mobile home was one way of fulfilling this duty.¹³⁴ The court then went on to say that the seller's argument that the continued occupancy of the mobile home was tantamount to an exercise of ownership and thus an acceptance of the mobile home would be contrary to the "rule of reasonableness" evident throughout the Code.¹³⁵ The court further noted that the seller had shown no prejudice resulting from the buyers' continued occupancy of the mobile home.¹³⁶

Subsequent to *Minsel*, a number of other courts also concluded that continued occupancy of a mobile home by buyers who gave notice of rejection or revocation of acceptance did not operate as a reacceptance which would render ineffective any attempted rejection or revocation of acceptance.¹³⁷ The courts gave several different rationales for their decisions, in-

131. 32 Mich. App. 10, 188 N.W.2d 9, 9 U.C.C. Rep. Serv. 448 (1971).

132. *Id.* at 15, 188 N.W.2d at 12, 9 U.C.C. Rep. Serv. at 451.

133. The buyers in *Minsel* had made a substantial down payment on the mobile home and thus had a security interest in the mobile home pursuant to § 2-711(3). The duty to hold the goods with reasonable care under § 2-602(2)(b) only applies where the buyer does not have a security interest in the goods. Hence, the *Minsel* court's reliance on the latter section seems misplaced. However, a buyer who has a security interest in rejected goods is under an article 9 duty to use "reasonable care in the custody of collateral in his possession." U.C.C. § 9-207(1).

134. 32 Mich. App. at 14, 188 N.W.2d at 11, 9 U.C.C. Rep. Serv. at 451.

135. *Id.*

136. *Id.* at 15, 188 N.W.2d at 12, 9 U.C.C. Rep. Serv. at 451.

137. *E.g.*, *Mobile Home Sales Management, Inc. v. Brown*, 115 Ariz. App. 11, 562 P.2d 1378, 21 U.C.C. Rep. Serv. 1040 (1977); *Keen v. Modern Trailer Sales, Inc.*, 40 Colo. App. 527, 578 P.2d 668, 24 U.C.C. Rep. Serv. 881 (1978); *Lawrence v. Modern Mobile Homes, Inc.*, 562 S.W.2d 729, 24 U.C.C. Rep. Serv. 874 (Mo. Ct. App. 1978); *Erling v. Homera, Inc.*, 298 N.W.2d 478, 30 U.C.C. Rep. Serv. 181 (N.D. 1980); *Jorgensen v. Pressnall*, 274 Or. 285, 545 P.2d 1382, 18 U.C.C. Rep. Serv. 1206 (1976). *Contra Bowen v. Young*, 507 S.W.2d 600, 14 U.C.C. Rep. Serv. 403 (Tex. Civ. App. 1974) (continued occupancy constitutes acceptance thereby invalidating attempted revocation of acceptance).

cluding the following: continued use was substantially the same as storing goods for the seller's account, which the buyer is allowed to do under section 2-604;¹³⁸ continued use was the most feasible way of protecting the mobile home from further damage;¹³⁹ the general "rule of reasonableness" was found to pervade the Code;¹⁴⁰ buyers experienced hardship when they vacated another residence and invested substantially all of their savings in the mobile home;¹⁴¹ continued use was the direct result of "oppressive conduct" of the seller in not allowing the buyers to reject the mobile home;¹⁴² and, when buyers made down payments on the mobile homes, continued occupancy was justified in order to preserve the collateral securing the security interest granted to such buyers under section 2-711(3) of the Code.¹⁴³

Although these courts apparently concluded that the continued use was not "wrongful" as against the seller, many of them nevertheless held that it was appropriate to award damages to the seller in the amount of the reasonable rental value of the mobile home during the period of continued occupancy.¹⁴⁴ Analytically, it is difficult to justify requiring a rejecting buyer to pay the seller the reasonable rental value of the mobile home during the period of continued occupancy when that occupancy is not "wrongful as against the seller."¹⁴⁵

Despite this analytical difficulty, other courts quickly began to apply this "reasonableness" analysis to cases involving goods other than mobile homes. One of the earliest of such cases was *Fablok Mills, Inc. v. Cocker Machine & Foundry Co.*,¹⁴⁶ which involved the sale of defective knitting machines.

138. *Erling v. Homera, Inc.*, 298 N.W.2d 478, 482, 30 U.C.C. Rep. Serv. 181, 188 (N.D. 1980).

139. *Mobile Home Sales Management, Inc. v. Brown*, 115 Ariz. App. 11, 15 n.2, 562 P.2d 1378, 1382 n.2, 21 U.C.C. Rep. Serv. 1040, 1046 n.2 (1977); *Jorgensen v. Pressnall*, 274 Or. 285, 292, 545 P.2d 1382, 1386, 18 U.C.C. Rep. Serv. 1206, 1212 (1976).

140. *Lawrence v. Modern Mobile Homes, Inc.*, 562 S.W.2d 729, 733, 24 U.C.C. Rep. Serv. 874, 880 (Mo. Ct. App. 1978).

141. *Mobile Home Sales Management, Inc. v. Brown*, 115 Ariz. App. 11, 15 n.2, 562 P.2d 1378, 1382 n.2, 21 U.C.C. Rep. Serv. 1040, 1046 n.2 (1977); *cf. Jones v. Abriani*, 169 Ind. App. 556, 569, 350 N.E.2d 635, 644, 19 U.C.C. Rep. Serv. 1102, 1113 (1976).

142. *Jones v. Abriani*, 169 Ind. App. 556, 569, 350 N.E.2d 635, 644, 19 U.C.C. Rep. Serv. 1102, 1113 (1976).

143. *Id.*; *see also Keen v. Modern Trailer Sales, Inc.*, 40 Colo. App. 527, 530, 578 P.2d 668, 670, 24 U.C.C. Rep. Serv. 881, 883 (1978); *Lawrence v. Modern Mobile Homes, Inc.*, 562 S.W.2d 729, 732, 24 U.C.C. Rep. Serv. 874, 878 (Mo. Ct. App. 1978); *Jorgensen v. Pressnall*, 274 Or. 285, 291-92, 545 P.2d 1382, 1385-86, 18 U.C.C. Rep. Serv. 1206, 1212 (1976). For a discussion of this question in greater detail, *see infra* text accompanying notes 241-52.

144. *E.g.*, *Erling v. Homera, Inc.*, 298 N.W.2d 478, 483-84, 30 U.C.C. Rep. Serv. 181, 189-90 (N.D. 1980); *Jorgensen v. Pressnall*, 274 Or. 285, 292, 545 P.2d 1382, 1386, 18 U.C.C. Rep. Serv. 1206, 1212 (1976).

145. One court justified this result on the ground that the equitable remedy of rescission requires the rescinding party to restore to the other party everything of value received under the rescinded contract. *Erling v. Homera, Inc.*, 298 N.W.2d 478, 483-84, 30 U.C.C. Rep. Serv. 181, 190 (N.D. 1980). However, in view of the Code's abandonment of the use of the term "rescission," *see* U.C.C. § 2-608 comment 1, this reasoning is not persuasive.

146. 125 N.J. Super. 251, 310 A.2d 491, 13 U.C.C. Rep. Serv. 449 (App. Div. 1973), *rev'g*, 120 N.J. Super. 350, 294 A.2d 62, 11 U.C.C. Rep. Serv. 59 (Law Div. 1972).

After almost two-and-one-half years of attempting repairs, the buyer gave notice of revocation of acceptance and demanded that the seller take back the machines and refund the purchase price. When the seller refused, the buyer continued to use some of the machines but replaced and stored other machines. The buyer brought suit and the court granted the seller's motion for summary judgment on the ground, *inter alia*, that the buyer's continued use of the goods after revocation barred the remedy of "rescission."¹⁴⁷ On appeal, the appellate division reversed and held that the reasonableness of the buyer's continued use was a question of fact for the trier, thus rendering summary judgment improper.¹⁴⁸ The court noted the *Minsel* "reasonableness" approach with approval and further noted that this seller was the only domestic manufacturer of the particular type of knitting machine and thus the buyer "was confronted with the grim choice of either continuing to use some of the machines or going out of business."¹⁴⁹ The court further noted that such use may have had the effect of mitigating the seller's damages and that the buyer was acting in good faith.¹⁵⁰

Inevitably, courts began to face the situation of a buyer's continued use in the context of automobile sales. The decisions in these cases are essentially impossible to reconcile. In *Underwood v. Monte Asti Buick Co.*,¹⁵¹ a buyer of a defective used car drove the car at least 14,000 additional miles after giving notice of revocation of acceptance.¹⁵² The court, in a suit in equity for rescission, held that such continued use barred the buyer from seeking rescission.¹⁵³ A number of other courts have reached similar results on similar facts.¹⁵⁴

A substantially different view was taken in *Pavesi v. Ford Motor Co.*¹⁵⁵ In that case, the buyer of a new car sought to revoke his acceptance some

147. 120 N.J. Super. at 355, 294 A.2d at 65, 11 U.C.C. Rep. Serv. at 63.

148. 125 N.J. Super. at 258-59, 310 A.2d at 495, 13 U.C.C. Rep. Serv. at 454.

149. *Id.* at 258, 310 A.2d at 495, 13 U.C.C. Rep. Serv. at 454. The court did not attempt to square this statement with the fact that the buyer had replaced some of the machines.

150. *Id.*

151. 73 Pa. D. & C.2d 773, 20 U.C.C. Rep. Serv. 657 (Pa. C.P. 1976).

152. The facts contained in the opinion indicate that the figure for the additional mileage after notice of revocation may have been considerably higher. *See id.* at 781, 20 U.C.C. Rep. Serv. at 662.

153. *Id.* at 780-81, 20 U.C.C. Rep. Serv. at 662.

154. *E.g.*, *Waltz v. Chevrolet Motor Div.*, 307 A.2d 815, 12 U.C.C. Rep. Serv. 874 (Del. Super. Ct. 1973) (continued use invalidates attempt to revoke acceptance); *Charney v. Ocean Pontiac, Inc.*, 17 U.C.C. Rep. Serv. 982 (Mass. Dist. Ct. 1975) (buyer's use of car for several months, including a cross-country drive, amounted to a new acceptance of the car); *Bassman v. Manhattan Dodge Sales*, 5 U.C.C. Rep. Serv. 128-29 (N.Y. Sup. Ct. 1968) (buyer's "continued use of the automobile controverted the claim of 'revocation of acceptance' as indicated in § 2-608" of the Code); *Cooper v. Mason*, 14 N.C. App. 472, 188 S.E.2d 653, 10 U.C.C. Rep. Serv. 1128 (1972) (continued use invalidates attempt to revoke acceptance); *Gasque v. Mooers Motor Car Co.*, 227 Va. 154, 313 S.E.2d 384, 38 U.C.C. Rep. Serv. 120 (1984) (distinguishing need to use cars from need to use mobile homes).

155. 155 N.J. Super. 373, 382 A.2d 954, 23 U.C.C. Rep. Serv. 929 (1978), *overruled in* *Ramirez v. Autosport*, 88 N.J. 277, 440 A.2d 1345, 33 U.C.C. Rep. Serv. 134 (1982) (to the extent *Pavesi* suggests the Code expressly recognizes rescission as a remedy).

seventeen months after the date of purchase on the ground that the paint on the car cracked and peeled and three attempts by the seller to repaint the car had failed to cure the problem. Some seven or eight months after the final, unsuccessful attempt at repainting, the buyer brought an action for rescission. In response to the seller's argument that the buyer should be barred from rescission due to his continued use of the car, the court stated:

No longer is a buyer barred from the remedy of rescission because of his continued use of substantially impaired goods which are a necessity to him; all reasonable leeway is granted to the rightfully rejecting or revoking buyer. To require such a buyer to discontinue his use and suffer financial or other hardship would be contrary to the Code's rule of reasonableness and its underlying purposes and policies.¹⁵⁶

The court then allowed rescission, subject to a set-off in favor of the seller for a stipulated per-mile charge based on the buyer's continued use of the car.¹⁵⁷ A substantial number of cases, including the bulk of the most recent cases, have reached the same result on reasoning very similar to that in *Pavesi*.¹⁵⁸

As this discussion indicates, there are two seemingly contradictory approaches to resolving the question of the effect of continued use of the nonconforming goods on the validity of the buyer's attempted rejection or revocation of acceptance. The first, mirroring the general rule at common law and under the Uniform Sales Act, holds that any significant use after rejection or revocation of acceptance is wrongful against the seller and thus bars the buyer from claiming a rightful rejection or a justifiable revocation of acceptance. The second, arising from the mobile home cases in the early 1970's, holds that so long as the buyer's continued use is "reasonable," it does not render ineffective the buyer's earlier rejection or revocation of acceptance, although it does give the seller a claim for a set-off in the amount of the reasonable-use value of the goods during the time of the buyer's continued use.

Both views have much to recommend them. The view that any use constitutes an acceptance is consistent with pre-Code law under the Uniform

156. *Id.* at 377, 382 A.2d 956, 23 U.C.C. Rep. Serv. at 932-33.

157. *Id.* at 379-80, 382 A.2d at 957, 23 U.C.C. Rep. Serv. at 934-35.

