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## Under the Spreading Analogy of Article 2 of the Uniform Commercial Code

### Cover Page Footnote

Professor of Law, University of Miami.

# UNDER THE SPREADING ANALOGY OF ARTICLE 2 OF THE UNIFORM COMMERCIAL CODE

DANIEL E. MURRAY\*

## I. INTRODUCTION

OVER six decades ago Dean Pound forecast that American courts would eventually adopt the view that statutes should be received fully into the body of the law "to be reasoned from by analogy the same as any other rule of law"<sup>1</sup> on the principle that statutory law is of equal authority to case law and then eventually on the basis that statutory law is a later and more direct expression of the general will and a superior authority to judge-made rules. Pound's basic theory of the adoption would seem to bear some modest relationship to Lord Coke's statement which was derived from Bracton:

"Equitie" is a construction made by the judges, that cases out of the letter of a statute, yet being within the same mischiefe, or cause of the making of the same, shall be within the same remedie that the statute provideth: and the reason hereof is, that for the law-makers could not possibly set downe all cases in expresse terms . . . .<sup>2</sup>

It has been shown elsewhere that this extended application of statute law was developed in the fourteenth century,<sup>3</sup> but the American common law system adopted the unfortunate, and now tired, shibboleth that statutes in derogation of the common law are to be construed strictly.<sup>4</sup> It should be noted, however, that the English courts have extended the application of statutes by analogy in a manner similar to that advocated by Pound.<sup>5</sup>

In 1930, Professor Karl N. Llewellyn stated that:

Finally, statutes have a wording fixed and firm. And their effect is local for the single state. You cannot reason from a statute to the common law. The statute of one state affords no ground for urging a like conclusion in another with no similar statute. If anything, the contrary.<sup>6</sup>

After discussing the strict and liberal approaches to the interpretation of statutes, Professor Llewellyn continued:

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1. Pound, *Common Law and Legislation*, 21 *Harv. L. Rev.* 383, 385 (1908).

2. 1 E. Coke, *Institutes of the Laws of England* § 21 (1st Am. ed. 1853).

3. T. Plucknett, *Statutes & Their Interpretation in the First Half of the Fourteenth Century* 72-81 (1922). But cf. Thorne, *The Equity of a Statute and Heydon's Case*, 31 *Ill. L. Rev.* 202, 204 (1936). See also Loyd, *The Equity of a Statute*, 58 *U. Pa. L. Rev.* 76 (1909).

4. 3 J. Sutherland, *Statutes and Statutory Construction* §§ 6201-06 (3d. ed. F. Horack, Jr. 1943, Supp. 1971).

5. R. Cross, *Precedent in English Law* 164-69 (2d ed. 1968).

6. K. Llewellyn, *The Bramble Bush* 78 (1930).

One more thing I must mention before I leave these statutes: if they are local, territorial in their effect, if they afford no ground for reasoning to the reservoir of law, then when you meet a statute in a case, you can skate over it? . . . You cannot read a statute like a case. There is no pleasant repetition of the same thought in different forms. Each word stands there. You get it, or you miss the whole. There is nothing that one dares to scant. There is little indeed of dictum in a statute. Eyes out, then, for *each word* of each statute that you meet!<sup>7</sup>

As late as 1962, Professor Llewellyn apparently found little occasion to modify his views as to the conservative (if not grudging) reception given to statutes by many case-oriented American courts.<sup>8</sup> Support for his stance may be found in the fact that for years after the enactment of the Uniform Negotiable Instruments Law (NIL), courts throughout the United States decided negotiable instrument cases by completely ignoring the NIL in favor of common law cases.<sup>9</sup> For some reason, the Uniform Commercial Code (UCC or Code) has enjoyed a cordial acceptance in the courts. For example, the New York Court of Appeals in the case of *Greenberg v. Lorenz*<sup>10</sup> basically adopted section 2-318 of the UCC one year before New York adopted the Code.<sup>11</sup> In a similar vein, the New Jersey Supreme Court in the famous case of *Henningsen v. Bloomfield Motors, Inc.*<sup>12</sup> accepted the principle of unconscionability contained in section 2-302 of the UCC one year before that state's adoption of the Code.<sup>13</sup> In addition, the District of Columbia Court of Appeals applied the principles of section 2-302, in its development of the common law, to a fact situation which occurred prior to the adoption of the Code.<sup>14</sup>

This hospitable welcome to the Code before its adoption (or before its effective date) in the various states has continued, and now American courts seem almost zealous in extending the reach of Article 2 into non-sales areas, in a manner not inconsistent with the prescient thoughts of Dean Pound. The remainder of this article will attempt to show this "extension by analogy" approach of the courts. Unfortunately, this extension has not been consistent in all fields.

