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Allocation of Scarce Goods under Section 2-615 of the Uniform Commercial Code: A Comparison of Some Rival Models

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Section 2-615 of the Uniform Commercial Code authorizes a contract seller to allocate goods in short supply when full performance has become commercially impracticable. Most of the cases under and commentary on that section have focused on the issue of commercial impracticability. The allocation aspects of the section have attracted much more modest attention in the cases and in the scholarly journals.

The purpose of this article is to examine critically the allocation rule set out in section 2-615(b). That subsection authorizes a seller, upon a finding of commercial impracticability, to allocate "in any manner which is fair and reasonable." By reference to a series of sources I propose to give meaning to the "fair and reasonable" language, to examine alternative modes of allocation under that language, and to suggest the reasons and policies that might cause a seller to choose one mode over another and that should cause a court to direct that one or another method of allocation be followed.

My thesis in this article is threefold: first that the courts' general refusal to overturn most sellers' allocation plans has been a wise decision; second that a variety of appropriate reasons cause the typical seller to use a largely pro rata allocation plan; third that reference both to the common law history and to non-common law methods of allocation within the Code and under the federal administrative agencies gives some insight about the rare case in which a court should disapprove a proposed allocation plan and about the safeguards that need to be set up for a seller who would deviate from a pro rata allocation scheme.

*This article was stimulated by research into the allocation process in the chemical industry during the shortage of 1974 and following. I intend to follow this article with a discussion of the allocation methods which were used in the chemical industry.

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1 U.C.C. § 2-615(b) reads as follows:

Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for future manufacture. He may so allocate in any manner which is fair and reasonable.
I. ALLOCATION AT COMMON LAW – THE PRO RATA MODEL

Beginning in the middle of the nineteenth century there have been several episodes of allocation litigation. Each of these episodes corresponds with some disruption of the economy such as war, labor strife, and, more recently, the Arab oil embargo. The earliest comprehensive discussion grew out of the shipment of coal from Maryland to Massachusetts during the Civil War. Episodes which also involved coal arose around the turn of the century and during World War I. The need for products such as sulphuric acid to produce ammunition during World War I produced another series of cases. Finally are the petroleum products cases produced by the Oil Embargo of 1973 and attendant market disruptions.

For the purpose of this Section, I limit consideration to the cases in which the seller of goods has failed to deliver contracted-for quantities and has argued in a lawsuit between itself and the buyer that seller has discharged its responsibility by prorating or by some other allocation scheme. I thus exclude cases that involve proration under insurance contracts or prorations of the kinds discussed below under Article 9 or under federal standards.

In the earliest case, Oakman v. Boyce, an 1868 Massachusetts case, the contract called for delivery of 5,000 tons of "Franklin" "Run of Mine" coal on board at Baltimore at $6.00. It was signed early in April of 1864 and, by usage of trade, provided for the delivery "from time to time as purchasers might need it, during the shipping season, which lasted to the end of the year." The defendant shipped only "several hundred tons" under the contract. Ultimately he argued that he was excused from his obligation for sub-

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3 Oakman v. Boyce, 100 Mass. 477 (1868).


8 See Part III A infra.

9 See Parts III B and III C infra.

10 100 Mass. 477 (1868).
sequent deliveries because the Baltimore and Ohio Railroad was interrupted "for a short time by freshets in April" and because there was "a serious interruption from the invasion of Maryland by the Southern armies under General Early" during the latter part of July. This interruption apparently lasted until late September. The defendant proved the other contracts made by him during 1864, the amount of coal mined and received by him, and the various prices and dates of deliveries under the contracts.

The trial court's jury instruction is a fundamental statement of a pro rata method of distribution that could be used today.

You are to apply that to the case of a man carrying on the coal business, in which the other contracting party does not expect him to perform the contract at once; would not be satisfied if he did, but expects it to be carried along through the season. Therefore it will be for you to consider whether it would or would not be reasonable for him to make other contracts than simply this one. What, under that stipulation, would be the duty of the defendant, and what would be his rights? Would he have a right, in your judgment, under that state of facts, to make other contracts than the one with the plaintiffs? Why, how could he carry on his business otherwise? He is going to mine, we will say, 50,000 tons. The plaintiffs are to take 5000. They want that coal delivered along through the season as it comes. Is he not reasonable and right, in April, in making contracts with nine other persons for 5000 tons apiece, expecting to supply them all along? If, then, he has come down in the month of May 5000 tons of coal, is it or not a reasonable and proper performance of his contract, although he has enough to give the plaintiffs all their coal, if it was then sent off, for him to deliver 500 tons to the plaintiffs, and 500 tons to each of the nine others, thus disposing of five thousand tons of the whole product of the year? I can see no reason to doubt, gentlemen, that that would be right. And if he had customers at home, besides his contracts to deliver in distant cities; if he had men who kept little coal-yards in Baltimore, who wanted 100 tons, or railroads or steamboats there, which he was accustomed to supply, would it be reasonable, and consistent with the intention of the parties and the scope of this contract, that he should supply these customers? —that is, that he should carry on his business just as he would if no other accident

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11 Id. at 478-79.
were to happen? I do not mean that he should be imprudent, and not keep a little ahead, as every prudent man, having contract to fill, should do; but having made his arrangements to supply all his customers, and expecting that he would be able to supply them all, — if that was his mode of carrying on his business, until some interruption occurred from some source, I shall instruct you, as matter of law, that he would not be responsible to these plaintiffs, simply from the fact that he may have had on hand a quantity of coal sufficient to supply them with the whole 5000 tons, which he did not deliver to them, but delivered to somebody else. That is, that upon the proof that it was not expected nor desired he should deliver it; that it was not intended by the parties; and is not the legal construction of this contract, that he was to suspend all his other business until he had performed his contract with the plaintiffs; and that the plaintiffs’ contract was obviously left open to be performed in order with the rest of his business; and that if he continued to perform it reasonably, until some interruption occurred which is provided for in the contract, he would not be responsible, although he may have had coal enough on hand to discharge it.\(^\text{12}\)

The court apparently allowed non-contract customers in the Baltimore area, to whom the seller was “accustomed to deliver,” to share in the pro rata distribution scheme. To that extent there is at least implicit rejection of the proposition that one who has a contract should stand on a better footing than a customary spot purchaser. One wonders whether the court would have adopted some other allocation scheme if the plaintiff had been a consumer rather than a middle man who stood simply to lose his profit. One also wonders whether the court would have adopted a different position if the plaintiff had asserted some rationale based on the words of the contract, the timing of their delivery, or the time of contracting. In the instructions, the court assumed that all of the deliveries to all of the contracting and non-contracting parties would be interspersed. Thus if one takes the position that there should be allocation based upon the time of delivery as opposed to the time of contracting,\(^\text{13}\) one might still arrive at the same conclusion on the facts of this case; since each was entitled to some delivery before the others, there had to be proration.

\(^{12}\) Id. at 479-81.

