

Chapter 3. Uniform Commercial Code (UCC)

After reviewing this chapter, you should be able to:

- 1. Describe how contracts governed by Article 2 differ from those governed under the common law of contracts*
- 2. Understand the various ways of entering into sales contracts*
- 3. Describe the UCC Statute of Frauds*
- 4. Understand transfer of title and risk of loss*
- 5. Understand bulk sales transfers*
- 6. Understand the nature of a negotiable instrument*
- 7. Identify the different kinds of commercial paper and the formal requirements of negotiability*
- 8. Define a “holder in due course”*

Laws relating to the sale of goods (sales law) have their origin in the common-law principles of contracts (basic contract law). However, Article 2 of the Uniform Commercial Code (UCC), which governs sales law, has made changes that meet the needs of merchants and consumers who deal with each other contractually in a modern business world. In effect, the UCC has relaxed the rules relating to sales transactions by removing many of the technical requirements found in basic contract law. Under the UCC, it is now easier to form a binding sales contract. In fact, a sales contract may be made in any manner sufficient to show that the parties intended to be bound, even though essential terms such as price, quantity, place and time for delivery, and terms of payment are missing. These missing terms can be added later by the parties or supplied under other provisions of the Code. To offset these relaxed rules, however, the Code does insist that the parties perform in good faith (honestly) and that the dominant party deal fairly with the other party to the sales transaction.

The UCC defines a sale as a contract that transfers ownership of goods from the seller (vendor) to the buyer for a price. Under the UCC, goods are defined as tangible personal property. The term *goods* also includes other items such as growing crops and timber to be cut, minerals (including gas and oil), and structures – if severance is to be made by the seller – money bought and sold as a commodity, the unborn young of animals, items specially manufactured for a buyer, and items that are attached to real property that can be easily removed without doing material harm. The term *goods* does not include intangible personal property such as shares of stock.

Article 2 generally applies to all sellers and buyers, whether they are merchants or nonmerchants. In a few limited provisions of Article 2, some special rules apply only to sales

contracts between merchants. A merchant is a professional. He or she either sells goods of the type involved in the sales contract or has specialized knowledge of the goods by virtue of his or her profession. A nonmerchant is defined as a casual seller.

Article 2 of the UCC has made substantial changes to basic contract law in the areas of offer and acceptance and consideration. An action for breach of contract under the Code must be brought within four years of the breach. Under the most current version of the UCC statute of frauds, most contracts for the sale of goods costing \$5,000 or more must be in writing to be enforceable; however, it may be years before all states have increased the amount from the old \$500 limit to the new \$5,000. Under the Code, courts can now deal directly with unconscionable contracts – that is, contracts that are unfair.

The parties to a sales contract do not always specify in the contract when title and risk of loss are to pass from seller to buyer. In such cases, rules under Article 2 of the UCC will apply.

In a sale by a merchant to a consumer at the merchant's place of business, risk of loss passes to the buyer when the buyer takes physical possession of the goods. If the seller is not a merchant, the risk of loss passes when the seller has tendered delivery.

If the seller is to ship the goods (Free on Board or Freight on Board [FOB] shipping point), risk of loss passes from the seller to the buyer on proper delivery of the goods to an independent carrier. If the seller is to deliver the goods (FOB destination), risk of loss passes after the goods have been delivered to the destination point.

In a sale on approval, risk of loss and ownership remain with the seller until the buyer accepts the goods by approval. In a sale and return, the buyer accepts risk of loss and ownership of the goods at the time of the sale; both the risk and title will revert to the seller if the buyer returns the goods.

A bulk transfer is the sale of all or a major part of the stock of merchandise, materials, supplies, or other inventory at one time and not during the ordinary course of business. The bulk-transfer law protects creditors by giving them the right to void a bulk sale (within six months) if the bulk-sale buyer does not notify them before the sale takes place.

A buyer generally obtains no better title to goods than the seller had. A person who has no title cannot pass a title on. Thus, a thief cannot pass legal title on to a good faith purchaser. The UCC allows at least two exceptions to this general rule: 1) a buyer with a voidable title can transfer a valid title to a third party who obtained the goods for value and in good faith, and 2) any merchant who is given temporary possession of goods can transfer a valid title to those goods to a buyer in the ordinary course of business.

