

Installment Contracts Under UCC 2-612: A Surprisingly Wide Path Around the Perfect Tender Rule

by Joseph A. Kuiper

Introduction

A common challenge facing attorneys involved in litigation under Article 2 of the UCC is how to approach a case from the standpoint of achieving the best possible rejection and acceptance rights. The ordinary rule governing rejection under Article 2 is known as the *perfect tender rule*. It allows a buyer to reject goods for any defect in the goods or tender of delivery. This is a harsh standard that strongly favors buyers. Understanding this, sellers faced with litigation under Article 2 often look for ways to get around the UCC altogether, such as by arguing that the contract is for services rather than goods and thus is governed by the common law's more generous substantial performance rule. While that approach is undoubtedly wise, an additional, and often overlooked, strategy lies in the treatment of installment contracts under UCC 2-612. That provision, when applicable, provides standards of rejection and cancellation that are far preferable to sellers than the perfect tender rule. Moreover, the Code makes it much easier to create an installment contract than many attorneys might realize.

This article provides an overview of the general rules governing installment contracts. It begins with a discussion of the perfect tender rule and then addresses the very different standards for rejection and cancellation that apply under Section 2-612. The rest of the article is devoted to the surprisingly flexible standards for the creation of an installment contract. The goal is to assist attorneys not only in advocating for or against the existence of an installment contract during litigation but also in proactively structuring agreements in a way that either avoids or takes advantage of Section 2-612.

Standards of Rejection for Single-Delivery Contracts

Most attorneys probably have some familiarity with the standards of rejection governing noninstallment, single-delivery contracts under Article 2. The standard, as set forth in

UCC 2-601, states that a buyer may reject "if the goods or the tender of delivery fail in *any respect* to conform to the contract" ¹ Under this rule, a buyer may generally reject for any defect in the quality of the goods, the timing of performance, or the manner of delivery. As one court has explained, "Conformity [for purposes of this rule] does not mean substantial performance; it means complete performance."²

The principal counterbalance to the perfect tender rule is the seller's right to cure under UCC 2-508.³ The right to cure serves to mitigate, to some extent, the harshness of the perfect tender rule by providing the seller with a second chance to bring the goods into conformity with the contract. But even the right to cure does not completely offset the broad rights of rejection given to buyers by the perfect tender rule. The right to cure is available, in most cases, only when the time for performance has not expired.⁴ That means it is not available, for example, when goods are delivered on an agreed-upon date but the buyer does not reject until the time for performance has passed. In those situations, the seller is entitled to a "further reasonable time" to cure only if the seller had reasonable grounds to believe the goods would be acceptable to the buyer as delivered "with or without money allowance."⁵

In short, although the right to cure might minimize the severity of the perfect tender rule in some cases, the playing field for single-delivery contracts is still heavily slanted in favor of buyers. All of this changes, however, when the rules governing installment contracts come into play.

Standards of Rejection and Cancellation for Installment Contracts

The Code's treatment of installment contracts under UCC 2-612 is radically different from its treatment of single-delivery contracts. A buyer's right of rejection under an installment contract is governed by Section 2-612(2). That provision states that a buyer

“may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured”⁶ This is a rigorous standard, since the buyer must show not only that the value of the installment is “substantially impaired”⁷ but also that the defects are not fixable.⁸ Thus, even when the defects are substantial, the buyer must accept the installment so long as the seller gives “adequate assurance” of cure.⁹ The lone exception is when the defects are so serious that they substantially impair the value of the entire contract for the buyer.¹⁰ The net effect of these rules is to make it significantly more difficult for a buyer to reject under an installment contract than under a single-delivery contract.