\(^{13}\) It is not apparent from the case that the buyer gave any reason why he should have priority over any other claimant. There is no suggestion that his contract was made before others or that the terms of his contract differed from those of any other contracting party.
The jury found for the defendant and that finding was affirmed on appeal. The appellate court squarely faced the question who among three possible parties should enjoy the profit that resulted from a substantial rise in price: the Boston buyer, Maryland seller, or all buyers pro rata? In effect the court held that the defendant-seller satisfied his obligation by pro rata distribution of the available supply.

In a second widely cited nineteenth century case, *McKeefrey v. Connellsville Coke and Iron, Co.*, a Pennsylvania court recognized the propriety of a pro rata distribution system in a case involving the sale of coke. The shortage was not of coke but of rail cars to deliver the coke. Adopting a pro rata scheme with preference for carloads sent to blast furnaces over foundries, the court relied in part on the custom in the trade. As in *Oakman v. Boyce*, the court explicitly rejected the defendant’s argument that he should have had priority and should have received 100% of his deliveries before certain others received any of their deliveries; the court described such a priority system as “destructive to the trade.” Exactly what the court meant by the quoted phrase is

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14 The appellate court stated as follows:

The jury were cautioned that this apportionment by the defendant should be made fairly and in entire good faith; that he had no right to deprive the plaintiffs of their full proportion of the supply from the mines, for the sake of obtaining a larger price by sales to other parties, nor by new contracts or sales not in the course of his usual and ordinary business, after the cause of deficiency happened.

*Id.* at 486.

15 The plaintiffs had apparently argued that since the defendant admittedly had 5,000 tons on hand during the year and since they had a contract for delivery of 5,000 tons, *ipso facto* the defendant was liable for his failure to deliver. Although the court did not state plaintiffs' claim for damages, the instruction by the lower court specified that the plaintiffs had a claim for “a very large amount of money” and had

...lost the opportunity to put into their pockets a profit of somewhere from 15-20,000 dollars, according to the testimony, as they might have sold their coal sooner or later, as prices went up. It is undoubtedly a great disappointment to men to lose such an amount as that; in looking at it from the plaintiff's side of the case, they having made a contract which they hoped would be obligatory and would bring the coal, and having made it in the hope of realizing some profit, when it turned out that, if performed, as they expected and intended it should be, it would have given them a very great profit, its non-fulfillment was undoubtedly a great disappointment to them, and they would be glad to get as much of that sum as the jury shall find they are entitled to.

*Id.* at 483-84. On appeal the plaintiff apparently argued to the judge that the instruction just quoted had “unfairly prejudiced the minds of the jury towards them, by representing their claim in the light of a gambling speculation.” *Id.* at 486.

16 56 F. 212 (3d Cir. 1893).

17 *Id.* at 215-16.

18 The contention that the plaintiff should have supplied them with all the cars received from the railroad company, up to the required number, and if not, that a distribution should have been made upon the basis of the orders on hand at the date of the contract, is not only against common usage, as we have seen, but is unrea-
unclear. Perhaps the court had concluded that the idea of sharing is so deeply ingrained in the trade that if a seller attempted to do something else it would be boycotted by the other members of the trade. Perhaps the court was simply concerned about the seller who deals partly with non-contract but continuing customers and partly with the contract customers. In such a case perhaps the court assumed that one who did not recognize the right of a non-contract customer to share would lose that customer. The court apparently assumed that a priority system which gave 100% of the coke to some and none to others would cause the other to buy elsewhere not only during the period of shortage but also thereafter.

By the turn of the century in *Jessup & Moore Paper Co. v. Piper*¹⁹ and *Luhrig Coal Co. v. Jones & Adams Co.*²⁰ we see that the idea of proration is well entrenched, at least in coal car shortages. In *Jessup & Moore*, Judge McPherson instructed the jury to apply a pro rata measure and rejected the idea that contract plaintiffs should have first call on all of the railroad cars.²¹

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²⁰ 141 F. 617 (6th Cir. 1905). The allocation scheme was specifically incorporated into the contract in a somewhat inartful way:

(6) The party of the second part shall use every reasonable effort to secure sufficient cars for the shipment to the party of the first part of all the coal called for by this contract, and if it fails to secure sufficient cars to do so, it agrees to load and deliver to the party of the first part a part of the cars it may receive in the proportion that the coal called for under this contract each day bears to the total production of coal from the mines of the party of the second part for such day.

²¹

Id. at 619.

It is at that point that we approach the question of fact that is to be submitted for your determination—that is, the allegation upon the part of the defendants that they did not have sufficient cars to enable them to fulfill their contracts, and therefore that they did the next best thing; that is to say, they apportioned their cars among all their customers, giving to each one his due and ratable share. If the facts were as averred by the defendants, I think that would be a fair, a reasonable, and proper thing to do. I do not think the defendants could be called upon to carry out one contract in full at the expense of all the other contracts for which they were equally bound, but that if there was a genuine scarcity of cars, so that it was impossible for them, for example, to carry out more than twenty-five per cent. of their contracts, if they carried out twenty-five per cent. of each contract I think that would be perfectly fair and proper and lawful to do, under such a contract as lies before us.

By the time of the 1916 coal car shortages, and somewhat later World War I shortages of "pyrites," the doctrine of proration had ample authority both in the custom and in the cases. Although the court in *Consolidation Coal Co. v. Peninsular Portland Cement Co.* was again referring to a shortage of coal cars, its statement could have a broader application:

Plaintiff, as a purchaser of coal in large amounts, can scarcely be presumed to have thought that its contract was the only one defendant had, especially as the amount plaintiff contracted for was only 1½ per cent of defendant's total output for each of the three preceding years—in fact, the ratio was even less during the year here in question. The possibility of car shortage is universally recognized.

In two cases involving contracts for "pyrites" or sulphuric acid during World War I, the courts in *Acme Manufacturing v. Arminius Chemical Co.* and *Davison Chemical Co. v. Baugh Chemical Co.* recognized the right of a seller to allocate on a pro rata basis when it has an appropriate excuse. The price per unit of sulphur during the period of those contracts increased from 9½ cents to approximately 25 cents per unit. Courts in both *Acme Manufacturing* and *Davison Chemical* looked with a jaundiced eye upon the seller's argument that it had acted in good faith in prorating its short supply. Although both accepted the legitimacy of the "doctrine of prorating," each concluded that the seller had not properly prorated but had in fact diverted its supply of sulphur to higher priced non-contract uses.

Thus by the end of the second decade in the twentieth century, the doctrine that sellers of goods should allocate in times of shortage by prorating among existing customers was well established and had been recognized not only in the coal trade but in chemicals and iron. Subsequent common law cases recognized the existence of the doctrine in the sale of flowers, agricultural prod-

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23 272 F. 625, 630 (6th Cir. 1921).
24 264 F. 27 (4th Cir. 1920).
25 133 Md. 203, 104 A. 404 (1918).
ucts,\textsuperscript{28} and cement.\textsuperscript{29} Before the Uniform Commercial Code was enacted, the doctrine had virtually quashed any argument against a pro rata allocation system in such cases. Moreover, these cases had already addressed many of the exceptions and subtleties that one must consider in forming an appropriate pro rata scheme.