The seller performs the sales contract by delivering conforming goods; the buyer performs by accepting and paying for these goods, assuming, of course, that there has been a proper delivery by the seller and that the goods do conform to the contract. The UCC governs performance unless the seller and the buyer make other arrangements in the sales contract. If either the goods or the delivery does not conform to the contract, the seller has the right to correct the defect in certain circumstances. If the seller does not correct the defect or is not allowed to, then the buyer may reject the goods, in effect canceling the contract. If after a reasonable inspection the buyer accepts nonconforming goods, however, he or she may no longer reject them.

Remedies available to the buyer for breach of a sales contract by the seller are: 1) suing for breach of warranty, 2) canceling the contract, 3) canceling the contract and suing for damages, and 4) suing to obtain the goods. The buyer may exercise more than one of these remedies, depending on the individual case.

Remedies available to the seller if the buyer breaches the sales contract are 1) canceling the contract, 2) reselling the goods and suing for damages, 3) suing the buyer to recover the purchase price, 4) suing the buyer to recover damages for nonacceptance, 5) withholding delivery of the goods, and 6) reclaiming the goods from the buyer.

Article 2 of the UCC provides for two types of warranties made by sellers: express warranties and implied warranties. Express warranties can arise in several ways. The seller may make a factual statement or a promise about the product, may describe the goods to the buyer, or may show the buyer a sample of the item being sold. To constitute an express warranty, the statement, description, or sample must be part of the basis of the sale. The two types of implied warranties are the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. Another type of warranty that exists under the Code is the implied warranty of title. Express warranties can be excluded from sales contracts by using clear, specific language that meets the requirements of the UCC, or by simply refraining from using language, descriptions, or samples that induce people to purchase the goods. The expressions “as is” and “with all faults” exclude all implied warranties except the implied warranty of title. The implied warranty of title is excluded only if the seller specifically states that no warranty of title is given or if the buyer realizes, or should realize, that the seller does not own the goods. If the buyer examines the goods, sample, or model or has refused to do so after a demand by the seller, there is no implied warranty as to the defects that were or should have been obvious.

Commercial paper is governed by the provisions of Article 3 of the UCC and consists of written documents or instruments that are available in the business world and that can be used as a substitute for money or a means of extending credit. There are two types of commercial paper:

promises to pay and orders to pay. Promissory notes and certificates of deposit are promises to pay. Drafts and checks are orders to pay. Notes have two parties. The maker is the person making the promise to pay, and the payee is the person to whom the note is payable. Drafts and checks have three parties. The party issuing the draft or check is the drawer, the party to whom the instrument is payable is the payee, and the party ordered to pay is the drawee. A check is a type of draft in which the drawee is always a depository institution and the drawer is the depositor. Instruments that serve as commercial paper may be either negotiable or nonnegotiable, depending on the language used in the instrument.

To be negotiable, commercial paper must meet the following requirements: 1) be in writing, 2) be signed, 3) contain a promise or order to pay, 4) contain an unconditional promise to pay, 5) be payable in a “sum certain,” 6) be payable on demand or sight or at a defined time, 7) be payable to order or to bearer, and 8) designate a drawee or place of payment with certainty.

In terms of commercial paper, to negotiate means to transfer title or ownership to another person or party in return for value received. How commercial paper can be negotiated depends on whether the instrument is an order instrument or bearer instrument. Order instruments are negotiated by endorsement and delivery, and bearer instruments are negotiated by delivery. There are four basic endorsements: blank, special, restrictive, and qualified. A blank endorsement consists only of the signature of the endorser and makes an instrument payable to the bearer. A special endorsement names the person who is to receive the instrument and includes the signature of the endorser: “Pay to the Order of . . .” A restrictive endorsement limits what the party to whom the instrument is transferred may do with the instrument: “For Deposit Only.” A qualified endorsement “without recourse” relieves the endorser from future liability if the instrument is not paid by the maker or drawee when presentment is made.

Commercial paper can be discharged by five means: payment, alteration, the statute of limitations, bankruptcy, or cancellation. When the party who is liable for payment of the instrument pays the amount to the holder, the instrument will normally be discharged. If the holder of commercial paper alters it in any significant and/or fraudulent manner, the obligation of any party whose liability has been changed by the alteration will be discharged. If commercial paper is not paid on time, the statute of limitations begins to run from the due date of the instrument. The instrument will be discharged if suit is not brought within the statutory period (usually six years). Discharge through bankruptcy of a debt evidenced by commercial paper will also discharge the instrument. A cancellation is any act that indicates that the obligation is ended and the commercial paper is discharged (markings such as “paid,” “void,” and “cancelled” are examples of cancellation).

