

# IDENTIFYING FUNGIBLE GOODS UNDER THE UCC THROUGH A CONTEXTUAL LENS

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## I. INTRODUCTION

Economic downturn causes warehouses to fill up with goods.<sup>1</sup> Many of these goods are fungible products. Some have been purchased, some not. But how these fungible goods are identified in these warehouses—separated and segregated out—for particular customers is of vital importance in certain circumstances. Similarly, periods of financial distress often motivate parties to find cheap and efficient ways to discharge their obligations, be it through bankruptcy, contract breach, or some other state sanctioned debt relief.<sup>2</sup> Business bankruptcies have increased dramatically as a result of the financial market turmoil caused by the sub-prime mortgage crisis.<sup>3</sup> Thus, in periods of financial distress,

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1. See Anthony Karydakis, *Slim Chance of a Turnaround in 2009*, CNNMONEY.COM, available at [http://money.cnn.com/2009/01/30/news/economy/Karydakis\\_turnaround.fortune/index.htm](http://money.cnn.com/2009/01/30/news/economy/Karydakis_turnaround.fortune/index.htm) (last visited Sept. 15, 2009) (discussing the increasing rate in which warehouses are filling up).

2. James A. Chatz & Joy E. Levy, *Alternatives to Bankruptcy*, 17 NORTON J. BANK. L. & PRAC. 1, art. 5 (Feb. 2008).

3. John Hartgen, *Total Bankruptcy Filings Up 34 Percent, Business Filings Up 61 Percent in Third Quarter*, AM. BANKR. INST., Dec. 15, 2008, available at <http://www.abiworld.org/AM/Template.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=55930> (last visited Sept. 15, 2009) (“Business filings for the 3-month period ending September 30, 2008, totaled 11,504, up 61 percent from the 7,167 bankruptcy business cases filed in the same period in 2007.”).

it is imperative that buyers, sellers, creditors, and debtors know whose goods are whose. This Article seeks to clarify one of those elusive legal concepts under the Uniform Commercial Code (UCC) as it pertains to sales contracts: the identification of fungible goods.

When it comes to fungible goods, the identification requirement of UCC Article 2 (Article 2) seemingly has an identity problem. Identification means “the process or event in which an individual item or items become designated as the particular goods to be sold under the contract.”<sup>4</sup> Article 2 requires that the goods be identified to the contract before certain rights or obligations are determined. For instance, identification is necessary for title to goods to pass, for risk of loss to shift, to obtain a special property interest, or to pursue certain legal remedies.<sup>5</sup> When parties contract to sell goods, it is often clear what goods are to be sold under the contract. However, in some situations involving fungible goods, the answer may not be that obvious.

For example, when a seller and a buyer enter into a contract whereby a seller is to sell the buyer 5,000 fungible widgets, exactly which 5,000 widgets from the whole lot of widgets are to be sold under the contract is often unknown before performance is due. Under Article 2, parties’ rights and obligations sometimes depend upon whether the goods have been identified to the contract. A survey of the current case law on identification reveals that courts have applied different standards to determine when fungible goods are “identified” in different contexts. This Article examines courts’ approaches to identification of fungible goods in four different contexts.

Part II of this Article outlines the basic principles of identification and fungible goods.<sup>6</sup> It provides a framework for an examination of the different identification approaches courts have used. Part III examines in detail the different identification approaches in four contexts: (1) the casualty loss context;<sup>7</sup> (2) the resale or remedial context;<sup>8</sup> (3) the title

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4. JAMES BROOK, *SALES AND LEASES, EXAMPLES AND EXPLANATIONS* 293 (Aspen Publishers, 4th ed. 2006).

5. *See, e.g.*, U.C.C. § 2-401 (2007) (passage of title); U.C.C. § 509 (2007) (risk of loss); U.C.C. § 2-501 (2007) (property interest); U.C.C. § 2-706 (2007) (remedial context).

6. *See infra* Part II (discussing the UCC concepts of identification and fungible goods).

7. *See infra* Part III.A (discussing how fungible goods are strictly identified in the casualty loss context).

8. *See infra* Part III.B (examining how courts apply the identification requirement liberally in the context of fungible goods and the seller’s resale remedy).

context;<sup>9</sup> and (4) the insolvency context.<sup>10</sup> Specifically, this Part addresses courts' determinations as to whether identification is required for fungible goods in these contexts and to what extent. Although not specifically acknowledged by any court, the case law survey shows that courts' approaches to the identification requirement vary with context. When identification of fungible goods arises in the casualty context, courts have generally applied a strict approach—refusing to find identification unless certain conditions have been met. Courts in both the resale and the title context have generally adopted a more liberal approach—either dispensing with the identification requirement altogether or finding the identification requirement satisfied even though goods have not been specifically designated. Similarly, in the insolvency context, courts have adopted the more liberal approach.

Part IV then examines the different approaches in light of the public policy reasons underlying the UCC.<sup>11</sup> This Part concludes that the courts' seemingly discordant treatment of the identification requirement is in fact supported by the policy reasons behind Article 2.

## II. THE BROADER CONTEXT: IDENTIFICATION AND FUNGIBLE GOODS IN UCC ARTICLE 2

The UCC Article 2 applies to transactions in goods.<sup>12</sup> Goods include all things moveable at the time of identification to the contract.<sup>13</sup> The UCC is to be construed liberally<sup>14</sup> to promote the UCC's underlying purpose of simplifying and clarifying the law governing commercial transactions.<sup>15</sup> The stated policies of the UCC include: (1) simplifying and clarifying the law governing commercial transactions; (2) permitting

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9. See *infra* Part III.C (exploring the liberal approach courts take toward identifying fungible goods in the passage of title context).

10. See *infra* Part III.D (discussing the approach courts take when identifying fungible goods where the seller becomes insolvent and in determining whether the buyer has a special property interest).

11. See *infra* Part IV (arguing that the varied contextual approach court's take is actually supported by the underlying policies of the UCC).

12. U.C.C. § 2-102 (2007). For a complete discussion of the current U.C.C.'s scope provision and the revised U.C.C.'s scope provision, see generally Ann Lousin, *Proposed UCC 2-103 of the 2000 Version of the Revision of Article 2*, 54 SMU L. REV. 913, 915-25 (2001).

13. U.C.C. § 2-105(1) (2007). The unborn young of animals are considered goods. *Id.* Under certain circumstances, materials attached to realty may also be goods. See U.C.C. § 2-107 (2007).

14. U.C.C. § 1-102(1) (2007).

15. U.C.C. § 1-102(2) (2007).

the “expansion of commercial practices through custom, usage, and agreement;” and (3) unifying the law across various jurisdictions.<sup>16</sup>

### A. Identification Defined

“Identification is that process by which goods are linked, set aside, or otherwise designated as those to which a contract refers.”<sup>17</sup> Identification requires some overt act by at least one of the parties in some situations.<sup>18</sup> Identification has been defined as a commitment of goods to the buyer under the contract provisions by the seller.<sup>19</sup> The UCC Article 2 “frequently draw[s] distinctions based on whether goods have been identified as to the specific goods to which the contract refers.”<sup>20</sup> Article 2 has seemingly adopted the all-purpose stance that when in doubt, goods should be considered identified.<sup>21</sup>

Identification has been described as an “elusive and ephemeral” concept,<sup>22</sup> and has been dismissed as of limited importance in the grand scheme of the UCC.<sup>23</sup> Legal scholars have paid scant attention to this

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16. U.C.C. § 1-102(2)(a)-(c) (2007). Courts may justify reliance on different jurisdictional interpretations of the UCC to promote uniformity. *Metro. Alloys Corp. v. State Metals Indus., Inc.*, 416 F. Supp.2d 561, 566 (E.D. Mich. 2006).

17. *Servbest Foods, Inc. v. Emessee Indus. Inc.*, 403 N.E.2d 1, 7 (1980). *See also In re Ashby Enters. Ltd.*, 262 B.R. 905, 912 (Bankr. D. Md. 2001) (“Identification is the process that transforms unascertained goods into specific goods so that they become the goods to which the contract refers.”). *Id.*

18. Shivbir S. Grewal, *Risk of Loss in Goods Sold During Transit: A Comparative Study of the U.N. Convention on Contracts for the International Sale of Goods, the U.C.C., and the British Sale of Goods Act*, 14 L.A. INT’L & COMP. L.J. 93, 109 (1991). However, in some instances, such as when an animal is conceived, no overt action is required for identification. U.C.C. § 2-501, cmt. 6.

19. 77A C.J.S. *Sales* § 217 (2008). “Identification of goods” has been defined as a “process that enables a buyer to obtain an identifiable (and therefore insurable) interest in goods before taking possession from the seller.” BLACK’S LAW DICTIONARY 761 (8th ed. 1999).

20. *See* DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON THE SALE AND LEASE OF GOODS 223 (4th ed. 2004).

21. U.C.C. § 2-501, cmt. 2 (2007) (“In view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification.”); *see also In re Doughty’s Appliance, Inc.*, 236 B.R. 407, 416 (Bankr. D. Or. 1999). As shown in Part III.A, however, this is not always the case.

22. *Wilson v. M&W Gear*, 442 N.E.2d 670, 674 (1982).

23. *Id.* at 671 (stating identification is relatively unimportant under the U.C.C.); *Servbest Foods, Inc.*, 403 N.E.2d at 8 (“[T]he function of identification in the Code is limited.”). The U.C.C. was drafted under the sponsorship of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. M. Christie Helmer, *Has China Adopted the U.C.C.?*, 11 INT’L LEGAL PERSP. 159 (2001). It was presented to the fifty-two states in 1952 for potential adoption. *Id.*

concept.<sup>24</sup> Others have been quick to retort that “[n]othing could be further from the truth.”<sup>25</sup> Indeed, identification is a steady concept underlying many of the UCC’s most important provisions.<sup>26</sup> Absent identification, title to goods cannot pass, in certain cases the risk of loss cannot shift, any property interest or insurable interest cannot be obtained, and some remedies for breach may be unavailable.<sup>27</sup> Thus, in certain scenarios, proper identification of goods can make all the difference.

UCC Section 2-501 provides the dichotomous manner in which identification occurs.<sup>28</sup> First, if goods are currently in existence, then “identification occurs when the contract is made.”<sup>29</sup> Second, if the goods are future goods,<sup>30</sup> goods are identified when “shipped, marked, or otherwise designated by the seller as goods to which the contract refers.”<sup>31</sup> Identification does not depend upon whether the goods are deliverable or whether the goods are completely processed.<sup>32</sup> A seller’s “duty . . . to segregate and deliver the goods” is apart from identification.<sup>33</sup>

### *B. Fungible Goods Defined*

Still, identifying fungible goods can pose unique problems. In an age of assembly lines, mass production, and bulk merchandise, many sales contracts governed by the UCC pertain to “fungible goods.” Fungible goods are goods of which each individual unit is identical with every other unit in the bulk.<sup>34</sup> A bulk is “a ponderous shapeless mass of

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24. The authors of this article have been unable to locate a single journal article dealing specifically with the concept of identification.

25. *Wilson*, 442 N.E.2d at 678 (Hieple, J., dissenting).

26. See U.C.C. §§ 2-401 (2007) (passage of title), 2-501 (2007) (buyer’s insurable interest), 2-613 (2007) (casualty loss exception to performance), 2-509 (2007) (risk of loss in absence of breach), 2-703 (2007) (resale remedy). Overall, identification is important for about twenty of the UCC’s provisions. Linda J. Rusch, *The Concept of Identification*, HAWKLAND UNIFORM COMMERCIAL CODE SERIES, § 2-501:1 (West 2008).

27. See, e.g., U.C.C. § 2-401 (passage of title); U.C.C. § 509 (risk of loss); U.C.C. § 2-501 (property interest); U.C.C. § 2-706 (2007) (remedial context).