Many of the cases had dealt with the difficult question, among whom does one prorate? In the earliest case, \textit{Oakman},\textsuperscript{30} the court concluded that the Maryland mine owner had a right to serve his regular and presumably non-contract “customers” in the Baltimore market and to prorate among them along with the contract customer from Boston. The court in \textit{Jessup & Moore}\textsuperscript{31} held that one could not add new contracts after the shortage had arisen. It is not clear from that case whether the court was describing persons who might have fit the “customer” class in \textit{Oakman} or whether these were entirely new buyers. Likewise the court in \textit{Acme}\textsuperscript{32} held that one should not add new customers at a time when the sulphur prices had radically increased and the seller was either unable or unwilling to meet its contract obligations. In such cases the courts were well aware that the seller was likely to serve its selfish interests by allocating larger than pro rata amounts to spot buyers or others who would pay at a new and presumably radically elevated shortage price. Perhaps in an over-reaction to that fear, the court in \textit{Garfield & Proctor Coal Co. v. Pennsylvania Coal & Coke Co.}\textsuperscript{33} held that one who had bought another’s mines could not prorate to the old customers of those mines. It is unclear from the decision whether the court referred to the output of the purchased mines themselves or only to output of all mines owned by the buyer. If it was characterizing the output of the purchased mines themselves, the case seems wrong. Likewise the courts in \textit{Davison Chemical}\textsuperscript{34} rejected the defendant’s argument that it had a right to prorate to new customers who were added in the prospect of enlarged facilities. The court intimated that the very attempt to enlarge the facility was the cause for the shortage.

Thus in one way or another, most of the proration plans recog-
nized that there was a limited class entitled to proration and that those not within the class were to be excluded entirely from the seller's output. Some explicitly recognized the seller's right to allocate to non-contract customers. The facts of some of the other cases are not clear; perhaps regular customers were excluded from allocation schemes in some of those.

In addition the cases reveal consideration of a few of the more subtle problems that are present today in a basic pro rata allocation scheme. For example, the *McKeefrey* court acknowledged, apparently with approval, the custom in the coke trade to give priority to blast furnace use of coke over foundry use of coke.\(^\text{35}\)

Likewise we see the courts beginning to wrestle with the question of the basis of the proration. In *McKeefrey*, for example, the allocation was made not on the basis of actual production of the buyers but on "oven capacity."\(^\text{36}\) One who thinks about it for a moment will realize that the label "proration" covers a wide variety of possible systems. For example, one might prorate based upon deliveries over an historic period, upon contract amounts during the current period, or upon current needs. By choosing the basis for proration, one can substantially favor one customer over another without deviating from a general pro rata scheme.

II. THE CASES UNDER SECTION 2-615—PRO RATA ALLOCATION CONTINUED

Section 2-615's allocation scheme rests squarely on the cases described above. One can see elements of those cases both in the language of the section and the comments under section 2-615.

Subsection (b) reads in full as follows:

Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

It is conceivable that one could establish an allocation scheme that would give 100% to one class, a lesser percentage to another and yet fit within the obligation to allocate in "fair and reasonable" method. However, in light of the history recounted above and of the comments it seems likely that the drafters visualized some form

\(^{35}\) 56 F. 212, 213-14 (3rd Cir. 1893).

\(^{36}\) *Id.* at 214.
of pro rata system when they authorized a "fair and reasonable" allocation method.

Comment 11 of section 2-615 uses the verb "prorate," and, more clearly than the section itself, contemplates a proration scheme as the typical one. The seller is admonished in the first sentence to "take account of all in supplying one." In the next to the last sentence, the seller is told that, "in case of doubt [one's] contract customers should be favored and supplies prorated evenly among [the customers] regardless of price." Thus the most plausible reading of section 2-615(b) is that it calls for a proration method as the basic allocation scheme, but that it does not rule out some, perhaps substantial, deviations from a pro rata scheme.

There are only four post-Code allocation cases under section 2-615. Three are energy crisis cases; one involves the allocation of new cars by General Motors. All are unremarkable.

In the first case, Mansfield Propane Gas Co., Inc. v. Folger Gas Co., the trial court found that the Uniform Commercial Code did not apply and held that the seller of propane gas had to give full deliveries to its contract customer at the expense of other non-contract customers. On appeal the Georgia court reversed and sent the case back with instructions to provide for a fair and reasonable allocation. In Cecil Corley Motors Co., Inc. v. General Motors Corp., the court was relieved of any obligation to examine the General Motors Pontiac division allocation scheme when the plaintiff failed to prove that it had placed any orders for cars that the Pontiac division had not filled.

Of somewhat more interest are the two cases that involved the

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37 The comment reads in full as follows:

An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

U.C.C. § 2-615, Comment 11 (1972 version).


39 Id. at 871, 204 S.E.2d at 628, 14 U.C.C. REP. at 957.


41 Id. at 835.
Atlantic Richfield Company, *Intermar, Inc. v. Atlantic Richfield Co.* and *Terry v. Atlantic Richfield Co.* In each of those cases, gasoline station operators, an Atlantic Richfield Co. franchisee and an independent operator, challenged the Atlantic Richfield Co. allocation scheme that was in effect in 1973. As it was applied in the Philadelphia area, the court reports the scheme as follows:

"Until further notice, our sales of gasoline to you beginning June 1, 1973, will be limited to (104%) of our sales to you during the comparable calendar month of 1972, except in those cases where a different basis is approved due to such factors as the lack of 1972 sales history or the occurrence of a material intervening event. Any amount available to you in any month cannot be carried over to the succeeding month."

The plan illustrates how one might deal with the claims for equity of various people in a pro rata allocation scheme, and it illustrates some of the complexities that are inevitably involved with such a plan. Note, for example, the last sentence which prohibits carryovers, an issue present in almost every pro rata scheme. Moreover, the Atlantic Richfield Co. scheme had alternative rules for those who could fit them:

"In the event a base month is determined to have been adversely affected by a natural and non-recurring event (e.g., traffic disruption, reconstruction, temporary closure, etc.), Region or Zone Managers may approve an alternate basis which shall be an average of the nearest preceding and successive full month on each side of the period of interruption."

In each of the Atlantic Richfield Co. cases the plaintiffs presented a variety of allegations. In the Philadelphia case the buyer alleged that Atlantic Richfield Co. was conspiring with the buyer’s regular non-discount dealers to freeze it out of the market. In the California case the franchisee argued that his was a hardship case because he had opened his station in 1971 and thus should have had some other form of proration than one based on 1972 sales when he was relatively new in the business. The California court affirmed the summary judgment of the trial court in Atlantic Richfield Co.’s favor; the court in Philadelphia declined to grant the plaintiff an injunction. In effect it allowed the Atlantic Richfield Co.’s allocation

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45 *Id.* at 91.
scheme to stand until the conclusion of the suit.