158. *E.g.*, *Johnson v. General Motors Corp.*, 233 Kan. 1044, 668 P.2d 139, 36 U.C.C. Rep. Serv. 1089 (1983) (buyer's needs for transportation, coupled with lack of public transportation, justified buyer's continued use of vehicle); *Johannsen v. Minnesota Valley Ford Tractor Co.*, 304 N.W.2d 654, 31 U.C.C. Rep. Serv. 558 (Minn. 1981); *O'Shea v. Hatch*, 97 N.M. 409, 640 P.2d 515, 33 U.C.C. Rep. Serv. 561 (N.M. Ct. App. 1982) (sale of nonconforming horse; continued use, including surgery to correct nonconformity, did not constitute acceptance in view of seller's failure to retake possession of horse and lack of prejudice to seller); *McCullough v. Bill Swad Chrysler-Plymouth*, 5 Ohio St. 3d 181, 449 N.E.2d 1289, 36 U.C.C. Rep. Serv. 513 (1983) (buyer's limited financial resources, absence of good faith by seller, and lack of prejudice to seller justified continued use by the buyer); *Hardimon v. Cullum & Maxey Camping Centers, Inc.*, 591 S.W.2d 771 (Tenn. Ct. App. 1979). *But see* *Ramirez v. Autosport*, 88 N.J. 277, 440 A.2d 1345, 33 U.C.C. Rep. Serv. 134 (1982) (overruling *Pavesi* to the extent it suggests the Code expressly recognizes rescission as a remedy and holding that revocation is tantamount to, and replaces, rescission as a remedy under the Code).

Sales Act, and, because the drafters of the Code did not expressly deal with the question of continued use, it could be argued that they intended to endorse the earlier judicial interpretation of the effect of continued use. Furthermore, this view is consistent with, but not compelled by, the language of section 2-606(1)(c), which provides that acceptance of goods occurs when the buyer "does any act inconsistent with the seller's ownership."¹⁵⁹ Finally, this view is consistent with the common-sense inference that a buyer who claims that goods are nonconforming, but who continues to use such goods for the purpose for which they were purchased, is trying to have his cake and eat it too.¹⁶⁰

On the other hand, the "reasonableness" approach recognizes that a buyer, particularly a consumer buyer, may have no realistic economic alternative but to continue to use the goods—even though they are worth considerably less than what he bargained for—because of the prohibitive costs of replacing the goods, financing that replacement, and then storing the nonconforming goods. Furthermore, since by hypothesis the rejection or revocation of acceptance was substantively correct, it is the seller's own default which gives the buyer this "grim choice."¹⁶¹ Finally, the seller could have prevented the buyer's continued use by retaking possession of the goods.

A more appropriate way to analyze the problem of the buyer's continued use of the goods after rejection or revocation of acceptance is suggested by *Stroh v. American Recreation & Mobile Home Corp.*,¹⁶² and two earlier commentators.¹⁶³ In *Stroh*, the buyers sought to revoke their acceptance about one year after purchase of a mobile home and continued to reside in the mobile home for an additional seventeen months. The court, in affirming the buyers' right to revoke their acceptance, nevertheless held that their continued occupancy of the mobile home was wrongful against the seller, but noted that this should merely entitle the seller to an award of damages for the value of the continued use to the buyers.¹⁶⁴ While the court in *Stroh* did not amplify its reasoning on this point, the result is perfectly consistent with the language of the relevant sections of the Code. Although section 2-602(2)(a) provides that after rejection "any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller,"¹⁶⁵ this section does not specifically provide what remedy the seller has with regard to the buyer's "wrongful" exercise of ownership.

159. U.C.C. § 2-606(1)(c).

160. See *Can-Key Indus., Inc. v. Industrial Leasing Co.*, 286 Or. 173, 183, 593 P.2d 1125, 1131, 26 U.C.C. Rep. Serv. 675, 682 (1979).

161. *Fablok Mills, Inc. v. Cocker Mach. & Foundry Co.*, 125 N.J. Super. 251, 258, 310 A.2d 491, 495, 13 U.C.C. Rep. Serv. 449, 454 (App. Div. 1973).

162. 35 Colo. App. 196, 202, 530 P.2d 989, 993, 16 U.C.C. Rep. Serv. 726, 731 (1975).

163. Whaley, *supra* note 69, at 65; Note, *Buyer's Continued Use of Goods After Revocation of Acceptance Under the Uniform Commercial Code*, 24 WAYNE L. REV. 1371, 1382 (1978).

164. 35 Colo. App. 196, 202, 530 P.2d 989, 993, 16 U.C.C. Rep. Serv. 726, 731 (1975).

165. U.C.C. § 2-602(2)(a).

In contrast, section 2-606(1)(c) provides that an acceptance of goods occurs when the buyer "does any act inconsistent with the seller's ownership."¹⁶⁶ The substantial similarity in the language used in these sections could be interpreted as meaning that any act which is wrongful against the seller also constitutes an acceptance—or a reacceptance in the case of revocation of acceptance—by the buyer, thus justifying the approach that any use constitutes acceptance. This interpretation, however, overlooks official comment 4 to section 2-606, which provides: "Under paragraph [(1)(c)], any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance."¹⁶⁷ With this comment in mind, one could readily conclude that although any act of ownership may be wrongful against the seller under section 2-602(1)(a), such an act amounts to an acceptance only where the act of ownership is also inconsistent with the buyer's claim of rejection or revocation of acceptance.¹⁶⁸

If this view is accepted, then every continued use of goods subsequent to rejection or revocation of acceptance is an act of ownership wrongful against the seller, thus entitling the seller to damages for the wrong.¹⁶⁹ However, unless the continued use is also inconsistent with the claim of rejection or revocation of acceptance, the continued use does not amount to an acceptance or a reacceptance barring the buyer's remedies of rejection or revocation of acceptance.

This suggested approach will usually lead to the same result as the "reasonableness" approach, but it has a number of advantages. First, it gives full effect to the language of both sections 2-602 and 2-606, as well as the official comments thereto.¹⁷⁰ Second, it avoids the problem of deciding which considerations are to be taken into account in determining what is "reasonable" use and what is not.¹⁷¹ Third, and most important, because the inquiry

166. U.C.C. § 2-606(1)(c).

167. U.C.C. § 2-606 comment 4.

168. Because a buyer who revokes his acceptance has the same rights and duties with regard to the goods as if he had rejected them, U.C.C. § 2-608(3), the comment applies to cases of revocation as well as rejection.

169. Some uses may be so *de minimis* as to give rise to no claim for damages at all.

170. One commentator has suggested that because so many other provisions in the Code make reference to reasonableness as a standard governing a party's conduct, it is consistent to read a "reasonable use" exception governing a buyer's continued use of goods into §§ 2-602 and 2-608. Note, *supra* note 163, at 1383 & n.88. The counter-argument is that, when the drafters intended a reasonableness standard to govern a party's conduct, they had no difficulty making such a standard explicit. See *supra* note 86 and accompanying text.

171. One commentator has suggested the following considerations: the character of the goods; whether the seller instructed the buyer with regard to the disposition of the goods; prejudice to the seller; the length of time of the continued use; and alternatives to the buyer's continued use. Note, *supra* note 163, at 1383-86. Few courts have endeavored to articulate the considerations going into the ultimate determination of reasonableness. In *Minsel v. El Rancho Mobile Home Center, Inc.*, 32 Mich. App. 10, 188 N.W.2d 9, 9 U.C.C. Rep. Serv. 448 (1971), the seminal "reasonableness" case, the court considered the failure of the seller to respond to buyer's notice of rejection, absence of a showing of prejudice to the seller, and absence of evidence indicating that buyer's continued occupancy was in bad faith or avoidable. In *McCullough v. Bill Swad Chrysler-Plymouth, Inc.*, 5 Ohio St. 3d 181, 449 N.E.2d 1289, 36 U.C.C. Rep.

is directed at whether the buyer's continued use is consistent with his claim of rejection or revocation of acceptance, it focuses the court's attention on what should be at the center of the dispute between the buyer and the seller: whether the goods conformed to the contract and, in the case of revocation of acceptance, whether any nonconformity substantially impaired the value of the goods to the buyer. This approach also recognizes the legitimacy of awarding damages to the seller for the value to the buyer of his continued use of the goods, because such use is conceded to be "wrongful" as against the seller. Finally, it also avoids the conceptual difficulty of the "reasonableness" approach of awarding damages to the seller based on conduct which is, by definition, reasonable conduct on the part of the buyer.

The following sections of this article deal with acts of dominion over the goods, other than continued use, which have given rise to a claim that the buyer has exercised ownership of the goods and thus forfeited his right to reject the goods or revoke acceptance of them.

D. Alteration or Modification of the Goods, Including Repair

Under the Uniform Sales Act, a buyer who sought rescission but who thereafter materially altered, manufactured, or processed the goods was deemed to have waived his remedy of rescission.¹⁷² Although not always expressed by courts reaching this conclusion, the underlying reason for this result seems to be the Uniform Sales Act's provision that the buyer could not rescind "if he fails to return or to offer to return the goods to the seller in substantially as good condition as they were in at the time the property was transferred to the buyer."¹⁷³ Because a material alteration of the goods would prevent the buyer from returning the goods to the seller in such condition, rescission was not allowed and the buyer was relegated to a suit for damages.

Although the drafters of the Code intended to do away with some of the more technical problems associated with the remedy of rescission,¹⁷⁴ a number of cases decided under the Code have stated, in broad language, that any

Serv. 513 (1983), the court considered the following: the seller's instructions to the buyer upon notice of revocation; the business or personal needs of the buyer compelling continued use; assurances by the seller that the defects would be cured; the buyer's good faith; and the lack of prejudice to the seller. *See id.* at 184, 449 N.E.2d at 1293, 36 U.C.C. Rep. Serv. 518-19. The careful reader is compelled to conclude that courts articulate considerations which are likely to lead to the conclusion that the buyer's continued use was reasonable. Indeed, of the large number of cases purporting to adopt a "reasonableness" approach, only a very few have found the buyer's continued use to be unreasonable so as to bar rejection or revocation of acceptance as a remedy. *E.g.*, *Underwood v. Monte Asti Buick Co.*, 73 Pa. D. & C.2d 773, 20 U.C.C. Rep. Serv. 657 (Pa. C.P. 1976); *Fargo Mach. & Tool Co. v. Kearney & Trecker Co.*, 428 F. Supp. 364, 21 U.C.C. Rep. Serv. 80 (E.D. Mich. 1977).

172. *E.g.*, *Powers v. Rosenbloom*, 143 Me. 361, 62 A.2d 531 (1948) (removal and sale of parts from refrigerator held to preclude rescission).

173. UNIF. SALES ACT § 69(3) (1906) (act superseded by Uniform Commercial Code 1952).

174. *See supra* text accompanying note 27.

material alteration of the goods by the buyer constitutes "an act inconsistent with the seller's ownership," and thus an acceptance of the goods pursuant to section 2-606(1)(c). One commentator has noted that there is "no case in this area in which the buyer has succeeded [in rejecting the goods]."¹⁷⁵ In order to more fully understand the effect of a material alteration of the goods, however, a closer reading of the cases is necessary.

Two early cases broadly stated that any material alteration of the goods constitutes an acceptance of the goods, but in neither case did the facts indicate that there had been any alteration in the goods other than normal wear and tear through use by the buyer.¹⁷⁶ Several subsequent cases have restated the rule in equally broad language. However, many of these cases did not involve a dispute where the buyer was claiming that the goods were nonconforming. Instead, some cases involved the question whether the modification or alteration constituted an acceptance of the goods thereby doing away with the requirement of a writing under the Code's statute of frauds provision.¹⁷⁷ Others involved the question whether the modification constituted an acceptance of the goods for purposes of applying the Code's risk of loss rules.¹⁷⁸ Furthermore, most of the cases stating this broad rule have involved situations where the material alteration or modification occurred prior to the discovery of the alleged nonconformity and prior to any claim of rejection or revocation of acceptance.¹⁷⁹ In these circumstances, the controlling provision of the Code would seem to be section 2-608(2), which sets out as a requirement for a justifiable revocation of acceptance that such revocation occur "before any substantial change in condition of the goods which is not caused by their own defects."¹⁸⁰ Even aside from the clear language of section 2-608(2), barring revocation of acceptance due to previous alteration or modification makes sense because the material alteration of the

175. Minitzer, *Buyer's Right of Rejection: A Quarter Century Under the Uniform Commercial Code, and Recent International Developments*, 13 GA. L. REV. 805, 828 (1979).

176. *Marbelite Co. v. City of Philadelphia*, 208 Pa. Super. 256, 222 A.2d 443, 3 U.C.C. Rep. Serv. 845 (1966) (traffic lights); *F.W. Lang Co. v. Fleet*, 193 Pa. Super. 365, 165 A.2d 258, 1 U.C.C. Rep. Serv. 177 (1960) (compressor of ice cream freezer removed and used to operate air conditioner).

177. *E.g.*, *Engle Mortgage Co. v. Triple K. Lumber Co.*, 56 Ala. App. 337, 321 So. 2d 679, 18 U.C.C. Rep. Serv. 310 (1975); *Johnson v. Holdredge Coop. Equity Exch.*, 206 Neb. 568, 293 N.W.2d 863, 29 U.C.C. Rep. Serv. 764 (1980). Section 2-201(3)(c) of the Code dispenses with the requirement of a writing with respect to goods "which have been received and accepted." U.C.C. § 2-201(3)(c).

178. *Park County Implement Co. v. Craig*, 397 P.2d 800, 2 U.C.C. Rep. Serv. 379 (Wyo. 1964) (truck undergoing modification by buyer destroyed by fire; no claim that truck was defective prior to fire).

