

# Mixed Contracts and the U.C.C.: A Proposal for a Uniform Penalty Default to Protect Consumers

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## **Abstract:**

Although Article 2 of the Uniform Commercial Code provides a standard set of rules for goods transactions, it is silent on the treatment of mixed goods and services contracts. Without guidance from the Code, courts have taken a number of different approaches to such contracts. These varied tests encourage opportunistic behavior: sellers withhold information about implied warranties during negotiations, and can later claim they do not apply. Uninformed buyers must either forfeit their warranty protection or resort to an expensive court determination of the Code's applicability.

This Article proposes a "penalty default" of applying the Code in consumer contracts that involve both goods and services. The new default rule would induce sellers to provide warranty information to buyers at the time of contracting. When sellers failed to provide information, buyers would receive warranties that sellers could not easily refuse to honor. If states adopted the proposal, therefore, buyers and sellers would decide warranty applicability during negotiations. Consumers would be protected from unbalanced contracts and courts would be relieved of resolving mixed contract warranty disputes.

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## INTRODUCTION

When the principal drafter of the British Sale of Goods Act of 1893, M.D. Chalmers, visited the United States in 1902, he beseeched the American Bar Association to establish uniform sales laws across the states.<sup>1</sup> Chalmers suggested that legal codification provides an inexpensive alternative to common law development;<sup>2</sup> whereas codes address many expected legal issues, common law courts are restricted to the issues in dispute in each case and require years of costly litigation to develop fields of law.<sup>3</sup> Chalmers attributed the conflicting tangle of laws among states to the common law system.<sup>4</sup> He suggested that a uniform sales law would aid merchants<sup>5</sup> and lawyers<sup>6</sup> because they could quickly determine their rights and responsibilities throughout the states without extensive searches of each state's judicial decisions.<sup>7</sup> Other scholars have noted that courts often decide issues to establish a fair result in the case at hand,<sup>8</sup> thereby creating shortsighted precedents. In contrast, codification establishes rules with strong theoretical underpinnings that are appropriate for a variety of situations.<sup>9</sup>

In 1952, The National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) released the Uniform Commercial Code (U.C.C. or the Code) for adoption by the states as a standardized set of laws for commercial transactions.<sup>10</sup> The

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<sup>1</sup> M.D. Chalmers, *Codification of Mercantile Law*, 19 LAW Q. REV. 10, 18 (1903).

<sup>2</sup> *Id.* at 16.

<sup>3</sup> *Id.* at 16-17.

<sup>4</sup> *Id.* at 17.

<sup>5</sup> *Id.* at 14.

<sup>6</sup> *Id.* at 17.

<sup>7</sup> *Id.* at 17-18.

<sup>8</sup> Daniel A. Farber & Philip P. Frickey, *In the Shadow of the Legislature: The Common Law in the Age of the New Public Law*, 89 MICH. L. REV. 875, 876 (1991).

<sup>9</sup> Ugo Mattei, *Basic Issues of Private Law Codification in Europe: Trust*, 1 GLOBAL JURIST FRONTIERS, art. 5, at 3 (2001), available at <http://www.bepress.com/gj/frontiers/vol1/iss1/art5>.

<sup>10</sup> John M. Breen et al., *The Lost Volume Seller and Lost Profits Under U.C.C. 2-708(2): A Conceptual and Linguistic Critique*, 50 U. MIAMI L. REV. 779, 810. See generally Allison Dunham, *A History of the National Conference of Commissioners on Uniform State Laws*, 30 LAW & CONTEMP. PROBS. 233 (1965) (describing the history of the U.C.C.).

drafters devoted Article 2 of the Code to “goods,” which are defined as “all things that are movable at the time of identification to a contract for sale.”<sup>11</sup> The Article references particular features of goods transactions, such as conditions for returning nonconforming goods,<sup>12</sup> special rules for goods delivered in installments,<sup>13</sup> and implied warranties regarding the goods sold.<sup>14</sup> The drafters did not intend Article 2 to be used for transactions in “services,” which are “intangible commodit[ies] in the form of human effort, such as labor, skill, or advice.”<sup>15</sup>

The exclusion of services created a dual law of contracts: the U.C.C. governs goods transactions, while the common law applies to transactions beyond the scope of the U.C.C.<sup>16</sup> Consequently, Code provisions that were designed to protect consumers do not apply in service transactions. For example, the U.C.C. imposes implied warranties, which are default obligations flowing from sellers to buyers under certain circumstances.<sup>17</sup> These warranties apply without a promise or representation by sellers, so buyers are frequently entitled to compensation when they receive products that do not perform as expected.<sup>18</sup> The great majority of court decisions involving service transactions do not recognize a similar implied warranty in the common law; instead, the older doctrine of caveat emptor (“buyer beware”) applies.<sup>19</sup> Some scholars believe

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<sup>11</sup> U.C.C. § 2-103(k) (2006).

<sup>12</sup> § 2-608.

<sup>13</sup> § 2-612; *see* § 2-208(1); § 2-609(3).

<sup>14</sup> §§ 2-314 to -315.

<sup>15</sup> BLACK’S LAW DICTIONARY: POCKET EDITION 648 (3d ed. 2006).

<sup>16</sup> HENRY D. GABRIEL & LINDA J. RUSCH, THE ABCS OF THE UCC: (REVISED) ARTICLE 2: SALES 6 (Amelia H. Boss, ed., 2004).

<sup>17</sup> The implied warranties that are relevant for this paper are the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. *See* U.C.C. §§ 2-314 to -315 for an explanation of when these implied warranties apply.

<sup>18</sup> *See* RICHARD E. SPEIDEL & LINDA J. RUSCH, COMMERCIAL TRANSACTIONS: SALES, LEASES, AND LICENSES 16 (2d ed. 2004), for justifications of the implied warranty of merchantability.

<sup>19</sup> *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 344 (5th ed. 2000) (stating that implied warranties do not apply to services); Rachel B. Adler, *Device Dilemma: Should Hospitals Be Strictly for Retailing Defective Surgical Devices*, 5 ALB. L.J. SCI. & TECH. 95, 101 (1994) (same); Michael J. Miller, *Strict Liability, Negligence and the Standard of Care for Transfusion-Transmitted Diseases*, 36 ARIZ. L. REV. 473, 490 (1994) (same); *see also* Walter G. Wright, Jr., &

that services should contain implied warranties to protect buyers and allocate losses efficiently.<sup>20</sup> The implied warranty would hold service providers “responsible for failing to live up to the duties society imposes upon them.”<sup>21</sup> In other words, sellers would be liable whenever the consumer did not receive the expected result from the service, whether it was a completed bookcase or a patched heart. Other scholars argue that implied service warranties would deter surgeons from providing life-saving treatment.<sup>22</sup> This argument, however, ignores the possibility for surgeons to contract around implied warranties; adding a disclaimer of implied warranties in patient contracts would be easier for surgeons than leaving the field altogether. Nevertheless, it may be reasonable not to include implied warranties in service transactions because there are many small-time service providers who do not enter formal contracts (in which warranties could be disclaimed). It is likely that people who perform odd jobs could not afford the liability that would attach whenever results do not match buyer expectations.

A related question is whether Article 2 should apply to “mixed” contracts involving both goods and services.<sup>23</sup> The drafters avoided this issue by stating only “this article applies to transactions in goods.”<sup>24</sup> As with other legal issues that are not resolved in statutory codes,<sup>25</sup>

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Stephanie M. Irby, *The Transactional Challenges Posed by Mold: Risk Management and Allocation Issues*, 56 ARK. L. REV. 295 (2003) (noting that most courts have held that architects do not “impliedly warrant design services”). In a marked departure from other states, Kansas recognizes implied warranties in service transactions. *See infra* note 30.

<sup>20</sup> *See, e.g.*, Miller, *supra* note 19, at 495-506 (arguing that implied warranties or strict liability for services would accord with buyer expectations, allocate loss to those who profit, spread losses, encourage safer services, and internalize costs).

<sup>21</sup> *Id.* at 495.

<sup>22</sup> Thomas D. Overcast et al., *Malpractice Issues in Heart Transplantation*, 10 AM. J.L. & MED. 363 (1985) (“[I]n the harsh reality of scientific uncertainty it is entirely unreasonable to suggest a standard that requires the medical profession to guarantee a particular result.”).

<sup>23</sup> Mixed transactions have also been referred to as “hybrid transactions.” *E.g.*, Note, *Products and the Professional: Strict Liability in the Sale-Service Hybrid Transaction*, 24 HASTINGS L.J. 111 (1972).

<sup>24</sup> U.C.C. § 2-102 (2006); *see* GABRIEL & RUSCH, *supra* note 16, at 4-5.

<sup>25</sup> *See* Chalmers, *supra* note 1, at 16-17.

mixed contracts have resulted in much expensive litigation.<sup>26</sup> A number of courts have considered whether mixed contracts contain implied warranties.<sup>27</sup> In the prototypical mixed contracts case, a buyer files suit alleging that a seller violated implied warranties because the goods involved in the transaction proved unmerchantable<sup>28</sup> or unfit for the buyer's particular purpose.<sup>29</sup> The seller then argues that the U.C.C.'s implied warranties do not apply because the contract was not purely a "transaction[] in goods."<sup>30</sup> When the buyer alleges breach of implied warranties, the seller prefers application of the common law, rather than the U.C.C., because the common law generally does not contain implied warranties.<sup>31</sup> Courts have employed a few tests to determine whether the U.C.C. applies to each mixed transaction.<sup>32</sup>

Unfortunately, these approaches encourage deception by sophisticated parties. A sophisticated repeat seller who is contracting with a less-informed buyer for goods and services will realize that implied warranties may not apply to the transaction. Sellers are able to use this additional knowledge to their advantage by deliberately avoiding the topic of implied warranties during negotiations. Consumers are not aware that they can negotiate the application of these

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<sup>26</sup> See YVONNE W. ROSMARIN & JONATHAN SHELDON, SALES OF GOODS AND SERVICES § 8.7, at 158-64 (National Consumer Law Center 2d ed. 1989).