28. U.C.C. § 2-501(1).

29. U.C.C. § 2-501(1)(a).

30. U.C.C. § 2-105(2) (2007) (“Goods which are not both existing and identified are ‘future’ goods.”).

31. U.C.C. § 2-501(1)(b).

32. U.C.C. § 2-501, cmt. 4.

33. U.C.C. § 2-501, cmt. 5.

34. *Mississippi State Tax Comm. v. Columbia Gulf Transmission*, 161 So.2d 173, 178 (1964); see also *Emery v. Weed*, 36 U.C.C. Rep. Serv. 827 (Pa. Comm. 1982) (“Fungible goods have been defined as such property where each unit is the equivalent of

material.”<sup>35</sup> An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined.<sup>36</sup>

The Code also provides that goods which are not fungible shall be deemed fungible if the parties agree that unlike units are to be treated as equivalents.<sup>37</sup> The UCC’s definition of fungible goods encompasses nearly all bulk goods.<sup>38</sup> The comments to the UCC state that:

[U]ndivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough . . . to effect an identification if there is no explicit agreement otherwise.<sup>39</sup>

The UCC states that so long as the fungible goods are “agreed upon by number, weight, or other measure,” the goods may be sufficiently identified.<sup>40</sup> The reason for this is because fungible goods usually are sold by “weight, measure, or count,” and not by description.<sup>41</sup> Thus, an

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any other unit. . . . By fungible goods are meant goods any unit of which is from its nature or by mercantile custom treated as the equivalent of any other unit.”); *Merchs. Refrigerating Co. v. United States*, No. S-77-454, 1979 WL 1310, at \*5 (E.D. Cal. Mar. 2, 1979) (“Fungible is defined as of such a kind or nature that one specimen or part may be used in place of another specimen.”) (internal quotations omitted). The Code defines fungible to be “goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit.” U.C.C. § 1-201(17) (2007).

35. *Merchs. Refrigerating Co.*, 1979 WL 1310, at \*5.

36. U.C.C. § 2-105(4) (2007); see also Samuel Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 562, 571-72 (1950) (criticizing the U.C.C.’s “fungible goods” definition as ambiguous in that it is unclear whether the fungible goods definition applies only to agreements to sell goods, agreements to transfer title to a select portion, or both).

37. U.C.C. § 1-201(17) (2007). For instance, cattle in a larger herd specified by number and year are sufficiently identified because cattle are customarily valued by age. *Watts v. Hendry*, 13 Fla. 523, 1869 WL 1564, at \*5-6 (1869). This case involved an action for trover. *Id.* Trover is a common law action for the recovery of damages for the conversion of property. BLACK’S, *supra* note 19, at 1545. Trover damages are measured by the value of the property. *Id.*

38. Grewal, *supra* note 18, at 110. Fungible goods have been held to include, for example, sugar, *Great W. Sugar Co. v. Pennant Prods., Inc.*, 748 P.2d 1359, 1361 (1987); burlap bags, *Atlanta Chem. Co. v. Hardin Bag Co., Inc.*, 176 S.E. 772 (1934); cattle, *Watts*, 13 Fla. at \*5-6; oranges, *Quality Fruit Buyers, Inc. v. Killamey Fruit Co.*, 269 So.2d 424 (1972); grains, coal screenings, liquids, and cases of dog food, *Servbest Foods, Inc.*, 403 N.E.2d at 9.

39. U.C.C. § 2-501, cmt. 5 (2007).

40. U.C.C. § 2-105(4).

41. *Servbest Foods, Inc.*, 403 N.E.2d at 8.

ownership interest of an undetermined amount exists by measuring the share of each owner in relation to the entire bulk.<sup>42</sup>

Despite the seemingly clear guidelines of the UCC, identifying fungible goods can pose unique problems and what constitutes "identified fungible goods" varies with context; the next Part discusses this issue.<sup>43</sup>

### III. IDENTIFICATION OF FUNGIBLE GOODS: A CONTEXTUAL DISCUSSION

This Part examines how courts identify fungible goods differently in varying contexts.<sup>44</sup> First, this Part explores identification of fungible

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42. Grewal, *supra* note 18, at 110. In other words, what is identified is (1) the bulk and then (2) the interest separately, rather than the interest in the bulk.

43. See *infra* Part III. (examining identification of fungible goods in distinct contexts).

44. Due to the dearth of case law available on risk of loss and identification of fungible goods, no thorough discussion can effectively be had concerning whether courts apply identification strictly or liberally in the risk of loss context. However, the identification of fungible goods is still relevant to the risk of loss context. Where there is no breach, the identification requirement may determine who bears the risk of loss in goods. Comment 2 to Article 2-509 points out that where "the seller buys the goods afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the risk of loss can pass." Grewal, *supra* note 18, at 109. The authors of this article propose that courts should interpret the concept of identification for fungible goods strictly in the risk of loss context so the seller cannot easily shift the loss to the buyer. The seller, as the one shipping the goods, is in control of the goods. Thus, the seller can identify the fungible goods, should the seller choose. In addition, the seller is in the best position to assess the risks of transporting the goods and therefore the best party to procure the appropriate insurance. The usual commercial practice of purchasing insurance and contractual allocation of risk of loss may explain the absence of case law involving the risk of loss issue.

The strict identification approach is supported by the English approach to the passage of risk of loss in the absence of a breach. In the English system, for the risk of loss to pass in a fungible bulk, the items must be separated and appropriated from the mass. Daniel E. Murray, *Risk of Loss of Goods in Transit: A Comparison of the 1990 Incoterms with Terms from Other Voices*, 23 U. MIAMI INTER-AM. L. REV. 93, 98 (1991). For instance: The sale in England of an undivided interest in a larger amount of goods, such as selling 120,000 gallons of spirit from a larger quantity of spirits by the issuance of a delivery order which is accepted by the warehouseman will transfer the risk of loss in deterioration while in storage, but it will not transfer the property in the spirits because the sold fungible spirits have not been separated (appropriated) from the mass.

The UCC avoids the pitfalls of the English system by denigrating the importance of title and allowing for the appropriation of undivided shares in fungible goods upon the mere making of the contract. *Id.* In fact, a major difference between the UCC and the U.N. Convention on Contracts for the International Sale of Goods ("CISG") is that the UCC requires that goods be identified before the risk of loss can pass. Grewal, *supra* note 18, at 108. According to author Grewal, in the risk of loss context, all doubts should be



goods in the casualty context.<sup>45</sup> The identification of fungible goods is not only required in this context, but strictly applied. Second, this Part analyzes the identification of fungible goods in the breach of contract or remedial context.<sup>46</sup> Next, this Part explores how fungible goods in the passage of title context are identified.<sup>47</sup> Last, this Part discusses the approach courts take to identify fungible goods, if at all, in the insolvency context.<sup>48</sup> As a guiding principle, courts have typically analyzed the purpose of the underlying UCC provision to determine whether identification of fungible goods is necessary in a particular context.<sup>49</sup>

#### A. *The Casualty Context: A Strict Approach*

Identification is of primary importance in the context of casualty loss.<sup>50</sup> A casualty loss is a loss arising out of a sudden, unexpected, or unusual event, such as a fire, storm, or shipwreck. Article Section 2-613 allows a seller faced with a casualty loss to wholly or partially avoid a contract when certain requirements are satisfied.<sup>51</sup>

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resolved in favor of identification and identification is to be given limited effect. *Id.* at 109. Grewal acknowledges that no specific statutory authority supports this rule and thus relies on a comment to the UCC. *Id.* However, neither Grewal's approach, nor the comment, address the problem of identifying fungible goods. In Grewal's later discussion of fungible goods, Grewal does not address whether identification should be construed strictly or liberally. The authors of this article believe that courts should strictly identify fungible goods in the risk of loss context so a seller cannot easily shift the loss on to the buyer.

45. See *infra* Part III.A (finding that courts approach the identification of fungible goods narrowly, requiring a meeting of the minds rather than specification by kind and amount).

46. See *infra* Part III.B (discussing how courts liberally identify goods in the resale context, at times refusing even to require that fungible goods be identified).

47. See *infra* Part III.C (examining the liberal approach courts take toward identifying fungible goods in the title context).

48. See *infra* Part III.D (examining how courts liberally identify fungible goods in favor of finding a buyer's special property interest over a creditor's interest).

49. *Servbest Foods, Inc.*, 403 N.E.2d at 8; see also John M. Breen, *Statutory Interpretation and the Lessons of Llewellyn*, 33 LOY. L.A. L. REV. 263, 267, 285 (2000) (stating that Llewellyn believed that both the articulation and the interpretation of legal language is always done with a purpose in mind).

50. See Michael Spak, *Theft as Casualty Loss: The Little Known Remedy*, 21 U. TOL. L. REV. 757, 767 (1990) (stating that "[i]n case law considering section 2-613, the issue of identification of the goods to the contract has been of primary importance"); U.C.C. § 2-613 (2007) (stating that the casualty loss exception requires for its performance goods to be identified).

51. U.C.C. § 2-613. The casualty exception provided for in the U.C.C. is derived from the common law exception to *pacta sunt servanda* ("the agreement of the parties must be

One of the main requirements for a seller to avail himself of the casualty excuse under UCC Section 2-613 is that the goods must be identified.<sup>52</sup> Some courts have applied the identification requirement strictly in the casualty context involving a sale of fungible goods to prevent the seller from using it as an “easy out.”<sup>53</sup> In order to satisfy the identification requirement, courts require a meeting of the minds as to the goods identified.<sup>54</sup> Moreover, mere specification of kind and amount will not suffice.<sup>55</sup> A strict standard of identification for fungible goods in the casualty context is justified in a practical sense and consistent with the UCC because it prevents a seller from invoking the impossibility defense where replacement goods can readily be obtained.<sup>56</sup> This concept will be further explored in Part IV.<sup>57</sup>

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observed”), which allowed parties to void a contract if the particular thing necessary for performance was destroyed. David C. Bugg, *Crop Destruction and Forward Grain Contracts: Why Don't Sections 2-613 and 2-615 of the U.C.C. Provide More Relief?*, 12 HAMLINE L. REV. 669, 674 (1989). Courts applying the common law contract principle flatly reject the casualty loss exception where the goods are fungible. *See, e.g.*, *Specialty Tires of Am., Inc. v. Cit Group/Equip. Fin.*, 82 F. Supp. 2d 434, 439-40 (W.D. Pa. 2000) (applying Pennsylvania law).

52. Bugg, *supra* note 51, at 671. In general, the three requirements of U.C.C. § 2-613 include: (1) identification of the goods; (2) casualty is the fault of neither party; and (3) the risk of loss has not passed to the buyer. *Id.* Some commentators have argued that a contract concerning fungible goods is never truly impossible to perform. They are not the type of contracts envisioned by UCC Article 2-613. BROOK, *supra* note 4, at 408-09 (4th ed. 2005) (see example no. 2 and explanations arguing that a seller would not be excused from delivery under Article 2-613 where the contract was not the type which “required goods which had to be identified at the time of the contract”). Fungible goods may not be necessarily identified at the time of the making of the contract. Courts have not addressed the issue of whether a seller of fungible goods can ever avail itself of the Article 2-613 casualty loss exception. Courts that have addressed the casualty loss issue involving fungible goods have simply focused on whether the identification requirement was satisfied, without addressing the threshold issue. It is entirely conceivable a contract involving sale of fungible goods may fall within the scope of Article 2-613 where the contract “requires for its performance goods identified when the contract is made.” U.C.C. § 2-613. Hence, the identification requirement is relevant to the casualty loss issue because it is a necessary (although not sufficient) condition to a seller’s ability to avoid a contract under Article 2-613.

53. *See* Part III.A.1 (illustrating cases in which courts refuse to find fungible goods identified even though specified by kind and weight).

54. *See* Part III.A.2 (positing that courts require the buyer and seller to reach a meeting of the minds in order for fungible goods to be identified).

55. *See* Part III.A.1 (examining court cases where identification is applied strictly in the casualty context).

56. Spak, *supra* note 50, at 769; *see also* Williston, *supra* note 36, at 585 (stating that the purpose of U.C.C. § 2-613 is to excuse performance as if the goods were ‘irreplaceable’ or ‘unique’).

57. *See infra* Part IV.