Parties liable for payment on negotiable instruments are classified as either primary parties or secondary parties. Makers of notes and acceptors of drafts are primary parties. Drawers and endorsers are secondary parties. A primary party has unconditional liability for payment of the instrument according to its terms. The liability of the secondary party is conditional. To hold a secondary party liable, the holder of the paper must a) present the instrument for payment to the primary party, b) have the primary party dishonor the instrument, and c) give notice of dishonor to the secondary party. Generally the drawer, as a secondary party, has to pay even if the conditions of presentment, dishonor, and notice are not met.

To qualify as a holder in due course, a holder must take the instrument for value, in good faith, and without knowledge that the paper might be overdue or dishonored or that the party may have a defense against it. A holder who does not qualify as a holder in due course is considered an ordinary holder and is in the legal position as an assignee of a contract. Defenses against holders of negotiable instruments are classified as personal defenses and universal defenses. Personal (limited) defenses are good against ordinary holders, assignees, and the immediate parties to commercial paper; but they are not good against holders in due course. Universal (real) defenses are good against assignees and all holders in due course. Personal defenses include 1) fraud in the inducement, 2) lack of consideration, 3) payment at or before maturity, 4) lack of delivery of a complete instrument, 5) unauthorized completion of an incomplete instrument, and 6) slight duress. Universal defenses consist of 1) fraud in the execution, 2) forgery, 3) minority, 4) material alteration, 5) illegality, and 6) serious duress.

Under a ruling by the Federal Trade Commission, if a consumer who buys on credit gives the seller a negotiable instrument and the seller negotiates the instrument, the person taking the instrument cannot become a holder in due course. The FTC rule, however, does not apply when a consumer purchases goods or services and pays by check. The party to whom a check has been negotiated may qualify as a holder in due course.

Review Questions

1. Frank, the owner of a bicycle store, sells a pre-owned motorcycle to Wilhelm. Frank is a merchant for purposes of the UCC if he:
 - a. enjoys riding motorcycles every weekend
 - b. subscribed to motorcycling magazines
 - c. holds himself out by occupation as having knowledge and skill unique to motorcycles
 - d. has sold bicycles for 20 years

2. Mark and Jason enter into a contract in which Mark agrees to deliver cement to Jason at a construction site. They neglect to include a price in the agreement. A court will:
 - a. refuse to enforce the agreement
 - b. select the lowest quoted price for cement and insert it into the contract
 - c. determine a reasonable price for the cement and insert it into the contract
 - d. leave the parties in the position in which it found them

3. Acme Company offers in writing to sell Tech Corporation 1,000 computers for a total of \$1,000,000 and states that it will keep the offer open for seven days. On the fourth day, Tech sends an acceptance to Acme via next-day mail, but the acceptance is misdelivered, and Acme does not receive it until after the seven-day period expires. In these circumstances:
 - a. no contract is formed because Acme did not receive the letter of acceptance in time
 - b. no contract is formed because Tech should have used a quicker means of communication to notify Acme of its acceptance
 - c. no contract is formed because the acceptance was dispatched too late
 - d. a contract is formed because the acceptance was dispatched in time and in a manner reasonably calculated to give Acme notice

4. Nancy sells fur coats to Patricia, pursuant to an existing contract. Nancy concludes, however, that due to increasing pelt prices, she cannot continue to supply the coats at the agreed price. Nancy asks Patricia to agree to a ten percent increase in the price. Patricia agrees but later changes her mind. Patricia:
 - a. may cancel the contract without any further liability
 - b. may cancel the contract so long as she gives reasonable notice
 - c. will be liable for breaching the contract if she cancels it
 - d. none of the above

5. The parties to a contract for a lease of goods with payments in excess of \$5,000 may satisfy the Statute of Frauds by:
 - a. executing a written memorandum of their oral agreement
 - b. giving additional consideration to each other
 - c. filing a notice of their oral contract in the public records
 - d. all of the above

6. Alpha Computers, Inc. and Omega Electronics contract for a sale of 30 hard drives from Alpha to Omega. The hard drives are stored in City Warehouse. Under the contract, Alpha is

required to give Omega a warehouse receipt for the goods, which Omega will then pick up. Title to the goods passes to Omega:

- a. when Omega orders the hard drives from Alpha
- b. when Alpha gives Omega a warehouse receipt for the goods
- c. when Omega picks up the goods
- d. after Omega inspects the goods for defects

7. Southern Distribution, Inc. signs a receipt for goods that will also serve as a contract for the goods' transportation. This is:

- a. a bill of lading
- b. a destination contract
- c. a shipment contract
- d. a warehouse receipt

8. Fran leaves a pair of recently purchased shoes at a shoe store so that they might be dyed for a wedding. The shoe store accidentally sells Fran's shoes to Jan, who has no knowledge that the shoes belong to someone else. Fran can recover from:

- a. Jan for the return of the shoes, but she cannot recover from the shoe store because it made an honest mistake
- b. the shoe store for the purchase price of the shoes, but cannot recover from Jan because she had no knowledge that the shoes were owned by Fran
- c. both the shoe store and Jan
- d. none of the above

9. Chris in New York purchases chocolate from Sweet Candies in Los Angeles. The parties agree that Sweet will bear the risk of loss while the goods are in transit. The chocolate is destroyed near Chicago while aboard a carrier. The loss is suffered by:

- a. Chris
- b. Sweet
- c. the carrier
- d. both a and b

10. Speed Boater Company agrees to let Robin take a particular boat out for a "test run" to see if he is interested in purchasing it. Robin tries the boat for a few hours and returns it to the dealer's dock, where they complete the sale. This transaction is:

- a. a sale on approval
- b. a sale or return
- c. a consignment
- d. none of the above

11. In April, Phil buys from Henry a corn crop that Henry has not planted but hopes to harvest in the fall. After the corn is planted, Phil obtains insurance coverage on the crop. The corn is destroyed in a storm before it is harvested. Phil can:

- a. not collect on the insurance because he did not have an insurable interest in the corn
- b. not collect on the insurance because Henry was not a co-beneficiary under the insurance policy
- c. collect on the insurance because he had an insurable interest in the corn
- d. collect on the insurance because Henry did not have an insurable interest in the corn

12. Surgical Products Company contracts to deliver emergency medical supplies to Edison, using only Associated Airways. If Associated declares bankruptcy, then:

- a. the entire contract will be void
- b. Surgical may still deliver its goods to Edison in any reasonable manner
- c. only Edison may elect to perform the contract
- d. none of the above

13. Olympic Steel contracts for a sale of steel to A&B Machines, Inc. After Olympic ships the steel, A&B breaches the contract. Incidental damages arising from the breach include the costs to Olympic of:

- a. designing the goods
- b. manufacturing the goods
- c. marketing the goods
- d. transporting the goods

14. Oxford Software and Compute-a-Rama contract for Oxford's delivery of software to Compute-a-Rama. Oxford learns of Compute-a-Rama's insolvency while goods it has shipped are still in transit. Oxford may:

- a. not interfere with the shipment
- b. not interfere with the shipment if it involves goods valued in excess of \$500
- c. demand that the carrier stop only if the quantity shipped is at least a carload or more
- d. demand that the carrier stop delivery regardless of the quantity shipped

15. Erin pays half of the price for a shipment of computers that remain with the seller, Digital Computers, Inc. Within ten days of the payment, Digital becomes insolvent. Erin can recover the goods if:

- a. damages would be inadequate
- b. Digital has no other obligations
- c. Erin cannot obtain recover
- d. the computers are identified in the contract

16. Bentley orders a carload of "Grade A winter wheat" from Graham, but Graham ships "Grade B winter wheat" to Bentley. Bentley accepts the nonconforming wheat, but wishes to recover damages. Bentley must:

- a. notify Graham of the breach within a reasonable time after the defect was discovered
- b. notify Graham of the breach within one week of using or reselling the wheat
- c. keep the nonconforming wheat until any dispute is resolved
- d. none of the above

17. Schiff Sports contracts for the sale of sports equipment to the Athletic Source. Schiff ships nonconforming goods, which the Source accepts. In the Source's suit against Schiff for damages, the measure of damages is the difference between:

- a. the contract price and the Source's sales price
- b. the value of the goods as accepted and their value if they had been as promised
- c. the Source's sales price and the value of the goods promised
- d. the value of the goods as promised and the contract price

18. Molly goes to a gas station and has the oil in her car changed. The service technician learns that Molly plans to take a long trip and advises the use of a particular type of oil, to which Molly agrees. The oil breaks down while Molly is on her trip, causing damage to her car's engine. Molly may recover from the gas station for breaching:

- a. an express warranty
- b. an implied warranty of merchantability
- c. an implied warranty of fitness for a particular purpose
- d. a warranty of title

19. Stan wishes to sell his sport utility vehicle (SUV). To avoid liability for any implied warranties, the sales agreement should note that the SUV is being sold:

- a. "as is"
- b. by a nonmerchant
- c. for cash
- d. in mint condition

20. A-1 Tools, Inc. agrees to sell five lawn mowers to Green Landscaping Service. Their contract states that the mowers are being sold "as is." This statement effectively disclaims:

- a. the implied warranty of fitness for a particular purpose only
- b. the implied warranty of merchantability only
- c. the implied warranty of fitness for a particular purpose and the implied warranty of merchantability
- d. nothing

21. Allrite Products, Inc. manufactures microwave ovens. Jill discovers that her Allrite oven is defective. Jill sues the manufacturer for product liability based on negligence. To win, Jill must show that:

- a. Allrite sold the oven to Jill
- b. the "defect" was a commonly known danger
- c. Jill knew and appreciated the risk caused by the defect
- d. Jill suffered an injury caused by the defect

22. To pay his state's auto tag and title fees, Dave writes a check to the appropriate public agency. Dave is the:

- a. drawer
- b. drawee
- c. endorser
- d. payee

23. Carol wishes to negotiate a bearer instrument in her possession to Jim for an order instrument that Jim holds. Endorsements are required to negotiate:

- a. bearer instruments only
- b. order instruments only
- c. both bearer instruments and order instruments
- d. none of the above

ABA Preparatory Course: Practice 2/Business Law/Ch. 3

24. Bob receives a check from A-1 Industrial Corporation. Bob endorses the check to Quick Cash, Inc. by writing “pay to the order of Quick Cash” and signing his name. This endorsement is:

- a. a blank endorsement
- b. a qualified endorsement
- c. a restrictive endorsement
- d. a special endorsement

25. Tom, in good faith and for value, gets from Fritz a negotiable bearer instrument. Tom does not know that Fritz stole the instrument. Tom is:

- a. not a holder in due course because the instrument is a bearer instrument
- b. not a holder in due course because Fritz did not acquire the instrument in good faith
- c. not a holder in due course because Fritz did not acquire the instrument for value
- d. a holder in due course because the good faith requirement applies only to the holder, not the transferor

26. Frank is secondarily liable on a promissory note, of which Erin is the maker. Ace Credit Company is the current holder of the note. Frank will be obligated to pay the note when:

- a. Ace breaches one or more of the transfer warranties
- b. Ace negotiates the note to EZ Collection Agency, a third party
- c. Ace presents the note for payment
- d. Erin defaults on the note

27. Walt gives a \$2,000 promissory note to Paul for Paul’s agreement to deliver a truckload of lumber to Walt’s Shop. The delivered lumber is useless, due to termite infestation. Walt may defend his decision not to pay the promissory note based on:

- a. breach of warranty
- b. lack of consideration
- c. fraud in the inducement
- d. undue influence

28. Bo’s bank refuses to honor a check that would create an overdraft in his account. Bo:

- a. can sue his bank because it has a duty to pay all overdrafts
- b. can sue his bank only if the bank agreed to honor his overdrafts
- c. cannot sue his bank if the check was more than six months old
- d. cannot sue the bank because Bo and his bank are not in privity of contract

29. Delta Capital Corporation wants to perfect a security interest in a negotiable instrument owned by Quality Investments, Inc. This can be accomplished:

- a. only by filing a financing statement
- b. only by taking possession of the instrument
- c. by filing a financing statement or taking possession of the instrument
- d. none of the above

30. Fred conceals assets from his bankruptcy proceeding with the intent to defraud his creditors. When this is discovered, the court may:

- a. only deny a discharge
- b. only distribute Fred's assets to his creditors
- c. only order that Fred remain liable for the unpaid portions of the creditors' claims
- d. deny a discharge, distribute Fred's assets to his creditors, and order that Fred remain liable for the unpaid portions of the creditors' claims

Review Question Solutions

1. C
2. C
3. D
4. C
5. A
6. B
7. A
8. B
9. B
10. A
11. C
12. B
13. D
14. D
15. D
16. A
17. B
18. C
19. A
20. C
21. D
22. A
23. B
24. C
25. D
26. D
27. A
28. B
29. B
30. D

Explanations of Review Question Solutions

1. **The correct answer is C**, holds himself out by occupation as having knowledge and skill unique to motorcycles. It is pretty obvious that enjoyment (A), motorcycle magazine subscriptions (B), and the sales of bicycles (D), which are not motorcycles, do not constitute expertise in the area of motorcycles. Frank is not in the business of selling motorcycles.