This article will not consider the extension of Article 2 to franchise contracts or the application of the unconscionability principle of Article 2 to security transactions under Article 9.<sup>15</sup>

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7. *Id.* at 80-81.

8. K. Llewellyn, *Jurisprudence: Realism in Theory and Practice* 190, 222-29, 339 (1962).

9. W. Britton, *Bills and Notes* § 3, at 13-14 (2d ed. 1961).

10. 9 N.Y.2d 195, 173 N.E.2d 773, 213 N.Y.S.2d 39 (1961).

11. New York adopted the Uniform Commercial Code in 1962 (ch. 553, [1962] N.Y. Laws 185th Sess. 2580) [The Uniform Commercial Code will hereinafter be cited as U.C.C.].

12. 32 N.J. 358, 161 A.2d 69 (1960).

13. Ch. 120, [1961] N.J. Acts 722.

14. *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

15. As to franchise agreements see Gellhorn, *Limitations on Contract Termination Rights*

## II. IMPLIED WARRANTY IN THE LEASE OF CHATTELS

The extensions by analogy of the UCC's implied warranties of quality to a lease of chattels was perhaps facilitated by the fact that some pre-Code courts had held that a lessor of chattels impliedly warranted their quality.<sup>16</sup> Professor Gilmore (the draftsman of the Comments to the Code) perhaps had these cases in mind when he stated that "the 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 . . . to sales contracts . . . . They may arise in other appropriate circumstances such as in the case of bailments for hire . . . ."<sup>17</sup>

It might be expected that courts would refer to this comment as a springboard for their analogies; this, however, is not universally so. In general, the courts have been content to extend implied warranty concepts to chattel leases either by ignoring the UCC or by misstating its provisions. For example, in a case involving the lease of a "U-Haul" trailer, a lower Pennsylvania court stated that "the authorities are uniform in holding that the implied warranty arises in the case of a lease as freely as in the case of a sale."<sup>18</sup> The court did not cite the Code which had been in effect for approximately eight years at the time of the decision; it was content to rely on three Pennsylvania pre-Code cases.

In a somewhat similar vein, a lower New York trial court, in a case involving a lease of an allegedly defective coffee vending machine, apparently held that the controversy was controlled by sections 2-302, 2-316 and 9-206 of the Code without giving any authority or rationale for the decision.<sup>19</sup> In *Fairfield Lease Corp. v. Commodore Cosmetique, Inc.*,<sup>20</sup> a beauty parlor leased a coffee making machine for the convenience of its customers. The lessor assigned its interests to Fairfield Lease Corp., and the beauty parlor refused to continue its rental payments when the

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—Franchise Cancellations, 1967 Duke L.J. 465; Hewitt, Termination of Dealer Franchises and the Code—Mixing Classified and Coordinated Uncertainty with Conflict, 22 Bus. Law. 1075 (1967). For two very recent franchise-distributorship cases under the UCC, see *Spiering v. Fairmont Foods Co.*, 424 F.2d 337 (7th Cir. 1970); *Division of the Triple T Service, Inc. v. Mobil Oil Corp.*, 60 Misc. 2d 720, 304 N.Y.S.2d 191 (Sup. Ct. 1969). See also Comment, Unconscionability—The Code, the Court and the Consumer, 9 B.C. Ind. & Com. L. Rev. 367 (1968).

16. Farnsworth, Implied Warranties of Quality in Non-Sales Cases, 57 Colum. L. Rev. 653 (1957).

17. U.C.C. § 2-313, Comment 2. See also Uniform Commercial Code Commentary, Blood Transfusions and the Warranty Provisions of the Uniform Commercial Code, 9 B.C. Ind. & Com. L. Rev. 943 (1968).

18. *Henry v. Hostetler*, 3 UCC Rep. Serv. 614, 615 (Pa. C.P. Bucks County 1966).

19. *Fairfield Lease Corp. v. Colonial Aluminum Sales, Inc.*, 3 UCC Rep. Serv. 858 (N.Y. Sup. Ct. 1966).