1. *The Casualty Context's Strict Identification of Fungible Goods*<sup>58</sup>

Courts have taken a strict approach to identification of fungible goods in the casualty context. Contrary to the UCC, they have held that identification merely by kind and amount is insufficient.<sup>59</sup> For example, in *Bende & Sons Inc. v. Crown Recreation, Inc.*, the plaintiff agreed to sell to the government of Ghana 10,000 pairs of combat boots for a certain price.<sup>60</sup> The plaintiff then ordered those 10,000 pairs of boots<sup>61</sup> from Kiffe, the defendant.<sup>62</sup> Kiffe then placed the order with its supplier.<sup>63</sup> While the boots were in transit by train from Korea to the United States, the train derailed and most of the boots were destroyed.<sup>64</sup>

The defendant, Kiffe, argued that his performance was excused under UCC Section 2-613.<sup>65</sup> The court rejected the defendant's defense

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58. In general, it is unclear in the context of fungible goods if where a contract merely specifies the quantity, type, weight, and price, such goods would be sufficiently identified for the forming of a contract. Compare *Atlanta Chem. Co. v. Hardin Bag Co., Inc.*, 176 S.E. 772 (1934) (stating that a written contract between a manufacturer of burlap bags and a fertilizer dealer which provides for the sale of "quantity, new 34,000, goods 40/10 oz., cut 54, price plain, per M. 136.50," is sufficient as an identification of the goods to constitute a contract of sale), with *Atlanta Chem. Co. v. Hardin Bag Co., Inc.*, 176 S.E. 772 (1934) (Jenkins, J., dissenting) ("[T]he contract fails utterly to provide by its own terms what it was that the plaintiff sought to sell and what it is the defendant is sought to be charged with purchasing.").

59. *Bunge Corp. v. Recker*, 519 F.2d 449, 450-51 (8th Cir. 1975) (stating that specifying kind and amount is insufficient for identification in casualty context); *Bende & Sons, Inc. v. Crown Recreation, Inc.*, Kiffe Prods. Div., 548 F. Supp. 1018, 1019 (D.C.N.Y. 1982) (stating same); *Valley Forge Flag Co., Inc. v. N.Y. Dowel & Moulding Import Co. Inc.*, 395 N.Y.S.2d 138 (1977) (holding that identification of fungible goods will occur in casualty context only where there is "meeting of the minds" between the parties). See, e.g., *ConAgra, Inc. v. Bartlett P'ship*, 540 N.W.2d 333, 337 (1995); *Wickliffe Farms, Inc. v. Owensboro Grain Co.*, 684 S.W.2d 17, 19 (1985); *Colley v. Bi-State, Inc.*, 586 P.2d 908, 911-12 (1978); *Ralston Purina Co. v. McNabb*, 381 F. Supp. 181, 182 (W.D. Tenn. 1974) (applying Tennessee law).

60. *Bende & Sons, Inc.*, 548 F. Supp. at 1019; see also *Dreyfus Co., Inc. v. Royster Co.*, 501 F. Supp. 1169, 1171 (E.D. Ark. 1980) (holding that soybeans, a fungible good, were not sufficiently identified even though the contract specified the amount, kind, and price, for the purposes of U.C.C. Section 2-613).

61. While not specifically stated by the court, the boots were fungible goods. See U.C.C. § 1-201(17) (2007) (stating goods are any unit which "by nature or usage of trade, the equivalent of any other like unit").

62. *Bende & Sons, Inc.*, 548 F. Supp. at 1019. The purchase order specified the size distribution and described the boots as "leather upper, lace-up front, black, with reinforced bottom sole, Korean made but all Korean markings removed from boots, in neutral boxes in sizes." *Id.*

63. *Id.* at 1020.

64. *Id.*

65. *Id.*

based on UCC Section 2-613, holding that the goods were not sufficiently identified to the contract.<sup>66</sup> The federal district court for New York stated that identifying the goods by amount and kind was insufficient and that there had to be an actual meeting of the minds as to the particular and actual goods designated.<sup>67</sup> The court reasoned that the boots were not identified for three reasons. First, the contract failed to designate the particular manufacturer of the goods.<sup>68</sup> Second, the seller, Kiffe, had not yet entered into a contract with its supplier and thus the purchase orders could not have identified any particular kind of boot.<sup>69</sup> And last, the court stated that the boots were in no way "shipped, marked, segregated, or otherwise designated at the time the sale was made."<sup>70</sup> Thus, the boots were not identified and the seller could not avoid the contract under UCC Section 2-613.<sup>71</sup>

Similarly, in *Bunge Corp. v. Recker*, the Eighth Circuit Court of Appeals refused to apply UCC Section 2-613 where the seller and buyer only specified the amount and kind of soybeans to be provided.<sup>72</sup> The contract provided that the seller would provide the buyer with 10,000 bushels of a specific kind of "yellow soybeans at \$3.35 per bushel."<sup>73</sup> The court did not set forth its line of reasoning and ignored the fact that the soybeans were fungible goods, rather summarily stating that the contract did not identify the goods.<sup>74</sup>

Even compelling, rational inferences that support identification of fungible goods are given little weight.<sup>75</sup> For example, in *Colley v. Bi-State*, a seller of wheat sued his buyer for failing to pay.<sup>76</sup> The buyer counterclaimed for damages for the seller's failure to deliver remaining bushels.<sup>77</sup> The seller claimed that he was excused from delivering the

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66. *Id.* at 1021.

67. *Id.* at 1021; *see also ConAgra, Inc.*, 540 N.W.2d at 337 (stating that corn, a fungible good, was not sufficiently identified in the casualty context even though it was specified by kind and amount).

68. *Bende & Sons, Inc.*, 548 F. Supp. at 1021.

69. *Id.*

70. *Id.* *But see* U.C.C. § 2-501, cmt. 5 (2007) (stating that fungible goods can be identified by reference to an *undivided share*).

71. *Bende & Sons, Inc.*, 548 F. Supp. at 1021.

72. *Bunge Corp.*, 519 F.2d at 450-51 (8th Cir. 1975). The soybean harvest was destroyed by bad weather. *Id.*

73. *Id.* at 450.

74. *Id.* at 451; *but see* U.C.C. § 2-105(4) (2007) (stating that so long as fungible goods are "agreed upon by number, weight, or other measure," the goods may be identified).

75. *Colley v. Bi-State, Inc.*, 586 P.2d 908 (1978).

76. *Id.* at 909.

77. *Id.*

remaining bushels because his crop was destroyed by hot and dry weather.<sup>78</sup> The written agreements between the buyer and seller, however, did not specify that the wheat had to be grown on the seller's farm.<sup>79</sup> The court thus held that the seller's performance could not be excused under the casualty exception because the wheat was not identified; the seller could procure wheat from another market.<sup>80</sup> The court even went so far as to suggest that the seller buy wheat from the "black market" to satisfy his contractual obligations.<sup>81</sup> However, the seller claimed that Washington law only allowed licensees, and not producers or growers, to deal in grain.<sup>82</sup> Therefore, according to the seller, by law he could not have contracted to sell grain in excess of what he grew.<sup>83</sup> The court rejected this argument, however, and went to the heart of the matter: "[The seller] believed that he could fulfill his agreement with grain produced on his own property. He gambled that wheat prices would drop and that he would harvest a bumper crop. He lost on both counts. [The licensing statute] does not change his liability for non-performance."<sup>84</sup> Thus, the seller could not escape liability because he could get grain elsewhere.<sup>85</sup> It was of no consequence to the court that the seller lacked the necessary license to do so.<sup>86</sup> Thus, in the casualty context involving fungible goods, courts have applied the identification requirement strictly.

*2. The Casualty Context Requires Fungible Goods to be Identified with a Meeting of the Minds*

For fungible goods to be sufficiently identified to the contract in the casualty context, there must be a meeting of the minds.<sup>87</sup> In *Valley Forge*

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78. *Id.* at 910.

79. *Id.* Other courts agree that where a contract for fungible crops does not specify the land from which the crop is to come, the defense of impossibility or impracticability is unavailable. See also *Ralston Purina Co. v. McNabb*, 381 F. Supp. 181, 182 (W.D. Tenn. 1974); *Wickliffe Farms, Inc.*, 684 S.W.2d at 19.

80. *Colley*, 586 P.2d at 912.

81. *Id.* at 911-12.

82. *Id.* at 912.

83. *Id.*

84. *Id.*

85. *Id.* See also *ConAgra, Inc.*, 540 N.W.2d at 337 (1995) (holding that a partnership-seller was not relieved of contractual obligations to provide corn where it could acquire corn anywhere and from anyone as it was merchantable); *Ralston Purina Co. v. McNabb*, 381 F. Supp. 181, 182 (W.D. Tenn. 1974) (applying Tennessee law).

86. *Colley*, 586 P.2d at 912 (1978).

87. Bugg, *supra* note 51, at 672 ("[T]he intent of the parties must be ascertained in order to determine if the goods have been identified to the contract, unless the seller has

*Flag Co. v. New York Dowel & Moulding Import, Co., Inc.*, the buyer-plaintiff and seller-defendant entered into a contract whereby the plaintiff agreed to buy 30,000 dowels<sup>88</sup> of one particular size and diameter, and 100,000 dowels of another size.<sup>89</sup> The court noted that these products were fungible.<sup>90</sup> Because these goods were fungible, the court required “more than just an identification in a sales contract by kind and amount. . . .”<sup>91</sup> The court required a “meeting of the minds by the parties as to the particular or actual goods designated to be bought and sold.”<sup>92</sup> Because there was no evidence that these fungible goods had been otherwise identified by the parties despite their stated amount and kind, the goods were not identified for purposes of UCC Section 2-613.<sup>93</sup> Thus, the court ruled the defendant-seller was not entitled to the casualty excuse of performance.<sup>94</sup>

As the next Parts illustrate, this approach is in stark contrast with the liberal interpretation courts have applied to identification in the resale and title contexts.

#### *B. The Resale or Remedial Context: A Liberal Approach*

In the remedial context, identification is necessary where the seller seeks to avail himself of his resale remedy.<sup>95</sup> For instance, where a seller contracts with a buyer for the sale of certain fungible goods, the seller can resell those goods to another party if the buyer in some manner breaches.<sup>96</sup> However, those goods need to be identified. To facilitate the resale remedy, UCC Section 2-704 gives the seller the right to identify goods to the contract not already identified upon learning of the buyer’s breach.<sup>97</sup>

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expressly assumed the risk of continued existence of the goods.”); *see also* *Emery v. Weed*, 494 A.2d 438, 441 (1985); 67 AM. JUR. 2D *Sales* § 540 (2008).

88. *Valley Forge Flag Co., Inc. v. N.Y. Dowel & Moulding Import Co. Inc.*, 395 N.Y.S.2d 138 (1977). A dowel is an interchangeable pole-like piece of wood usually used for fastening woodwork.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Valley Forge Flag Co., Inc.*, 395 N.Y.S.2d at 138.

95. U.C.C. § 2-706(1) (2007).

96. *Id.*

97. U.C.C. § 2-704(1) (2007).

The resale remedy has been termed one of the seller's "self-help remedies."<sup>98</sup> The seller may resell the goods so long as the seller does so in good faith and in a commercially reasonable manner.<sup>99</sup> The seller may recover from the buyer the difference between the resale price and the contract price along with any incidental damages, less expenses saved.<sup>100</sup> The resale remedy is favored by courts because it dispenses with the need for litigation.<sup>101</sup> The resale remedy also allows a seller to mitigate damages caused by a buyer's breach.<sup>102</sup>

The important caveat is that the seller can only resell *identified* goods.<sup>103</sup> Generally, courts take a liberal approach when assessing the identification requirement for the resale of fungible goods.<sup>104</sup> Indeed, as this Part shows, in the context of the resale remedy under the UCC, courts are split over whether fungible goods must even be identified at all to allow a seller to resell.<sup>105</sup> Nevertheless, even courts that do require that fungible goods be identified apply the concept liberally. The goods need not be physically set aside and even goods not originally identified to the contract may be substituted for other fungible goods.<sup>106</sup>

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98. Ray G. Rezner & Elyse M. Tish, *Basic U.C.C. Skills 1990: Article 2: Buyer's and Seller's Remedies*, PRAC. L. INST. 201, 243 (June 1, 1990). The resale remedy has been termed one of the seller's self-help remedies. *Id.* For a discussion of the resale remedy and the problem of the lost volume seller, see WHALEY, *supra* note 20, at 309-19.