179. *E.g.*, *United States ex rel. Fram Corp. v. Crawford*, 443 F.2d 611, 8 U.C.C. Rep. Serv. 1210 (5th Cir. 1971); *Mazur Bros. & Jaffe Fish Co.*, 3 U.C.C. Rep. Serv. 419 (Veterans Administration Contract Appeals Board, June 25, 1965); *Brulé C.E. & E., Inc. v. Pronto Foods Corp.*, 3 Ill. App. 3d 135, 278 N.E.2d 477, 10 U.C.C. Rep. Serv. 634 (1971); *Ace Chem. Corp. v. Atomic Paint Co.*, 31 N.C. App. 221, 229 S.E.2d 55, 20 U.C.C. Rep. Serv. 664 (1976).

180. U.C.C. § 2-608(2).

goods may have caused or contributed to the nonconformity rather than any nonconformity for which the seller is responsible. Finally, where the material alteration occurs before the buyer attempts to reject or revoke his acceptance, a broad holding that such material alteration bars rejection or revocation of acceptance is consistent with the buyer's duty to hold the goods with reasonable care for a time sufficient for the seller to remove them.¹⁸¹ The clear import of this duty is that the seller is entitled to retake possession of the goods. However, where the goods have been materially altered before the seller is apprised of the alleged nonconformity, the seller will not be able to get back that which he tendered, but rather will get goods different in kind from what he sold.

These considerations which justify a broad rule denying the buyer the remedy of rejection or revocation of acceptance where the goods have been materially altered prior to the buyer's attempted rejection or revocation of acceptance do not necessarily apply to the situation where the buyer makes material alterations to the goods after he has given notice of rejection or revocation of acceptance. First, because the nonconformity occurred prior to the material alteration, the alteration could not be a contributing cause of the alleged nonconformity. Second, because the seller failed to pick up the goods from the buyer who was holding them at the seller's disposition, the seller would not be in a position to claim that he was prejudiced by an inability to get back the goods he tendered. A few courts have recognized these differences and allowed a buyer to revoke his acceptance of goods despite a material alteration that occurred after the revocation.

In *O'Shea v. Hatch*,¹⁸² the buyers bought a quarter horse based on representations that it was a registered gelding which could be used as a show horse and with children. The horse turned out to be a ridgeling—an imperfectly castrated stallion with an undescended testicle—and could not be used as a show horse or with children. The buyers attempted to revoke their acceptance, but the sellers refused to retake possession of the horse. The buyers then employed a veterinarian who surgically removed the horse's undescended testicle, but the horse still lacked the coordination and disposition necessary for use as a show horse or for use with children. In a subsequent suit brought by the buyers, the court held that the buyers had properly revoked their acceptance despite the surgical alteration of the horse and the buyers' continued use of the horse.¹⁸³

181. U.C.C. § 2-602(2)(b).

182. 97 N.M. 409, 640 P.2d 515, 33 U.C.C. Rep. Serv. 561 (N.M. Ct. App. 1982).

183. The court noted that the surgery was first suggested by the sellers and that the sellers offered to pay for the cost of surgery; this could have amounted to consent to the alteration by the sellers. *Id.* at 413-14, 640 P.2d at 519-20, 33 U.C.C. Rep. Serv. at 565. Where the seller has consented to, or supervised, the modification, such modification is not a bar to revocation of acceptance. *Butcher v. Garrett-Enumclaw Co.*, 20 Wash. App. 2d 361, 581 P.2d 1352, 24 U.C.C. Rep. Serv. 832 (1978). Furthermore, where the seller knew the buyer would process the material and that processing enhanced its value, such processing did not constitute an acceptance. *Lackawanna Leather Co. v. Martin & Stewart, Ltd.*, 730 F.2d 1197, 38 U.C.C. Rep. Serv. 475 (8th Cir. 1984).

In *Can-Key Industries, Inc. v. Industrial Leasing Corp.*,¹⁸⁴ the buyers purchased a turkey hatcher which proved to be defective. After the buyers gave notice of revocation of acceptance and the seller refused to retake possession of the hatcher, the buyers employed the original developer of the hatcher to try to modify it, but such efforts failed. The court held that the modifications and attempts to use the hatcher did not bar revocation of acceptance and noted that any contrary holding would penalize a good-faith effort on the part of the buyers to cure defects and would also be inconsistent with the duty to mitigate damages and the duty of good faith.¹⁸⁵

If these cases involving material alteration are viewed under the proposed analysis, it becomes clear why alteration in an attempt to repair nonconforming goods should not bar rejection or revocation of acceptance. Attempts to repair nonconformities after rejection or revocation of acceptance, even though they may constitute an "exercise of ownership by the buyer" and thus be wrongful as against the seller, should not preclude rejection or revocation of acceptance because the material alteration resulting from attempts to repair is perfectly consistent with the buyer's claim that the goods are nonconforming. Indeed, where a buyer has continued to use allegedly nonconforming goods after rejection or revocation of acceptance without attempting to repair the alleged nonconformity, such use would be very persuasive evidence that the goods were, in fact, conforming or that any nonconformity did not substantially impair the value of the goods to the buyer.

Of course, where a post-revocation alteration is not in the nature of repair, the material alteration may be inconsistent with the buyer's claim of rejection or revocation of acceptance, thus precluding the buyer from invoking those remedies. For example, where an allegedly nonconforming good is materially altered in the buyer's normal manufacturing process, such alteration is inconsistent with the buyer's claim of rejection or revocation of acceptance.¹⁸⁶

E. Sale of the Goods in the Ordinary Course of the Buyer's Business

A few cases have raised the question whether a buyer of goods, who thereafter resells the goods in the ordinary course of his business, may nevertheless revoke his acceptance of the goods. The answer has generally been that the buyer may not revoke in this situation, regardless of whether the resale occurred prior to any attempt to revoke acceptance of the goods¹⁸⁷

184. 286 Or. 173, 593 P.2d 1125, 26 U.C.C. Rep. Serv. 675 (1979).

185. *Id.* at 185, 593 P.2d at 1132, 26 U.C.C. Rep. Serv. at 684.

186. *See Ace Chem. Corp. v. Atomic Paint Co.*, 31 N.C. App. 221, 229 S.E.2d 55, 20 U.C.C. Rep. Serv. 664 (1976) (processing of nonconforming acetone into paint products after discovery of nonconformity but before attempt at revocation).

187. *E.g.*, *Pace v. Sagebrush Sales Co.*, 114 Ariz. 271, 560 P.2d 789, 21 U.C.C. Rep. Serv. 490 (1977); *Phil Jacobs Co. v. Mifflin*, 23 Ill. App. 3d 999, 320 N.E.2d 329, 16 U.C.C. Rep. Serv. 407 (1974); *Gulf Chem. & Metallurgical Corp. v. Sylvan Chem. Corp.*, 122 N.J. Super. 499, 300 A.2d 878, 12 U.C.C. Rep. Serv. 117 (Law Div.), *aff'd*, 126 N.J. Super. 261, 314 A.2d 73, 14 U.C.C. Rep. Serv. 123 (App. Div. 1973).

or subsequent to such an attempt.¹⁸⁸ The courts have generally justified this result on the theory that a resale in the ordinary course of the buyer's business is an "act inconsistent with the seller's ownership" and hence an acceptance of the goods under section 2-606(1)(c). One court also noted that a post-revocation resale is inconsistent with the buyer's duty to use reasonable care in holding the goods at the seller's disposition for a reasonable time.¹⁸⁹ It is difficult to quarrel with the results in these few reported cases, especially in light of the fact that some of these cases involved nonconformities relating to the quantity of the goods sold to the buyer, not their quality,¹⁹⁰ and also in light of the fact that some of these claims of nonconformity were not made until after the original seller had brought suit to recover the unpaid purchase price.¹⁹¹

However, it would be overstating the case to say that any resale in the ordinary course of the buyer's business should preclude revocation of acceptance. For example, in *In re H.P. Tool Mfg. Co.*,¹⁹² a hardware supplier bought a quantity of wrench kits from the seller. The supplier then resold the kits to its customers without opening the cartons containing the kits. After receiving complaints about the quality of the kits from its customers, the hardware supplier sought to revoke its acceptance of the kits. In an action by the seller's trustee to recover the unpaid purchase price, the court held that the hardware supplier's revocation of acceptance was valid.¹⁹³ The court stressed that the resale to the supplier's customers occurred before the supplier had any reason to know that the kits were nonconforming.¹⁹⁴

The results in these cases are consistent with the proposed analysis. Where the resale has occurred after the buyer claims to have rejected the goods or revoked his acceptance, any resale in the ordinary course of the buyer's business is not only an act inconsistent with the seller's ownership, but is also strong evidence that the goods conformed to the original contract for sale or that any nonconformity did not substantially impair their value to the buyer. On the other hand, where the resale occurred before the buyer had reason to know of the nonconformity, the resale, although "an act

188. *E.g.*, *Delhomme Indus., Inc. v. Houston Beechcraft, Inc.*, 735 F.2d 177, 38 U.C.C. Rep. Serv. 1210 (5th Cir. 1984) (applying Kansas law); *Alafoss v. Premium Corp. of Am., Inc.*, 599 F.2d 232, 26 U.C.C. Rep. Serv. 382 (8th Cir. 1979); *Borges v. Magic Valley Foods, Inc.*, 101 Idaho 494, 616 P.2d 273, 29 U.C.C. Rep. Serv. 1282 (1980); *Hays Merchandise, Inc. v. Dewey*, 78 Wash. 2d 343, 474 P.2d 270, 8 U.C.C. Rep. Serv. 31 (1970).

189. *Hays Merchandise, Inc. v. Dewey*, 78 Wash. 2d 343, 474 P.2d 270, 8 U.C.C. Rep. Serv. 31 (1970). See U.C.C. § 2-602(2)(b).

190. *Pace v. Sagebrush Sales Co.*, 114 Ariz. 271, 560 P.2d 789, 21 U.C.C. Rep. Serv. 490 (1977); *Phil Jacobs Co. v. Mifflin*, 23 Ill. App. 3d 999, 320 N.E.2d 329, 16 U.C.C. Rep. Serv. 407 (1974).

191. *Pace v. Sagebrush Sales Co.*, 114 Ariz. 271, 560 P.2d 789, 21 U.C.C. Rep. Serv. 490 (1977).

192. 37 Bankr. 885, 38 U.C.C. Rep. Serv. 110 (Bankr. E.D. Pa. 1984).

193. *Id.* at 888, 38 U.C.C. Rep. Serv. at 113.

194. *Id. Accord Jacob Hartz Seed Co. v. Coleman*, 271 Ark. 756, 612 S.W.2d 91, 30 U.C.C. Rep. Serv. 944 (1981).

inconsistent with the seller's ownership" and thus wrongful as against the seller, is not an act inconsistent with the buyer's claim of revocation of acceptance because it does not tend to show that the goods were conforming nor does it tend to show that the nonconformity did not substantially impair the value of the goods to the buyer.

F. Making Payments on the Goods

When the buyer has made payments on the goods to the seller, two reported cases have found that such payments bar a claim of revocation of acceptance.¹⁹⁵ In both cases, the payments were made before notice of revocation was given, which was in the buyer's answer to the seller's complaint for the unpaid purchase price. However, these cases should not be read as meaning that payments made to the seller prior to notice of revocation of acceptance always preclude the remedy of revocation of acceptance. Section 2-711(1) allows a buyer who justifiably revokes acceptance to recover "so much of the price as has been paid."¹⁹⁶ Furthermore, section 2-711(3) grants a buyer a security interest in the nonconforming goods to secure reimbursement for any payments made on the price of those goods.¹⁹⁷ These provisions would be rendered meaningless if any payment on the purchase price precluded the buyer from rejecting the goods or revoking his acceptance of them. Under the proposed analysis, the mere fact that the buyer has made payments on the goods to the seller before he has reason to know of the nonconformity should not preclude the buyer from rejecting the goods or revoking his acceptance of them. Even though such acts may be inconsistent with the seller's ownership, they are not inconsistent with the buyer's claim of rejection or revocation of acceptance.

No reported cases have dealt with the question of the effect of continued payments to the seller following the buyer's rejection or revocation of acceptance. Under the proposed analysis, payments made to the seller after revocation of acceptance should normally bar a buyer from claiming revocation of acceptance. Such an act is not only inconsistent with the seller's ownership, but it is also inconsistent with the buyer's claim of revocation of acceptance. Because a justifiable revocation of acceptance relieves the buyer of his obligation to pay the contract price,¹⁹⁸ continued payments constitute a recognition by the buyer that the contract price is still owing and are thus inconsistent with the claim of revocation of acceptance.

195. *Southern Union Gas Co. v. Taylor*, 82 N.M. 670, 486 P.2d 606, 9 U.C.C. Rep. Serv. 668 (1971); *Donnell & Mudge, Inc. v. Bonita Leather Fashions, Inc.*, 8 U.C.C. Rep. Serv. 699 (N.Y. App. Term. 1971).

196. U.C.C. § 2-711(1).

197. U.C.C. § 2-711(3).

198. *E.g.*, *CMI Co. v. Leemar Steel Co.*, 733 F.2d 1410, 38 U.C.C. Rep. Serv. 798 (10th Cir. 1984).