20. 7 UCC Rep. Serv. 164 (N.Y.C. Civ. Ct. 1969).

vending machine failed to operate properly. The assignee of the lease sued and the beauty shop claimed a breach of an implied warranty of fitness for use under section 2-315 of the Code. The assignee then replied that the lease provided that the beauty parlor would not raise this defense against the assignee of the lease pursuant to section 9-206 of the Code. The court first held that "with the placing of a vending machine in a shop such as this goes an implied warranty of fitness to the extent that it would be suitable for use for vending coffee with a minimal degree of care on the part of the lessee."<sup>21</sup> The court cited no authority for this holding. It further stated that because of the close alliance between the assignor and the assignee, the assignee would be estopped from enforcing the waiver clause and finished with the statement that "[i]n making this decision UCC § 9-206 was taken into consideration."<sup>22</sup> It is to be noted that the Code provides for the validation of waiver clauses in sale and lease agreements: "[A]n agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee . . ."<sup>23</sup> The Comment to this section notes that "[t]he same rules are made applicable to leases as to security agreements, whether or not the lease is intended as security."<sup>24</sup> It seems to be the unarticulated premise of this court that this section has the effect of applying the implied warranty sections of the Code to a lease.

A federal district court has held that the lessor of rental cars would be liable for breach of an implied warranty of fitness if the car had defective brakes which caused injury; however, an injured third person could not recover on this basis against the lessor because of an absence of privity which was supposedly required by the laws of West Virginia, Virginia and Maryland, any one of whose laws might have governed recovery.<sup>25</sup>

The relatively recent cases of *Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House, Inc.*<sup>26</sup> and *Sawyer v. Pioneer Leasing Corp.*<sup>27</sup> involved similar facts and reached the same results. In both cases machinery was leased for a period of five years; in *Hertz* the lease could have been renewed at the end of the five year period for a nominal yearly rental, while in *Sawyer* the evidence showed that the lessor would probably have sold the machinery to the lessee (at the expiration of the lease) if a price could have been negotiated. In both cases it

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21. *Id.* at 165-66.

22. *Id.* at 166 (citations omitted).

23. U.C.C. § 9-206(1) (emphasis added).

24. U.C.C. § 9-206, Comment 1.

25. *Debbis v. Hertz Corp.*, 269 F. Supp. 671, 679-81 (D. Md. 1967).

26. 59 Misc. 2d 226, 298 N.Y.S.2d 392 (Civ. Ct. 1969).

27. 244 Ark. 943, 428 S.W.2d 46 (1968).

appeared that the lessee had to assume the cost of repairs and both leases provided for a disclaimer of any implied warranties. Finally, both cases involved allegedly defective machinery. The *Hertz* court, after citing section 2-102 of the Code and various law review articles, relied heavily upon *Sawyer* in holding that the implied warranty sections of the Code may be applicable (depending upon the facts) to a lease or bailment of goods, and that any disclaimer of a warranties clause in the lease must meet the terms of section 2-316 as to conspicuous print, etc. It would be a mistake to assume that the *Hertz* and *Sawyer* cases held that the implied warranty sections of Article 2 apply to all chattel leases; the real holding in both cases can be summarized as follows:

We are holding that Section 85-2-316 (2) is applicable to leases *where the provisions of the lease are analogous to a sale*. Here, the contract provides that the lessee shall pay all expenses of repairs and maintenance. . . . The transaction really seems to be a sale in every respect, except for the fact that the instrument provided that the ice machine should be returned to the lessor.<sup>28</sup>

As the dissenting opinion in *Sawyer* pointed out,<sup>29</sup> it may be very difficult in any particular case to determine when a lease is analogous to a sale. What is the proper criterion to be applied—is it the length of the term of the lease, the intention of the parties, the lessee's obligation to repair, the lessee's ability to acquire title to the chattel at the end of the term, or a combination of these factors? It should be noted that the Code has adopted a relatively simple test to answer the similar problem of whether a lease of chattels is intended to be a security interest.

Whether a lease is intended as security is to be determined by the facts of each case; however . . . an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.<sup>30</sup>

In effect, the *Hertz* and *Sawyer* courts have implicitly adopted a modified version of the above test along with other tests to determine whether the lease is analogous to a sale; this would seem to be a roundabout way of achieving a desired end. If the courts can adopt the implied warranty provisions of the Code which are contained in Article 2, cannot the courts also adopt an approach based upon section 1-201(37) to determine "is this lease one intended for sale?"