<sup>27</sup> WHITE & SUMMERS, *supra* note 19, at 344 ("For the most part buyers seek Article 2 coverage because they wish to assert breach of the Code's warranty of merchantability); see, e.g., Princess Cruises, Inc. v. General Electric Co., 143 F.3d 828 (4th Cir. 1998); Coakley & Williams, Inc. v. Shatterproof Glass Corp., 706 F.2d 456 (4th Cir. 1983); Brandt v. Boston Scientific Corp., 792 N.E.2d 296 (Ill. 2003). Buyers seek Article 2 coverage for mixed transactions because state common law generally does not contain implied warranties. See Bruce A. Singal, *Extending Implied Warranties Beyond Goods: Equal Protection for Consumers of Services*, 12 NEW ENG. L. REV. 859, 931 (1977).

<sup>28</sup> See § 2-314 (explaining the types of transactions that contain warranties of merchantability).

<sup>29</sup> See § 2-315 (describing circumstances in which warranties of fitness for a particular purpose apply). A buyer may also seek Article 2 application in order to "take advantage of the statute of frauds, rules on unconscionability, good faith provisions, statute of limitations, or the rules of contract construction." WHITE & SUMMERS, *supra* note 19, at 344.

<sup>30</sup> U.C.C. § 2-102. Note that in Kansas, the buyer may be able to assert a common law breach of implied warranties even in service transactions. *E.g.* Corral v. Rollins Protective Services Co., 732 P.2d 1260, 1268 (Kan. 1987). When that state's laws govern a mixed transaction, parties may be less likely to dispute whether to apply the U.C.C.

<sup>31</sup> See *supra* note 19.

<sup>32</sup> See *infra* Section I.

warranties, perhaps assuming that some minimum warranty applies automatically, so they also do not raise the issue. Sellers therefore obtain higher prices and more contracts than they would be able to if their contracts specifically stated that implied warranties do not apply to the transaction. A seller may later refuse to honor implied warranties even though the parties did not negotiate the issue. If the goods are defective or unfit and the buyer asserts breach of implied warranties, the seller can respond that the implied warranties do not apply because the transaction is not covered by the U.C.C.<sup>33</sup> At this point, most buyers would likely decide that it is not worth their time to litigate the issue, thereby absolving the seller from liability for his or her unmerchantable or unfit products. Even if the buyer sues, the court may not apply the U.C.C.<sup>34</sup> Sellers, therefore, can often avoid implied warranties without mentioning them during negotiations merely because there is a chance that courts will not apply the U.C.C. to the transaction.

The issue of implied warranty disclaimers in mixed transactions is particularly salient considering the attention paid to warranty disclaimers in general. A warranty disclaimer is a provision to “negate or limit [a] warranty.”<sup>35</sup> In the 1990s, courts and scholars criticized the provisions of U.C.C. section 2-316 for allowing sellers to disclaim implied warranties with

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<sup>33</sup> If the seller honestly believes, based on his past experience with mixed contracts or his knowledge of the U.C.C., that implied warranties do not apply, his denial of liability would be in good faith. U.C.C. § 1-201 (2006) (noting that good faith, as applied in the U.C.C., means “honesty in fact and the observance of reasonable commercial standards of fair dealing”). As long as the U.C.C. arguably does not apply under one of the mixed contracts tests used by courts, the seller would have a reasonable basis for that belief. Such denials are almost encouraged by the case law, which exhibits no consistent basis on which to distinguish mixed transactions in which the Code applies from those in which it does not. WHITE & SUMMERS, *supra* note 19, at 345.

<sup>34</sup> For examples in which the court did not apply the U.C.C. under the majority rule “predominance test,” see *Kirkendall v. Harbor Insurance Co.*, 887 F.2d 857 (8th Cir. 1989) (applying Arkansas law) (stating that a blood transfusion is predominantly a service); *Ranger Constr. Co. v. Dixie Floor Co.*, 433 F. Supp. 442, 444-45 (D.S.C. 1977) (holding that the U.C.C. does not apply to a contract for installation of a resilient floor). *But see Docteroff v. Barra Corp.* 282 N.J. Super 230 (App. 1995) (ruling that the U.C.C. applies to a contract for sale and installation of a roof); *Pittsley v. Houser*, 872 P.2d 232 (Idaho App. 1995) (holding that the U.C.C. does apply to a contract for installation of a carpet).

<sup>35</sup> U.C.C. § 2-316 (2006).

boilerplate language.<sup>36</sup> Buyers who were not familiar with the U.C.C. might not notice or understand phrases such as “implied warranties are hereby expressly excluded.”<sup>37</sup> In response to such criticism, the NCCUSL and ALI amended section 2-316 in 2003.<sup>38</sup> Now, warranty disclaimers in consumer contracts must include specific phrasing in consumer-friendly terms designed to notify buyers that such warranties are excluded.<sup>39</sup> Unfortunately, these new disclaimer rules apply only to transactions that are already covered by the U.C.C. Thus, this remedy falls short of curing the inherent disadvantage facing unsophisticated buyers in mixed transactions. Consumers signing mixed contracts who do not see such disclaimers may assume that implied warranties will protect them from defective products. Instead, these consumers are left unprotected and uninformed.

A solution to this problem may lie in an “information-forcing penalty default” enforced against repeat sellers. Ian Ayres and Robert Gertner have described such penalty defaults as “designed to give at least one party an incentive to contract around the default rule and therefore to choose affirmatively the contract provision they prefer.”<sup>40</sup> These defaults are intended for

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<sup>36</sup> See *Cate v. Dover Corp.*, 790 S.W.2d 559 (Tex. 1990); Donald F. Clifford, *Non-UCC Statutory Provisions Affecting Warranty Disclaimers and Remedies in Sales of Goods*, 71 N.C. L. REV. 1011 (1993); Curtis R. Reitz, *Manufacturers’ Warranties of Consumer Goods*, 75 WASH. U. L.Q. 357 (1997).

<sup>37</sup> *Cate*, 790 S.W.2d at 560.

<sup>38</sup> See Linda J. Rusch, *Products Liability Trapped by History: Our Choice of Rules Rules Our Choices*, 76 TEMP. L. REV. 739, 741 n.7 (2003); see also Jack M. Graves, *Course of Performance as Evidence of Intent or Waiver: A Meaningful Preference for the Latter and Implications for Newly Broadened Use Under Revised U.C.C. Section 1-303*, 52 DRAKE L. REV. 235, 239 n.12 (2004) (noting that Article 2 underwent a major revision in 2003).

<sup>39</sup> To exclude the implied warranty of merchantability in a consumer contract, the disclaimer must “be in a record, be conspicuous,” and include the phrase “The seller undertakes no responsibility for the quality of the goods except as otherwise provided in this contract.” U.C.C. § 2-316(2) (2006). Similarly, a disclaimer of implied warranties of fitness in a consumer contract “must be in a record . . . be conspicuous” and state “The seller assumes no responsibility that the goods will be fit for any particular purpose for which you may be buying these goods, except as otherwise provided in the contract.” *Id.*

<sup>40</sup> Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989).

negotiations in which one side is in a contractual setting regularly, such as a merchant,<sup>41</sup> and is therefore more informed than the other party.<sup>42</sup> “By setting the default rule in favor of the uninformed party, the courts induce the informed party to reveal information.”<sup>43</sup> A penalty default, therefore, can serve to correct a less-informed party’s misunderstanding of the law governing the transaction by providing an incentive for the more informed party to raise the issue.

This paper proposes that states adopt a new uniform law establishing an information-forcing penalty default: the U.C.C. applies when a merchant is the seller in a mixed goods and services contract. The penalty default would force merchant sellers to either accept the warranties or disclaim them specifically and explicitly in the contract, as is presently the case for implied warranties on goods covered by the U.C.C. This penalty default would therefore provide less-informed buyers with either more protection of their rights (by arming them with legal recourse if the merchant does not contract around the default), or more information about the underlying law governing their contracts (if the merchant contracts around the default). When consumers are notified about the goods, services, and protections they will receive at the time of contracting, they can make a more informed choice about whether to accept the seller’s proposed terms or whether to enter the contract at all. Also, the penalty default would save significant litigation costs because it would compel parties to decide U.C.C. applicability *ex ante* rather than shifting that determination to a court after a dispute arises.

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<sup>41</sup> Merchants, as defined in the U.C.C., are likely to be in similar contract settings repeatedly. U.C.C. § 2-104(1) (2006) (“Merchant” means a person that deals in goods of the kind or otherwise holds itself out by occupation as having knowledge or skill peculiar to the practices or goods involved in the transaction or to which the knowledge or skill may be attributed by the person’s employment of an agent or broker or other intermediary that holds itself out by occupation as having the knowledge or skill.”).

<sup>42</sup> Ayres & Gertner, *supra* note 40, at 98.

<sup>43</sup> *Id.* at 99.

## I. EXISTING APPROACHES TO MIXED CONTRACTS

Courts have applied a few different tests to resolve whether the U.C.C. applies to mixed contracts. This Section describes these different methods and their respective advantages and disadvantages. Subsection A evaluates the majority approach predominance test, which applies the Code when the *main purpose* of the transaction is the sale of goods. Subsection B assesses a test that applies the U.C.C. only to the *component* of the transaction involving goods. Subsection C considers a third approach, which applies the Code to the whole transaction if the *dispute* primarily concerns the goods furnished. Subsection D explains and critiques a policy-based method for applying U.C.C. provisions to contracts that do not fall under the Code's purview. Finally, Subsection E discusses a plain language interpretation of the U.C.C.'s provisions that has not been applied by courts.