2. **The correct answer is C**, determine a reasonable price for the goods. Contracts can be imperfect relating to minor terms such as price, quantity, place and time for delivery, and payment terms. These items can be perfected later by mutual agreement or by court decision and should be accepted as long as the terms are reasonable. The courts will determine a reasonable price for the goods.

3. **The correct answer is D**. Acme Company does not have to actually receive the acceptance for the acceptance of the contract to be valid (C). B is not correct, because Tech Corporation need only reply within the time limit constraints, using a common carrier (the mail), with a reasonable expectation that the acceptance will be received on time (next-day mail). The fact that the mail is not received until after the period of seven days has expired is not relevant (A). Mailbox rule: Acceptance is operative as soon as it is out of the offeree's possession. Offeror must not stipulate the means for reply in the offer that excludes the means used. The means of delivery must be reasonable (not by carrier pigeon). And the mailed reply must be addressed correctly and have proper postage.

4. **The correct answer is C**. The acceptance of the change in price is a novation, or a new agreement between the parties, which replaces the old agreement. The new agreement is binding. The price increase seems appropriate and is not in any way an undue benefit to either party.

5. **The correct answer is A**. The statute of frauds governs contracts, which involve a dollar amount that exceeds \$5,000. Written memoranda must accompany these contracts to satisfy the statute of frauds (Restatement Second of Contracts, Section 110). Additional consideration (B), public filing (C), etc., are not required.

6. **The correct answer is B**. In the case of a public warehouse, there is no need for the purchaser to actually take receipt of the items. Normally inspection of the goods prior to acceptance of goods is required prior to acceptance of delivery. Should the purchaser of the goods neglect to inspect them prior to accepting receipt, the inspection becomes moot (D). Taking the warehouse receipt constitutes acceptance of the product (B); no pick-up of the goods is required (C). Once the purchaser takes the warehouse receipt, City Warehouse will hold the goods in the name of the purchaser.

7. **The correct answer is A**, a bill of lading. A bill of lading is a document issued to the shipper by a carrier of goods. A warehouse receipt (D) is a document issued to the bailor by a warehouseman (the warehouse is the bailee of the bailed goods). Both the bill of lading and the warehouse receipt are documents of title. A document of title is a document evidencing that the person possessing it is entitled to receive, hold, and dispose of the document and the goods it covers (UCC Section 1-201(b)(16)). A document of title goes beyond a shipment contract (C) or a destination contract (B). A destination contract is a sales contract that requires that goods be shipped FOB destination (freight on board) or FAS destination (free alongside – followed by a ship and a port). In this case, the seller has the risk of loss in transportation.

8. **The correct answer is B**. Normally, when the bailee sells goods to a third party, the bailor, who is the owner of the goods, can recover the goods from the third party purchaser, because the bailee did not have title to the goods. There is one exception under UCC Section 7-205: when a buyer in the ordinary course of business purchases fungible goods (every unit of

goods is the equivalent of any other like unit, either actually or by contract, i.e., the goods are substitutable with other goods similar or identical to them) from a warehouseman who is in the business of buying and selling such goods, the buyer takes title free and clear of all claims under the warehouse receipt (A). The dealer has the appearance of being the owner, and the purchaser has no knowledge of the bailment. The bailor must recover the purchase price of the shoes from the bailee. (Also see UCC Section 2-403(2), entrusting goods to a merchant who deals in goods of that kind.)

9. **The correct answer is B**, Sweet, the party who agreed to take the risk of loss while the goods are in transit. This assumes that the carrier has taken reasonable care to ensure that the goods would not be destroyed (C).

10. **The correct answer is A**, sale on approval. In a sale on approval, neither title nor risk of loss passes until the buyer approves. In a sale or return (B), title and risk of loss pass to the buyer, subject to the buyer's right to return the goods instead of paying the purchase price. A consignment (C) is the shipment of goods from one person to another. Sales on consignment mean something different to accountants: that is, when goods are consigned to another (consignee) who sells them as the agent of the owner (consignor).