99. U.C.C. § 2-706(1) (2007).

100. *Id.*

101. Rezner & Tish, *supra* note 98, at 244.

102. See, e.g., *Morton Regent Enters., Inc. v. Leadtec Cal., Inc.*, 74 Cal. App. 3d 842, 849 (1977) (discussing the seller's resale remedy as a way for the seller to mitigate damages); *S.A.M. Elec., Inc. v. Osaraprasop*, 39 F. Supp. 2d 1074, 1085 (N.D. Ill. 1999) (stating that the seller could not recover purchase price where the seller failed to mitigate his damages by exercising his resale remedy). Some courts require the seller to exercise his resale remedy as a way of mitigating damages. *K & D Distrib., Ltd. v. Aston Group (Mich.), Inc.*, 354 F. Supp. 2d 761, 768 (N.D. Ohio 2005) (stating that under Michigan law, the seller has an affirmative duty to exercise his resale remedy to mitigate damages).

103. U.C.C. § 2-706(4)(a) (2007).

104. See John R. Trentacosta, *Damages in Breach of Contract Cases*, 76 MICH. BUS. L.J. 1068, 1071 (1997) (stating that "due to advances in technology, many goods have become complicated assemblies of fungible parts" and at least one court has found "that the seller can substitute fungible goods for resale so long as the goods [are] truly . . . fungible").

105. See, e.g., *Quality Fruit Buyers, Inc. v. Killarney Fruit Co.*, 269 So.2d 424 (1972).

106. 4A ANDERSON U.C.C. 2-706:26 (3d ed.) (West 2008).

*1. Fungible Goods Need Not be Identified in the Seller's Remedial Context*<sup>107</sup>

One court that has specifically addressed the issue held that the UCC's identification provision as it pertains to the resale remedy *does not apply* to fungible goods.<sup>108</sup> In *Servbest Foods*, Servbest Foods, Inc., the plaintiff-seller, sued Emessee for contract damages.<sup>109</sup> Servbest and Emessee entered into a contract for the sale of 200,000 pounds of navel trimmings, a kind of meat.<sup>110</sup> The contract provided that delivery would occur by transferring invoices and warehouse receipts, and that the meat would be held in cold storage.<sup>111</sup> The meat was delivered per the terms, but Emessee never paid.<sup>112</sup> Servbest sought to mitigate its damages by reselling the navel trimmings at a higher price to a different buyer.<sup>113</sup> Later, Servbest sued Emessee for breach and the trial court entered judgment for Servbest, awarding damages based on UCC § 2-706.<sup>114</sup> Emessee contended on appeal that the trial court improperly calculated damages under UCC § 2-706 because the goods were not identified.<sup>115</sup> Neither party contested that the meat was a fungible good.<sup>116</sup>

To determine whether the identification provision applied, the Illinois Appellate Court examined the underlying purpose of the resale remedy.<sup>117</sup> The court reasoned that because the UCC as a whole embodies a liberal construction of contract to provide a practical working tool, the resale remedy is not restricted to only goods identified to the contract.<sup>118</sup> Identification for fungible goods, according to the court, is

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107. See *Servbest Foods, Inc.*, 403 N.E.2d at 7. For other courts adopting this approach see *Firwood Mfg., Co., Inc. v. Gen. Tire, Inc.*, 96 F.3d 163, 168 (6th Cir. 1996); *Apex Oil Co. v. Belcher Co. of N.Y.*, 855 F.2d 997, 1003 (2d Cir. 1988).

108. *Servbest Foods, Inc.*, 403 N.E.2d at 7. The Second Circuit has recognized that with respect to fungible goods, resold goods need not be the exact goods rejected or repudiated for there to be sufficient identification. *Apex Oil Co.*, 855 F.2d at 1002. The court stated, "at least where fungible goods are concerned, a seller is not irrevocably bound to an identification once made." *Id.* at 1003.

109. *Servbest Foods, Inc.*, 403 N.E.2d at 4.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* at 6.

115. *Servbest Foods, Inc.*, 403 N.E.2d at 7.

116. *Id.* at 8.

117. *Id.* But see *Apex Oil Co.*, 855 F.2d at 1002 (stating that the U.C.C.'s Section 2-501 definition of identification applies throughout Article 2).

118. *Servbest Foods, Inc.*, 403 N.E.2d at 8-9 ("Under [the defendant's] approach, a sale of any 200,000 pounds of meat from lot 19700 would constitute a proper resale while identical meat from a different lot would be insufficient for that purpose.").



not crucial to recovery under UCC Section 2-706.<sup>119</sup> The court further reasoned that because goods identified after the breach fix the seller's damages in the same way as if they had been identified before the breach, fungible goods, which by their nature are interchangeable, likewise satisfy UCC Section 2-706.<sup>120</sup> In other words, if goods are truly fungible, and goods originally identified are conforming, "then identification of the resale to the contract is established."<sup>121</sup> In sum, the court viewed the concept of identification under UCC Section 2-706 as distinct from identification as defined in UCC Section 2-501,<sup>122</sup> a view not all courts share.<sup>123</sup>

*2. Even if Identification is Necessary for Fungible Goods in the Resale Context, the Goods Need Not be Physically Set Aside*

However, the *Servbest* approach is not universally adopted. Some courts do require identification of fungible goods, but liberally apply the requirement. These courts hold that, in the resale context, goods need not be physically set aside or segregated.<sup>124</sup> For instance, in *Great Western Sugar Co. v. Pennant Products, Inc.*, the plaintiff-seller contracted with the defendant-buyer for specified quantities of sugar.<sup>125</sup> According to the terms of the contract, the plaintiff would sell the defendant 900,000 pounds of sugar at forty-six dollars per one hundred pounds in the fourth quarter of 1980 and 500,000 pounds of sugar at forty-five dollars per one hundred pounds in the first quarter of 1981.<sup>126</sup> After the defendant received 371,500 pounds, the defendant refused to purchase more.<sup>127</sup> The plaintiff brought suit for payment of the remaining, unshipped orders. The trial court found for the plaintiff and awarded the plaintiff incidental damages along with the price of goods identified to the contract.<sup>128</sup>

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119. *Id.* at 9.

120. *Id.*

121. *Id.* at 10.

122. *Id.*

123. *See Apex Oil Co.*, 855 F.2d at 1004, n.2 ("The *Servbest* court viewed identification under Section 2-501 and identification under Section 2-706 as different concepts . . . a view we reject . . .").

124. *Great W. Sugar Co. v. Pennant Prods. Inc.*, 748 P.2d 1359, 1361 (1987).

125. *Id.* at 1360. This case has also been interpreted to mean that when the seller has sufficient "inventory at all times . . . to fill the buyer's contract," there will be "sufficient identification of fungible goods . . . even though the goods have not been segregated nor put in containers labeled for the buyer." 3A ANDERSON U.C.C. § 2-501:29 (3d ed.).

126. *Great W. Sugar Co.*, 748 P.2d at 1360.

127. *Id.*

128. *Id.* at 1361. The trial court relied on C.R.S. § 4-2-709(1)(b), which is Colorado's adaptation of the U.C.C.'s § 2-709 (2007).

The defendant challenged the trial court's award of damages, arguing that the goods were not sufficiently identified.<sup>129</sup> The Colorado Court of Appeals, after first declaring that sugar was a fungible good, rejected the defendant's contention.<sup>130</sup> The court stated that because the plaintiff's inventory consisted of sufficient excess sugar to supply his obligation under the contract, there was no need to separate, segregate, or label the bags of sugar intended for the defendant.<sup>131</sup> Thus, the court held that identification was sufficient and affirmed the trial court's award of damages.<sup>132</sup> This certainly would not have satisfied the Eighth Circuit in *Bunge Corp.*<sup>133</sup>

*3. Even if Fungible Goods are Already Identified, Fungible Goods May be Substituted with Non-Identified Goods Under the Resale Remedy*<sup>134</sup>

In continuing this liberal application under the resale remedy, courts typically allow after-the-fact substitutions of already identified fungible goods.<sup>135</sup> This makes the original identification of the goods largely irrelevant. The Second Circuit has justified this approach with the following illustration:

[A]t least where fungible goods are concerned, identification is not always an irrevocable act and does not foreclose the possibility of substitution. . . . [I]t serves no purpose of the Code to force an aggrieved seller to segregate goods originally identified to the contract when doing so is more costly than mixing them with other identical goods. . . . [S]uppose that [the seller] had been unable to find someone to take the [fungible good] immediately after the [fungible good] was rejected by [the buyer] and that the only [storage] available to [seller] . . . was already half-full . . . . To mix the . . . [fungible good] with the [other fungible goods] in the only available [storage] and to identify the first 48,000 gallons sold to the contract is the only sensible thing to do. Doing so, of course, bases the damage award on resales of different [fungible goods] from that

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129. *Great W. Sugar Co.*, 748 P.2d at 1360.

130. *Id.* at 1360-61.

131. *Id.* at 1361. *But see* U.C.C. § 2-105(4) (2007) (requiring and specifying how fungible goods are to be identified).

132. *Great W. Sugar Co.*, 748 P.2d at 1361.

133. *Bunge Corp.*, 519 F.2d at 450-51.

134. *Apex Oil Co.*, 855 F.2d at 1005.

135. *Id.*

previously identified to the contract. Under a rule that prevents any reidentification of goods to a contract, [the seller] would be forced . . . to choose between its resale remedy and a costly diversion . . . .<sup>136</sup>

Thus, in the resale context, if the goods are fungible, some courts do not apply the identification requirement. Even where courts do apply this requirement, it is applied liberally, favoring identification even in the most hard-pressed circumstances. For instance, goods need not be separated or segregated out and even where goods have been identified they can be interchanged with other goods. This liberal approach is likewise sustained in the title context as the next Part explores.

### *C. The Title Context: Another Liberal Approach*

Similar to the resale context, courts apply the identification requirement liberally in the title context when dealing with fungible goods. UCC Article 2 provides that “title to goods cannot pass prior to their identification” absent any agreement between the parties to the contrary.<sup>137</sup> Prior to enactment of the UCC, courts seemed to have taken a stricter approach to the identification requirement. After the UCC, courts have not required that the goods be physically set aside for an identification to occur.

Prior to the UCC, in an action for replevin, fungible goods must have actually been set aside for goods to be identified. In *W.H. Courtright & Co. v. Leonard*,<sup>138</sup> the Iowa Supreme Court addressed whether 25,000 bricks were sufficiently identified such that the defendant could maintain an action for replevin.<sup>139</sup> The court stated that the bricks were not sufficiently identified despite a stated quantity and a specified location in

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136. *Id.*

137. U.C.C. § 2-401(1) (2007). The U.C.C. does allow for the passage of title where the parties explicitly agree otherwise. U.C.C. § 2-401(1); *see also* *Reeves v. Pillsbury Co.*, 625 P.2d 440 (Kan. 1981) (finding goods were identified as the parties specifically agreed how such goods were to be identified).

138. *W.H. Courtright & Co. v. Leonard*, 11 Iowa 32, 1860 WL 271 (1860). Though a pre-U.C.C. case, *W.H. Courtright & Co.* is nonetheless instructive as to how courts analyze the identification of fungible goods in certain contexts.

139. *Id.* at \*1. Replevin is an action for the repossession of personal property wrongfully taken or detained by the defendant. BLACK’S, *supra* note 19, at 1325. Replevin is a state law remedy. *Cassirer v. Kingdom of Spain*, 461 F. Supp. 2d 1157, 1178 (C.D. Cal. 2006).

the kiln.<sup>140</sup> The court reasoned that the bricks were not sufficiently identified because the bricks were not separated or distinguished from the other bricks in any way.<sup>141</sup> The bricks were not counted out nor divided.<sup>142</sup> Therefore, the court held that title did not vest and there could be no action for replevin.<sup>143</sup>

However, after the enactment of the UCC, at least one court has taken a more liberal approach to the identification of fungible goods. In *Circuit City Stores Inc. v. Commissioner of Revenue*, the Massachusetts Supreme Court addressed when title to certain retail items passed.<sup>144</sup> The defendant, Circuit City Stores Inc., sold electronic retail items in Massachusetts and then had customers pick up the items in New Hampshire to avoid a Massachusetts sales tax.<sup>145</sup> The transaction was referred to as an "alternative location sale."<sup>146</sup> An alternative location sale generated a receipt for the customer.<sup>147</sup> The receipt indicated: (1) the store location where the item was purchased; (2) a description of the item, including brand, model, and sales price; (3) a reserved notation; and (4) the location of the store designated for pick up.<sup>148</sup> The reserved notation did not indicate that the item was particularly set aside, but only that one less item was available for sale to other customers.<sup>149</sup> The Commissioner of Revenue of Massachusetts assessed a sales/use tax against the defendant, arguing that the sale occurred in Massachusetts, not New Hampshire.<sup>150</sup>

The defendant argued that because identification of the goods could not be made in alternative location sales prior to the time that the merchandise physically moved from the inventory and the serial number was scanned at the New Hampshire store, title did not pass until the sale

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140. *W.H. Courtright & Co.*, 1860 WL 271, at \*3. The court did not state the bricks were fungible goods. However, the court's comparison of bricks to other fungible goods, such as sheep in a flock, indicates that the court considered the bricks fungible. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. *Circuit City Stores Inc. v. Comm'r of Revenue*, 790 N.E.2d 636 (2003).