Some commentators have noted that many courts go to great lengths to apply the U.C.C. to mixed contracts involving consumers in order to protect these unsophisticated parties.<sup>44</sup> The courts determine that the U.C.C. applies to the transaction by loose application of the predominance approach or, if that is inapt, by selective use of the other tests or via application by analogy.<sup>45</sup> The various approaches are ex post attempts by courts to protect consumers.<sup>46</sup> As explained below, the existence of these various tests can, perversely, leave consumers in mixed

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<sup>44</sup> WHITE & SUMMERS, *supra* note 19, at 344 (“Sympathetic plaintiffs often bring breach of warranty suits, and these litigants may have greater success in invoking Code protection than parties to non-warranty disputes.”); *see* ROSMARIN & SHELDON, *supra* note 26, § 8.7.6, at 164 (“The court’s decision may be more a reflection of the equities of the particular case than a pronouncement of legal principles.”); Note, *Contracts for Goods and Services and Article 2 of the Uniform Commercial Code*, 9 RUTGERS-CAM. L.J. 303, 305-06 (1978).

<sup>45</sup> Application by analogy is a method courts use to apply UCC rules to transactions beyond the scope of the Code. ROSMARIN & SHELDON, *supra* note 26, § 8.7.5, at 163.

<sup>46</sup> Note, however, that some mixed contract disputes do not involve consumers, so courts may not give deference to either party. WHITE & SUMMERS, *supra* note 19, at 344. These cases also create precedents that may be difficult for later consumer litigants to overcome. *See* ROSMARIN & SHELDON, *supra* note 26, § 8.7.2.1, at 159 n.40.

transactions *less* protected before litigation.

When a dispute over implied warranties arises, the existence of multiple approaches may lead the seller to claim that there are no implied warranties based on his understanding of the case law. The seller's argument can be considered good faith,<sup>47</sup> even if its substance would not be borne out by the courts, because there are multiple approaches to mixed transactions, and many jurisdictions have experimented with more than one approach. When the seller refuses to honor implied warranties, a buyer must endure litigation in order to reap the benefit of a favorable court ruling. Yet most disputes do not develop into cases;<sup>48</sup> when a dispute cannot be resolved without litigation, many potential plaintiffs decide that the dispute is not worth further time, energy, or expense. Although a court may have ultimately determined that implied warranties inhere to a given hybrid transaction, a party who is unwilling to litigate does not receive the benefit of this ex post preference.

Moreover, a buyer's decision to litigate does not guarantee a favorable verdict. Not all courts choose to apply the U.C.C. to mixed contracts, nor do they necessarily endorse U.C.C. application by analogy, even in consumer transactions.<sup>49</sup> No matter the result, both parties expend significant litigation costs persuading the court to apply their favored approaches; the court also incurs expenses adjudicating the case.

In the Sections below, this paper addresses advantages and disadvantages of each approach *if it were to be adopted as the sole test* in a jurisdiction (or, where noted, as a second step after application of the predominance approach). Under current case law, most jurisdictions

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<sup>47</sup> See *supra* note 33.

<sup>48</sup> Court papers are filed in only five percent of grievances. OWEN M. FISS & JUDITH RESNIK, ADJUDICATION AND ITS ALTERNATIVES: AN INTRODUCTION TO PROCEDURE 434 (2003) (citing David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72 (1983)).

<sup>49</sup> *E.g.* Ranger Constr. Co. v. Dixie Floor Co., 433 F. Supp. 442, 444-45 (D.S.C. 1977) (holding that the U.C.C. does not apply to a contract for installation of a resilient floor).

have *not* adopted a single test for mixed contracts.<sup>50</sup> In current practice, therefore, mixed contracts are prone to the additional problems noted in the paragraphs above.

*A. Majority Approach: The Predominance Test*

Under the most common approach to mixed contracts, courts apply the U.C.C. and its implied warranties when the “predominant purpose” of the transaction is the purchase of goods.<sup>51</sup> Section 2-102 states that the Code applies to “transactions in goods,” and this test provides a reasonable interpretation of that language: a transaction “primarily for goods” can logically be considered a “transaction in goods.”<sup>52</sup> One frequently cited case, *Bonebrake v. Cox*, explains the predominant purpose test:

The test for inclusion [in the provisions of the U.C.C.] or exclusion [from these provisions] is not whether [the contract is] mixed, but, granting that [it is] mixed, whether [its] predominant factor, [its] thrust, [its] purpose, reasonably stated, is the rendition of service, with goods incidentally involved (e.g., contract with artist for painting) or is a transaction of sale, with labor incidentally involved (e.g., installation of a water heater in a bathroom).<sup>53</sup>

In *Bonebrake*, the court held that a bowling alley’s contract with a bowling equipment dealer for bowling equipment, installation, and lane resurfacing was predominantly a sale of goods. Thus, the dispute was subject to U.C.C. provisions.

Courts have reached conflicting results in determining the predominant purpose of mixed

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<sup>50</sup> ROSMARIN & SHELDON, *supra* note 26, § 8.7.6, at 164.

<sup>51</sup> *Id.* § 8.7.2.1, at 159; e.g. *De Filippo v. Ford Motor Co.*, 516 F.2d 1313 (3d Cir. 1975); *St. Anne-Nackawic Pulp Co. v. Research-Cottrell, Inc.*, 788 F. Supp. 729 (S.D.N.Y. 1992); *Hope’s Architectural Products, Inc. v. Lundy’s Constr., Inc.*, 781 F. Supp. 711 (D. Kan. 1991); *Nat’l Historic Shrines Found., Inc. v. Dali*, 4 U.C.C. Rep. 71 (N.Y. Sup. Ct. 1967). This approach has also been called the “predominate purpose test.” GABRIEL & RUSCH, *supra* note 16, at 5.

<sup>52</sup> *Union City Barge Line, Inc. v. Union Carbide Corp.*, 823 F.2d 129, 140 (5th Cir. 1987). One student note asserts that the predominant purpose approach is *not* a reasonable interpretation of 2-102 because it “fails to give the UCC its required liberal construction. Nowhere is it stated in Article 2 that that article of the UCC is inapplicable to contracts involving goods and services.” Note, *supra* note 44, at 307-08.

<sup>53</sup> 499 F.2d 951, 960 (8th Cir. 1974) (citation omitted).

goods and service contracts.<sup>54</sup> For example, *Riffe v. Black* held that the U.C.C. applies to the sale and installation of a swimming pool,<sup>55</sup> while *Gulash v. Stylarama* held that the U.C.C. does not apply to a similar transaction.<sup>56</sup> One explanation for such conflicts is that courts have looked at different factors to determine what constitutes the predominant purpose of the transaction.<sup>57</sup> In *Meyers v. Henderson Construction Co.*, the controlling factor was whether the goods installed were already a finished product; the court ruled that a contract to sell and install doors was primarily a sale of goods because the doors were already assembled.<sup>58</sup> Other courts have looked at the contract's language,<sup>59</sup> nature of the supplier's business,<sup>60</sup> and the intrinsic worth of the materials used.<sup>61</sup> Finally, some courts have looked at the bill to see whether goods and services are billed separately<sup>62</sup> or, alternatively, the percentage of the total price billed to goods.<sup>63</sup> The

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<sup>54</sup> ROSMARIN & SHELDON, *supra* note 26, §8.7.2.3, at 161; WHITE & SUMMERS, *supra* note 19, at 345. Also see cases in ROSMARIN & SHELDON, *supra* note 26, §8.7.2.3, at 161 nn.52-54 (listing conflicting results in cases involving the sale and installation of "flooring, heating and air conditioning equipment, and burglar alarm systems").

<sup>55</sup> 548 S.W.2d 175 (Ky. 1977).

<sup>56</sup> 33 Conn. Supp. 108 (1975).

<sup>57</sup> Note, however, that some commentators have claimed that courts selectively choose factors that lead them to apply the U.C.C., *see* ROSMARIN & SHELDON, *supra* note 26, at 164, particularly in consumer contracts. *See* WHITE & SUMMERS, *supra* note 19, at 345.

<sup>58</sup> 370 A.2d 547 (N.J. Super. Ct. App. Div. 1977). *See also* Standard Structural Steel v. Debron Corp., 515 F. Supp. 803 (D. Conn. 1980).

<sup>59</sup> WHITE & SUMMERS, *supra* note 19, at 344. *Compare* Bonebrake v. Cox 499 F.2d 951, 958 ("The language thus employed is that peculiar to goods, not services. It speaks of 'equipment,' and of lanes free from 'defects in workmanship and materials.' The rendition of services does not comport with such terminology.") *with* Van Sistine v. Tollard, 95 Wis. 2d 678 (Ct. App. 1980) (stating that the words "install," "move," and "reposition" reveal that the home remodeling contract was primarily for services).

<sup>60</sup> Ranger Constr. Co. v. Dixie Floor Co., 433 F. Supp. 442, 445 ("The defendant's responses to interrogatories indicated that the defendant was essentially a service corporation engaged in the installation and construction of flooring.").

<sup>61</sup> E.g. *Coakley*, 706 F.2d at 461 (1983) ("[T]he value of the [materials involved] is . . . one of several factors which must be evaluated [to determine whether the parties] deal[t] primarily with goods or services.").

<sup>62</sup> *WesTech Engineering, Inc. v. Clearwater Constr., Inc.* 835 S.W.2d 190, 197 (Tex. Ct. App. 1992 (ruling that goods were the "essence" of the transaction because service items were "in addition to the contract price"); *see* ROSMARIN & SHELDON, *supra* note 26, at 161; WHITE & SUMMERS, *supra* note 19, at 344.

<sup>63</sup> *See* WHITE & SUMMERS, *supra* note 19, at 344. *Compare* *Micro-Managers, Inc. v. Gregory*, 147 Wis. 2d 500 (1988) (ruling that the U.C.C. did not apply when over ninety percent of a computer software bill

court in *Riffe* ruled that the transaction was primarily for goods because of the difference in the costs of the goods involved versus the services,<sup>64</sup> but the court in *Gulash* stated that the transaction was primarily for goods because the pool was not a finished product when purchased.<sup>65</sup>

Even if a jurisdiction applied the predominant purpose approach exclusively,<sup>66</sup> the different factors relied on by courts provide sellers with various rationales for claiming that the U.C.C. and its implied warranties do not apply to the transaction. Because sellers have numerous possible defenses to U.C.C. applicability, the predominant purpose approach leads to less protection for buyers who are unwilling to litigate, just as when courts are open to using multiple tests. If the issues are litigated, the existence of various controlling factors may induce parties to expend significant resources instead of settling, because each party has a legitimate chance of prevailing in court.<sup>67</sup> The court, moreover, consumes public resources in deciding the issues because they are fact-sensitive and not well-suited to summary judgment. The different tests, even within the predominant purpose approach, therefore encourage wasteful ex post expenditure in determining U.C.C. applicability.