None of the post-Code cases add much to the pre-Code cases. They seem simply to continue the policy set out in the earlier cases. Note that virtually every one of the cases recognizes some form of proration. However, several of the cases recognize that there may be certain priority rules. For example in \textit{McKeefrey}\footnote{McKeefrey v. Connellsville Coke & Iron Co., 56 F. 212 (3rd Cir. 1893).} the court stated that blast furnaces could have first priority, and the Atlantic Richfield cases\footnote{Intermar, Inc. v. Atlantic Richfield Co., 364 F. Supp. 82 (E.D. Pa. 1973); Terry v. Atlantic Richfield Co., 72 Cal. App. 2d 962, 140 Cal. Rptr. 510, 22 U.C.C. REP. 669 (1977).} recognize and approve the appropriateness of deviation from pro rata in certain circumstances, as when the allocatee is not in operation during the historic allocation period. In only four out of twenty-one cases did the courts strike down allocation schemes.\footnote{The four are: Acme Mfg. Co. v. Arminius Chem. Co., 264 F. 27 (4th Cir. 1920); Haley v. Van Lierop, 64 F. Supp. 114 (W.D. Mich.), aff'd, 153 F.2d 212 (6th Cir. 1945); Akins v. Riverbank Canning Co., 80 Cal. App. 2d 868, 183 P.2d 86 (1947); B.P. Ducas v. Bayer Co., 163 N.Y.S. 32 (Sup. Ct. 1916). Cf. Consolidation Coal Co. v. Peninsular Portland Cement Co., 272 F. 625 (6th Cir. 1921) (although the allocation scheme was not struck down on appeal, the opinion suggests that it would be found unfair on remand).} From the earliest times there has appeared to be a judicial willingness to give the seller a considerable degree of discretion.

III. ALTERNATIVE ALLOCATION MODELS

\textbf{A. Article 9-Priority By Agreement}

The most explicit, comprehensive, and widely-used allocation scheme in the Uniform Commercial Code is not contained in Article 2 nor is it addressed in the contract allocation cases. Rather it is the system of priorities among secured creditors and between secured creditors and others that is set out in Article 9 of the Uniform Commercial Code. Section 9-201 states the basic principle of Article 9, that a security agreement "is effective according to its terms between the parties, against purchasers of the collateral and against creditors." In other words, if one creditor has a security interest in personal property, that creditor has a right fully to satisfy itself out of that collateral before the collateral is used to satisfy even one penny of the interest of purchasers or the other creditors. Section 9-301 subordinates that interest to the claims of certain other parties when it is not "perfected," and section 9-312 states what the basic rule of allocation is among perfected secured creditors. The basic subsection is 5(a) which reads in part, "conflicting security interests rank according to priority in time of filing
or perfection. . . .” Finally section 9-504(1) makes it plain that a secured creditor with priority over another is to be fully satisfied before any money goes to any subordinate creditor.

The common law of creditors’ rights, ignoring bankruptcy, provides for a complete satisfaction of the creditor with the highest priority before any payment is made to subordinate creditors. Thus the creditor who either first achieves payment from the debtor or who first acquires a lien or first takes some other judicial action under the state law to validate its rights wins all. In all of these cases the senior party is fully satisfied before the junior parties receive a penny. Typically the court’s responsibility is only to rank the parties.

Under Article 9, priority generally goes to the creditor who first filed a public notice of its security claim. The Article contains an extensive and complex set of rules about what one must file and where one must file it. Depending upon the type of collateral, the residence of the debtor, and where the collateral is to be used, the Code gives the creditor directions to file in one state or another and within the state to file at the county level or the state capitol as the case may be. The function of such public notice provisions is to put subsequent parties on notice to prevent the debtor from causing a second diligent lender to give it money in the belief that lender will have a first claim. Absent some method of giving notice to subsequent parties, we can not tolerate an agreed priority system.

**B. Allocation of Natural Gas by the Federal Power Commission—Priority by Fiat**

The most widely used, non-UCC statutory allocation schemes

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49 U.C.C. § 9-504(1) reads as follows:

A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the Article on Sales (Article 2). The proceeds of disposition shall be applied in the order following to

(a) the reasonable expenses of retaking, holding, preparing for sale or lease, selling, leasing and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys’ fees and legal expenses incurred by the secured party;

(b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;

(c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

50 See generally Storke, An Introduction to Security, 16 Rocky Mt. L. Rev. 27 (1943).


cover petroleum products and natural gas. In the public’s mind, there is confusion between the two schemes. Although there is an interrelationship between the problems, to a substantial degree they are separate, are regulated by separate agencies, and result from shortages brought on by different causes. As early as 1970, some natural gas distribution companies had operating allocation schemes. These schemes had been established more than two years prior to the Arab Oil Embargo in response to a shortage of natural gas wholly unrelated to the ultimate rise in price of petroleum products that followed the Arab Oil Embargo of 1973.

To understand the original allocation plan it is necessary to know something about the natural gas industry. Broadly, the industry can be divided into three groups: the producers, the transporters, and the retailers. The producers are those who drill for natural gas, bring it out of the ground, and sell it to someone who will transport it to the market. The transporters are the pipeline companies who buy the gas in Texas or elsewhere and transport it through their pipelines to the retail markets. The retailers are the utilities. The interstate pipeline companies were subject to the jurisdiction of the Federal Power Commission (FPC) (now under the Department of Energy). It is that Commission that has fixed prices since the mid-fifties and more recently has set out plans that will allocate natural gas in times of shortage.

Although the FPC’s power to establish allocation systems was not entirely clear, various companies began to apply for approval of their curtailment plans in the early 1970’s. The upshot of these applications was a debate in the industry about the utility of a pro rata versus a priority system. Ultimately the FPC passed Rule

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57 M. Willrich, supra note 54, at 49.
59 In response to their inquiries, the Senate Committee on Commerce received statements advocating both a pro rata approach and the end-use approach advocated by the FPC. A spokesman for the Piedmont Natural Gas Company supported his argument for pro rata allocation by stating:

The fairest system for allocating natural gas is a pro rata percentage of contract volumes. Only on a pro rata curtailment of contract entitlements can communities and gas companies be encouraged to engage in self-help measures including synthetic natural gas plants and conservation. The FPC’s end-use curtailment discriminates between regions of the country as shown in the table below:
467-B, which gives top priority to residential users together with small commercial users; it gives lowest priority to users capable of burning other fuels who used more than 10 million cubic feet of natural gas per day. The rule now appears in the Code of Federal Regulations in part as follows:

(a)(1) The national interests in the development and utilization of natural gas resources throughout the United States will be served by recognition and implementation of the following priority-of-service categories for use during periods of curtailed deliveries by jurisdictional pipeline companies:

(i) Residential, small commercial (less than 50 Mcf on a peak day).