Payments made to an independent third-party lender, however, stand on a different footing. In *Jacobs v. Rosemount Dodge-Winnebago South*,¹⁹⁹ the buyers of a nonconforming motorhome continued making installment payments, after notice of revocation, to a bank which had financed the purchase price. The seller claimed that these payments, coupled with some continued use, operated to bar the claim of revocation. The court disagreed and said:

Unless the [buyers] had . . . continued to make the loan payments on [the motorhome], it would have been repossessed by the bank under the loan agreement. Such action would not be consistent with the buyer's duty to hold the goods with reasonable care at the seller's disposition, as required by [section 2-602(2)(b)].²⁰⁰

This result is also consistent with the proposed analysis which focuses on whether the post-revocation acts are inconsistent with the claim of revocation of acceptance. Because the obligation of the buyer to pay an independent third-party lender is not affected by the nonconformity of the goods,²⁰¹ continued payment to the third-party lender is in no way inconsistent with the claim that the goods are nonconforming or the claim that the nonconformity substantially impairs the value of the goods to the buyer. This result should be reached even though the continued payments would be an "act of ownership by the buyer" and hence "wrongful" against the seller under section 2-602(2)(b).²⁰²

VI. RIGHTS AND OBLIGATIONS OF BUYERS WHO HAVE A SECURITY INTEREST IN THE GOODS

When a buyer rightfully rejects goods or justifiably revokes his acceptance of goods, he is entitled to recover from the seller "so much of the price as has been paid."²⁰³ Furthermore,

[o]n 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 (Section 2-706).²⁰⁴

The remainder of this article will explore a number of issues relating to the buyer's security interest in goods after rejection or revocation of acceptance, including: (1) the types of payments which create a security interest; (2) the

199. 310 N.W.2d 71, 32 U.C.C. Rep. Serv. 456 (Minn. 1981).

200. *Id.* at 77, 32 U.C.C. Rep. Serv. at 465.

201. See *infra* text accompanying notes 320-46.

202. Under the proposed analysis, such a wrong only gives the seller a claim for damages, and it seems highly unlikely that the seller would be able to prove any damages arising from the buyer's continued payments to an independent third-party lender.

203. U.C.C. § 2-711(1).

204. U.C.C. § 2-711(3).

effect of loss of possession of the goods on the security interest; (3) the buyer's obligation to use reasonable care in the custody of the goods; (4) how the buyer may liquidate the security interest; and (5) the relative priority of the buyer's security interest and competing security interests in the same goods.

A. *What Payments Create a Security Interest?*

When a buyer makes a total or partial payment of the purchase price in cash and thereafter rejects or revokes his acceptance, the buyer has a security interest in the goods to the extent of such total or partial payment.²⁰⁵ The term "payments made on [the goods'] price"²⁰⁶ also "includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note."²⁰⁷ Hence, a buyer who gives a personal check in full or partial payment of the price²⁰⁸ or who executes a negotiable promissory note²⁰⁹ has "paid" the seller and has a security interest in the goods to secure the refund of such payment. Furthermore, a buyer who "trades in" an old car for a credit on the price of a new car has a security interest in the new car to secure repayment of the fair market value of the trade-in.²¹⁰

One other question relating to what outlays give a buyer a security interest in the goods is somewhat more difficult: does a buyer who has not made any payment on the purchase price, but who has incurred expenses of the type referred to in section 2-711(3), have a security interest in the goods to the extent of these expenses? One court has held that a buyer who had not paid any part of the purchase price nevertheless acquired a security interest in goods by virtue of incurring expenses in the care and custody of the goods. In *Askco Engineering Corp. v. Mobil Chemical Corp.*,²¹¹ a buyer of

205. *E.g.*, *Havas v. Love*, 89 Nev. 458, 514 P.2d 1187, 13 U.C.C. Rep. Serv. 466 (1973).

206. U.C.C. § 2-711(3).

207. U.C.C. § 2-711 comment 2.

208. Of course, if the check is subsequently dishonored, the buyer's tender of payment is defeated, U.C.C. § 2-511(3), and no security interest in the buyer would arise.

209. It is unclear from the official comment to § 2-711 whether the drafters meant to exclude signing a nonnegotiable note from the type of payment giving rise to a buyer's security interest. It could be argued that the giving of a nonnegotiable note does not affect the rights of the buyer and seller inter se, and thus there is no good reason to exclude the signing of a nonnegotiable note from the types of payments giving rise to a security interest. On the other hand, holders in due course of a negotiable instrument take free of all except the "real defenses." Thus, if the negotiable instrument is negotiated to a holder in due course, the buyer's obligation to pay the instrument according to its tenor is not subject to the defense that the seller breached the underlying contract for sale by delivering nonconforming goods. However, since a subsequent taker of a nonnegotiable note cannot be a holder in due course and cannot take free of the personal defenses of the maker-buyer, the buyer could defeat the claim to payment by a holder of a nonnegotiable instrument.

210. *Ramirez v. Autosport*, 88 N.J. 277, 440 A.2d 1345, 33 U.C.C. Rep. Serv. 134 (1982). In *Ramirez*, the seller had resold the trade-in to a third-party purchaser, so the buyers were awarded the fair market value of the trade-in. The court strongly implied that if the seller had retained the trade-in, the buyers would be entitled to return of the trade-in itself.

211. 535 S.W.2d 893, 19 U.C.C. Rep. Serv. 1119 (Tex. Civ. App. 1976).

nonconforming polyethylene reshipped it to the seller who refused to accept the reshipment. When the polyethylene was returned to the buyer, the buyer stored it and ran tests to determine its composition. When the seller sued for the unpaid purchase price, the buyer counterclaimed for its costs of reshipping, storing, and testing. The court stated that the buyer had acquired a security interest in the goods by virtue of the expenses it incurred for storing, testing, and attempting to resell the polyethylene.²¹² This result seems consistent with the language of section 2-711(3). This section is more expansive than its predecessor, section 69(5) of the Uniform Sales Act, which gave a rescinding buyer "a lien to secure the repayment of any portion of the price which has been paid,"²¹³ but said nothing about a lien covering the buyer's expenses as well.

The types of expenses which are secured by the security interest granted to the buyer under section 2-711(3) are those "reasonably incurred in their inspection, receipt, transportation, care and custody."²¹⁴ The official comment to section 2-711(3) states that the "buyer's security interest . . . is intended to be limited to the items listed in subsection (3)."²¹⁵ The question arises whether expenses incurred in repairing the goods are also covered by the buyer's security interest. In *Lanners v. Whitney*,²¹⁶ the buyer purchased a used airplane which turned out to be nonconforming. The buyer revoked his acceptance of the plane and sued for rescission and damages. The court awarded the buyer incidental damages, including amounts spent to repair the plane, and noted that the buyer had a security interest in the airplane to cover these amounts.²¹⁷ Generally, it would seem that expenses to repair the goods ought to be secured by the buyer's security interest as expenses "reasonably incurred" in the "care and custody" of the rejected goods.

When and to what extent expenses are "reasonably incurred" are questions of fact, and the reported decisions have not addressed these questions in any detail. However, some guidance may be derived from cases dealing with the award of incidental damages in the nature of expenses incurred in the care and custody of goods after rejection or revocation of acceptance.²¹⁸ In *O'Brien v. Wade*,²¹⁹ a buyer purchased a Labrador retriever for \$300 based on express warranties that the dog had been extensively trained for hunting and on a promise that registration papers for the dog would be furnished.

212. *Id.* at 896, 19 U.C.C. Rep. Serv. at 1123.

213. UNIF. SALES ACT § 69(5) (1906) (act superseded by Uniform Commercial Code 1952).

214. U.C.C. § 2-711(3).

215. U.C.C. § 2-711 comment 2.

216. 247 Or. 223, 428 P.2d 398, 4 U.C.C. Rep. Serv. 369 (1967).

217. *Id.* at 236-37, 428 P.2d at 404, 4 U.C.C. Rep. Serv. at 379.

218. Incidental damages recoverable by a buyer of nonconforming goods pursuant to § 2-715(1) of the Code are limited to "expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected." U.C.C. § 2-715(1). This language is virtually identical to the language describing the expenses secured by the buyer's security interest in § 2-711(3). See U.C.C. § 2-711(3).

219. 540 S.W.2d 603, 20 U.C.C. Rep. Serv. 386 (Mo. Ct. App. 1976).

The seller thereafter refused to supply the buyer with the promised papers, and the dog proved to be unsuitable for hunting. When the seller refused to cancel the contract, the buyer placed the dog in a kennel and sued for damages for breach of contract, seeking to recover the expenses of keeping the dog in the kennel, which by the time of trial exceeded \$3,000. After a judgment for the buyer, the seller appealed and claimed that the award of incidental damages was excessive.²²⁰ The appellate court agreed and reduced the award of incidental damages to an amount equal to the cost of boarding the dog in the kennel for sixty days, or a total of \$90.²²¹ The court relied on pre-Code cases holding that a buyer cannot retain goods which are "worthless" and thereby multiply the damages due from the seller.²²² However, the court noted, somewhat inconsistently, that the dog was worth about \$50 notwithstanding its unsuitability for hunting and the absence of proper registration papers.²²³

In contrast is *Keck v. Wacker*,²²⁴ where the buyers purchased a thoroughbred mare at auction for \$117,000 based on a description of the mare's breeding history contained in the auction catalogue. The description was erroneous and the buyers revoked their acceptance. The evidence at trial was that the mare was actually worth about \$40,000. The court found for the buyers and concluded that the buyers were entitled to incidental damages for the insurance, care, custody, and preservation of the mare from the date of sale to the date of judgment, a period of two-and-one-half years.²²⁵

These cases indicate the divergence of opinion in the courts about what expenses may be "reasonably incurred" in the care and custody of nonconforming goods. They do suggest, however, that unless the goods are essentially worthless, or unless the costs of care and custody greatly exceed the market value of the goods, the buyer should be entitled to recover expenses incurred in the care and custody of the goods from the date of rejection or revocation to the date of judgment. As a general proposition, the court should defer to the buyer's judgment in all but the most extraordinary circumstances. First, courts should recognize that the buyer is subject to being "whipsawed" by the seller. If the buyer decides to resell or destroy the goods rather than incur additional costs for their care and custody, the seller will argue that such acts are inconsistent with the seller's ownership and thus a reacceptance of the goods under section 2-606(1)(c).²²⁶ Furthermore, it is the seller who placed the buyer in the position of deciding what to do with the nonconforming goods by failing to retake possession of those

220. *Id.* at 604, 20 U.C.C. Rep. Serv. at 387.

221. *Id.* at 606, 20 U.C.C. Rep. Serv. at 389-90.

222. *Id.* at 605, 20 U.C.C. Rep. Serv. at 389.

223. *Id.* at 606, 20 U.C.C. Rep. Serv. at 389-90.

224. 413 F. Supp. 1377, 20 U.C.C. Rep. Serv. 94 (E.D. Ky. 1976).

225. *Accord* *Broglie v. MacKay-Smith*, 541 F.2d 453, 20 U.C.C. Rep. Serv. 114 (4th Cir. 1976); *Lanners v. Whitney*, 247 Or. 223, 428 P.2d 398, 4 U.C.C. Rep. Serv. 369 (1967).

226. *See supra* notes 172-94 and accompanying text.

goods, and any doubt about the reasonableness of expenses incurred in their care and custody should be resolved in favor of the aggrieved party, the buyer.

Finally, it should be noted that the buyer's security interest does not extend to the buyer's claim for "loss of the bargain" damages. The official comment to section 2-711 provides: "the buyer is not permitted to retain such funds [pursuant to his security interest] as he might believe adequate for his damages."²²⁷ Of course, the buyer retains a cause of action to recover such damages,²²⁸ but the claim to those damages is an unsecured one and the buyer cannot withhold possession of the goods from the seller based on the seller's failure to remit the amount of such damages to the buyer.

B. *The Requirement of Continued Possession*

Under the Uniform Sales Act, courts held that a rescinding buyer's lien on the goods was only effective as long as the buyer retained possession of the goods.²²⁹ The same result was reached in *Procter & Gamble Distributing Co. v. Lawrence American Field Warehousing Corp.*,²³⁰ where the court held that a buyer of oil stored in a warehouse subject to nonnegotiable bills of lading naming the seller as cosignor did not have a lien on the oil because it was not in his possession or control. The court relied on the language of section 69(5) of the Uniform Sales Act and seemed to equate that provision with section 2-711(3) of the Code.²³¹ This result seems correct for a number of reasons.

First, the language of section 2-711(3) itself refers to "a security interest in goods in his [the buyer's] possession or control."²³² Second, the official comments to section 2-711 make explicit cross-reference to section 69(5) of the Uniform Sales Act and say: "The prior uniform statutory provision is generally continued and expanded in Subsection (3)."²³³ Third, section 9-113, which relates to security interests arising under article 2, provides that, so long as the goods are not in the possession of the debtor (seller), there

227. U.C.C. § 2-711 comment 2. Of course, to the extent that expenses incurred in the care and custody of the goods might also constitute incidental damages pursuant to § 2-715, such damages are subject to the buyer's security interest.

228. U.C.C. § 2-711 comment 2.

229. *E.g.*, *Weaver v. Superior Court*, 93 Cal. App. 2d 729, 209 P.2d 830 (1949); *Railroad Waterproofing Corp. v. Memphis Supply*, 303 N.Y. 849, 104 N.E.2d 486 (1952); *In re Tuduri's Estate*, 156 Misc. 317, 281 N.Y.S. 630 (Sup. Ct. 1935).

230. 16 N.Y.2d 344, 213 N.E.2d 873, 266 N.Y.S.2d 785, 3 U.C.C. Rep. Serv. 157 (1965).

231. The court stated: "[N]o lien could have attached under subdivision 5 of former section 150 of the Personal Property Law, Consol Laws, c 41 [identical to section 69(5) of the Uniform Sales Act] (in effect in New Jersey as part of the Uniform Commercial Code at the time of these transactions) unless the buyer, although free from fault, has the goods in his possession or control." *Id.* at 353, 213 N.E.2d at 877, 266 N.Y.S.2d at 792, 3 U.C.C. Rep. Serv. at 162.