Also, the predominant purpose test may lead to inappropriate application of the U.C.C. to disputes involving the service component of a primarily goods transaction, or decisions not to apply the U.C.C. to disputes involving the goods component of a primarily service transaction.

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was for “labor”), *with J. Lee Gregory, Inc. v. Scandinavian House, L.P.*, 209 Ga. App. 285, (1993) (holding that the U.C.C. applies when the cost of goods represents two-thirds of the total cost billed).

<sup>64</sup> 548 S.W.2d at 177.

<sup>65</sup> 33 Conn. Supp. at 112.

<sup>66</sup> For explanation of the similar problems that can result when a jurisdiction applies multiple tests, see *supra* pp. 8-9. Although some jurisdictions have used only the predominant purpose test, courts have been willing to apply other approaches without precedent. *ROSMARIN & SHELDON*, *supra* note 26, at 159-62; *see, e.g.*, *Foster v. Colorado Radio Corp.*, 381 F.2d 222 (10th Cir. 1967).

<sup>67</sup> *See WHITE & SUMMERS*, *supra* note 19, at 345.

In *O'Laughlin v. Minnesota Natural Gas Co.*,<sup>68</sup> the court applied the predominance test and concluded that the U.C.C.'s implied warranties applied to a contract for the sale and installation of a furnace, even though the element of the contract in dispute was the installation. The language of implied warranties in the U.C.C. refers specifically to goods, so it could be difficult for courts to determine what sellers implicitly warrant regarding the services attached to a predominantly goods contract. Further confusing the issue, some courts hold that the U.C.C. does not apply to the service component of the transaction.<sup>69</sup> These conflicting results may lead to even more resources wasted on litigation.<sup>70</sup> Similarly, the predominant purpose approach may leave buyers unprotected when a dispute involves the goods in a transaction primarily for services.<sup>71</sup> Although the predominant purpose test is a reasonable interpretation of section 2-102, it yields conflicting results, leaves many buyers unprotected, and expends resources inefficiently.

### *B. The Component Test*

An alternative test used by courts applies the U.C.C. to the goods component of a mixed transaction, regardless of whether the primary purpose of the transaction is the sale of goods.<sup>72</sup> This "component test" represents a reasonable interpretation of section 2-102 if one considers the transaction to consist of two separate contracts, one for goods and another for services. The approach allows buyers to be protected by implied warranties for the goods they purchase, as

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<sup>68</sup> 252 N.W.2d 826 (Minn. 1977).

<sup>69</sup> *Lemley v. J&B Tire Co.*, 426 F. Supp. 1378 (W.D. Pa. 1977) (stating that the U.C.C. would not apply to the service component of a brake repair transaction); *Stephenson v. Frazier*, 399 N.E.2d 794 (Ind. Ct. App. 1980) (ruling that the U.C.C. applies to the sale of a moveable home, but not to services performed as part of that transaction). *But see Hudson v. Town and Country True Value Hardware, Inc.*, 666 S.W.2d 51 (Tenn. 1984) (applying a single measure of damages to all aspects of a mixed transaction).

<sup>70</sup> *Hudson*, 666 S.W.2d at 54. *See infra* quote accompanying note 79.

<sup>71</sup> *See supra* notes 49, 56.

<sup>72</sup> *See Foster v. Colorado Radio Corp.*, 381 F.2d 222 (10th Cir. 1967) (ruling that Article 2 applies to the office equipment purchased as part of the sale of a radio station).

they might expect based on their limited experience with commercial law. It also obviates the problems involved with applying the U.C.C. to the services component of the transaction.

*Newmark v. Gimbel's Inc.* allowed a buyer to sue a beauty parlor operator for violating implied warranties regarding a defective solution used as part of a beauty treatment.<sup>73</sup> Essentially, the court agreed to apply the U.C.C. to the goods portion of a mixed contract, even though the service portion was predominant.

Unfortunately, by splitting the contract into two parts, the component test may lead to additional work for courts. This approach requires courts to decide separately many issues beyond implied warranties, such as the statute of frauds, the parol evidence rule, and the statute of limitations.<sup>74</sup> When parties are unable to determine the relevant statute of limitations for their claims, they may waste resources on litigation merely to determine which set of law the court will apply.<sup>75</sup> For example, if the component test, rather than the predominant purpose test, had been applied in *Docteroff v. Barra Corp.*,<sup>76</sup> the court would have had to apply two different statutes of limitations to the transaction, significantly complicating the court's determination of breach. The difficulty associated with splitting contracts leads some courts to reject the component approach,<sup>77</sup> while other courts in similar cases divide the contract.<sup>78</sup>

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<sup>73</sup> 54 N.J. 585 (1969). For a suggestion that this case was decided based on policy rationales and a discussion of the early approaches to predominantly service transactions, see A. Mark Segreti, Jr., Note, *The Application of Implied Warranties to Predominantly "Service" Transactions*, 31 OHIO ST. L.J. 580 (1970).

<sup>74</sup> See *infra* quote accompanying note 79.

<sup>75</sup> See Thomas J. Stipanowich, *Reconstructing Construction Law: Reality and Reform in a Transactional System*, 1998 WIS. L. REV. 463, 512 ("Hybrid transactions raise difficult questions regarding applicable statutes of limitations . . . . Treatment of these issues is fragmented and . . . likely to lead to unpredictable or irrational results.").

<sup>76</sup> 282 N.J. Super 230 (App. 1995) (holding that the suit was governed by the U.C.C.'s four year statute of limitations rather than the state's six year statute of limitations for other contract disputes).

<sup>77</sup> *In re TMJ Implants Products Liability Litigation*, 872 F. Supp. 1019 (D. Minn. 1995) (ruling that the U.C.C. does not apply to any component of a transaction involving a doctor implanting a medical device).

<sup>78</sup> *Garcia v. Edwater Hospital*, 613 N.E.2d 1243 (Ill. App. 1993) (holding that a hospital's liability regarding an implanted heart valve could be based on an implied warranty of merchantability).

If a jurisdiction adopted the component approach as its exclusive test for mixed contracts, the problems of splitting contracts would be magnified. All mixed contract cases in which there were disputes involving both the goods portion and the services portion would require courts to engage in the tenuous process of component splitting. As one court noted, the application of more than one body of law to a mixed transaction may introduce “insurmountable problems of proof in segregating assets and determining their respective values at the time of the original contract and at the time of resale, in order to apply two different measures of damages.”<sup>79</sup> Also, use of the component approach would induce parties to seek court resolution of issues arising out of whether an element of the transaction is a service or a good.<sup>80</sup> For example, a seller may damage a rug in the process of installing it, and a court would have to determine whether an implied warranty of merchantability applied because the goods were damaged or did not apply because it involved the process of installation.<sup>81</sup> The increase in public costs, resistance of courts to applying two sets of law, and continuing necessity for court determinations suggest that the component approach would not be appropriate as an exclusive approach to mixed contracts.

### *C. The Gravamen Test*

One scholar has crafted a third test for mixed transactions in order to avoid the various conflicts arising out of the predominance and component approaches.<sup>82</sup> The test asks whether the gravamen *of the dispute* relates to goods or services. Although the gravamen approach seems reasonable, in that it applies the U.C.C. to disputes involving goods, it does not entirely comport with the language of section 2-102. That section notes that Article 2 applies to “transactions in

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<sup>79</sup> Hudson v. Town and Country True Value Hardware, Inc., 666 S.W.2d 51, 54 (Tenn. 1984).

<sup>80</sup> See Debra L. Goetz et al., Special Project, *Article Two Warranties in Commercial Transactions: An Update*, 72 CORNELL L. REV. 1159, 1163 (“The traditional distinction between services and tangible goods blurs in today’s complex commercial world.”).

<sup>81</sup> For examples of cases in which these problems may arise, see *supra* note 54.

<sup>82</sup> WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-102:04 (1982).

goods,”<sup>83</sup> implying that a set of laws governs the *transaction* rather than the *dispute* (which generally arises sometime after the transaction). It may violate the plain meaning of section 2-102 to apply a form of law to a transaction based on the subject of a later dispute instead of the subject of the transaction itself.<sup>84</sup>

In *Anthony Pools v. Sheehan*, the court applied a form of gravamen test to a transaction for the sale and installation of a pool and diving board.<sup>85</sup> The court noted, however, that it was only using the test because goods were not predominant and it was a commercial transaction for consumer goods.<sup>86</sup> This rationale suggests that *Anthony Pools* used a multi-part test:

- 1) Are goods the predominant purpose of the transaction? (A predominance test)
- 2) Are the goods supplied in a commercial transaction (rather than a professional services transaction)?
- 3) Is the merchandise supplied in the transaction a consumer good?
- 4) Are the goods supplied the gravamen of the dispute?

Under the *Anthony Pools* test, the U.C.C. applies if the first question is answered in the affirmative, *or* if questions two, three, and four are all answered in the affirmative. The court also brought in a component element: when applying the U.C.C. based on questions two through four, it applies only to the goods portion of the transaction. The court ruled that the diving board carried an implied warranty of merchantability because it fulfilled factors two through four.<sup>87</sup>

In *J.O. Hooker & Sons, Inc. v. Roberts Cabinet Co.*,<sup>88</sup> the court applied a simpler gravamen test. It stated the test as follows: “in . . . a mixed transaction, whether or not the

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<sup>83</sup> U.C.C. § 2-102 (2006).

<sup>84</sup> See Note, *Disengaging Sales Law from the Sale Construct: A Proposal To Extend the Scope of Article 2 of the UCC*, 96 HARV. L. REV. 470, 478 (1982).