An installment contract is also much more difficult to cancel than a single-delivery contract. Under the latter, a buyer who rightfully rejects is entitled to cancel the contract under UCC 2-711(1), as long as the seller has no available right to cure or is unable or chooses not to exercise that right.¹¹ In contrast, with an installment contract, the buyer’s right to reject a single installment does not necessarily justify canceling the entire contract. Instead, the buyer may cancel only if the nonconformity “substantially impairs the value of the whole contract.”¹² This prevents the buyer from canceling for trivial defects¹³ and even for serious defects that do not substantially impair the value of the entire contract.¹⁴

An example of the standards created by Section 2-612 can be found in the Oregon Supreme Court’s decision in *Continental Forest Products, Inc v White Lumber Sales, Inc*.¹⁵ The parties entered into an installment contract for the sale of 20 carloads of plywood. On inspecting the first shipment, the buyer discovered that 9 percent of the plywood was too thin, almost twice the level of deviation acceptable by industry standards. The buyer rejected the installment and refused to receive any more shipments under the contract. The court found the buyer in the wrong on both points. It held that the buyer was not entitled to reject the first installment because the seller was prepared to cure the nonconformity by way of a price adjustment. Next, it held that, even assuming the value of the first installment was substantially impaired, the defect did not substantially impair the value of the entire contract.¹⁶ Of course, as discussed above, this is very different than what would have occurred if the contract had been analyzed under the perfect tender rule.

Why Are Installment Contracts Special?

The case law, commentary, and other authorities addressing UCC 2-612 are silent about what makes installment contracts worthy of special treatment under the Code. However, the answer is most likely a combination of fairness and efficiency. Under an installment contract, the buyer has committed to the purchase of more than one shipment of goods from the seller. While it might be reasonable for a buyer to insist on perfection under a single-delivery contract, it is arguably not reasonable to permit a buyer to reject and cancel an installment contract for minor defects in one shipment. Thus, the Code requires the buyer to “give a little” to further the purposes of the transaction.

Installment contracts also bring efficiency to commercial transactions. With a single-delivery contract, a buyer typically shops around for the most attractive seller and negotiates the terms of a new contract every time a purchase is made. This can be cost effective from the buyer’s standpoint if a lower price is achieved, but any savings are potentially offset by the costs of shopping and negotiating. Likewise, from the seller’s standpoint, having to market goods to attract buyers and having to negotiate a new contract for each sale is not always the most cost effective way to proceed.

Installment contracts offer an answer to these problems by forming a single contract that serves the parties’ needs over a period of time. For the buyer, this means consistency and cost savings from having an established source of supply and in some cases by allowing the seller to offer the goods at a reduced price. For the seller, it means a predictable source of sales and an enhanced ability to forecast demand. Finally, for both parties, an installment contract offers the prospect of a more successful, even durable, commercial relationship. Because the parties are familiar with each other’s expectations and have an affiliation that extends beyond the next delivery, the odds of a successful transaction are improved. It seems likely the drafters recognized these advantages and sought to encourage them by making an installment contract much more difficult to cancel than a single-delivery contract.

What Qualifies as an Installment Contract?

The special treatment of installment contracts under the Code is not limited to making them hard to cancel. Section 2-612 makes

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them easy to create as well. When most people think of an installment contract, they imagine a situation in which a contract requires a certain quantity of goods to be delivered according to a periodic schedule, such as a contract for the sale of firewood to be delivered in installments of two cords per month. But the Code's treatment of installment contracts actually goes much further.

Section 2-612(1) defines an "installment contract" as "one which requires or authorizes the delivery of goods in separate lots to be separately accepted . . ." ¹⁷ The use of the words "or authorizes" in this provision extends the universe of installment contracts far beyond those that are required, or even contemplated, by the express terms of a contract. As the commentary to Section 2-612 explains, "[t]he definition of an installment contract is phrased more broadly in this Article [than in its previous incarnation in the Uniform Sales Act] so as to cover installment deliveries *tacitly authorized* by the circumstances or by the option of either party."¹⁸ Thus, it is not necessary that the contract be expressly denominated an installment contract or that the parties necessarily agree that delivery will be made in installments. As long as the contract permits or requires delivery of less than all the goods at one time, it may be classified as an installment contract for the purposes of Section 2-612.¹⁹

The degree of difficulty involved in applying the Code's definition of installment contract depends on the variety of contract involved in the case. In the easy cases, the contract *requires* the delivery and acceptance of goods in separate installments. For example, in the Second Circuit's decision in *Trans World Metals, Inc v Southwire Co*,²⁰ an installment contract was created where the parties agreed to the purchase of 12,000 metric tons of aluminum to be delivered in monthly installments of 1,000 metric tons. The harder cases, which are the subject of this article, involve contracts that can be said to "tacitly authorize" such installments even though the contract does not expressly require them. Not surprisingly, far fewer cases have dealt with this less obvious variety of contract, and Michigan state courts have yet to address the issue. However, the cases that have been decided offer insights into the types of factors courts look to in determining whether an installment contract has been created.