232. U.C.C. § 2-711(3).

233. U.C.C. § 2-711 comment on section changes.

is no requirement for a security agreement to make an article 2 security interest enforceable.²³⁴ Also, the official comments to this section go on to say that there is no need for a filing to perfect a security interest "where the goods are in the possession of the secured party [the buyer] or of a bailee other than the debtor [seller]."²³⁵ Because a security interest in goods can only be perfected either by filing or by possession,²³⁶ and because section 9-113 dispenses with the requirement of filing to perfect an article 2 security interest, one must look to the article 9 provision governing perfection by possession, section 9-305. That section provides that a security interest in goods may be perfected by possession, but such security interest "is perfected by possession from the time possession is taken without a relation back and continues only so long as possession is retained."²³⁷ Thus, if the buyer gives up possession of the goods, his security interest becomes unperfected. Furthermore, if he gives up possession of the goods to the seller, his security interest is not only unperfected,²³⁸ but there is no enforceable security interest at all in the absence of a security agreement signed by the seller.²³⁹ Finally, the result in *Procter & Gamble* makes sense because, so long as the buyer is in possession of the goods, it is unlikely that any of the seller's creditors would be misled into extending credit to the seller on the security of such goods,²⁴⁰ but the same cannot be said if the goods are in the seller's possession.

C. *The Duty to Hold the Goods With Reasonable Care and the Option to Use the Goods*

Unlike the rejecting or revoking buyer who does not have a security interest in the goods and whose only duty is to hold the goods with reasonable care for a time sufficient for the seller to retake possession of them,²⁴¹ a buyer who has a security interest in the goods "must use reasonable care in the custody and preservation of collateral in his possession."²⁴² What actions constitute "reasonable care" is a question of fact,²⁴³ but reported cases give some guidance about the resolution of this question.

In *McGinnis v. Wentworth Chevrolet Co.*,²⁴⁴ the buyer of a car revoked her acceptance and sought to recover the purchase price after she experienced

234. U.C.C. § 9-113(a), (b).

235. U.C.C. § 9-113 comment 2.

236. See U.C.C. §§ 9-302(1)(a), 9-305.

237. U.C.C. § 9-305.

238. It is highly unlikely that the seller would agree to execute a financing statement for filing, which is the only other way for a secured party to perfect a security interest in goods.

239. U.C.C. § 9-113(a). It is equally unlikely that the seller would agree to execute a security agreement.

240. Cf. WHITE & SUMMERS, *supra* note 3, § 23-10, at 933-34.

241. U.C.C. § 2-602(2)(b). See *supra* text accompanying notes 65-93.

242. U.C.C. § 9-207(1).

243. *E.g.*, Federal Deposit Ins. Corp. v. Marino Corp., 74 A.D.2d 620, 425 N.Y.S.2d 34, 28 U.C.C. Rep. Serv. 556, 558 (1980).

244. 57 Or. App. 443, 645 P.2d 543, 33 U.C.C. Rep. Serv. 1315 (1982), *rev'd on other grounds*, 295 Or. 494, 668 P.2d 365, 37 U.C.C. Rep. Serv. 130 (1983).

serious mechanical difficulties with the car. The seller refused to refund the purchase price or retake possession of the car, and the buyer stored the car in a garage for two years while pursuing litigation. The buyer drove the car about 3,000 miles in trips to the seller for repairs, to her attorney's office for the purpose of inspecting the car, and on other trips because she believed it was mechanically unwise to leave the car idle. The court indicated that such use was appropriate for the purpose of preserving the value of the car, citing section 9-207.²⁴⁵

Although some limited use for the purpose of preserving the collateral has been approved, courts have been less receptive to buyers' arguments that extensive use of the subject goods is authorized by section 9-207. A recent example is *Gasque v. Mooers Motor Car Co.*,²⁴⁶ where the court held that the buyers' driving of an automobile for 2,600 miles after giving notice of revocation of acceptance went far beyond the use required to safeguard the goods.²⁴⁷

A failure by a buyer to use "reasonable care" to preserve the collateral gives the seller a right to damages resulting from such failure, but does not invalidate the buyer's security interest.²⁴⁸

As noted earlier,²⁴⁹ buyers of goods who do not have a security interest and who continue to use the goods after rejection or revocation of acceptance are often found to have forfeited the right to reject or revoke acceptance as a result of such continued use. Buyers who have a security interest in such goods, however, have fared much better by virtue of section 9-207(4), which provides in relevant part: "A secured party [buyer] may use or operate the collateral for the purpose of preserving the collateral or its value"²⁵⁰ The principle underlying this section has been invoked in a series of cases involving buyers of mobile homes who continued to live in the homes after rejection or revocation of acceptance.²⁵¹ Courts have tended to uphold such continued use by the buyers on the ground that abandoning possession of the mobile home would invite damage from the elements or from vandals and that the only other alternative—covered storage—would be unduly expensive.²⁵²

245. 57 Or. App. at 448, 645 P.2d at 546, 33 U.C.C. Rep. Serv. at 1318.

246. 277 Va. 154, 313 S.E.2d 384, 38 U.C.C. Rep. Serv. 120 (1984).

247. *Id.* at 162, 313 S.E.2d at 390, 38 U.C.C. Rep. Serv. at 128.

248. U.C.C. § 9-207(3).

249. See *supra* text accompanying notes 126-71.

250. U.C.C. § 9-207(4).

251. *E.g.*, *Jones v. Abriani*, 169 Ind. App. 556, 350 N.E.2d 635, 19 U.C.C. Rep. Serv. 1102 (1976); *Lawrence v. Modern Mobile Homes, Inc.*, 562 S.W.2d 729, 24 U.C.C. Rep. Serv. 874 (Mo. Ct. App. 1978); *Keen v. Modern Trailer Sales, Inc.*, 40 Colo. App. 527, 578 P.2d 668, 24 U.C.C. Rep. Serv. 881 (1978); *Jorgensen v. Pressnall*, 274 Or. 285, 545 P.2d 1382, 18 U.C.C. Rep. Serv. 1206 (1976).

252. *E.g.*, *Jorgensen v. Pressnall*, 274 Or. 285, 292, 545 P.2d 1382, 1386, 18 U.C.C. Rep. Serv. 1206, 1212 (1976).

*D. Liquidating the Buyer's Security Interest:
Resale Under Section 2-706*

A buyer who has a security interest in goods after rightful rejection or justifiable revocation of acceptance may "resell them in like manner as an aggrieved seller (Section 2-706)." ²⁵³ It should be noted at the outset that the standards governing the liquidation of the buyer's security interest in the rejected goods are contained in section 2-706, not in the standards governing disposition of collateral by other secured parties contained in part 5 of article 9. ²⁵⁴

Section 2-706 contains relatively detailed procedural requirements which the rejecting buyer must follow in reselling the nonconforming goods. The buyer is given the options of selling at a public or private sale and as a unit or in parcels, ²⁵⁵ but "every aspect of the sale including the method, manner, time, place, and terms must be commercially reasonable." ²⁵⁶ The principal procedural requirement is that the buyer must give notice to the seller of the intention to resell at a private sale ²⁵⁷ and reasonable notice of the time and place of the sale if the resale is a public one. ²⁵⁸ If the proceeds from the resale exceed the amounts subject to the buyer's security interest, the buyer must account to the seller for such excess. ²⁵⁹

There is a substantial body of case law elaborating on the requirements of section 2-706 in cases where the buyer has breached and the seller resells the goods which were the subject of the breached contract. Many of the principles developed in these decisions, especially those dealing with questions of the proper form and content of the notice of resale and the commercial reasonableness of the terms of the sale, should be equally applicable to situations where a rejecting buyer is selling goods to satisfy his statutory security interest. This article will not attempt a comprehensive review of these cases, but will examine a set of discrete problem areas where the principles developed in cases involving a seller's exercise of his section 2-706 resale remedy should not apply to situations where a rejecting buyer is reselling nonconforming goods. These problem areas are: (1) who is entitled to notice?; (2) what is the effect of a resale price that is disproportionately small in comparison to the contract price?; and (3) what is the effect of a

253. U.C.C. § 2-711(3).

254. In addition to the explicit cross-reference to § 2-706 contained in § 2-711(3), § 9-113(c) provides that article 2 security interests are generally subject to the provisions of article 9, except that "the rights of the secured party [buyer] on default by the debtor [seller] are governed by the Article on Sales (Article 2)." U.C.C. § 9-113(c).

255. U.C.C. § 2-706(2).

256. *Id.*

257. U.C.C. § 2-706(3).

258. U.C.C. § 2-706(4)(b). This subsection excuses giving notice of the time and place of a public sale if the goods are perishable or threaten to decline in value speedily. No such exception is provided for where the resale is at a private sale.

259. U.C.C. § 2-706(6).

buyer's failure to follow the procedures for resale mandated by section 2-706?

1. Who is Entitled to Notice?

A literal reading of subsections (3) and (4) of section 2-706 indicates that only the seller of goods is entitled to receive notice of the rejecting buyer's resale. Limiting notice to the other party to the contract for sale makes sense when an aggrieved seller is utilizing the resale remedy of section 2-706 following a breach by the buyer. In those circumstances, it is unlikely that any person other than the buyer would claim an interest in the property being resold. In the typical situation where the buyer wrongfully rejects the goods, fails to make a required payment for them prior to delivery, or repudiates the contract, the goods will not have been in the buyer's possession and it is unlikely that any secured creditor of the buyer would have any enforceable interest in the goods.²⁶⁰

On the other hand, where the buyer has had possession of the goods over a period of time prior to revocation of acceptance, it is much more likely that a secured party of the buyer will claim a security interest in the goods. A competing secured party is entitled to notice of a sale of collateral from an article 9 secured party²⁶¹ but such is not the case of a competing secured party claiming an interest in rejected goods, at least under a literal reading of section 2-706.

A competing secured party could argue that he should be entitled to notice of the rejecting buyer's resale based on the language of sections 9-113 and 9-504. Section 9-113 provides that a security interest arising solely under article 2 is subject to the provisions of article 9 so long as the seller does not lawfully obtain possession of the goods, except that "the rights of the secured party [buyer] on default by the debtor [seller] are governed by the Article on Sales (Article 2)."²⁶² The 1978 official text of section 9-504 provides

260. One of the requirements for a security interest to be enforceable against third parties is that "the debtor [buyer] has rights in the collateral." U.C.C. § 9-203(1)(c). Although a buyer of goods acquires a "special property" in goods when they are identified to the contract, U.C.C. § 2-501(1), one court has held that a buyer's wrongful rejection of goods terminates this "special property" in goods. *Amoco Pipeline Co. v. Admiral Crude Oil Corp.*, 490 F.2d 114, 13 U.C.C. Rep. Serv. 1019 (10th Cir. 1974) (buyer wrongfully rejected crude oil and seller exercised its rights of stoppage in transit and reclamation before buyer filed for bankruptcy; held that order of bankruptcy court did not reach the oil because it was not "property" of the debtor).

261. U.C.C. § 9-504(3). This section was amended in 1972 to require notice only to other secured parties who had made a written request for notice. The 1962 version of this section provided for notice to all other secured parties who had filed a financing statement indexed in the name of the debtor or who were known to the secured party to have a claim against the collateral. See U.C.C. § 9-504(3) (1962).

262. U.C.C. § 9-113(c). A comment to this section states that "in the case of a buyer who has a security interest in rejected goods under section 2-711(3), the buyer is the 'secured party' and the seller is the 'debtor.'" *Id.* comment 3.

that a secured party disposing of collateral must give notice of the disposition to "any other secured party from whom the secured party has received . . . written notice of a claim of an interest in the collateral."²⁶³ The 1962 official text of section 9-504 required the secured party to give notice of disposition of the collateral to "any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or who is known to the secured party to have a security interest in the collateral."²⁶⁴

Thus, a competing secured party could argue that section 9-113 only refers to article 2 as governing the "rights" of the buyer on default, but section 9-504 governs the "duties" or "obligations" of the buyer, including the obligation to give notice to the persons described in section 9-504. However, an official comment to section 9-113 makes it clear that section 9-113(c) "makes inapplicable the default provisions of Part 5 of this Article, since the Sales Article contains detailed provisions governing . . . resale after breach."²⁶⁵ This language seems clearly to displace all of the default provisions of part 5 of article 9, regardless of whether these provisions are characterized as creating "rights" or imposing "duties" on the rejecting buyer.

Although section 2-706 imposes no requirement that a buyer give notice of resale to a secured party, in all likelihood a buyer who sells nonconforming goods without giving notice of the disposition to the secured party will be in default under the terms of the security agreement between the buyer and the secured party. A typical security agreement provides that any unauthorized sale or other disposition of the collateral will constitute an event of default.²⁶⁶

2. Resale Price Disproportionately Small in Comparison to Contract Price

When a seller exercises his resale remedy under section 2-706 after the buyer has breached, courts examine the discrepancy between the resale price and the contract price as one indication of whether the seller has resold the goods in good faith and in a commercially reasonable manner. For example, in *California Airmotive Corp. v. Jones*,²⁶⁷ where the contract price on the

263. U.C.C. § 9-504(3).

264. U.C.C. § 9-504(3) (1962).

265. U.C.C. § 9-113 comment 2 (citing §§ 2-706 and 2-711(3)).

266. See SECURITY INTERESTS: SELECTED PROBLEMS IN PERFECTION, PRIORITY, AND ENFORCEMENT app. 640, para. 3.2(e) (sample Loan and Security Agreement) (Practising Law Institute 1979).