<sup>85</sup> 455 A.2d 434, 441 (Md. 1983).

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> 683 So.2d 396 (Miss. 1996)

contract should be interpreted under the [U.C.C.] or our general contract law should depend on . . . whether the *dispute* in question primarily concerns the goods furnished or the services rendered.”<sup>89</sup> The court did not apply the U.C.C. because the dispute involved the services element of the transaction (disposing of cabinets) rather than the goods element (the new cabinets).<sup>90</sup>

Although the gravamen approach appears to provide implied warranty protection for buyers when goods are in dispute, it has the potential to cause many problems. If it were adopted as a state’s exclusive method for deciding mixed contract issues, buyers and sellers could not be sure which law governed their transaction until a dispute arose. This would be problematic for parties trying to determine their rights and responsibilities under a contract because different gap-fillers, such as statutes of limitations, would apply to the transaction depending on whether it is governed by a state’s common law or commercial code.<sup>91</sup>

Moreover, once litigation begins, a court applying this approach must determine the true items in dispute. This reliance on *ex post* determination by courts invites fraudulent claims; a seller who does not want the court to apply the U.C.C. may counterclaim for as many service-related issues as possible in hopes that the court would apply the common law, which generally does not contain implied warranties, to the entire transaction. Sellers have an incentive to load additional counter-claims for the express purpose of influencing the court’s choice of law, since such a decision is reached by looking at the dispute in its entirety. The burden on courts would be doubly increased by this outcome: first, courts would have to take an additional step of screening claims to determine the gravamen of the dispute; second, courts would need to adjudicate all the additional claims that were added for the purpose of influencing the choice of

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<sup>89</sup> *Id.* at 400.

<sup>90</sup> *Id.*

<sup>91</sup> See Stipanowich, *supra* note 75, at 512.

law. As an exclusive approach to mixed transactions, the gravamen test would force parties to begin litigation to determine the law governing their transaction, and would foster costly counterclaims to influence the court's choice of law.

*D. U.C.C. Applicability by Analogy: A Policy Approach*

Some courts have been willing to provide parties to mixed transactions with the benefits of U.C.C. provisions despite acknowledging that the U.C.C. itself is inapplicable to the transaction.<sup>92</sup> The theory underlying the application of these provisions is that the U.C.C.'s passage is evidence of legislative intent to abandon certain common law principles, even in non-goods transactions.<sup>93</sup> With regard to warranties, this extension of U.C.C. principles found support in an earlier version of an official comment to the express warranty provision of the U.C.C.:

[T]he warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. . . . [T]he matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.<sup>94</sup>

The comment has since been revised to remove mention of implied warranties and the suggestion that judges use the U.C.C. principles for guidance in cases that do not fall under Article 2.<sup>95</sup>

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<sup>92</sup> See, e.g., *Vitex Mfg. Corp. v. Caribtex Corp.*, 377 F.2d 795 (3d Cir. 1967) (applying U.C.C. section 2-708(2) damage provisions by analogy to a predominantly service transaction); *Glenn Dick Equipment Co. v. Galey Construction, Inc.*, 541 P.2d 1184 (Idaho 1975); see also WHITE & SUMMERS, *supra* note 19, at 27 (5th ed. 2000) (advocating that courts apply Article 2 by analogy in light of policy considerations); Note, *supra* note 84, at 477 (“[C]ourts apply Article 2 to transactions held not to be paradigmatic ‘sales of goods,’ but they do so only when the transactions closely resemble paradigmatic sales.”).

<sup>93</sup> JONATHAN SHELDON & YVONNE W. ROSMARIN, SALES OF GOODS AND SERVICES § 8.7.5, at 53 (National Consumer Law Center Supp. 1996); Comment and Casenote, *Dual Nature Contracts and the Uniform Commercial Code: Foster v. Colorado Radio Corporation*, 28 MD. L. REV. 136, 140 (1968).

<sup>94</sup> U.C.C. § 2-313 cmt. 2 (2000); see SHELDON & ROSMARIN, *supra* note 93, § 8.7.5, at 53. States do not adopt the official comments, but they “have influenced many judicial decisions.” SPEIDEL & RUSCH, *supra* note 18, at 16.

<sup>95</sup> U.C.C. § 2-313 cmt. 4 (2006) (“[This section] is not designed in any way to disturb those lines of case law which have recognized that warranties need not be confined to contracts within the scope of this Article.”).

Nevertheless, application by analogy could be justified in a more general sense by another official comment:

[The U.C.C.] is intended to make it possible for the law embodied in [it] to be developed by the courts in the light of unforeseen and new circumstances and practices. . . . The courts have often recognized that the policies embodied in an act are applicable in reason to subject-matter that was not expressly included in the language of the act . . . Nothing in the Uniform Commercial Code stands in the way of the continuance of such action by the courts.<sup>96</sup>

As suggested in the comment, courts have applied a number of provisions in the U.C.C. by analogy,<sup>97</sup> including implied warranties.<sup>98</sup>

Some commentators have justified applying U.C.C. provisions to non-U.C.C. sales on public policy grounds. An application of implied warranties by analogy in mixed transactions avoids the difficulties of proving negligence in a tort action because implied warranties are applied on a strict liability basis.<sup>99</sup> In addition, application by analogy comports with consumer reliance on seller claims.<sup>100</sup> It would also shift risks to least cost avoiders because sellers can more easily pressure manufacturers to make safer products.<sup>101</sup> Often, sellers are also better able to absorb any resulting loss.<sup>102</sup>

Although the policy approach is possible to justify on statutory grounds and can protect

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<sup>96</sup> § 1-103 cmt. 1.

<sup>97</sup> *E.g.* *Stern & Co. v. State Loan & Fin. Corp.* 238 F. Supp. 901 (D. Del. 1965) (applying the parol evidence rule as stated in U.C.C. section 2-202 by analogy to a contract for sale of stock); *Brown v. Coastal Truckways, Inc.* 261 S.E.2d 266 (N.C. Ct. App. 1980) (applying U.C.C. rules on accord and satisfaction by analogy to an employment contract); *see also* *SHELDON & ROSMARIN*, *supra* note 93, § 8.7.5, at 54 n.74 (listing cases in which U.C.C. provisions were applied by analogy).

<sup>98</sup> *See* *Conran v. Yager*, 263 S.C. 417, 211 S.E.2d 228 (1975) (applying rules on implied warranty disclaimers from U.C.C. section 2-316 by analogy in a real estate contract); *MacDonald v. Mobley*, 44 S.W.2d 916 (Tex. Civ. App. 1977) (same).

<sup>99</sup> *See* *Singal*, *supra* note 27, at 870 (1977); E. Allan Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653, 665 (1957).

<sup>100</sup> Note, *supra* note 44, at 313. *See also* *Newmark v. Gimbel's, Inc.*, 258 A.2d 697, 701 (N.J. 1969) (noting that the beauty parlor had solicited patronage, so the plaintiff could reasonably expect that she would not be injured).

<sup>101</sup> *See* Note, *supra* note 44, at 313-14; Note, *Products and the Professional: Strict Liability in the Sale-Service Hybrid Transaction*, 24 HASTINGS L.J. 111, 117 (1972).

<sup>102</sup> *SHELDON & ROSMARIN*, *supra* note 93, § 8.7.5, at 53; Note, *supra* note 44, at 313-14.

unsophisticated parties once they litigate, it would suffer from a number of problems as either a second step after a predominant purpose test, or if used exclusively.<sup>103</sup> The approach creates legal difficulties because it interprets U.C.C. provisions as law despite the fact that the court acknowledges the U.C.C. does not apply to the transaction. Parties could not be sure prior to litigation whether implied warranties would apply,<sup>104</sup> so sellers would still be able to deny liability before litigation by assuming that the public policy rationales tilt in their favor (for example, a seller could claim that a court would not impose implied warranties on a certain type of mixed contract because it could have a chilling effect on the industry in question). Also, the approach could lead to further confusion of state common law for service transactions: since the analogy approach implicitly acknowledges that the U.C.C. does not apply, later courts may apply provisions by analogy to pure service transactions.<sup>105</sup> Such extension would be unwarranted because many U.C.C. provisions were designed with the particular characteristics of goods contracts, and would therefore be difficult to adapt to service contracts.<sup>106</sup> Extension would also introduce difficulties in determining applicable law prior to litigating service contract disputes. Perhaps realizing the Code's limitations, the promulgators removed the official comment regarding application of implied warranties by analogy. Thus, the application by analogy

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<sup>103</sup> One scholar has criticized the analogy approach as follows:

First, to the extent that it operates to exclude nonparadigmatic sales from article 2 coverage, it subjects such sales to (often outdated) pre-Code and (often inappropriate) non-Code law. Second, courts wishing to avoid the first disadvantage may be tempted to distort the facts so that the transaction will more closely resemble a conventional sale. Third, the approach induces unstructured consideration of numerous factors and is therefore difficult to apply.

Note, *supra* note 84, at 478 (citations omitted).

<sup>104</sup> *Id.* ("That the body of law to which a contract is subject should vary during the development of the contractual situation is an obvious impediment to commerce.").

<sup>105</sup> Some cases have already extended the approach to service transactions. *Southwestern Bell Telephone Co. v. FDP Corp.*, 811 S.W.2d 572 (Tex. 1991) (stating that reference to the U.C.C. is "instructive" in advertising contract). It is likely that this extension would become more prevalent if the analogy approach were adopted as an exclusive test.

<sup>106</sup> See *supra* notes 12-14 and accompanying text for examples of provisions specifically tailored to goods transactions.

approach faces a slippery-slope, as it risks a potentially limitless over-application of the U.C.C. beyond that intended by the drafters.

The disruptions to state common law caused by this approach would also be unpredictable and divergent across jurisdictions. The types of contracts falling under the analogy approach would be arbitrary because precedents would be created ad hoc based on the particular parties involved in the first case to decide an issue.<sup>107</sup> Disputes over similar bundles of goods and services in different states would lead to conflicting lines of authority because policy considerations often differ among cases. The unpredictability of results would encourage litigation, and its accompanying waste of resources, in mixed contract disputes. As with the gravamen approach, parties would be required to enter litigation to clarify their rights and duties under the contract.