(In percent)

<table>
<thead>
<tr>
<th>State</th>
<th>1974-75 Winter</th>
<th>1975 Summer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mississippi</td>
<td>9.59</td>
<td>7.72</td>
</tr>
<tr>
<td>Alabama</td>
<td>30.72</td>
<td>29.53</td>
</tr>
<tr>
<td>Georgia</td>
<td>30.27</td>
<td>23.02</td>
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<tr>
<td>North Carolina</td>
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<tr>
<td>South Carolina</td>
<td>42.99</td>
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<tr>
<td>Virginia</td>
<td>32.98</td>
<td>36.53</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>16.37</td>
<td>15.46</td>
</tr>
<tr>
<td>Maryland-Delaware</td>
<td>23.98</td>
<td>31.62</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>19.53</td>
<td>24.46</td>
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<tr>
<td>New Jersey</td>
<td>21.73</td>
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</tr>
<tr>
<td>New York</td>
<td>19.35</td>
<td>40.30</td>
</tr>
</tbody>
</table>


An advocate for the FPC approach of allocation based on end-use, National Economic Research Associates, Inc., arrived at its position by reasoning:

First, as to actual allocations in a critical shortage period, where hardship is threatened: the best rule to follow is to give priority to the users who are least able to convert to the use of other fuels, in the short run. A residence with a gas furnace cannot burn oil in that furnace; installation of oil equipment is expensive (relative to the annual fuel bill) and, on a wholesale basis, the shift is probably not practicable. Similarly, gas cooking equipment, in homes and in commercial establishments, would have to be completely replaced if gas were not available. The same is true for some industrial uses. At the other end of the scale it is possible in many industrial installations (including power plants) to convert, relatively simply and inexpensively (in terms of conversion cost) to oil; and the advantages of keeping such facilities on gas are minimal.

The second criterion which needs to be considered is the physical ability to "turn off" or in any way limit gas supply to different segments of the user group. It is virtually impossible, with gas supply systems presently in use, to do this for the smaller users. Only the very large users can physically be cut off in an emergency situation.

In the light of these two circumstances the FPC end-use curtailment priority system under Order 467-B is about as reasonable a one as could be devised to cope with short-term emergency allocation problems.


(ii) Large commercial requirements (50 Mcf or more on a peak day), firm industrial requirements for plant protection, feedstock and process needs, and pipeline customer storage injection requirements.

... (ix) Interruptible requirements of more than 10,000 Mcf per day, where alternate fuel capabilities can meet such requirements.

Obviously the document represents important judgments not only about whether one should have a pro rata or a priority distribution scheme but also about the relative merits of the various claims to the scarce resource.

(a)(i) The national interests in the development and utilization of natural gas resources throughout the United States will be served by recognition and implementation of the following priority-of-service categories for use during periods of curtailed deliveries by jurisdictional pipeline companies:

(i) Residential, small commercial (less than 50 Mcf on a peak day).

(ii) Large commercial requirements (50 Mcf or more on a peak day), firm industrial requirements for plant protection, feedstock and process needs, and pipeline customer storage injection requirements.

(iii) All industrial requirements not specified in paragraph (a)(i)(ii), (iv), (v), (vi), (vii), (viii), or (ix) of this section.

(iv) Firm industrial requirements for boiler fuel use at less than 3,000 Mcf per day, but more than 1,500 Mcf per day, where alternate fuel capabilities can meet such requirements.

(v) Firm industrial requirements for large volume (3,000 Mcf or more per day) boiler fuel use where alternate fuel capabilities can meet such requirements.

(vi) Interruptible requirements of more than 300 Mcf per day, but less than 1,500 Mcf per day, where alternate fuel capabilities can meet such requirements.

(vii) Interruptible requirements of intermediate volumes (from 1,500 Mcf per day through 3,000 Mcf per day), where alternate fuel capabilities can meet such requirements.

(viii) Interruptible requirements of more than 3,000 Mcf per day, but less than 10,000 Mcf per day, where alternate fuel capabilities can meet such requirements.

(ix) Interruptible requirements of more than 10,000 Mcf per day, where alternate fuel capabilities can meet such requirements.

(2) The priorities-of-deliveries set forth above will be applied to the deliveries of all jurisdictional pipeline companies during periods of curtailment on each company's system; except, however, that, upon a finding of extraordinary circumstances after hearing initiated by a petition filed under § 1.7(b) of the Commission's rules of practice and procedure, exceptions to those priorities may be permitted.

(3) The above list of priorities requires the full curtailment of the lower priority category volumes to be accomplished before curtailment of any higher priority volumes is commenced. Additionally, the above list requires both the direct and indirect customers of the pipeline that use gas for similar purposes to be placed in the same category of priority.

(4) The tariffs filed with this Commission should contain provisions that will reflect sufficient flexibility to permit pipeline companies to respond to emergency situations (including environmental emergencies) during periods of curtailment where supplemental deliveries are required to forestall irreparable injury to life or property.

18 C.F.R. § 2.78(a) (1978).
Subsequently the Commission passed order 467-C, which provides for relief from the rigid priority set out in order 467-B and permits one who has a particularly appealing case to make his case before the FPC.\textsuperscript{61}

A case representative of one of those who might seek exception to the general priority scheme is \textit{Texas Eastern Transmission Corp.}\textsuperscript{62} In that case the city of Lawrenceburg, Tennessee asked for an allocation over and above that which it would have enjoyed under the curtailment that had been in effect. It pointed out that approximately 3500 people in the city were employed at a single manufacturing plant. This plant depended upon natural gas to run its boiler; under the allocation scheme it would have had to close its boiler and thus the plant. The FPC granted a larger allocation in view of the fact that Lawrenceburg was a town of only 10,000 and was already severely depressed.

The early FPC allocations did not deal with intrastate pipelines,

\textsuperscript{61} Request for relief from curtailment shall be filed under § 1.7(b) of this chapter and shall conform to the requirements of §§ 1.15 and 1.16 of this chapter. Those petitions shall use the priorities set forth in (paragraph (a)(1), of this section) above, the definitions contained in paragraph (b)(3) of this section and shall contain the following minimal information:

(1) The specific amount of natural gas deliveries requested on peak day and monthly basis, and the type of contract under which the deliveries would be made.

(2) The estimated duration of the relief requested.

(3) A breakdown of all natural gas requirements on peak day and monthly bases at the plant site by specific end-uses.

(4) The specific end-uses to which the natural gas requested will be utilized and should also reflect the scheduling within each particular end-use with and without the relief requested.

(5) The estimated peak day and monthly volumes of natural gas which would be available with and without the relief requested from all sources of supply for the period specified in the request.

(6) A description of existing alternate fuel capabilities on peak day and monthly bases broken down by end-uses as shown in paragraph (b)(3) of this section.