A more important question remains—why must the courts find that the lease resembles a sale before engrafting implied warranty concepts onto its terms? Admittedly, this approach creates a pose of logic around the

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28. *Id.* at 957, 428 S.W.2d at 54.

29. *Id.* at 958, 428 S.W.2d at 54.

30. U.C.C. § 1-201(37).

decision; it appears, however, to be a relatively small extension of the law. Courts in other non-sale situations have adopted implied warranty concepts without straining to correlate the particular transaction with a sale. For example, once courts under an implied warranty theory have allowed bystanders to recover for their injuries,<sup>31</sup> or persons who are trying out goods to recover for their injuries,<sup>32</sup> the necessity for a "sale" has vanished. As soon as a court has dispensed with the necessity of privity, it has also dispensed with the necessity of a sale.

This grafting of Article 2 sales warranty concepts onto lease transactions tends to create additional problems which are not always perceived by the courts. For example, a New York trial court was confronted with an airplane lease which provided that the lessor " 'makes no express or implied warranties or representations as to any matter whatsoever, including, without limitation, the condition of the aircraft, its merchantability or its fitness for any particular purpose.' " <sup>33</sup> The lease provided that it was governed by the law of Massachusetts, and the court stated that the law of that state precluded the granting of a motion for summary judgement when the lessee asserted that this disclaimer clause was unconscionable under section 2-302 of the Code. The court accepted the assertion of the defense of unconscionability without recognizing that a lease, rather than a sale, was involved. In addition, the court made no reference to section 2-316 of the UCC, which might have invalidated the disclaimer as a matter of law without any testimony, while in deciding the question of unconscionability a court must allow the introduction of testimony.<sup>34</sup> In effect, the court made more work for itself by an incomplete analysis of the problem. In a somewhat similar approach, the Municipal Court of the City of Boston held section 2-302 of the Code applicable to invalidate a clause in a truck lease which purported to make the lessee liable for loss regardless of fault. The court, however, also held that it was error for the trial judge to make a finding of unconscionability without giving the parties the opportunity to present evidence and remanded the case for a new trial.<sup>35</sup>

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31. E.g., *Toombs v. Fort Pierce Gas Co.*, 208 So. 2d 615 (Fla. 1968), noted in 23 U. Miami L. Rev. 266 (1968).

32. E.g., *Matthews v. Lawnlite Co.*, 88 So. 2d 299 (Fla. 1956).

33. *Electronics Corp. of America v. Lear Jet Corp.*, 55 Misc. 2d 1066, 1067, 286 N.Y.S.2d 711, 713 (Sup. Ct. 1967).

34. U.C.C. § 2-302(2). Another New York court has applied the unconscionability rule of Article 2 to police a lease of a coffee vending machine. The court held that a lease which provided that the lessor could repossess the leased chattel and accelerate all unaccrued and unearned rent if the lessee should violate any clause of the agreement, even though it was a trivial default under the entire lease, would be struck down as an attempt to exact a penalty. *Fairfield Lease Corp. v. Umberto*, 7 UCC Rep. Serv. 1181 (N.Y.C. Civ. Ct. 1970).

35. *E.F. Lynch, Inc. v. Piccirilli*, 28 Mass. App. Dec. 49 (Boston Mun. Ct. 1964).



In a recent Florida case, a lessee rented (on a month to month basis) a forklift to remove wheel chair passengers from its aircraft. The lessor knew the proposed use to be made of the forklift and performed maintenance and repair under the terms of the lease. The forklift dropped a wheel chair passenger who recovered damages from the airline-lessee, which then sought damages from the lessor for breach of warranty of fitness. The Supreme Court of Florida paraphrased section 2-315 of the Code and held that:

The general rule can be stated as follows: In the absence of an agreement to the contrary, where the lessor has reason to know any particular purpose for which the leased chattel is required and that the lessee is relying upon the lessor's skill or judgment to select or furnish a suitable chattel, there is an implied warranty that the chattel shall be fit for such purpose.<sup>36</sup>

The court was careful to note that a warranty of fitness will not arise in all lease transactions. Whether that warranty would arise may depend upon whether the lessor possessed or should have possessed expertise in the characteristics of the leased chattel, whether the lessee's reliance upon the lessor's selection of a suitable chattel was commercially reasonable, whether the lessor was a mass dealer in the leased chattel or if the transaction was an isolated occurrence.