To make matters worse, courts may find different policy arguments convincing, or decide to adapt the provisions in different ways, leading to greater conflicts in the mixed contract case law. After the adoption of this approach, buyers who are unwilling to litigate would be no better off than before, because sellers could still find some case law supporting a refusal to honor implied warranties for a mixed transaction. The policy approach, therefore, would be inappropriate as an exclusive or additional test for applying implied warranties because it provides no protection prior to litigation, could confound state contract law, and would encourage further resource waste.

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<sup>107</sup> Note, *supra* note 44, at 321 (“[A]pplication of a specific section of Article 2 to a particular fact situation will result in that situation and any subsequent identical fact patterns being governed by the whole of Article 2. This situation could prove troublesome if the Code were applied to an isolated issue without an examination of the possible impact of the entire Code on that fact pattern.”); *see* ROSMARIN & SHELDON, *supra* note 26, § 8.7.6, at 164 (National Consumer Law Center 2d ed. 1989) (“[T]he particular posture of a goods and services case may be as determinative of the case’s outcome as the legal theory the court uses . . . . The court’s decision may be more a reflection of the equities of the particular case than a pronouncement of legal principles.”); WHITE & SUMMERS, *supra* note 19, at 344.

*E. Goods Contracts Only Approach*

Another possible interpretation of section 2-102 deserves mention because courts might find it tempting when confronted with the conflicting case law described above. The language “applies to transactions in goods”<sup>108</sup> could be interpreted to mean exclusive application to transactions dealing only with goods. This interpretation would provide a predictable result of not applying the U.C.C. in all mixed contracts disputes. It may, however, violate the U.C.C.’s requirement for liberal construction.<sup>109</sup> In resolving mixed contract disputes under the various approaches, courts may nevertheless be attracted to a plain meaning approach that leads to predictable results.

Unfortunately, this test would harm uninformed buyers who might expect that the U.C.C.’s implied warranties would inhere to a mixed transaction, particularly one that is predominantly for goods. If the U.C.C. is applied only to pure goods transactions, buyers would not be protected by implied warranties even in disputes over the goods component when there are policy reasons for applying the U.C.C. In addition, this approach could lead to fraud by sellers who would add small service elements to their goods contracts in order to avoid the U.C.C.’s implied warranties. For example, in a contract for sale of a large television, the seller would offer to bring the television outside to the buyer’s car. Most consumers would not realize that this small service would eliminate implied warranties for the goods. This approach should not be adopted because it would exacerbate the problem of sellers seeking to avoid implied warranties without informing buyers. This perverse result also contradicts a key goal of the U.C.C.: consumer protection.<sup>110</sup>

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<sup>108</sup> U.C.C. § 2-102 (2006).

<sup>109</sup> § 1-103 (“[The U.C.C.] must be liberally construed . . .”).

<sup>110</sup> SPEIDEL & RUSCH, *supra* note 18, at 653.

## II. PROPOSAL: AN INFORMATION-FORCING PENALTY DEFAULT FOR MIXED CONTRACTS

This Section presents a proposal for protecting consumers in mixed contract disputes. Subsection A details the common information failures in the existing approaches to mixed contracts. Subsection B explains the theory of penalty defaults and argues that a penalty default would be appropriate for mixed contracts involving consumers. Subsection C suggests specific language to add to the U.C.C. and provides two alternative methods for enactment across states. Subsection D defends the penalty default proposal against likely objections.

### *A. Common Failures in the Existing Approaches*

In addition to the disadvantages noted in Section I, the existing approaches to mixed goods and services contracts suffer from information failures that lead to inequitable results. Essentially, consumers enter into inequitable mixed contracts because they are unaware that implied warranties may not apply to the goods involved in the transaction. During negotiations, the seller has an incentive not to mention that fact because, if known, it would reduce the seller's bargaining power in the transaction. When buyers do not see any warranty disclaimers, they may simply assume, based on their limited experience with goods contracts, that the law provides some warranties regarding the goods purchased. Since these buyers bargain under this assumption, sellers are able to obtain contract prices above what buyers would be willing to pay if they knew the goods effectively do not contain warranties.

As mentioned in the introduction to Section I, the goods effectively *will not* contain warranties if the buyer is unwilling to litigate the issue to determine whether they apply after a seller claims they do not. To have a chance of receiving the benefit of a warranty, the buyer must invest significant time and money in litigation. Merchant sellers, because of their significant experience with mixed contracts, are informed of the confused law governing these

transactions. In the current approaches, these sellers are rewarded for not disclosing this information: they receive higher prices at the time of contracting and do not need to honor implied warranties when a dispute arises. In other words, sellers are able to capture rents during contract negotiations because of their superior information. (Sellers may still honor implied warranties in order to preserve their reputation, but this incentive may be insufficient for sellers who cater to diverse clientele or large geographical markets.) Thus, the current approaches create perverse, inequitable, and undesirable seller-side incentives.

Most of the approaches in Section I would not solve these information problems if adopted as exclusive tests. Sellers would still be able to refuse to honor implied warranties under the predominant purpose approach based on an understanding that a particular factor in the contract would render the U.C.C. inapplicable. Sellers could even set up the contract to ensure that a version of the predominant purpose approach would indicate inapplicability; for example, they could indicate in the final bill that the majority of the cost was for services, even if the true costs were mostly goods. Similarly, the goods-only approach would lead sellers to include small service items in their contracts without informing the buyers that the service would obviate any implied warranties.

The gravamen approach would provide an even easier fraud opportunity, because sellers would not need to be forward thinking at the time of contracting. Instead, sellers could assert counterclaims after a dispute arose in order to convince the court that the essence of the dispute was services. Notably, the approach does not provide any answer to the question of which law applies until there is a dispute. If a buyer asked a seller whether the contract contained implied warranties, the seller could legitimately say he did not know, and that a court would have to make such a determination. Sellers would not inform buyers during negotiations regarding the

application of the U.C.C. to mixed contracts because they would count on their ability to assert counterclaims later to ensure it would not apply.

The policy approach is particularly susceptible to the information failures noted above. To justify a refusal to honor implied warranties, sellers would find some policy basis on which to claim that the equities of the transaction dictated that the U.C.C. would not apply.<sup>111</sup> Moreover, it would be difficult to predict whether a court would decide an individual issue in favor of a buyer because some courts may be more receptive to seller's concerns,<sup>112</sup> such as the ability to compete with other service providers. Under a policy approach, therefore, merchants would have an incentive during negotiations to withhold information from buyers regarding their rights. In the event that the buyer asserts breach, merchants could claim that courts would not find an implied warranty.

As an exclusive test, the component approach would not allow sellers to claim that implied warranties do not apply to the goods component of the transaction because implied warranties would always apply to the goods.<sup>113</sup> Sellers would likely add disclaimers in accordance with section 2-316 that inform buyers of their rights. However, the component approach suffers from significant difficulties that militate against its adoption. Hybrid elements of the contract, such as services that cause damages to goods, would still require court resolution. In addition, parties who were unable to determine which provisions from the U.C.C. would apply to their contracts would also have to rely on court determinations. The court would then have to

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<sup>111</sup> In particular, sellers may claim that an imposition of implied warranties would have a chilling effect on the industry or would harm their ability to compete with foreign merchants.

<sup>112</sup> For example, conservative judges may be more receptive to policy arguments in favor of businesses.

<sup>113</sup> After exposure to the component rule, any sellers who claimed that implied warranties do not apply to goods would no longer be "honest in fact," so they would breach a duty of good faith in addition to the warranties. In simple mixed transactions, the seller's lawyer would probably inform the seller of his responsibilities and convince him to honor the warranties. Even if it went to trial, a court could decide this issue inexpensively on the pleadings.

undergo a complicated process: first, it would have to tease out the provisions that differ across the goods and services elements of the contract. Then, it would have to resolve any inconsistencies created by this dual set of laws. One court has already announced its aversion to this complicated process.<sup>114</sup> Despite its partial solution to seller claims, this approach is unwarranted because of the confusion it would engender and the litigation costs it would produce.

Another problem with the current approaches to mixed contracts is that they encourage parties to rely on ex post determination of U.C.C. application. Sellers do not know which approach a court will use in determining whether implied warranties apply to the transaction, but they do not want to inform buyers that the validity of the implied warranties might be in question. Therefore, sellers do not include any information about implied warranties or U.C.C. application in the contracts, and uninformed buyers do not question the omission.

Moreover, the current rules for applying the U.C.C. may be *mandatory* rules that cannot be altered through contract negotiation.<sup>115</sup> Although section 1-301 allows parties in domestic transactions to choose any state's laws, no state has announced that it is only applying a single test.<sup>116</sup> In effect, parties cannot decide during negotiations whether the U.C.C. will apply to their

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<sup>114</sup> Hudson v. Town and Country True Value Hardware, Inc., 666 S.W.2d 51 (Tenn. 1984); *see supra* quote accompanying note 79.

<sup>115</sup> *See* Jack M. Graves, *Party Autonomy in Choice of Commercial Law: The Failure of Revised U.C.C. 1-301 and a Proposal for Broader Reform*, 36 SETON HALL L. REV. 59, 113 (“[A] uniform choice-of-law provision with a scope broad enough to include all . . . sales transactions would seem particularly beneficial in dealing with mixed transactions.”). Courts may be unlikely to accept agreements opting out of the U.C.C. because they might consider them an end-run around warranty disclaimer provisions of section 2-316. *But see* U.C.C. § 1-302(a) (“Except as otherwise provided . . . , the effect of provisions . . . may be varied by agreement.”).