11. **The correct answer is C**. Phil had an insurable interest in the corn and can collect on his policy. An insurable interest is an interest the insured has in the risk covered by the insurance contract. In sales, an insurable interest is a person's interest in goods, which can be insured against loss. The owner of an insurance contract cannot collect unless they have an insurable interest in the property insured.

12. **The correct answer is B**. When neither party is at fault and the agreed manner of delivery becomes commercially impracticable, if there is a reasonable substitute, it must be tendered and accepted (UCC Section 2-614(1)). Delivery is still required, so A is wrong. Commercially impracticable examples given by the code include situations in which the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable.

13. **The correct answer is D**, transporting the goods. The design, manufacture, and marketing expenses are not recoverable, since Olympic can still sell the product to another buyer. Incidental damages are those paid to the nonbreaching party arising from a reasonable attempt on the nonbreaching party arising from the breach and can be to avoid loss or mitigate damages. Examples of incidental damages include costs for inspection, receipt, transportation, care, or custody of the rejected goods. Only the transportation costs were costs arising from the breach. Consequential damages are those arising directly from the breach, which the breaching party reasonably could foresee would be a result of the breach. Consequential damages can be recovered only if the other party knew or had reason to know of the breach.

14. **The correct answer is D**. Oxford may demand that the shipper stop delivery. The seller and the buyer have a right to adequate assurance of performance. Bankruptcy of the buyer is indication that the buyer may not perform his or her part of the contract to accept receipt and pay for the goods delivered. In the case of reasonable grounds for insecurity, the seller may suspend performance of the contract (stop delivery), demand in writing adequate assurance of performance, and await a reply for a reasonable time, not to exceed 30 days (UCC Section 2-609). The seller's right to receive cash payment upon discovery of buyer's insolvency allows the seller to demand cash for product already delivered or to stop delivery of product in transit, unless payment is made in cash (UCC Section 2-702). Where the buyer becomes insolvent before its performance is due, the seller may withhold the goods (UCC Section 2-703(a)).

15. **The correct answer is D**, the computers are identified in the contract. The buyer has a right to recover the goods when the seller becomes insolvent, or where the buyer desires to

receive the goods and a substantial prepayment is made (half the price) and then finds out the seller is insolvent. UCC Section 2-502 allows the buyer to recover the goods if the following conditions are met: the goods must be identified to the contract, the buyer must have paid all or part of the purchase price, the buyer must be willing to pay the balance due, if any, and the seller must become insolvent within ten days after receipt of the first installment.

16. **The correct answer is A.** Under UCC Section 2-608, the buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him or her. Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the grounds for it and before any substantial change in the condition of the goods. The revocation is not effective until the buyer notifies the seller of the revocation. A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them. One week is too restrictive. And using or reselling the wheat is not a rejection but acceptance of the product. The wheat should be returned to the seller or the seller should pick up the wheat within a reasonable period of time.

17. **The correct answer is B.** If the store accepts the goods and does not return them or asks that they be picked up, then the store can recover only the difference between the price of goods as ordered and the price of goods delivered. The buyer has the right to accept the goods, notify the seller of the breach, and subtract damages from the purchase price or sue for damages (UCC Section 2-607). The loss in value to the company of goods as delivered vs. goods as ordered is a recoverable damage.

18. **The correct answer is C,** an implied warranty of fitness for a particular purpose. An express warranty (A) is a warranty expressed by a party: any affirmation of fact or promise made to the buyer which relates to the goods and becomes part of the basis of the bargain. An express warranty must be found in the sales agreement, advertising, plans, or instructions furnished with the goods (as in the packaging) or may be made orally, as a statement of fact and not a statement of opinion (UCC Section 2-313(2)). Implied warranties are those imposed on a sales transaction by statute or court decision. An implied warranty of merchantability (B) is for all merchants; simply stated, the goods are fit for the ordinary purposes for which such goods are used (UCC Section 2-314(2)(c)). An implied warranty for fitness for a particular purpose is where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods. There is, unless excluded or modified, an implied warranty that the goods shall be fit for such a purpose (UCC Section 2-215).

19. **The correct answer is A,** "as is." Unless the circumstances indicate otherwise, all implied warranties are excluded by expressions such as "as is," "with all faults," or other language which in common understanding calls the buyer's attention to the exclusion of the warranties and makes plain that there is no implied warranty (UCC Section 2-316(3)(a)).