The majority of courts will eventually adopt the view that the germane sections of Article 2 will apply to all leases of chattels on the basis that all such leases are "analogous" to sales of chattels. From the standpoint of the consumer-user, is there any real commercial difference between leasing a car for a year or buying a new one each year? Is there any real economic difference to a businessman between leasing office equipment for a period of a few years or buying new office equipment every few years? Of course, there are legal differences between leasing and buying chattels.<sup>37</sup> However, to allow the lease-sale distinction to preclude recovery based upon warranty can only be justified by preserving arcane distinctions which have lost their social utility.

The view that the majority of courts will apply Article 2 to all chattel leases is not extreme. The Supreme Court of New Jersey in *Cintrone v. Hertz Truck Leasing & Rental Service*<sup>38</sup> reached this point six years ago. In *Cintrone*, the plaintiff passenger was injured when the brakes failed on a truck leased to his employer. Hertz performed continuing maintenance on the truck, but the court's opinion failed to mention the terms of the lease. The court stated that the public offering of rental vehicles necessarily implies a representation that they are fit for operation during

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36. *W.E. Johnson Equip. Co. v. United Airlines, Inc.*, 238 So. 2d 98, 100 (Fla. 1970), aff'g 227 So. 2d 528 (Fla. Dist. Ct. App. 1969).

37. *L. Vold, Sales* § 4, at 24-25 (2d ed. 1959).

38. 45 N.J. 434, 212 A.2d 769 (1965).

the agreed rental period<sup>39</sup> and that this warranty or representation of fitness is independent of the lessor's maintenance obligations.<sup>40</sup> The court extended the coverage of this warranty to the plaintiff-employee.<sup>41</sup> With the question of warranty settled, a court should have little difficulty in assaulting the "citadel of privity" thereby extending the protection of the lease warranty to a noncontracting party.

### III. IMPLIED WARRANTIES IN THE SALE OF NEW HOMES

Although the Supreme Court of the United States held in 1884 that there was an implied warranty of quality in the sale by a contractor of "false work" which was for construction of a bridge,<sup>42</sup> the majority common law view in the United States was that a contractor-vendor did not impliedly warrant his structural improvements to land.<sup>43</sup> This caveat emptor concept prevailed long after the implied warranties of merchantability and fitness had developed in the sale of chattels both by case decision and by statute.<sup>44</sup>

The first gradual departure from the view that the builder-vendor did not impliedly warrant the quality of his house appeared in a 1930 English decision. In *Miller v. Cannon Hill Estates, Ltd.*<sup>45</sup> the court stated in dictum that a builder-vendor who sold a partially completed house during the course of construction impliedly warranted that it would be completed in an efficient and workmanlike manner, that proper materials would be used and that the house would be fit for human habitation.<sup>46</sup> In 1937, the English Court of Appeal expressly followed the *Miller* dictum and held that in the sale of a house under construction there is an implied warranty that the house will be finished in a workmanlike manner.<sup>47</sup> The court strove to find that the house was not complete at the time of sale since there would be no warranty in the sale of a completed house. This view appears to be the present day English rule.<sup>48</sup> The Supreme Court of Oklahoma and an Ohio appellate court have expressly followed the English view in the sale of a partially completed house, holding that

39. *Id.* at 446-47, 212 A.2d at 775-76.

40. *Id.* at 451, 212 A.2d at 778.

41. *Id.* at 457, 212 A.2d at 781.

42. *Kellogg Bridge Co. v. Hamilton*, 110 U.S. 108 (1884).

43. See authorities cited note 65 *infra*.

44. Sale of Goods Act of 1893, 56 & 57 Vict., c. 71, §§ 13-15; Uniform Sales Act §§ 14-16 (superseded by U.C.C. §§ 2-314, 2-315). See generally J. Benjamin, A Treatise on the Law of Sale of Personal Property 609-60 (8th ed. 1950).

45. [1931] 2 K.B. 113. It would appear that the case was decided on express warranty grounds and the discussion of an implied warranty was, therefore, dictum.

46. *Id.* at 122.