In *Midwest Mobile Diagnostic Imaging, LLC v Dynamics Corp of America*,²¹ the parties contracted for the purchase of four trailers

that were to be used to provide mobile MRI services for hospitals. When the first trailer failed to perform as expected, the buyer cancelled the contract. The case then went to litigation, where the seller argued, and the district court for the Western District of Michigan agreed, that the contract was an installment contract within the meaning of UCC 2-612. Although the contract had not required or expressly authorized shipment and acceptance in separate installments, the court believed the circumstances showed that such installments were at least "tacitly authorized." The court noted that the contract's payment schedule required that "the balance for *each* unit is due at the time of shipment."²² In addition, the court found, "based on the parties' testimony it is clear that both parties understood the trailers would be delivered in separate installments."²³ One additional factor that could have been noted by the court is that the parties had actually performed as though an installment contract existed by delivering and rejecting the first trailer as an independent unit.

The Arizona Supreme Court reached the same result in *Autonumerics v Bayer Indus*.²⁴ In that case, the parties contracted for the sale of 26 numerical controls for use in milling machines produced by the buyer. The purchase order stated that the order was for 26 systems, listed a per unit price for each system, and provided for a volume discount based on the quantity of goods actually delivered. The seller delivered the first control, but the buyer refused to accept any remaining deliveries. Analyzing the circumstances, the court held that an installment contract had been created even though the contract did not require or expressly authorize shipment and acceptance in installments: "The contract provides for no definite delivery date but anticipates delivery of each control separately over a period of time. This is evidenced by the acknowledgment calling for shipping 'as scheduled' and reference to discounts for units released for shipment within a one year period."²⁵ Here again, the court could also have mentioned that the first control had actually been delivered and accepted as an independent unit.

One interesting issue raised by Section 2-612 is whether a contract may be said to "tacitly authorize" shipment and acceptance in separate installments if the only evidence pointing to such authorization is that the contract does not expressly prohibit it. For example, if a buyer agrees to purchase 10 computer systems and the contract provides

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that delivery must be made by “January 1, 2005,” is the mere fact that the contract does not say “all computers must be delivered in one shipment” sufficient to make the contract an installment contract?

The official commentary to Section 2-612 and the scholarly treatises are silent on this issue. However, the answer likely depends on the language and circumstances of the contract. On the one hand, even when a contract does not expressly prohibit shipment or acceptance in installments, it might include other language suggesting that such installments are not authorized. For example, it might state that “the purchase price will be paid as soon as all computers have been delivered and accepted.” On the other hand, if the contract includes no such language, a court applying the full breadth of UCC 2-612 could very well conclude that the contract at least *permits* delivery and acceptance in separate installments.

This appears to have been the result reached in *Extrusion Painting, Inc v Awnings Unlimited, Inc.*²⁶ In that case, the buyer ordered a trial run of aluminum extrusions from the seller. When part of the order arrived, the buyer discovered that a typographical error had caused the seller to produce many times more aluminum than the buyer needed. The seller argued that an installment contract had been created, and the district court for the Eastern District of Michigan agreed, holding simply that “the contract between the parties tacitly authorized delivery in installments.”²⁷ Given the lack of any additional factors pointing to the creation of an installment contract—for example, price, delivery, or other similar terms—the court appears to have concluded that an installment contract was created merely because the agreement did not expressly *preclude* delivery and acceptance in installments.

A federal court in Pennsylvania reached a similar holding in *Traynor v Walters*.²⁸ The parties had contracted for the sale of a large quantity of Christmas trees to be delivered to the buyer “December 6–10.” Without pointing to any particular facts, the court concluded that the agreement “tacitly authorized installment deliveries at the option of the parties” and was therefore within the terms of Section 2-612.²⁹ Because the court offered no further explanation for its holding, it would appear to have been based, as in *Extrusion Painting, Inc*, merely on the fact that the contract did not prohibit delivery and acceptance in separate installments.³⁰

In summary, there are a number of fac-

tors that courts might find persuasive in holding that an installment contract has been created. The following is a nonexhaustive list of these factors based on the case law, the official commentary, and the scholarly treatises:

- The contract does not expressly require shipment or acceptance in one installment or does not expressly preclude shipment and acceptance in separate installments.
- The price terms suggest that payment for separate installments is permissible—for example, the contract breaks down the total price into smaller units and says the balance must be paid for each unit at the time of delivery or acceptance.
- The contract gives a deadline for performance but does not identify a particular date on which the goods must be delivered.
- The contract contains a delivery deadline for one or more items in the group but leaves the time for delivering the remaining items undefined.
- The contract gives a range of time over which delivery is to occur—for example, “from January to March.”
- The evidence shows that both parties subjectively believed installments were permissible under the contract.
- Delivery or acceptance is actually performed in one or more separate installments.
- The contract’s delivery and acceptance provisions, if any, are phrased in the singular, thus indicating that delivery and acceptance of one lot at a time is permissible—for example, “*the* vehicle must be delivered by the contract deadline,” or “*the* vehicle will be accepted only if”
- The contract includes a liquidated damages provision that suggests delivery or acceptance could be in installments—for example, it states that liquidated damages will be triggered “if a shipment is not received by the deadline” or “if an (or the) apparatus is not conforming.”

In the typical case, none of these factors will necessarily be dispositive. Courts will consider all the circumstances and may, of course, find a particular factor more or less convincing in one case than in another.

Conclusion

The perfect tender rule provides a buyer with considerable leeway to reject goods tendered by a seller. The Code’s treatment of installment contracts offers a break from this rule by eliminating the buyer’s ability to re-

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ject goods or cancel the contract absent serious defects. While not every contract will qualify for this treatment, UCC 2-612 is broad enough to encompass a variety of contracts that many attorneys might not think of as installment contracts. Armed with this knowledge, a seller involved in litigation has an increased chance of finding a way around the perfect tender rule. The success of that effort will depend heavily on the language of the contract itself. The parties' surest strategy therefore is to anticipate the issue during drafting and take steps to minimize or maximize the odds of the agreement being treated as an installment contract by a court.

NOTES

1. MCL 440.2601 (emphasis added).

2. *Printing Ctr of Texas, Inc v Supermind Publ'g Co*, 669 SW2d 779, 783 (Tex App 1984).

3. MCL 440.2508.

4. MCL 440.2508(1).

5. MCL 440.2508(2). If the right to cure is not available, a seller might seek assistance from other provisions of the Code. One approach is to argue, as a few courts have held, that a buyer violates the duty of good faith and fair dealing in UCC 1-203 when the circumstances suggest its motive in rejecting goods for a minor defect is to escape a bad bargain. See *TW Oil, Inc v Consolidated Edison Co*, 443 NE2d 932 (NY 1982); *Printing Ctr of Texas, Inc*, 669 SW2d at 784 ("evidence of rejection of the goods on account of a minor defect in a falling market would in some instances be sufficient to support a finding that the buyer acted in bad faith when he rejected the goods"). Another possible approach is to argue that the ordinary rules of rejection are modified by trade usage or course of performance, as provided by UCC 2-208. Of course, these are narrow avenues that in most cases are not likely to prove fruitful.

6. MCL 440.2612(2). As with most things under Article 2, the parties may vary the standards for the rejection of an installment contract by way of agreement. The official commentary states that "an installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure." MCL 440.2612 comment 4. However, the commentary notes that "[a] clause requiring accurate compliance as a condition to the right to acceptance must . . . have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction." *Id.*

7. "Substantial impairment," as explained by the official commentary, involves consideration of the quality, quantity, and assortment of goods as well as the time frame contemplated by the contract. *Id.* "It must be judged in terms of the normal or specifically known purposes of the contract." *Id.* The concept of substantial impairment has much in common with the concept of material breach under the common law. See James J. White & Robert S. Summers, *Uniform Commercial Code* 442 (4th ed 1995) (referring to list of factors spelled out for "material breach" under §241 of the Restatement (Second) of Contracts).