267. 415 F.2d 554, 6 U.C.C. Rep. Serv. 1007 (6th Cir. 1969).

subject airplane was \$100,000 and the buyer had, before default, made improvements costing about \$15,000, resale of the plane for \$31,000 was found to create a genuine issue of material fact as to whether such sale was commercially reasonable.²⁶⁸ Similarly, substantial discrepancy in the resale price and the prevailing market price of similar goods has been found to be evidence of bad faith or commercial unreasonableness.²⁶⁹

No such inference should necessarily be drawn from even a sizeable discrepancy between the contract price and the resale price obtained by a rejecting buyer. Because it is assumed that the goods did not conform to the contract and that the nonconformity substantially impaired the value of the goods to the buyer, one would expect for there to be a considerable gap between the resale price and the contract price. Furthermore, because nothing in section 2-706 exempts a resale from the ordinary rules governing implied warranties, the rejecting or revoking buyer will likely attempt to disclaim all warranties, which further increases the possibility that the resale will yield a comparatively low price. Thus, normally, a discrepancy between the contract price and the resale price should not be a factor in determining whether the buyer's resale was conducted in good faith and in a commercially reasonable manner.²⁷⁰ However, where the rejection or revocation of acceptance was based on a nonconformity not relating to the quality of the goods, such as a late delivery, a substantial discrepancy between the resale price and the contract price would be more relevant to a determination of good faith and commercial reasonableness.

3. Sanctions for Buyer's Noncompliance with Section 2-706

When an aggrieved seller exercises his resale remedy under section 2-706 but fails to follow the procedural requirements governing such resales, the sanction imposed on the seller for that failure is to prevent him from proving damages based on the difference between the contract price and the resale price. Instead, the seller is relegated to proving damages based on the difference between the contract price and the market price at the time and place of tender.²⁷¹

268. *Id.* at 556, 6 U.C.C. Rep. Serv. at 1010.

269. *See* *Coast Trading Co. v. Cudahy Co.*, 592 F.2d 1074, 25 U.C.C. Rep. Serv. 1037 (9th Cir. 1979) (collusive sale solely for purposes of fixing seller's damages).

270. The rejecting buyer's situation is closely akin to the situation of an aggrieved seller reselling wrongfully rejected goods which have been specially manufactured for the buyer's needs. *See* *Symonds v. Adler Restaurant Equip. Co.*, 10 U.C.C. Rep. Serv. 1179 (Okla. Ct. App. 1971) (resale of specially manufactured goods netted \$800 when contract price was \$3,600; held commercially reasonable).

271. *E.g.*, *Foxco Indus. v. Fabric World, Inc.*, 595 F.2d 976, 26 U.C.C. Rep. Serv. 694 (5th Cir. 1979); *Cole v. Melvin*, 441 F. Supp. 193, 22 U.C.C. Rep. Serv. 1154 (D.S.D. 1977); *Lee Oldsmobile, Inc. v. Kaiden*, 32 Md. App. 556, 363 A.2d 270, 20 U.C.C. Rep. Serv. 117 (1976); *B & R Textile Corp. v. Paul Rothman Indus.*, 27 U.C.C. Rep. Serv. 996 (N.Y. App. Term. 1979).

The sanction for an improperly conducted resale has no meaning at all in the situation where a rejecting buyer resells nonconforming goods to satisfy his article 2 security interest because the buyer will not be utilizing the resale provisions of section 2-706 to measure his damages for the seller's breach. Courts examining the problem of what sanctions to impose on a rejecting buyer who has failed to comply with the requirements of section 2-706 have reached different results.

In *Deaton, Inc. v. Aeroglide Corp.*,²⁷² a delay of nearly two years between the buyer's rejection of nonconforming goods and his sale of them was held to be commercially unreasonable. The court stated that "[e]xcessive delay in such a resale is enough to make the sale commercially unreasonable."²⁷³ The court noted that during the delay, the condition of the goods had further deteriorated, and that when the buyer had finally resold the goods without notice to the seller, he received only \$9,200.²⁷⁴ This was compared to the offer of the original seller to "repurchase" them for \$22,000.²⁷⁵ Having found that the buyer failed to comply with the requirements of section 2-706, the court refused to allow the buyer to recover the balance of the purchase price he had paid to the seller.²⁷⁶

In *Uganski v. Little Giant Crane & Shovel, Inc.*,²⁷⁷ the court held that a delay of two years and two months between the notice of revocation and the buyer's resale was commercially unreasonable. Because the resale of the nonconforming crane in question had been unreasonably delayed, the revoking buyer had to show that the price received on the resale of the crane equalled its fair market value at the time of revocation.²⁷⁸

In *Eska Kleiderfabrik v. Peters Sportswear Co.*,²⁷⁹ the buyer rejected about 9,000 coats and later resold them without informing the seller. The court found that the buyer had a security interest in the coats for storage and other costs, but that the buyer had failed to give the seller the required notice of intention to resell.²⁸⁰ In addition, the court found that the buyer had failed to account to the seller for the excess amounts received from the resale.²⁸¹ Despite these failures to comply with section 2-706, which the court stated "went beyond the range of permissible conduct for a buyer in possession of rejected goods,"²⁸² the court held that the buyer merely had to return to the seller the amount for which the jackets were resold, less the

272. 99 N.M. 253, 657 P.2d 109, 35 U.C.C. Rep. Serv. 130 (1982).

273. *Id.* at 259, 657 P.2d at 115, 35 U.C.C. Rep. Serv. at 139 (citing *McMillan v. Meuser Material & Equip. Co.*, 260 Ark. 422, 541 S.W.2d 911, 20 U.C.C. Rep. Serv. 110 (1976)).

274. *Deaton, Inc.*, 99 N.M. at 259, 657 P.2d at 115, 35 U.C.C. Rep. Serv. at 139.

275. *Id.*

276. *Id.*

277. 35 Mich. App. 88, 192 N.W.2d 580, 10 U.C.C. Rep. Serv. 57 (1971).

278. *Id.* at 113, 192 N.W.2d at 592, 10 U.C.C. Rep. Serv. at 74.

279. 483 F. Supp. 1228, 29 U.C.C. Rep. Serv. 534 (E.D. Pa. 1980).

280. *Id.* at 1234, 29 U.C.C. Rep. Serv. at 542.

281. *Id.* at 1235, 29 U.C.C. Rep. Serv. at 543.

282. *Id.* at 1234, 29 U.C.C. Rep. Serv. at 542.

buyer's expenses and a reasonable commission.²⁸³ However, the court did say that the duty to account to the seller included a duty to keep accurate records of the sales, and the buyer's failure to do so meant that all uncertainties with regard to the price for which the jackets were resold would be resolved against the buyer.²⁸⁴

These three cases closely parallel the three different sanctions courts have imposed on article 9 secured parties who fail to comply with the requirements of section 9-504 on disposition of collateral following default by the debtor. Some courts hold that such noncompliance bars the secured party from seeking a deficiency judgment.²⁸⁵ Other courts allow a secured party to pursue a deficiency judgment but require the secured party to overcome a rebuttable presumption that the value of the collateral equals the amount of the debt.²⁸⁶ Still other courts allow a debtor to set-off against any deficiency judgment the amount of actual damages the debtor can prove he suffered as a result of the secured party's noncompliance.²⁸⁷

In order to evaluate which of these approaches should be applied where a rejecting buyer fails to resell nonconforming goods in compliance with section 2-706, it is important to keep in mind the sorts of situations where the claim of noncompliance might arise. In the typical situation, where the resale has not yielded sufficient funds to cover the costs secured by the buyer's security interest, the buyer may sue to recover the remaining amounts due from the seller. In addition, the buyer may seek to recover his benefit-of-the-bargain damages or consequential damages, neither of which would be claims subject to the buyer's security interest in the rejected goods.

In these circumstances, several factors indicate that the court should not apply a sanction flatly denying the buyer any right to pursue the seller for these damages based solely on the buyer's noncompliance with section 2-706. First, many courts which apply this sanction when an article 9 secured party fails to follow the statutory requirements for disposition of collateral do not give any plausible explanation why such a sanction is appropriate.²⁸⁸

283. *Id.* at 1238, 29 U.C.C. Rep. Serv. at 548.

284. *Id.* at 1235, 29 U.C.C. Rep. Serv. at 544.

285. *E.g.*, Florida First Nat'l Bank v. Martin, 449 So. 2d 861, 38 U.C.C. Rep. Serv. 1073 (Fla. Dist. Ct. App. 1984); DiDomenico v. First Nat'l Bank, 57 Md. App. 62, 468 A.2d 1046, 37 U.C.C. Rep. Serv. 1427 (1984); Liberty Nat'l Bank v. Greiner, 62 Ohio App. 2d 125, 405 N.E.2d 317, 29 U.C.C. Rep. Serv. 718 (1978).

286. *E.g.*, Federal Deposit Ins. Corp. v. Rodenberg, 571 F. Supp. 455, 37 U.C.C. Rep. Serv. 665 (D. Md. 1983) (federal common law); 1st Charter Lease Co. v. McAl, Inc., 679 P.2d 114, 37 U.C.C. Rep. Serv. 1820 (Colo. Ct. App. 1984); Barney v. Morris, 168 Ga. App. 426, 309 S.E.2d 420, 37 U.C.C. Rep. Serv. 1434 (1983); Peoples-Merchants Trust Co. v. Dosis, 38 U.C.C. Rep. Serv. 1084 (Ohio Ct. App. 1980); Savoy v. Beneficial Consumer Discount Corp., 503 Pa. 74, 468 A.2d 465, 37 U.C.C. Rep. Serv. 1422 (1983).

287. *E.g.*, *In re* Deephouse Equip. Co., 38 Bankr. 400, 37 U.C.C. Rep. Serv. 1810 (Bankr. D. Conn. 1984) (applying Massachusetts law); Valley Mining Co. v. Metro Bank, 383 So. 2d 158, 28 U.C.C. Rep. Serv. 1231 (Ala. 1980); Gulf Homes, Inc. v. Goubeaux, 136 Ariz. 33, 664 P.2d 183, 37 U.C.C. Rep. Serv. 1803 (1983).

288. *E.g.*, Miles v. N.J. Motors, Inc., 44 Ohio App. 2d 351, 338 N.E.2d 784, 16 U.C.C. Rep. Serv. 555 (1975); One Twenty Credit Union v. Darcy, 40 Mass. App. Dec. 64, 5 U.C.C. Rep. Serv. 792 (1968).

Second, some courts have justified this result in an article 9 setting by finding an "accord and satisfaction" where the secured party has allegedly agreed to keep the collateral in satisfaction of the debt.²⁸⁹ That reasoning, which is seriously suspect even in the case of an article 9 secured party, is even harder to swallow in a situation where the rejecting buyer has notified the seller of the fact that the goods are nonconforming and that he wishes to return them to the seller in exchange for a refund of the purchase price. Third, the "no deficiency" rule may have some policy justification if it deters an article 9 secured party from future noncompliance with the requirements designed to protect debtors from creditor overreaching. Although that justification is not entirely implausible in the situation of a commercial lending institution which will likely be involved in sales of collateral on a frequent basis, it does not apply to a buyer of goods who will rarely, if ever, be faced again with a situation where a resale of nonconforming goods will be required.

The other two sanctions for noncompliance differ principally in how the burden of proof is allocated on the question of the debtor's damages flowing from the secured party's noncompliance with the requirements for reselling the collateral. Those courts which invoke a rebuttable presumption that the fair market value of the collateral is equal to the amount of the debt require the secured party to prove the extent of the injury to the debtor flowing from the secured party's noncompliance by a showing of the fair market value of the goods—that is, what the goods would have brought in a procedurally proper resale.²⁹⁰ This approach reflects the common wisdom that a secured party engaged in the business of lending is likely to be in a position to have employees or other agents with experience in the sale of various types of collateral and thus be able to establish the fair market value of the goods. However, it may be less appropriate to put that burden on a buyer of nonconforming goods, who is not likely to have similar expertise at his disposal unless he is engaged in the business of selling goods of that kind. On the contrary, one would normally assume that the seller of such goods would be in a better position to prove their fair market value. Thus, the better approach would be to award the breaching seller damages in the nature of a set-off to the buyer's damages but place the burden of proving fair market value on the seller.

E. Competing Security Interests in the Goods

Although no reported cases deal with the relationship of the buyer's section 2-711(3) security interest in rejected goods to a security interest in the same

289. *E.g.*, *Johnson v. Commercial Credit Corp.*, 117 Ga. App. 131, 159 S.E.2d 290, 4 U.C.C. Rep. Serv. 1183 (1968); *Moody v. Nides Fin. Co.*, 115 Ga. App. 859, 156 S.E.2d 310, 4 U.C.C. Rep. Serv. 508 (1967).

290. *See supra* note 286.

goods held by another, common sense would indicate that, in our credit-oriented society, persons other than the buyer may often claim a security interest in rejected goods. This section will analyze the relationship of the buyer's security interest in the goods to four potential classes of competing security interests: (1) a security interest retained by the seller to secure any unpaid purchase price; (2) a security interest given by a consumer buyer to a seller and subsequently assigned by the seller to a third party; (3) a security interest given by a nonconsumer buyer to a seller and subsequently assigned by the seller to a third party; and (4) a security interest given by the buyer to an independent third-party lender who has no connection with the seller.