(7) For the alternate fuels shown in paragraph (b)(5) of this section, provide a description of the existing storage facilities and the amount of present fuel inventory, names and addresses of existing alternate fuel suppliers, and anticipated delivery schedules for the period for which relief is sought.

(8) The current price per million Btu for natural gas supplies and alternate fuels supplies.

(9) A description of efforts to secure natural gas and alternate fuels, including documentation of contacts with the Federal Energy Office and any state or local fuel allocation agencies or public utility commission.

(10) A description of all fuel conservation activities undertaken in the facility for which relief is sought.

(11) If petitioner is a local natural gas distributor, a description of the currently effective curtailment program and details regarding any flexibility which may be available by effectuating additional curtailment to its existing industrial customers. The distributor should also provide a breakdown of the estimated disposition of its natural gas estimated to be available by end-use priorities established in paragraph (a)(1) of this section for the period for which relief is sought.

\textsuperscript{62} 52 F.P.C. 1744 (1974).
for they were not subject to the FPC's jurisdiction, nor did the FPC purport to order allocations among pipelines. Recently Congress has given the President the power under certain circumstances to require the transfer of gas from one pipeline company to another and from the intrastate to the interstate market in certain circumstances. The President exercised the authority to allocate among pipelines during the early part of 1977. Finally note that the allocation to any particular retailer (utility) is dependent upon that utility's report of the types of users. FPC Order 467-B directs "deliveries by jurisdictional pipeline companies"; it does not speak in terms to the utilities. Thus it is conceivable that a state public service commission could order a distribution different from the historic distribution on which the allocation was based. Presumably such distribution would then cause a change in the allocation under 467-B, but it is only indirectly that the FPC controls the ultimate use to which the natural gas is put.

C. Petroleum Allocation

As the UCC cases discussed above show, there were sporadic shortages of gasoline at least as early as the summer of 1973. With the imposition of the Arab Oil Embargo in the fall of 1973, it became clear that the shortage would grow much more severe. Congress hastily passed legislation to authorize allocation of petroleum products; the administration established a Federal Energy Office which became the Federal Energy Administration, and ultimately regulations on allocations were published. The Emergency Petroleum Allocation Act passed by Congress on November 27, 1973

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63 In the words of John Nassikas, then Chairman of the Federal Power Commission, "[I]t should be noted that the Commission does not have authority to compel interconnection and deliveries between interstate pipeline companies... The disposition of natural gas in intrastate commerce is subject to local authority, in most instances, exercised by the respective State public utility commissions." Federal Preparedness to Deal with the U.S. Natural Gas Shortage Emergency: Hearings Before a Sub-Committee of the House Committee on Government Operations, 94th Cong., 1st Sess. 14 (1975).
65 18 C.F.R. § 2.78(a)(2) (1978), which is quoted in full at note 58 supra.
sets out a series of concerns whose ultimate resolution could involve some non-pro rata aspects. It essentially authorizes pro rata allocation among all marketers and refiners based on the amount each one bought in 1972. Here too the structure of the industry arguably called for a particular scheme of allocation. Unlike the natural gas industry, which is not fully integrated, the largest traditional gasoline and petroleum product sellers were involved in every level of the industry. They were not only the drillers but also the owners, transporters, wholesalers, and retailers. In recent times unintegrated independents have grown up in every phase of the industry, but the dominant persons in the market were the large, highly integrated oil companies. Moreover, at least with respect to gasoline purchases, the retail relationship in the natural gas industry is quite different from that found in the petroleum in-

69 15 U.S.C. § 751(b) (1976) provides:

(a) The Congress hereby determines that—

(1) shortages of crude oil, residual fuel oil, and refined petroleum products caused by inadequate domestic production, environmental constraints, and the unavailability of imports sufficient to satisfy domestic demand, now exist or are imminent;

(2) such shortages have created or will create severe economic dislocations and hardships, including loss of jobs, closing of factories and businesses, reduction of crop plantings and harvesting, and curtailment of vital public services, including the transportation of food and other essential goods; and

(3) such hardships and dislocations jeopardize the normal flow of commerce and constitute a national energy crisis which is a threat to the public health, safety, and welfare and can be averted or minimized most efficiently and effectively through prompt action by the Executive branch of Government.

(b) The purpose of this chapter is to grant to the President of the United States and direct him to exercise specific temporary authority to deal with shortages of crude oil, residual fuel oil, and refined petroleum products or dislocations in their national distribution system. The authority granted under this chapter shall be exercised for the purpose of minimizing the adverse impacts of such shortages or dislocations on the American people and the domestic economy.

(c)(1) To the extent practicable and consistent with the objectives of subsections (b) and (d) of this section, the mandatory allocation program established under the regulation under subsection (a) of this section shall be so structured as to result in the allocation, during each period during which the regulation applies, of each refined petroleum product to each branded independent marketer, each nonbranded independent marketer, each small refiner and each independent refiner, and of crude oil to each small refiner and each independent refiner, in an amount not less than the amount sold or otherwise supplied to such marketer or refiner during the corresponding period of 1972, adjusted to provide—

(A) in the case of refined petroleum products, a pro rata reduction in the amount allocated to each person engaged in the marketing or distribution of a refined petroleum product if the aggregate amount of such product produced in and imported into the United States is less than the aggregate amount produced and imported in calendar year 1972; and

(B) in the case of crude oil, a pro rata reduction in the amount of crude oil allocated to each refiner if the aggregate amount produced in and imported into the United States is less than the aggregate amount produced and imported in calendar year 1972.


71 M. WILLRICH, supra note 54, at 111-19.
dustry. A typical residential customer has a continuing relationship with his gas utility; that same consumer might buy gasoline for his automobile at a different station every time he fills his tank. Thus, an allocation based upon end use but implemented one or two steps away from the end use purchaser is possible in the natural gas industry, but it is not workable in the petroleum industry.

As ultimately promulgated, the regulations under section 753 contemplate primarily a pro rata scheme but with some priority elements. For example, the regulation on gasoline allocation gives first priority to agricultural production and to certain Department of Defense uses. Then it has a series of prorations, some based on “current requirements,” others based upon “base period use” (presumably a lower amount than current requirements), and so on.

IV. THE MODELS AND EXPERIENCE COMPARED

Consideration of the allocation schemes described above leaves one with a variety of questions. How does one justify radically different allocation by federal agencies of similar commodities used for similar purposes? Why is it so obviously right on the one hand to give full priority to secured creditors and on the other to insist on pro rata distribution among claimants under section 2-615? Unless one can draw appropriate distinctions, either the Congress or the FPC is wrong; either the system of priorities set out in Article 9 is not justified or the assumption of pro rata distribution in section 2-615 is indefensible. We turn to those questions.

As a first step in determining which model should be used to shape the allocation schemes under section 2-615, one should analyze the reasons that caused the parties, the Congress, or the
various agencies to adopt the allocation schemes that they did adopt.