145. *Id.* at 637. Three customer-witnesses testified that they bought an item at a Circuit City store in Massachusetts and then picked up their purchase in New Hampshire because Circuit City employees advised them that they could avoid sales tax by doing this. *Id.* at 638. In fact, one employee actually drew the customer a map of driving directions to the nearest New Hampshire store. *Id.*

146. *Id.* at 637.

147. *Id.*

148. *Id.*

149. *Circuit City Stores, Inc.*, 790 N.E.2d at 636-37.

150. *Id.* The Appellate Tax Court found in favor of the Commissioner. *Id.* The Commissioner successfully argued that a sale takes place at the cash register. *Id.* at 639.

in New Hampshire.<sup>151</sup> Thus, according to the defendant, there was no “sale” in Massachusetts.<sup>152</sup> The court rejected the defendant’s contention,<sup>153</sup> stating that because of the reserve notation, the goods had been sufficiently identified for the passage of title.<sup>154</sup> One of the defendant’s managers testified that the reserve system was the equivalent of moving merchandise to a phantom location.<sup>155</sup> The reserve system was sufficient even absent any physical moving or setting aside.<sup>156</sup> The court distinguished identification in the risk of loss context with identification in the title context, stating that the assumption of the risk of loss was based on the physical location of the goods.<sup>157</sup>

The court further rejected the need for strict identification of fungible goods altogether.<sup>158</sup> The goods at issue were fungible and “[c]ustomers do not choose items in a store such as Circuit City by a particular serial number, but only by make and model.”<sup>159</sup> The court held that only the serial number is necessary for identification of fungible goods of this nature.<sup>160</sup>

Thus, in the context of title passage, fungible goods must be identified. However, identification may occur even though the goods prescribed by the contract are not actually set aside or physically segregated from the collective mass.

#### *D. The Special Property Interest Context*<sup>161</sup>

In the special property interest context, courts have adopted a liberal approach to the identification requirement, similar to the resale and the

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151. *Id.* at 642.

152. *Id.*

153. *Circuit City Stores, Inc.*, 790 N.E.2d at 642.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* at 642; *see also* Grewal, *supra* note 18, at 109 (stating that normally, identification requires an overt act by at least one of the parties).

158. *Circuit City Stores Inc.*, 790 N.E.2d at 642.

159. *Id.*

160. *Id.* (citing *Chokel v. First Nat’l Supermarkets, Inc.*, 660 N.E.2d 644 (1996) and *Cushing v. Breed*, 96 Mass. 376 (1867)). *But see also* *Elder Offshore Leasing Inc. v. Bolivarian Rep. of Venz.*, 116 Fed. Appx. 541 (5th Cir. 2004) (requiring some sort of affirmative act by one of the parties for identification of fungible goods in the title context).

161. This Part does not discuss situations in which the goods are in the possession of the buyer. The reason this Article does not explore such situations is simple: if the buyer is in possession of the goods, they have already separated and thus identified. Therefore, where the buyer is in possession, identification is a non-issue.

title contexts.<sup>162</sup> A special property interest refers to an insurable interest, an insolvency interest, or a security interest. Under the UCC, the passage of title is not necessary for a party to obtain a security or insurable interest in goods.<sup>163</sup> The UCC has created the concept of identification to protect the buyer's expectation interest in goods.<sup>164</sup> The identification requirement thus limits situations in which a buyer of goods may exercise his rights.<sup>165</sup>

A buyer obtains a special property and insurable interest in goods when the goods have been identified to the contract.<sup>166</sup> If the buyer files bankruptcy before identification of the goods, the buyer has no rights in the goods and thus the goods do not become part of the buyer's estate.<sup>167</sup> If the seller becomes insolvent within ten days after he receives the first installment on their price, the buyer has a right to recover the goods if the goods are identified to the contract.<sup>168</sup> Identification is a necessary condition to the buyer's security interest in the goods. Where a buyer already paid for the goods before the seller filed for bankruptcy, the identification requirement determines who is to bear the loss between the buyer and the secured creditors of the seller/debtor.<sup>169</sup> Under the UCC Article 2, upon satisfaction of certain conditions, identification gives the

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162. "Insurable interest," "insolvency interest," and "security interest" are all used interchangeably throughout this section. In essence, all terms denote a special property interest.

163. *Bankruptcy and Article Two of the Uniform Commercial Code: The Right to Recover Goods Upon Insolvency*, 79 HARV. L. REV. 598, 600 (1966) [hereinafter *Bankruptcy and Article Two*].

164. *Id.* at 600.

165. *Id.* Identification also provides visible evidence of an adverse interest in the goods; however, such evidence may be lacking if the goods are fungible. *Id.* at 603 n.46.

166. U.C.C. § 2-501 (2007). Where goods are prepared, set aside, and tagged for a party, the goods will be sufficiently identified such that that party obtains an insurable interest. *In re Tenn. Forging Steel Corp.*, 24 U.C.C. Rep. Serv. 326 (1978).

167. Rusch, *supra* note 26, at 564. If the seller files bankruptcy before the goods are identified to the contract, the goods become part of the seller's bankruptcy estate. *Id.* at 567. If the goods were identified to the contract after the seller filed and the buyer made the identification, the buyer's action would be a violation of the automatic stay as an act to obtain possession of estate property. *Id.* If the seller identifies the goods afterward, the buyer would not be violating the stay as the buyer is not acting, however the seller would be violating the post-petition transfer of estate property without court approval. *Id.* at 567-68.

168. U.C.C. § 2-502(2), and cmt. 1 (2007); see also Peter A. Alces & David Frisch, *Commercial Codification as Negotiation*, 32 U.C. DAVIS L. REV. 17, 28-44 (1998) (discussing U.C.C. § 2-502 as an elusive remedy that will likely escape all buyers).

169. See U.C.C. § 2-501 (stating that a buyer obtains a special property interest in goods when the goods have been identified to the contract).

buyer the right to recover the goods, that is to take the goods over the claim of other ordinarily secured creditors of the seller/debtor.<sup>170</sup>

Generally, courts have found that so long as the fungible goods are existing, an amount is specified, and the contract refers to an undivided bulk, then the goods are sufficiently identified to give a buyer-plaintiff a special property interest over a third party creditor.<sup>171</sup> Where the defendant-debtor prepares, sets aside, and tags goods for the buyer-plaintiff, such fungible goods will be sufficiently identified.<sup>172</sup> Further, the fact that the plaintiff-buyer, rather than the seller, identifies the goods does not mean fungible goods are not identified.<sup>173</sup>

Courts disagree as to whether fungible goods must be identified at all in the insolvency context. Moreover, even courts that do require identification of fungible goods apply this requirement liberally, allowing *any* person to separate and segregate the goods, not requiring physical separation at all, or even allowing a party to identify fungible goods through silent acquiescence.

*1. Identification for Fungible Goods is Unnecessary in the Insolvency Interest Context*

Similar to the resale context, at least one court has disregarded the need for identification of fungible goods in its entirety in the insolvency context. In *Wilson v. M&W Grain*, Wilson, the plaintiff, bought an M&W grain drill from Colusa Farm Equipment.<sup>174</sup> M&W Grain, the defendant, delivered two identical drills to Colusa.<sup>175</sup> M&W Grain maintained a security interest in Colusa's inventory that included the two drills.<sup>176</sup> M&W Grain was a secured creditor of the seller. Colusa notified

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170. U.C.C. § 2-502.

171. *In re W. Iowa Limestone, Inc.*, 538 F.3d 858, 866-67 (8th Cir. 2008) (holding that a limestone was sufficiently identified where it was identified by weight in each bill of sale); *Martin Marietta Corp. v. N.J. Nat'l Bank*, 612 F.2d 745, 749 (3d Cir. 1979).

172. *In re Tenn. Forging Steel Corp.*, 24 U.C.C. Rep. Serv. 326 (1978) (finding two hundred sixty-eight tons of steel product were sufficiently identified when they were prepared, set aside, tagged, and available for pickup by the plaintiff).

173. *Martin Marietta Corp.*, 612 F.2d at 749-50.

174. *Wilson v. M&W Gear*, 442 N.E.2d 670, 671 (1982). One scholar argues that *Wilson* and related cases indicate that courts adopt a temporal definition of a "buyer" under the UCC. David Frisch, *Buyer Status Under the U.C.C.: A Suggested Temporal Definition*, 72 IOWA L. REV. 531 (1987).

175. *Wilson*, 442 N.E.2d at 671. While the court did not maintain that the drills were fungible per se, the court did note there is no substantial distinction between, "buying 20 tons of a fungible out of a dealer's 500 ton inventory and buying one grain drill out of a dealer's two drill inventory." *Id.* at 674.

176. *Id.*

Wilson when the drill arrived.<sup>177</sup> The two drills had different serial numbers: 1018 and 1057.<sup>178</sup> One drill was sold and the other drill, drill 1018, was listed as unsold. After Colusa's default on payments to M&W, M&W seized the drill.<sup>179</sup> Wilson then demanded that M&W turn the drill over to Wilson.<sup>180</sup> The trial court awarded damages to the plaintiff, Wilson, equivalent to the value of the drill.<sup>181</sup>

M&W appealed, arguing that the goods were not sufficiently identified as the drill referred to in the contract.<sup>182</sup> The Illinois Court of Appeals analyzed whether Wilson constituted an ordinary buyer under UCC Section 9-307(1).<sup>183</sup> If Wilson constituted an ordinary buyer, Wilson would have procured a security interest superior to the secured creditor's. The court completely disregarded the identification requirement for actions brought under UCC Section 9-307(1).<sup>184</sup> The court stated that identification as a whole is relatively unimportant under the UCC.<sup>185</sup> Ultimately, the court affirmed the finding for the buyer, Wilson.<sup>186</sup>

The dissent, however, vehemently disagreed with the majority's cursory dismissal of the UCC's identification requirement.<sup>187</sup> The dissent stated that if the drill had never been identified as to Wilson, then Wilson

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177. *Id.* In fact, Colusa repeatedly notified Wilson that the drill arrived and requested that Wilson pick it up. *Id.*

178. *Id.*

179. *Wilson*, 442 N.E.2d at 671.

180. *Id.*

181. *Id.*

182. *Id.* The plaintiff brought an action for replevin or damages. *Id.* In essence, the defendant argued that because the plaintiff failed to identify the drill as the drill in the contract, there could be no action for replevin. *Id.* Damages would be allowed only where the property is not found or not returned. *Wilson*, 442 N.E.2d at 671.

183. *Id.* at 672. U.C.C. § 9-307 states that "[a] buyer in ordinary course of business . . . other than the a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." U.C.C. § 9-307 (2007). This "ordinary buyer" provision is an exception to the general rule that the holder of a perfected security interest has an interest in the secured property superior to unsecured creditors and subsequent purchasers of the property. *Wilson*, 442 N.E.2d at 672. Although the "ordinary buyer" provision is an Article 9 concept, it still applies Article 2's concept of identification. *See id.*

184. *Id.* at 673 (citing *Chrysler Credit Corp v. Sharp*, 288 N.Y.S.2d 525 (1968); *Rex Fin. Corp v. Mobil Am. Corp.*, 580 P.2d 8 (1978)).

185. *Wilson*, 442 N.E.2d 670, 673 (1982).

186. *Id.* at 675.