8. In many cases there will be a correlation between the significance of a defect and the ability of the seller

to cure it. As one author explains, although "[t]heoretically, whether a defect is a major or minor defect presents a question which is distinct from the question of whether the defect may be cured . . . , [a]s a practical matter, . . . the two questions will tend to merge or fuse. Thus it is most likely that when a defect may be readily 'cured' either by a correction of the goods themselves or by a price adjustment, a court will be inclined to conclude that the defect is a minor defect. If the defect cannot be cured it is increasingly likely that it will not be regarded as minor." Ronald A. Anderson, *Anderson on the Uniform Commercial Code* 249 (3d ed 1981).

9. MCL 440.2612(2). Of course, just because a defect is minor and therefore does not justify rejection under UCC 2-612(2) does not mean the seller is off the hook entirely: "It is true that the buyer cannot justify the rejection of an installment on the basis of a minor nonconformity. Such a nonconformity, however, constitutes a breach of contract for which the seller is liable. Thus, upon acceptance, the seller becomes liable for damages under 2-714." Thomas M. Quinn, *Quinn's Uniform Commercial Code and Law Digest* (2d ed 1991). Such damages are measured by the difference between the value of the goods with and without the defect, together with incidental and consequential damages. MCL 440.2714(2)–(3). However, damages under this section are available only if the buyer has accepted the goods and given notification to the seller of his or her intent to declare the contract in breach. MCL 440.2714(1).

10. See MCL 440.2612(3).

11. See MCL 440.2711(1). The interaction of the right to cancel and the right to cure is explained by the official commentary to UCC 2-711(1): "Despite the seller's breach, proper tender of delivery under [2-508] or replacement can effectively preclude the buyer's remedies under [2-711(1)] . . ." MCL 440.2711 comment 1.

12. MCL 440.2612(3). Here again, the official commentary is instructive: "Whether the non-conformity in a given installment justifies cancellation as to the future depends, not on whether such non-conformity indicates an intent or likelihood that future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract." MCL 440.2612 comment 6. Thus, in the words of one court, "the question is one of *present* breach which focuses on the importance of the nonconforming installment relative to the contract as a whole." *Midwest Mobile Diagnostic Imaging, LLC v Dynamics Corp of America*, 965 F Supp 1003, 1016 (WD Mich 1997) (emphasis added).

13. See *Midwest Mobile Diagnostic Imaging, LLC*, 965 F Supp at 1015.

14. Even then, the Code provides that the right to cancel is lost if the buyer fails to "seasonably notif[y]" the seller of its intent to cancel or if the buyer "brings an action with respect only to past installments or demands performance as to future installments." MCL 440.2612(3).

15. 856 Or 466, 474 P2d 1 (1970).

16. A similar example is found *Holiday Mfg Co v BASF Sys, Inc*, 380 F Supp 1096 (D Neb 1974). In that case, the buyer cancelled an installment contract for the sale of six million cassettes after encountering "continuous quality problems and delivery delays" in receiving shipments. Although the court did not question the quality problems or delays in some of the shipments, it held that they were not so serious as to substantially impair the value of the whole contract.

17. MCL 440.2612(1). UCC 2-105 defines a "lot" as a "parcel or single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract." MCL 440.2105. The same section defines "commercial unit" as "such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit

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may be a single article (as a machine) or a set of articles” *Id.* Thus, the terms “lot” and “commercial unit” are not mutually exclusive. A contract for the sale of several commercial units (such as computer systems), which called for delivery one unit at a time, would qualify as a shipment in “separate lots” within the meaning of UCC 2-612.

18. MCL 440.2612 comment 1 (emphasis added).

19. See Anderson, *supra* note 9, at 246.

20. 769 F2d 902 (2d Cir 1985).

21. 965 F Supp 1003 (WD Mich 1997).

22. *Id.* at 1010 (emphasis in original).

23. *Id.* Although a subjective understanding is not necessary to the creation of an installment contract, it does go a long way toward showing that such a contract was at least authorized under the circumstances.

24. 144 Ariz 181, 696 P2d 1330 (Ariz Ct App 1984).

25. *Id.* at 186.

26. 37 F Supp 2d 985, 996–997 (ED Mich 1999).

27. *Id.* at 997.

28. 342 F Supp 455 (MD Penn 1972).

29. *Id.* at 461.

30. Although the court did not say so, it might also have given some weight to the fact that the parties had agreed that delivery would take place “December 6–10,” thus suggesting that partial deliveries during those days were permissible under the contract.



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