Turning first to the Article 9 priority system, one sees that priority is necessary in any system in which the security interests are to be recognized. Priority is the essence of security; without it one does not have any security system. It is important, however, to note certain aspects of the typical security system in order to understand why they might not be applicable to other circumstances. First, in the typical Article 9 security arrangement, the allocator (i.e., the debtor) is presumably no longer in business after the allocation becomes effective. It has been dismembered by its secured and unsecured creditors. Its long-term (post-allocation) interests differ from those of one who expects to be in business after the shortage ends and who has an interest in long-term retention of its customers.

Second, the Article 9 scheme is the product of the common law and statutory history in Anglo-American jurisprudence. It embodies a complex and explicit set of notice requirements that are designed to put those who would be subordinate on notice of their subordinate position. Without such a scheme it would be unfair to subordinate later parties. Hard experience has taught that a priority arrangement absent notice fosters collusive activity between one party and the allocator against other parties.\textsuperscript{74}

What are the virtues and the vices of a first-in-time, first-in-right priority allocation scheme? A fact conceived by some to be a vice, but only dimly articulated in the cases, is the fact that some persons who are later in time deal with the debtor without checking notice files because of ignorance of the system; these persons are still subordinated to earlier persons' claims. This fact is manifested in the cases principally by a hostility to the secured parties' status in some bankruptcy courts.\textsuperscript{75} Those courts will be quick to strike down a security interest or find it to be ineffective in competition with unsecured creditors. A virtue of the system is that it unbundles the various promises of the allocator. That is to say, the secured creditor presumably charges a lower interest rate in return for a first claim. Other lenders who do not enjoy such priority presumably charge higher interest rates for their unsecured credit. The presence of the priority system makes possible separate bargaining for the loan itself on the one hand and for the right to a first claim

\textsuperscript{74} See G. Gilmore, supra note 52, at 438-41, 462-80.

on the other. If there were no such system, there could be no such bargaining, and it is conceivable that all of the potential allocatees would charge the higher rate, or that some of those who would lend secured would chose not to lend at all. At least this much is clear: the abolition of a priority system would deprive the allocator of one of the kinds of contracts that he is now free to make. Even under the current system he has the power to make everyone share pro rata by refusing to grant a security interest to any of his lenders.

We have seen that at common law the typical allocation scheme in contract cases was a pro rata division of the available commodity. The most significant difference between the Article 9 scheme on the one hand and the common law or Article 2 scheme on the other was pointed out by the court in Oakman where it referred to the fact that the seller who was allocating had to remain in business after the shortage. The court concluded that if the seller allocated 100% to certain buyers and nothing to others, seller would wipe out its long-run business prospects. The court assumed that those who received nothing would look elsewhere and would have memories long enough to know that they should not deal with the seller after the shortage was over. Of course it does not necessarily follow that a buyer which is cut off will forsake its seller. It is conceivable that it will simply bargain for greater priority after the shortage is over. Nevertheless it seems likely that it is in the seller's long-term interest to keep all of its customers as happy as possible and not to make a small number very happy and a larger number very unhappy. There are circumstances, however, under which it would be in the seller's interest to allocate all to one and none to the rest. For example, if a buyer had constructed his plant next to the seller's source of supply on the implicit understanding that the buyer would take all or almost all of the output of that particular source, other buyers from distant points could not argue that they had a right to share in that source if they had never shared in it prior to the shortage.

One should not dismiss the possibility that the common law pro rata schemes are really an outgrowth of the trade practice in the coal industry. As we have seen above, some of the early cases purported to be carrying out the trade practice. The apparent adoption of that rule by later cases and the comments in the Uniform

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76 Of course it is also conceivable for some low-risk, wealthy debtors that security would prove only to be the frosting on the cake and that secured lenders would continue to lend for the same interest rate they would have charged on a secured loan.
77 Oakman v. Boyce, 100 Mass. 477, 480 (1868) (quoting trial judge's instructions to the jury).
78 Consolidation Coal Co. v. Peninsular Portland Cement, 272 F. 625 (6th Cir. 1921); McKeefrey v. Connellsville Coke & Iron Co., 56 F. 212 (3d Cir. 1893).
Commercial Code may have elevated a trade practice that is not necessarily the practice in all trades to the level of a rule of law.

The natural gas allocation offers yet another model. Like the Article 9 allocation scheme, it is a priority allocation method. Unlike the Article 9 scheme, it is not based upon the allocatee's diligence nor upon any individually negotiated right to a higher allocation. It has come about by order of the FPC and is based on a judgment of the social utility of giving 100% of the needs to one group while withholding gas from others. In some ways the natural gas allocation scheme is the most interesting of all. Note that El Paso first proposed what was essentially a pro rata scheme. The FPC overruled El Paso and its Rule 476-B set out a priority allocation scheme. The motivation for that scheme was the belief that individual home owners and certain other parties had to receive all of their needs before others received any of their needs. That judgment was based apparently on health considerations and also on other value judgments about the relative efficiency of the natural gas and alternative fuels' end uses. Doubtless the power of Congress, responsive to the millions of votes of residential gas users, was not lost on the FPC.

A priority allocation scheme not negotiated by the allocator but dictated by a governmental agency lacks some of the virtues of a negotiated scheme. Since the residential use goes to the top of the list without paying anything extra for that right, the scheme does not produce an unbundling or a possibility of direct negotiations for the right to receive higher allocations. To the limited extent that the allocation scheme gives higher priority to non-interruptible customers, it offers the possibility of unbundling. The natural gas allocation scheme interjects an additional question, namely who should have the right to make the value judgments about the social utility of various uses? Although allocations are sometimes made by private parties on the basis of social utility, we commonly reserve such judgments to governmental officials such as the Congress, the state legislatures, and the FPC. To what extent should private parties be permitted such judgments?

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80. See notes 59-61 and accompanying text supra.
81. In the words of Professor Willrich, with "jobs, profits, lifestyles and votes at stake, it seems inevitable as well as proper under the American form of government that administration of a serious energy shortage will be a highly politicized process from beginning to end." M. Willrich, supra note 54, at 3 (1976).
83. Several of my respondents in interviews in the chemical industry reported specific allocations to certain buyers based upon judgments about social utility. For example, two sellers of chlorine reported that they had given more than pro rata allocations to municipalities for use in water purification.
Finally there are the petroleum allocations, which, unlike the natural gas scheme, are pro rata allocations at the resale level. Here it appears that the motivation on the part of the Administration and the Congress was to protect independent sellers.\textsuperscript{84} Congress feared that the integrated oil companies would cut off the independent wholesalers and retailers in order more effectively to control the market after the shortage had passed. It was apparently the judgment of the Administration and the Congress that such independents were an important source of competition in non-shortage times and that they should be protected.\textsuperscript{85} The federal agencies, like the common law contract sellers, looked beyond the shortage to the market that will exist after the shortage in order to shape the allocation scheme. Unlike the common law case, however, the pro rata rule is here not dictated by the interest of the seller—whose interest might be the converse—but by a social judgment that independent wholesalers and retailers of gasoline serve a useful social purpose and should be protected.