187. *Id.* at 675 (Heiple, J., dissenting) (stating that the majority defies rational analysis, states bad law, and republishes an earlier erroneous decision).



could have no interest in it.<sup>188</sup> The dissent aptly illustrated the divergent analyses courts utilize depending on the context of identification:

Assuming arguendo that fire or act of God had destroyed the drill or that the drill was stolen during the period it was on the premises of Colusa, would the loss have fallen on Wilson? Clearly not. Wilson had a contract of purchase for delivery of [the drill]. His contract did not call for the delivery of a particular make and type of drill ... Since drill 1018 was not identified to him, he would not have had to accept the loss if it had been destroyed on Colusa's sales lot or been stolen. Likewise, it is clear that he had no right to replevin that item.<sup>189</sup>

The dissent argued that the majority ignored clearly applicable statutory language that stated that no insurable interest and neither title could pass before a good had been sufficiently identified.<sup>190</sup>

*2. Where Identification of Fungible Goods is Required, Goods Need Not be Physically Separated*

Other courts that require identification of fungible goods in the insolvency context apply the requirement liberally. For instance, where the seller makes no objection to the plaintiff's identification, the seller acquiesces by silence to the buyer's identification.<sup>191</sup> In keeping with this liberal application, physical segregation is not required.<sup>192</sup>

In *In re Doughty's Appliance Inc.*, the debtor, Doughty's Appliance, Inc., sold home appliances and electronic equipment at retail.<sup>193</sup> Transamerica and Amana provided inventory floor financing to Doughty's and both perfected security interests in the inventory.<sup>194</sup> Doughty's defaulted in its payments to both Transamerica and Amana and they repossessed their collateral, the inventory.<sup>195</sup> The Trustee for Doughty's bankruptcy estate filed an adversary complaint to determine

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188. *Id.* at 678 (Heiple, J., dissenting).

189. *Id.* at 678 (Heiple, J., dissenting).

190. *Id.* (Heiple, J., dissenting).

191. *Martin Marietta Corp.*, 612 F.2d at 750; see also 77A C.J.S. *Sales* § 217 (2008).

192. *Henry Heide, Inc. v. Atl. Mut. Ins. Co.*, 363 N.Y.S.2d 515 (1975).

193. *In re Doughty's Appliance, Inc.*, 236 B.R. at 409.

194. *Id.*

195. *Id.*

the rights of Transamerica and Amana compared to the rights of Doughty's customers with pending sales orders.<sup>196</sup>

The customer sales were evidenced by sales orders which included the name of the manufacturer, the standard model number (SKU), the stock number, and a description of the product, including color.<sup>197</sup>

Transamerica and Amana argued that the sales orders did not identify the appliances sufficiently for the purposes of UCC Section 9-307 and thus the buyers did not have a valid security interest.<sup>198</sup> The court applied UCC Section 2-501's definition of identification to resolve the matter.<sup>199</sup> The court reasoned that because UCC Section 9-307, which provides for the "ordinary buyer" exception to the general rule that a party to a security interest prevails over competing claims, the consumer buyer must present a claim to *identified* goods to prevail.<sup>200</sup>

The court held that even though serial numbers were not included on each order form, the items were sufficiently identified.<sup>201</sup> Moreover, it is interesting to note that the court found the items to be sufficiently identified even though these fungible goods were not separated from the mass. Instead, the court noted that this was not necessary because the mass itself was in constant flux:

Doughty's was a volume retailer . . . Doughty's had lines of credit with its suppliers that allowed it to fill inventory orders on a revolving basis. If a particular appliance or equipment model was not in stock in sufficient quantities to fill all customer orders on a given day, Doughty's would fill the customers' Sales Orders from its next deliveries from the manufacturer.<sup>202</sup>

The *Doughty* court is not the only court to recognize that fungible goods need not be physically segregated for identification to be

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196. *Id.* The customers had their respective products tagged with their names in inventory. *Id.*

197. *Id.* The sales orders were divided into three categories: 1) those for which no down payment was made; 2) those for which some down payment was made; and 3) those for which an entire purchase price was paid. *In re Doughty's Appliance, Inc.*, 236 B.R. at 410. Customers who made no down payment were required to pay Transamerica or Amana the entire retail purchase price to receive their goods. *Id.*

198. *Id.* at 409.

199. *Id.* at 415.

200. *Id.* (emphasis added). *But see Wilson*, 442 N.E.2d at 673 (rejecting the need for identification entirely in the U.C.C. Section 9-307 context). For a more thorough discussion of U.C.C. Section 9-307 and the ordinary buyer exception, see *Herman v. First Farmers State Bank of Minier*, 392 N.E.2d 344 (1979).

201. *In re Doughty's Appliance, Inc.*, 236 B.R. at 416.

202. *Id.*

sufficient. The New York Supreme Court has likewise ruled that fungible goods need not be physically set aside for a buyer to obtain a special property interest in goods, such as an insurable interest. In *Henry Heide Inc v. Atlantic Mutual Insurance Co.*, the plaintiff purchased 3200 one hundred pound bags of sugar from Olavarria & Co.<sup>203</sup> Olavarria had over 75,000 one hundred pound bags of sugar at its warehouse.<sup>204</sup> When the plaintiff went to pick up its sugar, it discovered that Olavarria had been dispossessed and had only eighteen bags of sugar on hand.<sup>205</sup> The plaintiff then sought to recover its payment from the plaintiff's insurer.<sup>206</sup>

The insurer claimed that the plaintiff had no insurable interest in the property because the bags of sugar were unidentifiable and not actually separated from the mass of sugar.<sup>207</sup> The court stated that sugar was a fungible good.<sup>208</sup> Because sugar was a fungible good, the failure to segregate it or separate it out was of no consequence.<sup>209</sup> The court found sufficient identification through the use of invoices detailing the price and amount of the sugar.<sup>210</sup> Therefore, the plaintiff had an insurable interest in an identified good and the defendant had to pay.

Thus, in the insolvency or insurable interest context, courts are not in accord that fungible goods must be identified. Nonetheless, the courts that do require fungible goods to be identified apply the concept liberally, in favor of identification.

#### *E. A Cross-Contextual Comparison: Understanding the Whole*

Before exploring the *why* behind these divergent interpretations, this Part encapsulates the prior discussion: comparing the treatment of identification of fungible goods across the four different contexts.

First, it is unclear whether identification of fungible goods is even required at all in certain contexts.<sup>211</sup> While the casualty context very

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203. *Henry Heide, Inc.*, 363 N.Y.S.2d at 515. The order was part of a larger order of 6,000 100-pound bags. 2,800 bags had already been delivered. *Id.*

204. *Id.*

205. *Id.* Dispossession is the deprivation of, or eviction from, rightful possession of property. BLACK'S, *supra* note 19, at 505.

206. *Henry Heide, Inc.*, 363 N.Y.S.2d at 515. For a discussion of the intersection of bankruptcy and insurance, see generally SUSAN N.K. GUMMOW, *BANKRUPTCY AND INSURANCE LAW MANUAL* 1 (2d ed. 2007).

207. *Henry Heide, Inc.*, 363 N.Y.S.2d at 515.

208. *Id.* at 488.

209. *Id.*

210. *Id.*

211. *Compare Wilson*, 442 N.E.2d at 673 (1982) (stating that identification is relatively unimportant in the insurable interest context), and *Servbest Foods, Inc.*, 403 N.E.2d at 7 (stating that identification is not required in the remedial context), with *In re Dougherty's*

clearly requires identification of fungible goods,<sup>212</sup> the same cannot be said of the insolvency and remedial contexts.<sup>213</sup> These latter two contexts have split authority on whether fungible goods must be identified.<sup>214</sup>

Second, even if identification is required for fungible goods, the manner of identification is anything but consistent. For instance, the casualty context requires a meeting of the minds for fungible goods to be identified.<sup>215</sup> The insolvency context, on the other hand, allows any party, buyer or seller, to identify fungible goods.<sup>216</sup> The remedial resale context allows for substitution of goods already identified with goods not originally identified by the parties.<sup>217</sup>

A similar dichotomy is present in assessing whether fungible goods may be identified by kind. Apart from the fact that the UCC specifically allows for identification by kind and amount for fungible goods, in the casualty context, courts hold that the specification of fungible goods by kind and amount is insufficient.<sup>218</sup> Conversely, in the title context, courts hold that specification of just the make and model is sufficient.<sup>219</sup> Moreover, in the insolvency and remedial resale contexts, actual physical segregation of fungible is not required for identification.<sup>220</sup> Thus, what constitutes identification of fungible goods varies with context.

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*Appliance Inc.*, 236 B.R. at 409 (requiring identification in the insurable interest context), and *Apex Oil Co.*, 855 F.2d at 1004 n.2 (stating that identification is required in the remedial context).

212. *Valley Forge Flag Co., Inc.*, 395 N.Y.S.2d at 138.

213. Compare *supra* Part III.B.1, with *supra* Part III.D.1 (both stating that fungible goods need not be identified when the goods are fungible).

214. Compare *Servbest Foods, Inc.*, 403 N.E.2d at 7 (stating that the UCC provision regarding identification does not apply in the seller's resale context where the goods are fungible), and *Wilson*, 442 N.E.2d at 671 (stating that fungible goods need not be identified in the insolvency context), with *Apex Oil Co.*, 855 F.2d at 1004 n.2 (rejecting the *Servbest* approach in the remedial context), and *In re Doughty's Appliance, Inc.*, 236 B.R. at 409 (requiring fungible goods be identified in the insolvency context).

215. *Valley Forge Flag Co.*, 395 N.Y.S.2d at 138.

216. *Marietta Corp.*, 612 F.2d at 749-50.

217. *Apex Oil Co.*, 855 F.2d at 1005.

218. *Bunge Corp.*, 519 F.2d at 450-51.

219. *Circuit City Stores, Inc.*, 790 N.E.2d at 642.

220. See, e.g., *In re Doughty's Appliance, Inc.*, 236 B.R. at 409; *Great W. Sugar Co.*, 748 P.2d at 1361; *Henry Heide, Inc. v. Atl. Mut. Ins. Co.*, 80 Misc.2d 485, 486 (1975).

IV. SUPPORTING CONTEXTUAL DISSONANCE<sup>221</sup>

As its title suggests, one of the important goals of the UCC is to create uniformity among different states.<sup>222</sup> The UCC aims to provide lawyers and businesses with a clear roadmap so that they can structure transactions such that they will be given legal effect. One is apt to question whether the varying interpretations of identification of fungible are consistent with the Code.<sup>223</sup> As this Part will show, this contextual dissonance best serves numerous other underlying policies of the UCC, albeit at the expense of uniformity.

*A. The Casualty Context: A Strict Approach Protects Contract Expectations*

One of the UCC's overarching policies is to promote contract formation.<sup>224</sup> The UCC Article 2's identification requirement is not meant to stifle contract formation.<sup>225</sup> A strict approach to the identification requirement in the casualty loss context is consistent with this important goal because it makes it less likely that a seller can avoid a contract. For example, assume a seller and a buyer enter into a contract for 10,000 widgets for \$100.00 total. While the widgets are in transit, the widgets are destroyed by a storm, in other words, by no fault of either party. The seller may seek to avoid the contract now as the market for widgets now prices 10,000 widgets at \$500.00. The seller has a full stock of widgets on hand. The seller invokes UCC Section 2-613, arguing these goods were not sufficiently identified.

A strict approach in this context protects the parties' expectations regarding contracts and fosters the contractual parties' (in this case, the buyer's) reliance on contracts, one of the important goals of the Article 2. Because the goods are fungible goods, in a practical sense the seller can still perform; he just needs to obtain the replacement goods from his

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221. Indeed, a contextual approach may be just pragmatic adjudication at work. See RICHARD A. POSNER, LAW, PRAGMATISM, AND DEMOCRACY 67 (2003) ("Judicial interpretation generally proceeds in two steps. The first is to infer a purpose from the language and context of the contractual or statutory text in issue, or from a body of pertinent judicial decisions that have established a rule. The second step is to decide what outcome in the case at hand would serve that purpose best."). *Id.*

222. U.C.C. § 2-102(a) (2007).

223. *Wilson*, 442 N.E.2d at 678 (Heiple, J., dissenting) (stating that a party should not in one case bear the risk of loss, but have no insurable interest in goods because of a different application of identification).