20. **The correct answer is C,** both implied warranty of merchantability and fitness for a particular purpose. Unless the circumstances indicate otherwise, all implied warranties are excluded by expressions such as "as is," "with all faults," or other language which in common understanding calls the buyer's attention to the exclusion of the warranties and makes plain that there is no implied warranty (UCC Section 2-316(3)(a)).

21. **The correct answer is D,** Jill suffered an injury caused by the defect. Allright's sale of the oven is not controlling; that is, the basis of implied warranties and not the manufacturer's warranties. Allright's manufacture of the product is enough to make them liable. Risk (C) and defects (B) do not give rise to product liability; only damages do. Where a defect in manufacturing or design due to negligence gives rise to injury, the manufacturer is liable for damages.

22. **The correct answer is A**, drawer. The drawer is the person who initially draws or creates and signs a draft. The drawee (B) is the person on whom a draft is drawn and ordered to pay. The “endorser” (C) is the person who signs on a (financial) instrument (i.e., a check) or a paper attached to it other than as a maker, drawer, or acceptor. An endorsee is the person named by an endorser on an instrument to whom it is to be paid. The payee (D) is the person to whose order the (financial) instrument is originally written. The payor bank is the bank by which an item is payable as drawn or accepted (UCC Section 4-105(3)).

23. **The correct answer is B**, order instruments only. Bearer instruments (A) are like cash and are owned by the bearer, the person in possession of an instrument, document of title, or certificated security payable or deliverable to bearer or indorsed in blank (signature without additional words). An instrument is a writing that evidences a right to payment of money, including negotiable instruments and also certified securities.

24. **The correct answer is C**, a restrictive endorsement, which is an endorsement that determines the type of interest in the instrument transferred. An endorsement is an endorser’s signature on an instrument, or on a paper attached to it. A blank endorsement (A) is an endorsement that does not specify any particular endorsee. An endorsee is the person named by an endorser on an instrument to whom it is to be paid. A qualified endorsement (B) is an endorsement that disclaims or qualifies the liability of the endorser on the instrument. A special endorsement (D) is an endorsement that specifies a particular endorsee.

25. **The correct answer is D**. A bearer instrument is like cash and transfers to the recipient upon the good faith of the recipient (A). The transferor does not have to have good faith: only the transferee (B and C). A bearer is a holder who is in possession of an instrument, which is bearer paper on its face, i.e., made out to Bearer or Cash or to the equivalent of these, such as a blank endorsement (UCC Section 1-201(5)). A bearer is not a holder in due course unless other conditions are met. A holder in due course (definition) is the holder of a negotiable instrument who takes it for value, in good faith, and without notice that the instrument is overdue or has been dishonored for any defense against, or claim to, the instrument by any person (UCC Section 3-302).

26. **The correct answer is D**. Erin, the primary obligee on the note, must default on the note before the co-signer, or the secondary obligee, is responsible to pay the note. Negotiating the note to another note holder (B) does not require Frank to pay. When Ace presents the note for payment (C), that does not require Frank to pay. Transfer warranties (A) are irrelevant.

27. **The correct answer is A**, breach of warranty. Consideration is the legal price bargained for a promise and inducing a party to enter into a contract. Without consideration, there is no contract. In this case, the \$2,000 promissory note is consideration (B). Fraud is a misrepresentation of fact, known to be false, intentionally made to induce another person to make or to refrain from making a contract, and reasonably relied on by the other person. In order for fraud to be a crime, the person making the misrepresentation must materially benefit from the act. There does not seem to be any fraud involved (C). Undue influence (D) is unfair persuasion by one who, because of his relationship with another, dominates the other. The question mentions no relationship or dominance of one party over the other in the contract. A warranty is an express or implied assurance that certain facts exist; an affirmation of fact or an express promise made by the seller or the manufacturer of goods, or a promise implied in a sales transaction by law that the goods sold are of a certain quality or will perform in a certain manner.

28. **The correct answer is B**. Bo can sue the bank only if it agreed to cover his overdrafts. Banks do *not* have a duty to pay all overdrafts.

29. **The correct answer is B.** Perfecting an interest in a negotiable interest is accomplished by taking possession of the instrument. Filing of financial statements (A and C) is irrelevant.

30. **The correct answer is D.** The intent to defraud the creditors gives the bankruptcy court the right to do all three.