Other allocation plans could be used, but are commonly rejected by contract sellers. The first is a "delay model," under which the seller does not discharge its full obligation by a pro rata allocation, but simply extends the time under its contract. The seller thus

\textsuperscript{84} Frank Zarb, Administrator for the Federal Energy Administration, outlined the general thrust of the petroleum allocation regulation as follows:

There are three primary programs by which crude oil is allocated under the Mandatory Petroleum Allocation Regulations. First, domestic crude oil supply relationships existing on December 1, 1973 have been frozen to ensure continuing supplies to small and independent refiners and to provide a supply base for calculation of buy/sell list amounts. Second, an allocation program, known as the buy-sell program, has been established among refiners to provide access to crude oil supplies for small and independent refiners. This program is generally designed to protect the competitive viability of small and independent refiners and to assure adequate supplies of refined products in all geographic regions on an equitable basis.

Third, the entitlements program is designed to provide all refiners with equal access to low priced domestic old crude oil to mitigate widely divergent feedstock costs among refiners resulting from the two tier price system.


\textsuperscript{85} The acute shortages of some petroleum products in December 1973, and January and February 1974, caused the program to be oriented initially toward avoiding regional inequity [sic] in supplies. The shortage hit hardest regions supplied heavily by independents. Soon, however, the primary objective of regulation seems to have become protection of the independent sector of the industry. [William] Simon is said to have been a key supporter of that objective. Thus a severe petroleum shortage provided the immediate impetus for launching a massive regulatory program which quickly became justified in terms of much longer range policy concerns—namely, preservation of the petroleum industry structure.

makes full, albeit delayed, deliveries over a longer period of time. Such a method differs from the pro rata allocation method in that it requires the seller to deliver the full quantity at the contract price and deprives it of the right of satisfying its full obligation with a lesser quantity at the contract price and of charging a higher price for subsequent deliveries. Sellers commonly reject the "delay model" as conflicting with both their long- and short-term interests. They fear the loss of the angered buyers after the shortage has passed. In the short term, sellers must deliver larger amounts at the lower prices that prevailed before the shortage, as opposed to satisfying their pre-shortage obligations fully and then delivering under new contracts at higher prices later.

A priority scheme based upon some judgment about the social utility of the various users is also likely to conflict with both the seller’s long- and short-term interests. Presumably in the agreed priority arrangement, the seller is able to acquire a premium from one buyer in return for the promise to give it everything before the seller gives anything to another. If this allocation has been made not on the basis of the agreement but on the basis of the social utility of certain uses, the seller may find itself selling not only to its lowest priced buyers but also aggravating its best customers and so frustrating both its long- and short-term interest.

The last model commonly rejected by sellers is one that would require a complete revamping of our judgments about section 2-615 itself. This might be called the price allocation model. One might change the law so that a rise in costs would free a seller from its contract obligations much more readily than is now the case under section 2-615(a). So freed, the seller would be free to raise prices to the level at which the supply offsets demand. The seller would allocate the scarce resource to those who were able and prepared to pay the highest price. This model will seldom apply under current law for two reasons. First, section 2-615(b) explicitly rejects it when the seller has some of the contracted-for commodity. Whatever “fair and reasonable” means, clearly it does not include auctioning the goods to those who will pay the highest price. In other cases where the seller may have sufficient supply to meet contract obligations but where costs have radically increased, the courts have generally refused to find commercial impracticability and thus have rejected the seller’s argument that it is free from its contract obligations under section 2-615(a).86

A second reason of equal or greater importance for rejecting the price rise option is the damage it will do to the seller's long-term interests. In my studies of contracting in the chemical industry, respondents frequently stated the belief that there was something improper and immoral about raising one's price to take advantage of a shortage. The people who are so outraged would, in most circumstances, respond by reducing their purchases from the seller after the shortage. The seller which raised its prices to what others regarded as immoral levels would thus suffer a long-term sales decline.

Putting aside many unique situations and ignoring qualifications, one generally concludes that sellers use and favor pro rata distribution methods not because the law says they must or because trade practice suggests that such methods are appropriate, but because it is in their long- and short-term interest normally to do so.

To what extent under section 2-615 should a court either mandate a pro rata system or order a non-pro rata scheme? A principal lesson from the experience of the past ten years and from the common law cases before that time is that it should be a rare case when the courts do either. In the last ten years we have seen different federal agencies come to different conclusions about allocations of similar energy resources. Given that federal diversity, how can one argue as a general proposition that a private seller is acting in an unreasonable manner if it uses proration rather than a priority system? That experience suggests that, at a minimum, a seller needs some latitude based on the circumstances in its trade.

A second reason for judicial abstention is that court monitoring of an allocation system is likely to cost much but produce little. Consider a large chemical company that is allocating hundreds of products to thousands of buyers on thousands of different contracts under tens of thousands of different delivery dates and terms. The company itself may not know the extent to which its employees are following the plan. Clearly judicial inquiry into the operation of such a plan would be costly, too costly in my judgment to be justified by the correction of an occasional wrong.

Third, there is good reason to believe that the market itself will punish inappropriate behavior. Certainly that was the belief and the intention of the parties in the chemical trade. The moral indignation of the consumer over "price gouging" is substantial; no rational seller can ignore it. The long-term interest of the seller in retaining his customers will almost always temper outrageous behavior during a shortage.

There is at least one case in which it is appropriate for the court to impose a pro rata system in the face of an agreed priority sys-
tem. That is the case in which the seller has failed by its behavior or by explicit notice to make others aware that it has agreed to favor one buyer over another. Article 9 tells us that we need notice of any agreed priority and that it would be unfair to other buyers who purchased without notice of such an agreement to allow it to be carried out.

Conversely, if there was an agreement for priority and that agreement was adequately communicated to the other parties, should the court not enforce such an agreement? I believe that the court should. If, for example, a buyer of a chemical product builds its plant next door to the seller’s plant under the implicit assurance that the buyer will take the entire output of that plant, I would argue that there is a priority allocation scheme and that the seller should be ordered to make deliveries to the buyer to the exclusion of others.

V. Conclusion

An analysis of the common law cases and those under section 2-615, and a comparison of other allocation schemes dictated by the government or authorized by the Code tells us several things. First, it demonstrates that a contract seller will normally use some form of pro rata allocation scheme. It is in the seller’s interest to do so and is normally not unfair to other parties to have that happen. Second, this history tells us that almost all pro rata schemes contain some deviation, for there is need for flexibility to recognize buyers with particular needs and demands. Third, the history suggests that most systems have certain self-policing methods, and are built on an extraordinarily complex structure of acts, contracts, and assumptions. Thus, courts should only rarely and in the most egregious case act to overturn an allocation scheme.