224. U.C.C. § 2-501, cmt. 2 (2007).

225. See U.C.C. § 2-501, cmt. 2 (stating that the general policy is to resolve all doubts in favor of identification).

stores.<sup>226</sup> The seller does not get to avoid the contract to the buyer's detriment where the seller can still perform.<sup>227</sup> Thus, a strict approach to the identification requirement for fungible goods in this context enforces parties' original agreements<sup>228</sup> and prevents an overbroad, exploitative exception.

*B. The Title and Resale Context: A Liberal Approach Encourages Efficient Commercial Resolution*

However, in the title and resale contexts, a strict application of the identification requirement with regard to fungible goods in the resale and title contexts would actually inhibit contract formation. A strict application would also discourage sellers from exercising their duty to mitigate, resulting in inefficiency. For instance, if identification of the subject of the contract is recognized as an essential element to the formation of a contract,<sup>229</sup> than interpreting identification strictly for

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226. Spak, *supra* note 50, at 769; *see also* Williston, *supra* note 36, at 585 (stating that the purpose of U.C.C. Section 2-613 is to excuse performance as if the goods were 'irreplaceable' or 'unique'). Merely because a contract has become more difficult in its performance due to unforeseen expenses incurred with performance, this is not a sufficient excuse for failure to perform. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 107 (Aspen Publishers 6th ed. 2003).

227. The converse is true as well. Suppose the market price had changed and 10,000 widgets were now being sold for \$10.00 per 10,000. If the buyer attempted to invoke the identification provision, it would shield the buyer's action as well. Richard A. Posner notes that in the circumstance where the seller seeks to avoid the contract, solely because the contract has become genuinely impossible to perform, it does mean that the seller should escape liability for the buyer's losses that resulted in the seller's failure to perform. POSNER, *ECONOMIC ANALYSIS*, *supra* note 226, at 105. The seller may have implicitly included a promise to insure the buyer. *Id.* Through insurance, the seller can reduce the costs created by the risk of loss, exchanging the possibility of a loss for a smaller, certain cost (the insurance premium). *Id.* Where it becomes more economical or efficient to breach the contract, this article in no way maintains that such breach should not be permitted. *See id.* at 119-200 (detailing circumstances where breach may be most efficient). Parties can still breach as long as they are willing to suffer the legal consequences of a breach. A party's unwillingness to proceed because of these new economic circumstances should not be *excused* or provide a basis for avoiding the contract. To do so, would allow the breaching party to avoid the contract and provide no remedy to the innocent party.

228. Indeed, enforcing parties' agreements according their intentions is a concern that overrides even the most economic and efficient interpretations. *Id.* at 96-97. However, inefficiency may serve as important evidence as to mistake, incapacity, or other grounds for inferring that the agreement does not promote the parties' mutual intentions. *Id.* at 97.

229. *Georgian Co. v. Bloom*, 108 S.E. 813 (1921) (stating that the first essential of a sale is that there must be an identification of the thing sold).

fungible goods—that is requiring them to be physically set aside—hampers contract formation.

In the resale context, the resale remedy is favored by courts because it dispenses with the need for litigation and encourages sellers to mitigate damages.<sup>230</sup> For example, assume a seller makes gizmos, a fungible good. The seller agrees to sell twenty gizmos to the buyer for \$20.00. The gizmos are identified only by amount and type. The buyer never takes delivery or breaches in some other way. If the identification requirement is interpreted strictly, the seller may not be able to resell these gizmos. Without the ability to identify the goods to the contract, the seller would not know which goods to sell. Instead, the seller is forced to procure other, more costly remedies to recover for the breach, despite the availability of other buyers. For this reason, the UCC Article 2 explicitly gives a seller the right to identify the goods to the contract after a buyer's breach.<sup>231</sup> Thus, a liberal interpretation of the identification requirement is justified to promote resale, mitigation of damages,<sup>232</sup> and getting goods to market.

*C. The Special Property Interest Context: A Missing Villain Still Warrants a Liberal Approach*

However, while the strict/liberal dichotomy works well and is supported by the text and spirit of the Article 2 in the above three contexts, the special property interest context poses a unique problem to which this traditional strict/liberal dichotomy seems ill-suited. As this next Part discusses, this context's distinct dilemma would appear to warrant a different approach. Nevertheless, upon closer examination, when comparing both sophisticated and unsophisticated buyers with secured creditors, underlying UCC policy dictates a liberal interpretation of identification of fungible goods in both such situations.

*1. The Special Property Interest Context Presents the Problem of the Missing Villain*

The insolvency context poses a unique problem to the identification of fungible goods. In the casualty, remedial and title contexts, the

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230. Rezner & Tish, *supra* note 98, at 244.

231. U.C.C. § 2-704 (giving an aggrieved seller the right “to identify the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control”).

232. POSNER, *ECONOMIC ANALYSIS*, *supra* note 226, at 98 (stating that one of the five distinction economic functions of contract law is to reduce the costs of resolving contract disputes).

identification requirement for fungible goods is applied either liberally or strictly.<sup>233</sup> In these contexts, either approach is justified because it protects the parties' expectations, enables efficient contract formation and resolves disputes appropriately between the two contractual parties—a breaching party and an injured party.<sup>234</sup> Hence, in all three contexts, the court settles the dispute between a *culpable party* and an *innocent party*. This element—a dispute between a culpable and an innocent party—is absent in the special property interest context.<sup>235</sup>

When a seller becomes insolvent, the identification issues usually arises when a buyer to a sale of goods contract has paid for the goods and the seller files for bankruptcy prior to the goods being delivered to the buyer. Under bankruptcy law, upon the seller's filing of the bankruptcy petition, all of the seller's property in its possession (including the goods already paid for by the buyer) becomes part of the bankruptcy estate.<sup>236</sup> A creditor's rights are determined by state law.<sup>237</sup> State law, in turn, generally abides by its adopted version of UCC Article 9 to determine a creditor's interest. Under Article 9 of the UCC, a secured creditor of the debtor, typically a bank which has provided the seller with financing secured by all of the seller's inventory, would be paid out of the bankruptcy estate first, prior to a buyer, unless the buyer is a buyer in the ordinary course of business.<sup>238</sup> For a buyer to be a "buyer in the ordinary course of business," he must demonstrate that the goods were identified.<sup>239</sup> Thus, whether the goods are identified may be determinative in deciding who has the superior interest.

In the insolvency situation, the identification requirement determines who has better rights to the goods—the buyer or the secured creditor of the seller/debtor. The court has to decide which party, between two

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233. See *supra* Part III.A-C (discussing how courts identify fungible goods differently in each context).

234. See *supra* Part IV.A-B (exploring how the varying approaches to identifying fungible goods depends upon the underlying UCC provision under which the identification principle is invoked).

235. This is called the problem of the "Eternal Triangle of the Law." Menachem Mautner, *The Eternal Triangles of the Law: Toward a Theory of Priorities in Conflicts Involving Remote Parties*, 90 MICH. L. REV. 95, 114-29 (1991). The eternal triangle of the law involves an honest man, a rascal, and another honest man. *Id.* at 95.

236. 11 U.S.C. § 521 (2009).

237. *In re Walters*, 176 B.R. 835, 881 (Bankr. N.D. Ind. 1994) (stating that while bankruptcy law provides federal machinery for enforcing creditor's rights, the rights themselves are created by state law).

238. U.C.C. § 9-307 (2007).

239. U.C.C. § 9-307. See also *Big Knob Volunteer Fire Co. v. Lowe & Moyer Garage, Inc.*, 487 A.2d 953, 958 (1985) (stating that identification, rather than delivery, is the point at which a person becomes a buyer in the ordinary course of business).



innocent parties, has a stronger property interest. The buyer has an interest in the goods as he has paid for them. The secured creditor has an interest in the same goods because of the security interest attached to the goods as result of the inventory financing.<sup>240</sup> In essence: the problem with bankruptcy and insolvency proceedings is “that the ‘villain’ of this piece has left the stage-permanently.”<sup>241</sup> An insolvent party is in no position to make the parties whole and it is up to the court to determine which of two innocent parties should bear the loss.<sup>242</sup> This unique problem distinguishes the insolvency context from the other contexts explored in this Article.

*2. Despite this Nuanced Context, A Liberal Application is Supported by UCC Policy*

With the foregoing problem in mind—a dispute between two equally innocent parties—this Article turns to whether courts’ current approach is consistent with the principles of the UCC. Two points are of interest here. The identification concept is an Article 2 concept while the “buyer in the ordinary course” concept is an Article 9 concept. Article 2 is designed to facilitate and encourage commercially reasonable behavior.<sup>243</sup> Article 9, which contains the “buyer in the ordinary course” concept, however, has a different aim: establishment of a system of public notice for creditors.<sup>244</sup> Article 9 embodies the very idea of “diligence gaining.”<sup>245</sup> Thus, when these two sections intersect, the aim should be to facilitate commercially reasonable behavior, but also establish a clear priority system for security interests.<sup>246</sup>

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240. See Mautner, *supra* note 235, at 95, 99.

241. *In re Doughty's Appliance, Inc.*, 236 B.R. at 411; see also Mautner, *supra* note 235, at 114-29.

242. *In re Doughty's Appliance, Inc.*, 236 B.R. at 411.

243. Richard L. Barnes, *Toward a Normative Framework for the Uniform Commercial Code*, 62 TEMP. L. REV. 117, 120 (1989).

244. *Id.* at 120.

245. See, e.g., U.C.C. § 9-312 (2007) (stating that a security interest is perfected by the first to file); U.C.C. § 9-301 (2007) (providing that local law governs perfection and priority); U.C.C. § 9-313 (2007) (stating that perfection occurs no earlier than the time the party takes possession); U.C.C. § 9-307 (2007).

246. Richard Barnes best encapsulated the idea of “synchronizing” Sections of the Code best when he wrote:

Where parts of a machine are not synchronized, it is better to refer to the function of the machine as a whole before making adjustments so that the parts operate together smoothly. To adjust them as individual systems may induce even greater perturbations when their separate functions are combined. For this reason it is important to be cognizant of the articles and their individual underlying reasoning and purposes, as well as to be aware of their comparative

As explained in Part III.D, courts apply the identification concept liberally in favor of a buyer in the ordinary course of business—sometimes refusing to apply the concept at all, and other times stating goods are sufficiently identified even though they have not been separated from a fungible bulk.<sup>247</sup> As this Part demonstrates, a singularly liberal interpretation *is* consistent with UCC policy, even though the context is uniquely nuanced.

As a general matter, the purpose of the identification requirement in the insolvency context is to determine the point in time when the buyer has an insurable interest in the goods or a special property interest of some kind.<sup>248</sup> A liberal approach to the identification requirement tips the scale in favor of a buyer at the expense of a secured creditor. Conversely, a strict approach tips the scale in favor of the secured creditor at the expense of a buyer in the ordinary course. In which direction *should* the scale tip according to the policies embodied by the UCC? As shown below, regardless of the buyer's sophistication, the secured creditor will always be in a better position to protect its interests; thus, a liberal interpretation in favor of the buyer is consistent with the UCC.

*a. A Sophisticated Buyer vs. A Secured Creditor: Sophisticated Buyers Warrant a Liberal Interpretation*

It may seem that sophisticated buyers or merchants warrant a strict interpretation because they are in a better contracting position with the seller; the buyer can negotiate timing, terms, and payment; and the buyer can purchase fungible goods elsewhere on the market. Sophisticated buyers are in a superior contracting position with the seller/debtor at the time they purchase the goods.<sup>249</sup> During the contract negotiations or purchases, buyers can effect proper identification by requiring some type of labeling, segregation, contracting for the risk of loss, or specifying the

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reasoning and purposes as integral parts of the entire Code's reasoning and purpose. The code is not a uniform treatment of all commercial law. The extent to which it is a commercial code is a function of the aggregation of its articles. The better it meshes, the better it will operate as a code.

Barnes, *supra* note 243, at 119 n.7.

247. See *supra* Part III.D.

248. *Martin Marietta Corp.*, 612 F.2d at 749.