<sup>116</sup> The only state that has not adopted Article 2, Louisiana, *see* Larry T. Garvin, *Uncertainty and Error in the Law of Sales: The Article Two Statute of Limitations*, 83 B.U. L. REV. 345, 360 n.63 (2003), has its own implied warranties. *See* Elizabeth A. Frolich, Note, *Statutes Aiding States’ Recovery of Medicaid Costs from Tobacco Companies: A Better Strategy for Redressing an Indentifiable Harm?*, 21 AM. J.L. & MED. 445, 462 n.149 (1995). Sellers, therefore, would be unlikely to choose Louisiana law in order to avoid U.C.C. application.

transaction. The current rules thus impinge freedom of contract.

When buyers decide to bring suit regarding mixed contracts, parties' conversations with lawyers to determine their rights are unlikely to resolve the disputes. Lawyers inform their respective clients that there is no "reliable principle to distinguish the cases where the Code applies and those where it does not."<sup>117</sup> Since the case law is so unclear, the outcome is contingent on the court's approach, as well as the court's willingness to entertain policy arguments. In this way, the current approaches to mixed contracts "inefficiently shift the process of gap filling to ex post court determination."<sup>118</sup>

#### *B. An Information-Forcing Penalty Default for Mixed Contracts*

In *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, Ian Ayres and Robert Gertner describe the concept of penalty default rules and present a theory regarding when these rules are appropriate.<sup>119</sup> A default rule fills a gap in an incomplete contract, and governs unless the parties contract around it.<sup>120</sup> Prior to the article by Ayres and Gertner, the prevailing theory regarding gap-filling default rules was that they should reflect what the majority of parties in the transactional setting "would have wanted."<sup>121</sup> The article acknowledges that such majoritarian defaults are suitable for many contracts in which transaction costs can be decreased by reducing the number of terms the parties need to negotiate.

A default rule for mixed contracts is appropriate because both parties would prefer to choose whether to have the U.C.C. apply to their transaction if there were no strategic advantages to withholding information. This choice is not available under a mandatory rule. (As

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<sup>117</sup> WHITE & SUMMERS, *supra* note 19, at 345.

<sup>118</sup> Ayres & Gertner, *supra* note 40, at 93.

<sup>119</sup> *Id.*

<sup>120</sup> *Id.* at 87. The authors note other names that have been used to refer to default rules: "Default rules have alternatively been termed background, backstop, enabling, fallback, gap-filling, off-the-rack, opt-in, opt-out, preformulated, preset, presumptive, standby, standard-form and supplementary rules." *Id.* at 91.

<sup>121</sup> *Id.* at 89-90.

noted in Subsection II.A, the current approaches are effectively mandatory rules because parties have no way to contract around them). Buyers certainly would prefer to negotiate whether to have implied warranties, instead of finding out after a dispute arises that sellers refuse to honor them. Buyers would also find undesirable the prospect of litigation in the event of seller refusal. If sellers were unable to capture rents from their superior information, they, too would prefer to resolve expected contract issues through negotiation instead of litigation.

The majority of contracting parties would likely settle for no warranties because sellers possess superior bargaining power in negotiations and generally do not want additional responsibilities. Unfortunately, this majoritarian default would not solve the issues of asymmetrical information and rent-seeking in mixed contracts. Sellers would rely on the default and, consequently, not inform buyers that warranties will not apply. The majoritarian default would actually exacerbate problems for buyers because they would have no chance of prevailing even if they were willing to litigate.

Ayres and Gertner suggest, however, that defaults set *against* what the majority of parties would have wanted can sometimes establish more efficient outcomes.<sup>122</sup> When the default establishes a provision that one or more parties would not want, those parties have “an incentive to contract around the default rule and therefore to choose affirmatively the contract provision they prefer.”<sup>123</sup> By choosing this provision, they “reveal information to [the] other” parties.<sup>124</sup> Moreover, parties are more likely to contract around a default when they are more informed about the type of transaction, as with merchants who routinely deal with mixed contracts. Merchants are “systematically [more] informed” because they are “repeatedly in the relevant

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<sup>122</sup> *Id.* at 91.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

contractual setting while the other side rarely is.”<sup>125</sup> Ayres and Gertner state that penalty defaults are particularly appropriate when set against more informed parties because they encourage those parties to reveal information to less informed parties in the process of contracting around the default.<sup>126</sup> Setting a default contrary to what the majority wants encourages contractual negotiation. Penalty defaults, therefore, level the playing field by providing the less-informed party with more information and, accordingly, greater leverage.

A penalty default of applying the U.C.C. to mixed contracts between consumers and merchants would encourage merchants to reveal information regarding the implied warranties. As described more fully in Section II.C, the proposed default rule would require that sellers disclaim warranties in addition to the U.C.C. itself in order to contract around the default; this rule would force merchants to inform buyers that non-U.C.C. contract law generally does not contain implied warranties. Therefore, in contracting around the default, a mixed contract seller would inform the mixed contract buyer that warranties do not apply to the transaction. The buyer would better comprehend the contract’s terms, and would be able to make an informed decision whether to enter the contract. Also, the price negotiated would reflect an improved understanding of both parties’ rights and obligations. The buyer would be informed at the time of contracting of the seller’s warranty obligations instead of finding out when a dispute arose. Of course, a seller could still choose not to include any provisions regarding choice of law or

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<sup>125</sup> *Id.* at 98.

<sup>126</sup> *Id.* at 94. Ayres and Gertner provide the example of a court setting a default that package shippers do not have to pay for unforeseeable consequential damages to the product shipped. This default encourages customers shipping expensive items to add a provision in the contract that the shipper is responsible for any damages. That provision informs the shipper that the product is expensive, which may affect further contract negotiations. If the default were instead set such that the shipper does have to pay consequential damages, the customer has no incentive to inform the seller of the value of the product, the shipper has no notice to exercise additional care, and contract terms are less tailored. *Id.* at 101-04; *See* Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854); William Bishop, *The Contract-Tort Boundary and the Economics of Insurance*, 12 J. LEGAL STUD. 241, 254 (1983).

implied warranty disclaimers, but that would leave the default in place and provide protection for the buyer.

The penalty default for mixed contracts would encourage merchants to reveal that implied warranties do not apply to the transaction. The default would “reduce the opportunit[y] for . . . rent-seeking, strategic behavior”<sup>127</sup> because merchants would no longer receive high prices without having to inform buyers of their rights.<sup>128</sup> Merchants who do not contract around the default would not be able to claim that implied warranties do not apply. After exposure to the default rule, that claim would no longer be in good faith and would therefore result in further seller liability.<sup>129</sup> Any disputes that arose would likely be resolved when a merchant’s lawyer informed him of his certain liability or, if the matter went to court, would likely incur low litigation costs, as it could easily be resolved based on the pleadings or summary judgment.

Penalty defaults are particularly appropriate when it is cheaper for parties to negotiate a term *ex ante* than for courts to determine *ex post* what the parties would have wanted.<sup>130</sup> Sometimes parties do not negotiate a particular term in order to lessen the costs of negotiating. These parties figure that they can “shift the process of gap filling to *ex post* court determination,” but this is an inefficient result because it consumes public resources.<sup>131</sup> By setting a penalty

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<sup>127</sup> In the shipping context with a default rule that the shipper must pay for consequential damages, customers could strategically ship expensive items at the cost of any other item, and know they would be compensated for any damages done. The result would be inefficient because shippers would not exercise the care that they would have if they were fully informed. *See* Ayres & Gertner, *supra* note 40, at 101-04.

<sup>128</sup> Another example of a penalty default to reduce rent-seeking behavior is a rule that Internet sites cannot provide customer information to “data mining” firms. Such a rule would prevent websites from capitalizing on the personal data they obtain from customers without informing customers that it will be disclosed. To contract around the default, websites would need to obtain permission for such disclosures, thereby informing the customers of the intended use of the data. Peter H. Huang, *The Law and Economics of Consumer Privacy Versus Data Mining* 19-20, SOC. SCI. RES. NETWORK (May 27, 1998), <http://ssrn.com/abstract=94041>.

<sup>129</sup> *See* *Patin v. Thoroughbred Power Boats Inc.*, 294 F.3d 640, 656 (5th Cir. 2002) (noting that bad faith sellers may be subjected to additional damages).

<sup>130</sup> Ayres & Gertner, *supra* note 40, at 93.

<sup>131</sup> *Id.* at 93.

default that the U.C.C. applies to mixed contracts between merchants and consumers, therefore, courts and lawmakers can induce parties to decide issues at the time of contract negotiations and lessen public costs.<sup>132</sup> Instead of relying on expensive ex post court preferences for consumer claims, the penalty default encourages parties to decide the issue inexpensively during negotiations.

States should, therefore, establish default application of the U.C.C. to contracts between merchant-sellers and consumer-buyers.<sup>133</sup> This rule would provide consumers with either more protection of their rights, or more information about the underlying law governing their contracts. Either way, the penalty default would ameliorate the asymmetry of power between the parties. It would also clarify the law regarding mixed contracts and reduce litigation costs.

In addition, mixed contracts should inform consumers that services do not contain implied warranties. As noted earlier, courts have decided almost uniformly that the common law does not contain implied warranties for services.<sup>134</sup> It would be an inappropriate extension of the U.C.C. to imply warranties by default that do not normally exist, but it may be reasonable to impose a duty on sellers to inform buyers that these warranties do not exist. This duty can be combined with a penalty: if sellers do not inform buyers that there are no such implied warranties, they are responsible for reasonably foreseeable damages resulting from the services portion of the contract. Such a penalty would avoid the problem of splitting contracts because the U.C.C. provisions would apply to all aspects of the transaction. It would also avoid the

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<sup>132</sup> For example, under a majoritarian default that courts determine custody and visitation rights, divorcing parents may rely on these courts to determine child custody terms; in contrast, the much-derided penalty default of joint custody in divorce proceedings may induce parents to create a parenting plan, reducing public costs. Margaret F. Brinig, *Penalty Defaults In Family Law: The Case Of Child Custody*, 33 FLA. ST. U. L. REV. 779, 799 (2006).

<sup>133</sup> The U.C.C. defines these contracts as “consumer contracts.” U.C.C. § 2-103 (2006).