1. Seller's Security Interest

The easiest case of conflicting security interests to resolve is where the seller extends credit to the buyer and retains a security interest in the goods to secure the unpaid balance of the purchase price. A "security interest" is defined in the Code as "an interest in personal property or fixtures which secures payment or performance of an obligation."²⁹¹ A rightful rejection or justifiable revocation of acceptance terminates the buyer's obligation to pay.²⁹² Once the underlying obligation is extinguished, so is the security interest.²⁹³

Even though the seller's security interest is extinguished, if the seller filed a financing statement covering the goods, the buyer may have difficulty reselling the goods under section 2-706 because potential purchasers may be unwilling to buy goods which are the subject of a filed financing statement.²⁹⁴ The solution to this problem lies in section 9-404 of the Code. This section provides that, where there is no outstanding secured obligation, the secured party must, on written demand by the debtor, send a properly executed termination statement.²⁹⁵ Failure of the secured party to furnish such a termination statement within ten days after proper demand renders the secured party liable in the amount of \$100 and, in addition, for any loss caused to the debtor by such failure.²⁹⁶ Hence, a buyer with a security interest in rejected goods would be well advised to make written demand on the

291. U.C.C. § 1-201(37).

292. M. RIGG & R. ALPERT, SALES OF GOODS AND SERVICES 182 (1982).

293. *Id.*; *Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 570 F.2d 1220, 23 U.C.C. Rep. Serv. 1008 (5th Cir. 1978) (applying Kentucky law).

294. If the goods are consumer goods, no filing is required to perfect the seller's purchase money security interest, other than a security interest in motor vehicles which are required to be registered. U.C.C. § 9-302(1)(d). Thus, a purchaser of consumer goods at a buyer's resale takes free of the seller's security interest if he is without knowledge of the security interest, gives value, and buys for his own personal, family, or household purposes. U.C.C. § 9-307(2). See generally M. RIGG & R. ALPERT, *supra* note 292, at 182-83.

295. U.C.C. § 9-404(1). In the case of consumer goods, the secured party must file such termination statement within one month after there is no outstanding secured obligation or within 10 days after written demand from the debtor. *Id.*

296. *Id.*

seller to furnish a termination statement promptly after rejection or revocation of acceptance in order to facilitate a prompt resale.

2. Assignee's Security Interest—Consumer Buyer

In 1975, the Federal Trade Commission ("FTC") promulgated the Trade Regulation Rule Concerning Preservation of Consumer's Claims and Defenses.²⁹⁷ The purpose of this rule is to prohibit an assignee of a consumer credit contract²⁹⁸ from acquiring the status of a holder in due course of a negotiable instrument and thus cutting off the consumer's ability to assert most claims and defenses against the assignee.²⁹⁹ This purpose is achieved by making it an unfair or deceptive practice for a seller to take or receive a consumer credit contract which fails to contain a mandatory notice stating that any holder of the consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller.³⁰⁰ The rule also prohibits a seller from receiving the proceeds of a purchase money loan unless the consumer credit contract made in connection with the loan contains an essentially identical notice.³⁰¹ As a result of requiring such notice, the paper bearing the notice would not under state law be negotiable,³⁰² and thus any assignee of the consumer credit contract could not be a holder in due course. The rule has been thoroughly discussed elsewhere,³⁰³ and a detailed analysis of its provisions will not be undertaken here. Suffice it to say that an assignee of a consumer credit contract which complies with the notice requirements of the rule is subject to all the claims and defenses which the consumer buyer could assert against the seller. Because the consumer buyer can assert the extinction of the obligation to pay the contract price as a result of the rejection or revocation of acceptance and the sub-

297. 16 C.F.R. § 433 (1985).

298. This term is defined as: "Any instrument which evidences or embodies a debt arising from a 'Purchase Money Loan' transaction or a 'financed sale' . . ." *Id.* § 433.1(i). The term "Purchase Money Loan" is defined as:

A cash advance which is received by a consumer in return for a "Finance Charge" within the meaning of the Truth in Lending Act and Regulation Z, which is applied, in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, or business arrangement.

Id. § 433.1(d). The term "financing a sale" is defined as: "Extending credit to a consumer in connection with a 'Credit Sale' within the meaning of the Truth in Lending Act and Regulation Z." *Id.* § 433.1(e).

299. See U.C.C. §§ 3-302 to -305.

300. 16 C.F.R. § 433.2(a) (1985).

301. *Id.* § 433.2(b).

302. WHITE & SUMMERS, *supra* note 3, § 14-8, at 572.

303. See, e.g., Garner & Dunham, *FTC Rule 433 and the Uniform Commercial Code: An Analysis of Current Lender Status*, 43 Mo. L. REV. 199 (1978); Note, *The FTC's Preservation of Consumers' Claims and Defenses: Consumer Security or Consumer Fraud?*, 11 VAL. U.L. REV. 263 (1976); Comment, *The FTC Holder in Due Course Rule: Neither Creditor Ruination Nor Consumer Salvation*, 31 Sw. L.J. 1097 (1977).

sequent invalidity of any security interest securing payment of the contract price, the assignee of the seller will be unable to enforce the debt or any security interest securing repayment of the debt.³⁰⁴ In addition to the FTC rule, there are also numerous state statutes limiting the scope of the "holder in due course" rule in the consumer setting.³⁰⁵

3. Assignee's Security Interest—Nonconsumer Buyer

In situations not involving consumer buyers, and thus outside the scope of the FTC rule and the state consumer-protection statutes just mentioned, the rights of a rejecting buyer in relation to an assignee of the seller depend on whether the assignee qualifies as a holder in due course or on whether the buyer has signed an agreement not to assert against an assignee any defense which he might have against the seller.

In order to qualify as a holder in due course of a negotiable instrument, an assignee of the seller must meet the well-known requirements of section 3-302(1) of the Code, which are as follows:

- (1) A holder in due course is a holder who takes an instrument
 - (a) for value; and
 - (b) in good faith; and
 - (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.³⁰⁶

The requirement of taking for value is defined in section 3-303,³⁰⁷ and the requirement of lack of notice is defined in section 3-304.³⁰⁸ If an assignee

304. In addition to assignments by the seller, the rule also applies to creditors who extend loans directly to consumers if the creditors are "affiliated" with the seller or if the seller refers customers to the creditor. 16 C.F.R. §§ 433.1(d), 433.2(b) (1985).

305. The statutes are reviewed in Willier, *Need for Preservation of Buyer's Defenses—State Statutes Reviewed*, 5 U.C.C. L.J. 132 (1972). For a discussion of the interplay between the FTC rule and the state statutes, see Comment, *supra* note 269, at 1103-06.

306. U.C.C. § 3-302(1).

307. The section provides:

A holder takes the instrument for value

- (a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or
- (b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or
- (c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person.

U.C.C. § 3-303.

308. The section provides:

- (1) the purchaser has notice of a claim or defense if
 - (a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or
 - (b) the purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged.
- (2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as

of the seller achieves the status of a holder in due course, he takes free of all but the limited "real defenses" specified in section 3-305(2).³⁰⁹ Thus, if the seller's assignee is a holder in due course, he would not be subject to the buyer's claim that the goods are nonconforming, and the buyer's undertaking to pay the contract price can be enforced by the assignee.³¹⁰

Furthermore, subject to any statute or decision establishing a different rule for buyers of consumer goods, an agreement by a buyer not to assert against the assignee any claim or defense which he might have against the

security for his own debt or in any transaction for his benefit or otherwise in breach of duty.

(3) The purchaser has notice that an instrument is overdue if he has reason to know

- (a) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or
- (b) that acceleration of the instrument has been made; or
- (c) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue. A reasonable time for a check drawn and payable within the states and territories of the United States and the District of Columbia is presumed to be thirty days.

(4) Knowledge of the following facts does not of itself give the purchaser notice of a defense or claim

- (a) that the instrument is antedated or postdated;
- (b) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof;
- (c) that any party has signed for accommodation;
- (d) that an incomplete instrument has been completed, unless the purchaser has notice of any improper completion;
- (e) that any person negotiating the instrument is or was a fiduciary;
- (f) that there has been default in payment of interest on the instrument or in payment of any other instrument, except one in the same series.

(5) The filing or recording of a document does not of itself constitute notice within the provisions of this Article to a person who would otherwise be a holder in due course.

(6) To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it.

U.C.C. § 3-304.

309. This section provides:

To the extent that a holder is a holder in due course he takes the instrument free from . . .

(2) all defenses of any party to the instrument with whom the holder has not dealt except

- (a) infancy, to the extent that it is a defense to a simple contract; and
- (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
- (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
- (d) discharge in insolvency proceedings; and
- (e) any other discharge of which the holder has notice when he takes the instrument.

U.C.C. § 3-305(2).

310. See, e.g., *Westinghouse Credit Corp. v. Chapman*, 129 Ga. App. 830, 201 S.E.2d 686, 13 U.C.C. Rep. Serv. 553 (1973).

seller is enforceable by an assignee who takes the assignment for value, in good faith and without notice of a claim or defense as to all but those defenses which could be asserted against a holder in due course.³¹¹ Even absent such an explicit agreement, where the buyer as a part of one transaction signs both a negotiable instrument and a security agreement, he is deemed to have agreed to such a waiver of defenses.³¹² Thus, an assignee of a sales contract containing, or deemed to contain, a waiver of defenses clause is not subject to the buyer's claim that the goods are nonconforming and can enforce the buyer's obligation to pay the contract price.³¹³

Therefore, an assignee who is either a holder in due course or a beneficiary of a waiver of defenses clause has a valid obligation owing from the buyer and, assuming that the prerequisites for the creation of a security interest have been met, an enforceable security interest in the goods. The question then becomes a matter of the relative priority of the assignee's and the buyer's security interests. Assuming that the assignee's security interest has been duly perfected by the timely filing of a financing statement, the assignee will be able to claim priority in the collateral. Because the assignee's security interest was "taken or retained by the seller of the collateral to secure all or part of its price," the assignee's security interest constitutes a "purchase money security interest."³¹⁴ Pursuant to section 9-312(4) of the Code, a purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.³¹⁵ Thus, assuming that the security interest of the assignee was timely perfected, the assignee would have priority over the buyer and any sale of the collateral by the rejecting buyer would not extinguish the assignee's security interest in the goods. The assignee would also be entitled to pursue the receipts of the sale under the Code's provision on proceeds.³¹⁶

If the collateral is "inventory,"³¹⁷ the assignee would also have priority over the buyer's security interest because the buyer would not have filed a financing statement covering the inventory which would give him the right of notification otherwise required for a purchase money security interest in inventory to achieve priority.³¹⁸

311. U.C.C. § 9-206(1).

312. *Id.*

313. *See, e.g., Credit Alliance Corp. v. David O. Crump Sand & Fill Co.*, 470 F. Supp. 489, 27 U.C.C. Rep. Serv. 291 (S.D.N.Y. 1979).

314. U.C.C. § 9-107(a).

315. U.C.C. § 9-312(4).

316. U.C.C. § 9-306.

317. "Inventory" is defined as goods "if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in business." U.C.C. § 9-109(4). Arguably, goods which have been rejected by a buyer would not be "inventory" because he holds them pursuant to his security interest under § 2-711(3), not for sale or lease.

318. *See* U.C.C. § 9-312(3).

Thus, assuming that the assignee's security interest has been duly and timely perfected, he will be entitled to claim priority over the buyer's section 2-711(3) security interest. If the assignee's security interest is unperfected, of course, the buyer has priority so long as his section 2-711(3) security interest remains perfected by his possession.³¹⁹

4. Third-Party Lender's Security Interest

When an independent third-party lender has acquired a security interest in the rejected goods, the buyer's obligations to that third party are totally independent of any claims or defenses which the buyer might be able to assert against the seller arising from the nonconformity of the goods. Thus, the buyer's obligation to pay the third-party lender pursuant to their agreement remains intact and the question again becomes one of the priority of the conflicting security interests in the goods.

Assuming that the third party advanced money to the buyer for the purpose of paying all or part of the purchase price of the nonconforming goods, the third party would have a purchase money security interest in the goods.³²⁰ Thus, the third party's purchase money security interest would have priority over the buyer's security interest in the same fashion as an assignee's purchase money security interest, assuming, of course, that the third-party lender's security interest was duly and timely perfected.³²¹

If the third-party lender's security interest is not a purchase money security interest, then the priority of the third-party lender's security interest in relation to the buyer's section 2-711(3) security interest is governed by subsections (a) and (b) of section 9-312(5), which provide:

- (a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.
- (b) So long as conflicting security interests are unperfected, the first to attach has priority.³²²

Before proceeding to look at some examples of how this section might apply, it is important to determine at what point in time a buyer's section 2-711(3)

319. U.C.C. § 9-301(1)(a). See U.C.C. § 9-305.

320. Section 9-107(b) provides:

A security interest is a "purchase money security interest" to the extent that it is . . .

. . . .

- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

U.C.C. § 9-107(b).

321. U.C.C. § 9-312(3), (4). See *supra* text accompanying notes 314-19.

322. U.C.C. § 9-312(5)(a), (b).

security interest becomes "perfected," because the buyer will not be in a position to perfect his security interest by filing in view of the fact that he has no financing statement to file. Because the only other way to perfect a security interest in goods is possession, one must look to section 9-305 for the article 9 rules governing perfection by possession. That section provides that a "security interest is perfected by possession from the time possession is taken without a relation back and continues only so long as possession is retained."³²³ Hence, for purposes of determining perfection, the date of the perfection of the buyer's security interest is the date he first acquired possession, assuming that his possession thereafter was continuous.³²⁴

It could be argued that the buyer's security interest does not arise until the buyer rejects the goods or revokes his acceptance in view of the language of section 2-711(3) that "[o]n rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control."³²⁵ However, an article 2 security interest is subject, with certain exceptions, to the requirements of article 9,³²⁶ including the requirements regarding perfection, and thus article 9 perfection provisions would override any contrary inference to be drawn from the language of article 2 regarding the time of perfection.