249. Sophisticated parties are often held to a higher standard than their non-sophisticated counterparts. See, e.g., *Matsumura v. Benihana Nat'l Corp.*, 542 F. Supp. 2d 245, 249 (S.D. N.Y. 2008); *Iron Dynamics v. Alstom Power, Inc.*, No. 1:06 -CV0357, 2007 WL 3046430, at \*8 (N.D. Ind. Oct. 15, 2007); *Valero Energy Corp. v. M.W. Kellogg Constr. Co.*, 866 S.W.2d 252, 256 (1993); *Minnesota Forest Prods., Inc. v. Ligna Mach. Inc.*, 17 F. Supp. 2d 892, 905 (D. Minn. 1998) (stating that the concept of a sophisticated buyer is broader than the UCC's "merchant" concept).

date title will pass.<sup>250</sup> Sophisticated buyers are also in a better position to negotiate the timing of payment to the seller or impose conditions on the payment to avoid the bankruptcy problem. In other words, sophisticated buyers can take efficient *ex ante* measures for risk reduction and accident prevention and thus should bear the burden.<sup>251</sup> Moreover, because the goods are fungible, a sophisticated buyer can obtain the goods elsewhere; a security interest, however, is not translatable to other sellers. Overall, this approach would be consistent with the fact that the buyer in the ordinary course is a limited concept; it is the exception to the rule, and not the rule.<sup>252</sup> Thus, the exception should be treated rather narrowly, justifying a narrow approach to identification of fungible goods.

Despite the above reasons supporting a strict interpretation of the identification requirement in the case of sophisticated buyers, more compelling reasons—reasons consistent with the purposes of the UCC—warrant a strict interpretation against *creditors* and not sophisticated buyers. As an initial matter, banks, most typically the financier for the seller's inventory financing, are virtually always treated as sophisticated parties because they typically have more bargaining power.<sup>253</sup> These sophisticated banks can both (1) recognize and anticipate recurrent issues and (2) more effectively negotiate it. Strict identification has an added benefit to the creditor; strict identification of the respective fungible goods serves as evidence to the rest of the world of the creditor's

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250. The fact that large sophisticated commercial consumers and retailers will often use pre-printed form contracts to increase efficiency in no way alters the fact that these sophisticated parties at least are in better negotiating circumstances, such that the sophisticated parties can address this issue. See POSNER, *ECONOMIC ANALYSIS*, *supra* note 226, at 115. In fact, one can easily imagine a scenario in which these sophisticated parties incorporate just such a provision providing for the manner of identification of fungible goods in their standard pre-printed forms.

251. Mautner, *supra* note 235, at 101.

252. See *In re Havens Steel Co.*, 317 B.R. 75, 80 (Bankr. W.D. Mo. 2004) (noting that the "buyer in ordinary course" is an exception to the general rule that a secured party's interest in collateral continues upon the sale of the collateral).

253. *In re Commercial Money Ctr., Inc.*, 350 B.R. 465, 486 (9th Cir. B.A.P. 2006) (holding that appellant bank "is a sophisticated commercial entity and nothing prevented it from verifying that financing statement had been filed, for from taking possession of the leases."); *In re McClintic*, 383 B.R. 689, 694 (S.D. Ohio 2008) (stating the bank was sophisticated); *In re Matrix Dev. Corp.*, No. 08-32798-tmb11, 2008 WL 4549117, at \*5 (Bankr. D. Or. Oct. 9, 2008) (stating that a bank was a sophisticated lender and thus on notice). *Dtex, LLC v. BBVA Bancomer, S.A.*, 405 F. Supp. 2d 639, 645-46 (D. S.C. 2005) (recognizing that a defendant bank was sophisticated like every other bank); *Hoosier Motor Co., Inc. v. LaPorte Sav. Bank*, No. 46A03-0802-CV-33, 2008 WL 2580545, at \*2 (Ind. Ct. App. June 30, 2008) (recognizing that a bank was a sophisticated business entity).

interest.<sup>254</sup> This coincides with the very purpose of Article 9, to establish a system of notice to creditors.<sup>255</sup>

Holding a sophisticated party to a stricter standard also serves the UCC's aim of promoting commercially reasonable behavior. Sophisticated parties should be aware of commercially reasonable behavior and applicable law. Thus, to hold creditors to a stricter standard imposes no undue hardship. Similarly, holding a creditor to a higher standard also serves to balance Article 9's aim of establishing a system of notice. The creditor should be aware that the inventory the creditor is financing would later be sold; in fact, the very aim of providing financing to the seller is that the creditor *believes* the seller will be able to sell the inventory and repay the debt.

In addition, while creditors lack contract negotiating power at the bankruptcy and insolvent stages in the game, creditors still retain a security interest and considerable leverage.<sup>256</sup> Even despite the fact that most of the leverage analysis occurs when the loan is originally incurred, and not later,<sup>257</sup> creditors can, and often do, impose considerable conditions in their loan documents to address future concerns.<sup>258</sup> This is the primary impetus for securing adequate collateral with the commencement of the loan. Similarly, goods encumbered with a security interest frequently enter the stream of commerce without the consent of the creditor.<sup>259</sup> Interpreting the identification requirement liberally makes it easier for a buyer to establish he was a buyer in the ordinary course of business.

Last, an important objective of inventory financing under the UCC is the protection of those buyers who buy the seller's inventory in the

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254. *Bankruptcy and Article Two*, *supra* note 163, at 603 n.46.

255. *Orix Credit Alliance, Inc. v. Heard Family Trucking, Inc.*, 177 B.R. 68, 73 (S.D. Miss. 1994); *Peoples Nat'l Bank of Mora v. Citizens Bank of Milaca-Ogilvie*, No. C2-93-1537, 1994 WL 71371, at \*1 (Minn. App. Ct., Mar. 8, 1994).

256. It is important to note that any creditor has a certain degree of leverage over a debtor. See ELIZABETH WARREN & JAY L. WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 4-5 (5th ed. 2006).

257. WARREN & WESTBROOK, *supra* note 256, at 4; see also James A. Chatz & Joy E. Levy, *Alternatives to Bankruptcy*, 17 NORTON J. BANK. L. & PRAC. 1, art. 5 (Feb. 2008) (stating that advancements in technology have allowed creditors to make more informed decisions about their debtors, but that this occurs prior to extending credit).

258. WARREN & WESTBROOK, *supra* note 256, at 4-5 (discussing a passage from a Bank of America lending guide).

259. Robert Dugan, *Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code*, 46 U. COLO. L. REV. 333 (1975). A "sophisticated" lender then would accommodate for this increased risk by diversifying its lending. See THOMAS SOWELL, *APPLIED ECONOMICS: THINKING BEYOND STAGE ONE* 143-44 (2009) (discussing diversification of assets as a way to decrease risk).

ordinary course of business.<sup>260</sup> The purpose of this exception is to ensure the certainty of commercial transactions.<sup>261</sup> The buyer in the ordinary course of business, sophisticated or not, has every reason to believe that the seller has a right to sell the goods and that the buyer can rely on the transaction.<sup>262</sup>

*b. An Unsophisticated Buyer vs. A Secured Creditor: Liberal Interpretation*

The underlying public policy of the UCC warrants a liberal interpretation of the identification requirement not only for sophisticated buyers, but also for ordinary consumers. To begin, courts have applied the identification requirement liberally to consumers.<sup>263</sup> Unsophisticated consumers, as opposed to both sophisticated buyers and creditors, are never in positions to negotiate the sale.<sup>264</sup> They also have little choice over the timing of the payment. In retail, consumers typically pay for the goods before the goods are delivered. Strict identification would be unfeasible and would place the unsophisticated consumer at a considerable disadvantage. For example, as Judge Posner recognizes, using standard pre-printed form contracts is the most efficient method of contract formation for seller and buyers.<sup>265</sup> The seller avoids the costs of negotiating and drafting a separate agreement with each and every

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260. Alejandro Lopez-Velarde & John M. Wilson, *A Practical Point-by-Point Comparison of Secured Transactions Law in the United States and Mexico*, 36 UCC L.J. 4, art. 1 (2004).

261. See Ferris, *Baker Watts, Inc. v. Stephenson*, 286 B.R. 109, 123 n.13 (2002) (stating that the purpose of Article 9 of the UCC is to create commercial certainty and predictability); see also *Lewiston State Bank v. Greenline Equip., LLC*, 147 P.3d 931 (2006).

262. See Samuel J.M. Donnell & Mary Ann Donnelly, *1991 Survey of New York Commercial Law*, 43 SYRACUSE L. REV. 157, 184 (1992).

263. Cf. *Wilson*, 442 N.E.2d at 675 (applying a liberal concept of identification where the plaintiff was a consumer and the creditor was a sophisticated lending institution).

264. Generally, adhesion contracts are offered on a take-it-or-leave-it basis where the seller hands the purchaser a standard printed contract that sets forth the parties' obligations, the purchaser signs it as he pleases, but there is no negotiation over terms. POSNER, *ECONOMIC ANALYSIS*, *supra* note 226, at 115. A major factor in whether a contract is one of adhesion is whether the consumer is sophisticated. See, e.g., *Alpha Sys. Integration, Inc. v. Silicon Graphics, Inc.*, 646 N.W.2d 904, 909-10 (2002); *Landreneau v. Fleet Fin. Group*, 197 F. Supp. 2d 551, 558 (M.D. La. 2002); *Reimonenq v. Foti*, 72 F.3d 472, 477 (5th Cir. 1996).

265. POSNER, *ECONOMIC ANALYSIS*, *supra* note 226, at 9115.

purchaser.<sup>266</sup> In addition, one can imagine the absurdity of having Average Joe work with the teenage store clerk to adequately segregate and label his television set to secure sufficient identification. However, one would consider it prudent for a large commercial buyer purchasing hundreds of televisions from a commercial retailer to ensure that the selected merchandise is sufficiently identified and thus reserved. Liberal interpretation is favored where it protects the good faith expectations of innocent buyers to maximize the market flow of goods.<sup>267</sup> Thus, compared to a creditor, identification of fungible goods should be effectuated liberally.

Creditors may protect themselves by requiring various inventory controls and reports.<sup>268</sup> Creditors, often large institutions, are better positioned to absorb the loss than an unsophisticated buyer.<sup>269</sup> If their security interest can be eliminated due to a liberal identification requirement, then this may dampen a creditor's desire to provide financing for sellers. Article 9 of the UCC permits use of inventory financing to encourage lenders to provide financing to companies.<sup>270</sup> However, for the reasons discussed above, a liberal application of the identification requirement would likely strike a better balance between the interests of buyers and secured creditors. In addition, a liberal approach for *both* sophisticated and unsophisticated consumers carries with it the benefit of a bright-line and consistent approach.<sup>271</sup>

## V. CONCLUSION

"No language stands alone. It draws life from its background."<sup>272</sup> Indeed, such a statement resonates with the UCC's concept of

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266. *Id.*; see also *Circuit City Stores Inc.*, 790 N.E.2d at 642 (noting that in the bulk retail market, consumers do not act with great levels of detail in selecting their purchases).

267. U.C.C. § 1-102 (2007) (providing that the Code should be interpreted liberally to effectuate its underlying purposes and policies); See Dugan, *supra* note 258, at 362 ("[E]nforcement of a secret lien against an innocent buyer results in an emotional and economic dislocation which, albeit personal to the buyer, may be no less traumatic than an injury caused by defective goods."). *Id.*

268. *In re Havens Steel Co.*, 317 B.R. 75, 83 (W.D. Mo. 2004).

269. *Id.*

270. *Permian Petroleum Co. v. Petroleos Mexicanos*, 934 F.2d 635, 649 (5th Cir. 1991).

271. Mautner, *supra* note 235, at 99. Efficiency seeks to minimize three costs: (1) the cost of preventing triangle conflicts; (2) the losses resulting from such conflicts; and (3) the costs involved in resolving these conflicts. *Id.*

272. Breen, *supra* note 49, at 266 (citing K.N. LLEWELLYN, *THE BRAMBLE BUSH* 79 (1951)).

identification, particularly in dealing with fungible goods. When identifying fungible goods, courts vary their respective requirements depending on the relevant context in which the identification issue arises. Such a contextual approach, although yielding inconsistent requirements for identification of fungible goods across contexts, is nonetheless based on firm reasoning and supported by the policy rationale underlying the UCC. However, the insolvency context presents unique policy concerns: the court must resolve competing claims between two innocent parties. Nevertheless, in this situation, the liberal approach courts currently adopt serves the underlying interests of the UCC.