<sup>134</sup> Unlike other states, Kansas has implied warranties for service transactions. *See supra* Introduction. The part of the proposal discussed in this paragraph, therefore, should not be adopted in Kansas.

current discrepancy in case law, in which some courts apply implied warranties by analogy to service components while others do not.<sup>135</sup>

*C. Method of Adoption: Addition to U.C.C. § 2-102*

To adopt this proposal, states should add additional provisions to section 2-102 of their commercial codes, which currently state that Article 2 applies to transactions in goods.<sup>136</sup>

Specifically, the change would consist of adding the following additional language as second and third subsections after the current language:

(2) When the transaction is a consumer contract, this Article also applies to contracts for goods *and* services. To opt out of this default, the parties must agree that Article 2 does not apply to their transaction. This agreement must be in a record and be conspicuous. To protect buyers who are unaware that other law may not contain implied warranties, the implied warranties in Sections 2-314 and 2-315 shall be enforced even if the parties have agreed that this Article does not govern their transaction. For these warranties to be excluded, regardless of whether the parties have opted out of the application of Article 2, the contract must disclaim them in accordance with Section 2-316.

(3) All consumer contracts involving goods *and* services must also include a provision stating “The seller undertakes no responsibility for the services provided except as otherwise provided in this contract.” If a consumer contract does not include this provision, the seller is liable to the buyer for any reasonably foreseeable damages resulting from the provision of services.

Consumer contract is defined in section 2-103 as a “contract between a merchant seller and a consumer.”<sup>137</sup> This restriction ensures that the penalty default is limited to the types of contracts containing the information disparities noted above. Since the U.C.C. does not contain a definition of “services,” states should also add one in section 2-103(1).<sup>138</sup>

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<sup>135</sup> *See supra* note 69.

<sup>136</sup> U.C.C. § 2-102 (2006) (“Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.”).

<sup>137</sup> U.C.C. § 2-103(d) (2006). For the U.C.C. definitions of “Consumer” and “Merchant,” see 2-103(c) and 2-104(1), respectively.

<sup>138</sup> For example: “‘Services’ means all intangible commodities in the form of human effort, such as labor, skill, or advice.” *See* BLACK’S LAW DICTIONARY: POCKET EDITION 648 (3d ed. 2006).

The addition of this penalty default directly in the states' commercial codes would ensure that the requirements for opting out of Article 2 are easily accessible to contract drafters. There are two methods in which to add the provision to the 2-102: adoption by the promulgators of the U.C.C. or directly by the states. If the changes were added by the NCCUSL and ALI in the next edition of the Code, that would facilitate adoption because many states routinely update their commercial codes using the amended versions of the U.C.C.<sup>139</sup>

This approach suffers from two possible difficulties. First, these organizations may resist a change that could expand the Code's scope to predominantly service transactions for which it was not originally designed. Second, states may choose not to make any revisions suggested by these organizations for reasons unrelated to this particular amendment.<sup>140</sup> If the change were instead proposed directly to states, for example, as a "Uniform State Law to Protect Consumers in Mixed Transactions," legislatures would consider it on its own merits and there would be no need to obtain the approval of the U.C.C.'s drafters. However, this second approach would require lobbying in individual states, and some lawmakers may oppose an act directly related to the U.C.C. that has not been approved by the NCCUSL and ALI.

The most effective way to implement the information-forcing penalty default would involve a bifurcated appeal to both the organizations and the states. First, promoters should lobby NCCUSL and ALI to adopt this proposal in its next set of amendments to the Code, and if these organizations resist or states refuse to adopt the amendments for reasons unrelated to this proposal, the penalty default should be presented directly to states as a uniform law. This integrated approach would provide the best opportunity for protecting consumers in mixed

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<sup>139</sup> See Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789, 801 (2002).

<sup>140</sup> See Steven B. Dow, *The Impostor Rule and the Nature of Forgery Under the Revised Uniform Commercial Code: A Doctrinal Analysis and Some Suggestions for the Drafting Committee*, 39 AM. BUS. L.J. 25, 25 n.1 (2001) (describing New York's refusal to adopt U.C.C. revisions based on disagreement with some of the new provisions).

transactions.

*D. Possible Objections to the Penalty Default*

Although the penalty default proposed in this paper could be criticized for failing to address mixed contracts that do not meet the U.C.C.'s definition of consumer contracts,<sup>141</sup> those contracts do not suffer from the information asymmetries that lead to rent seeking. Contracts *between* merchants generally do not contain significant information disparities because both parties have had repeated experience in commercial transactions. These contracts may benefit from a default rule as opposed to a mandatory rule, but there is no reason that the default should be set against what the majority of parties would have wanted. When both parties understand the law underlying a contract, neither party can use superior knowledge to capture rents. If a merchant desires a warranty in a contract with another merchant, an express warranty could be negotiated.

Generally, in contracts between non-merchants, neither party has experience with mixed transactions, nor with their myriad complexities and opportunities for manipulation. Neither party is a sophisticated seller, so no asymmetry of information exists. A penalty default is of no help when neither party has the information to provide to the other side; neither party would have the knowledge necessary for rent-seeking behavior. Indeed, the implied warranty of merchantability never applies to transactions between non-merchants. (The implied warranty of fitness for a particular purpose might, however, be appropriate to apply as a majoritarian default for mixed contracts that would invoke it if they were not mixed contracts.) The current approaches, though flawed, are sufficient for contract situations without information

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<sup>141</sup> For the U.C.C.'s definition of "consumer contract," see *supra* text accompanying note 137.

disparities.<sup>142</sup>

A different criticism of this approach is that it would give sellers greater power to opt out of the U.C.C.; this change, however, would have little effect in practice. Currently, parties do not negotiate the set of law that will apply to a mixed transaction. When a dispute arises, sellers claim that the U.C.C. does not apply, and buyers rarely challenge that assertion. In effect, sellers under current approaches opt out of the U.C.C. without informing buyers when contracting. With the penalty default in place, buyers would be able to negotiate the contract terms, and could decide whether to enter the transaction if sellers insisted on disclaiming implied warranties. The incremental gain in seller power pales in comparison to the greater flexibility for buyers to decide knowledgeably whether to enter contracts.

Some may also criticize the provision that requires sellers to disclose that there are no implied warranties for service aspects of mixed transactions. One potential criticism is that buyers would only receive this information (and the attendant penalty when sellers fail to comply) in mixed transactions rather than pure service transactions. However, it would be odd to include a single provision for service transactions requiring disclosure because the U.C.C. normally does not apply to these transactions; service contract drafters may not be alerted to consult the U.C.C. If legislatures were concerned about such a possibility, however, they could add such a statute to their general contract law. Some may also criticize the proposal for effectively imposing a default duty on parties who are unaware of the contractual language requirement. It is true that such parties would be required to pay for reasonably foreseeable

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<sup>142</sup> The best test for these transactions would probably be the predominant purpose approach, because it would allow parties to determine the set of law that applies before going to court in transactions that clearly involve more of one category than the other (this pre-litigation determination would not be possible in the policy and gravamen approaches). If the category is unclear and parties do litigate, at least the courts will not need to engage in complicated split analysis (as in the component approach). Also, the predominant purpose approach would not force parties to use a set of law that normally would not apply to the majority of the transaction, as the goods-only approach sometimes would.

damages resulting from the service component of mixed transactions. This risk is mitigated by the fact that the provision only applies to consumer contracts; the seller in such contracts must meet the definition of a merchant.<sup>143</sup> Sellers doing odd jobs will not have sufficient “knowledge and skill” to meet the definition of merchant, so they will not fall under the new provision’s purview. For contracts with actual information disparities, on the other hand, the provision provides consumers with more information that will allow them to make a decision whether to refuse the contract or to negotiate provisions that contract around any existing gap fillers. If the parties decide that the services should contain a warranty, for example, an express warranty regarding the services could be included. The services provision therefore informs consumers, provides them with protection if they are not informed, and exempts parties who are unlikely to be aware of the disclosure requirement.

### CONCLUSION

Although the U.C.C. provided a standardized code of law for goods transactions, it created a new set of problems because it is silent on the treatment of mixed transactions. Without guidance from the drafters of the Code, courts have established conflicting tests and precedents. Decisions have been based on the equities of individual lawsuits, resulting in an inconsistent mire of legal tests, much like those that existed before standardization. Despite much time and cost, the approaches that courts developed are ineffective in dealing with mixed goods and services contracts.

The existence of various tests has harmed consumers more than any individual approach. Sellers are able to withhold information from consumers during negotiations, and can later refuse to honor warranties. Unfortunately, none of the tests put forth by courts would be an appropriate single approach to mixed contracts. Courts have already criticized the only test that would

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<sup>143</sup> See *supra* note 41

provide consumers with protection, the component approach, because it is difficult to use in practice.

Fortunately, an information-forcing penalty default of applying the U.C.C. in consumer contracts would provide information to buyers during negotiations and prevent rent-seeking behavior by merchants. The default rule, as opposed to the mandatory rules inherent in the current approaches, would allow parties to determine whether warranties apply to the transaction, rather than leaving that question for a third party after a dispute arises. Moreover, if states adopt the penalty default, sellers will need to inform buyers at the time of contracting if they do not want implied warranties to apply. If sellers fail to provide information, buyers will receive warranties that sellers cannot easily refuse to honor. The default rule will effectively force parties to decide in advance the rights and responsibilities of each party, saving litigation costs for the contracting parties and the public. Scholars who criticize penalty defaults as “theoretical curiosit[ies]”<sup>144</sup> that “do more harm than good”<sup>145</sup> would do well to note the utility of this proposed default. If adopted, this new uniform law would protect buyers more than any singular alternative approach. Furthermore, the penalty default would encourage negotiation and information sharing, partly even out the negotiation imbalance between parties, and reduce public costs. Most importantly, the proposed law would eradicate the tangled mess of case law that currently threatens to ensnare the uninformed buyer.

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<sup>144</sup> Eric A. Posner, *There Are No Penalty Default Rules in Contract Law* 1 (Univ. of Chi. Law & Economics, Olin Working Paper No. 237), available at <http://ssrn.com/abstract=690403>.

<sup>145</sup> Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 618 (2003).