Moreover, granting priority to the buyer's security interest based on the date of first possession is consistent with the way article 9 treats perfection by filing. A secured party who files a financing statement before he makes any advances to the debtor takes priority over a second secured party who files later than the first secured party, even though the second secured party made advances to the debtor first and his advances were perfected when made, and even though the first secured party knew of the second secured party's advances.³²⁷

With these principles in mind, there are two situations where the question of priority might arise. First, where the third-party lender has filed a financing statement covering after-acquired property of the buyer-debtor prior to the time the buyer first takes possession of the goods in question, the third-party lender would prevail over the buyer. On the other hand, where the buyer takes possession of the goods prior to the time the third-party lender files its financing statement covering the goods, the buyer would prevail over the third-party lender.

While these results appear to be compelled by a literal interpretation of the article 9 priority provisions, they are hardly consistent with the expectations of the parties or the realities of commercial lending. It makes little

323. U.C.C. § 9-305.

324. If the buyer returns the goods to the seller for repair, the date of perfection of the buyer's security interest would be the date the goods were returned to the buyer after the last unsuccessful attempt at repair by the seller.

325. U.C.C. § 2-711(3).

326. U.C.C. § 9-113.

327. U.C.C. § 9-312 comment 5, example 1.

sense to accord priority to a third-party lender who has a perfected security interest in after-acquired property, yet deny priority to a third-party lender who made advances to the buyer in reliance on the security afforded by existing goods owned by the buyer. In the former situation, it is less likely that the lender was actually relying on the existence of the after-acquired property in determining whether to make the loan. In the latter situation, it is much more likely that the lender was actually relying on the buyer's apparent ownership of the goods when evaluating the assets available for liquidation in the event of the buyer's default.

The principal problem leading to these questionable results is the way article 9 treats a secured party's possession of collateral as a method of perfecting the secured party's security interest. Generally, of course, a third party's possession of goods which the debtor claims to own is excellent notice to a prospective lender that someone other than the debtor may claim an interest in the collateral.³²⁸ However, the same cannot be said when the owner of property has goods in his possession in which he may at some later time claim a security interest. In the latter situation, the buyer's possession does not give any notice at all to a prospective lender that the buyer may be, in effect, a competing secured party with a security interest in the collateral. Thus, according priority to the security interest of a rejecting buyer vis-à-vis an independent third-party lender cuts strongly against the Code's policy of not affording protection to "secret liens."³²⁹

The problem of priorities does not end here, however. Assuming that a rejecting buyer's article 2 security interest would have priority over the security interest of an independent third-party lender, the question remains whether the rejecting buyer's resale of the nonconforming goods extinguishes the subordinate security interest of that lender. A rejecting buyer who claims priority over the security interest of an independent third-party lender will likely claim that his resale of the goods operates to extinguish "any security interest or lien subordinate" to his security interest pursuant to section 9-504(4). However, as noted earlier,³³⁰ section 9-113 and the comments thereto indicate the drafters' intention to displace all of the default provisions of part 5 of article 9 in the case of a security interest arising solely under article 2, including, presumably, the provisions relating to the effect of a buyer's sale of nonconforming goods on competing security interests in the same collateral.

No resolution of this problem can be squared with both the existing language of the Code and the policy justifications underlying articles 2 and 9. If a court decides that the buyer's resale extinguishes the subordinate

328. See WHITE & SUMMERS, *supra* note 3, § 23-10, at 933-34.

329. See, e.g., 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 14.1, at 439 (1965). This principle has been firmly imbedded in the common law since *Twyne's Case*, 76 Eng. Rep. 809 (Star Chamber 1601).

330. See *supra* text accompanying notes 224-25.

security interest of the independent third-party lender, it would have to say that some provisions of part 5 of article 9 on default apply to article 2 security interests while others do not, thus ignoring the language of section 9-113 and the comments thereto. Such a holding would also allow a debtor (the rejecting buyer) to sell goods free of a perfected security interest he created where the holder of that perfected security interest had absolutely no notice of any competing security interest in the collateral. On the other hand, if section 9-504 does not apply to a buyer's resale, there is then no provision in article 2 which states the effect of a resale on a competing security interest.

Perhaps the most appropriate solution to this problem is to hold that, because a rejecting buyer's claim to priority is based on a literal reading of Code provisions which is inconsistent with the underlying Code policy of not giving effect to "secret liens," the buyer's resale should not extinguish the security interest of the third-party lender but instead limit the lender to pursuing the collateral and the proceeds thereof in the same manner in which a secured party would proceed when dealing with a situation where his debtor has wrongfully sold collateral.

If this analysis is pursued, the third-party lender's security interest in the goods continues after the sale by the buyer unless the sale was authorized by the secured party in the security agreement or otherwise.³³¹ Thus, unless the lender has authorized the buyer to sell the nonconforming goods,³³² the lender's security interest continues to be a perfected security interest in the goods in the hands of the purchaser of the goods.

The purchaser of the goods could claim that he is a buyer in ordinary course of business and that he thus takes free of the lender's security interest under either section 9-307(1) or section 2-403(1). However, a "buyer in ordinary course of business" is one "who 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 buys in ordinary course from a person in the business of selling goods of that kind."³³³ Normally, a purchaser at

331. U.C.C. § 9-306(2).

332. The language of § 9-306(2) is not a model of clarity. The relevant language provides: "[A] security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise . . ." *Id.* It could be argued that the term "or otherwise" modifies the word "authorized," and, because the buyer's resale is "authorized" by §§ 2-711(3) and 2-706, the secured party's security interest in the goods does not continue after the buyer has resold them. However, that interpretation is, at best, a strained reading of that section. In addition, courts have generally assumed that the term "or otherwise" modifies the words "by the secured party in the security agreement." *E.g.*, *First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc.*, 626 F.2d 764, 29 U.C.C. Rep. Serv. 743 (10th Cir. 1980). Furthermore, if the term "or otherwise" modifies the term "authorized," it would mean that the secured party could only authorize disposition of the collateral in the security agreement. Finally, § 9-306(2) begins with the phrase "Except where this Article [9] otherwise provides . . ." U.C.C. § 9-306(2). Thus, it could be argued that any provisions of article 2 are irrelevant.

333. U.C.C. § 1-201(9).

a buyer's resale will not likely qualify as a buyer in ordinary course of business for two reasons. First, the rejecting buyer will often not be "a person in the business of selling goods of that kind." Second, the rejecting buyer's resale is probably not a sale "in ordinary course." Although that term is not defined in the Code, one court has held that a purchaser at an execution sale is not a buyer in ordinary course,³³⁴ and a purchaser at a rejecting buyer's resale should likewise be held not to buy in ordinary course. Thus, the third-party lender should be able to reach goods in the hands of a purchaser at a buyer's resale.³³⁵

In addition to the continuation of the lender's security interest in the goods following their resale, the lender also has a security interest "in any identifiable proceeds including collections received by the debtor [buyer]."³³⁶ However, the lender's security interest in those proceeds is only a perfected security interest for a period of ten days after the disposition unless one of three things occurs: (1) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by a filing in the office(s) where the financing statement is filed;³³⁷ (2) the proceeds are "identifiable cash proceeds;"³³⁸ or (3) the security interest in the proceeds is perfected before the expiration of the ten-day period.³³⁹

It is unlikely that a lender will be able to avail himself of the first of these three alternative ways to continue the perfected status of his security interest in proceeds of the resale because the rejecting buyer will typically receive money or an instrument as proceeds of the resale of the nonconforming goods, and a security interest in money or an instrument can only be perfected by possession.³⁴⁰ Thus, the lender's previously filed financing statement could not operate to continue perfection of the lender's security interest in proceeds of this nature. Nor is the lender likely to succeed in continuing the perfection of his security interest by invoking the third exception if the proceeds are money or an instrument, because it is improbable that the rejecting buyer will agree to transfer possession of the proceeds to the lender.

The second exception is somewhat more likely to result in the lender having a continued perfected security interest in the proceeds of the buyer's resale. If the buyer puts the cash proceeds in a separate account, they remain "identifiable cash proceeds" subject to the lender's continued perfected security interest. Even if the proceeds are commingled in an account with

334. *National Shawmut Bank v. Vera*, 352 Mass. 11, 223 N.E.2d 515, 4 U.C.C. Rep. Serv. 1 (1967).

335. The purchaser at the resale may have a claim against the rejecting buyer for breach of the warranty of title, U.C.C. § 2-312(2), unless the rejecting buyer has effectively disclaimed that warranty. U.C.C. § 2-312(2).

336. U.C.C. § 9-306(2).

337. U.C.C. § 9-306(3)(a).

338. U.C.C. § 9-306(3)(b).

339. U.C.C. § 9-306(3)(c).

340. U.C.C. § 9-304(1).

other funds, many courts will apply the so-called "lowest intermediate balance" test, which provides that proceeds remain in the account so long as the account balance at all times is equal to or greater than the amount of the proceeds deposited in the account.³⁴¹ Thus, so long as the account balance exceeds the amount of the deposit, and so long as insolvency proceedings are not instituted by or against the buyer,³⁴² the lender will have a continuously perfected security interest in the proceeds from the buyer's resale.

Many of these rather abstruse questions relating to the relative priority of competing security interests in rejected goods are of more academic interest than practical significance. A rejecting buyer who attempts to sell nonconforming goods pursuant to section 2-706 and claim priority in the proceeds of that sale against a competing third-party lender risks substantial adverse consequences if he resells the goods without the permission of a lender with a perfected security interest in those goods. The typical security agreement provides that any unauthorized sale or disposition of the collateral constitutes an event of default under the security agreement,³⁴³ which typically allows the secured party to declare due immediately all amounts owed to the secured party³⁴⁴ and gives the secured party the right to pursue any other collateral in which the secured party has a security interest.³⁴⁵ Hence, there is substantial practical incentive for a rejecting buyer to cooperate with an independent third-party secured lender in disposing of the nonconforming goods.

Finally, the independent third-party lender may avoid the problem of the buyer claiming priority of his section 2-711(3) security interest by requiring the buyer to execute a security agreement containing a clause whereby the buyer agrees to subordinate any security interest in the goods that may be created in his favor to the security interest granted to the third-party lender.³⁴⁶

CONCLUSION

As the preceding discussion has illustrated, an attorney advising a rejecting buyer of nonconforming goods faces a bewildering body of conflicting case law dealing with questions of what the buyer may or may not do with the goods after rejection or revocation of acceptance. Although precise consistency of results is more than can be hoped for in view of the fluid standards of reasonableness and good faith which govern many of these questions,

341. *E.g.*, *In re Martin*, 25 Bankr. 25, 36 U.C.C. Rep. Serv. 671 (Bankr. N.D. Tex. 1982); *C.O. Funk & Sons, Inc. v. Sullivan Equip. Co.*, 89 Ill. 2d 27, 431 N.E.2d 370, 32 U.C.C. Rep. Serv. 1638 (1982); *Coachmen Indus., Inc. v. Security Trust & Sav. Bank*, 329 N.W.2d 648, 35 U.C.C. Rep. Serv. 1012 (Iowa 1983).

342. When insolvency proceedings are instituted by or against an article 9 debtor, the secured party's security interest in commingled accounts is substantially limited. *See* U.C.C. § 9-306(4).

343. SECURITY INTERESTS: SELECTED PROBLEMS IN PERFECTION, PRIORITY, AND ENFORCEMENT app. 640, para. 3.2(e) (sample Loan and Security Agreement) (Practising Law Institute 1979).

344. *Id.* at 642, para. 5.1(a).

345. *Id.* at 642-43, para. 5.1(b).

346. Subordination is authorized in U.C.C. § 9-316.

courts have introduced additional and needless confusion by failing to adopt a consistent method of analyzing what post-rejection or post-revocation acts by the buyer may invalidate his earlier rejection or revocation. This article has suggested an approach that would entitle a seller to recover damages from a buyer who continues to use or otherwise exercise dominion over goods after he has rejected them or revoked his acceptance of them. Only where the continued use or other exercise of dominion is inconsistent with the buyer's claim of rejection or revocation of acceptance should such acts result in the buyer's forfeiting his claim to rejection or revocation of acceptance. This approach gives full meaning to the language of the relevant Code provisions and the official comments thereto, recognizes the legitimate interests of both the buyer and the seller, and explains the results in most of the reported cases.

Many of the problems relating to the buyer's security interest in rejected goods are the result of an apparent lack of coordination between the provisions of article 2, which create security interests and provide for their liquidation, and the provisions of article 9, which govern questions of their validity, perfection, and priority.³⁴⁷ The solutions offered in this article are desirable only insofar as they seek to accommodate this lack of coordination between article 2 and article 9. However, until the Permanent Editorial Board for the Uniform Commercial Code undertakes a detailed examination of appropriate amendments to deal with article 2 security interests, it is likely that uncertainty and conflicting judicial decisions will continue to be the order of the day.

347. This lack of coordination has been pointed out previously in the context of an unpaid seller's claims against competing interests in the goods. See Jackson & Peters, *Quest for Uncertainty: A Proposal for Flexible Resolution of Inherent Conflicts Between Article 2 and Article 9 of the Uniform Commercial Code*, 87 YALE L.J. 907 (1978).