47. *Perry v. Sharon Dev. Co.*, [1937] 4 All E.R. 390 (C.A.).

48. See *Hancock v. B.W. Brazier (Anerley) Ltd.*, [1966] 1 W.L.R. 1317 (C.A.).

there is an implied warranty that the builder-vendor "would construct the house in a good and workmanlike manner and reasonably fit for occupancy as a place of abode,"<sup>49</sup> or would complete "the entire house in such a way that it would be reasonably fit for its intended use, and that the work would be done in a reasonably efficient and workmanlike manner."<sup>50</sup> It must be stated, however, that the Supreme Court of Ohio refused to follow the view (previously enunciated by the lower court) that there is an implied warranty in the sale of an incomplete residence which is subsequently completed by the general contractor. The court inadequately distinguished (or qualified) the decision of the Ohio appellate court, and then flatly stated:

We are of the opinion that the paucity of reported decisions involving an authentic common-law implied warranty involving real estate sales indicates that the doctrine of *caveat emptor* is so ingrained in our customary real estate transactions that few, if any, attempts have been made to pierce the shield of protection from specious claims of defect which it affords to vendors, not only of older buildings but of newly completed structures.<sup>51</sup>

There is a medieval flavor to reasoning which seems to imply that claims against builders must be spurious and that it is the court's task to protect the innocent land developer. It would appear that Oklahoma has not been confronted with a case involving the sale of a completed house, but it is probable that it will extend its holding in *Jones v. Gatewood*<sup>52</sup> to cover a completed dwelling when the case arises.<sup>53</sup>

With the exception of five states which adopted the Code in the fifties, the UCC was adopted in 46 jurisdictions between the years 1961 and 1968.<sup>54</sup> In the last decade the states of Arkansas,<sup>55</sup> Colorado,<sup>56</sup> Idaho,<sup>57</sup>

49. *Jones v. Gatewood*, 381 P.2d 158, 159 (Okla. 1963); accord, *Hoye v. Century Builders, Inc.*, 52 Wash. 2d 830, 329 P.2d 474 (1958). Washington has subsequently extended the warranty to include a completed house sold by the builder. See *House v. Thornton*, 76 Wash. 2d 428, 457 P.2d 199 (1969).

50. *Vanderschrier v. Aaron*, 103 Ohio App. 340, 342, 140 N.E.2d 819, 821 (1957); accord, *Staff v. Lido Dunes, Inc.*, 47 Misc. 2d 322, 329-30, 262 N.Y.S.2d 544, 551-52 (Sup. Ct. 1965) (dictum).

51. *Mitchem v. Johnson*, 7 Ohio St. 2d 66, 71, 218 N.E.2d 594, 598 (1966).

52. 381 P.2d 158 (Okla. 1963).

53. See *Carpenter v. Donohoe*, 154 Colo. 78, 83-84, 388 P.2d 399, 402 (1964); *Rothberg v. Olenik*, 262 A.2d 461, 467 (Vt. 1970), which discounted any difference as to the implied warranty between purchasing a completed house and one which is being constructed.

54. Uniform Commercial Code, Table 1, at 5 (Supp. 1970).

55. *Wawak v. Stewart*, 449 S.W.2d 922 (Ark. 1970).

56. *Carpenter v. Donohoe*, 154 Colo. 78, 388 P.2d 399 (1964); see *Glisan v. Smolenske*, 153 Colo. 274, 387 P.2d 260 (1963) which implied a warranty in the purchase of a house under construction.

57. In *Bethlahmy v. Bechtel*, 91 Idaho 55, 415 P.2d 698 (1966), the house was not completed at the time of the purchase.

Illinois,<sup>58</sup> Kentucky,<sup>59</sup> New Jersey,<sup>60</sup> South Dakota,<sup>61</sup> Texas,<sup>62</sup> Vermont,<sup>63</sup> and Washington<sup>64</sup> have held that the builder-vendor of a new home gives some species of implied warranty to the original buyer. These jurisdictions have justified these warranties by analogy to the implied warranties present in the sale of goods and have relied upon a series of law review articles<sup>65</sup> advocating this growth from the sale of goods analogy.

It is interesting to note that the courts have imposed this warranty responsibility upon the builder-vendor regardless of whether he is a mass production builder<sup>66</sup> or a relatively small contractor.<sup>67</sup> The old phobia of bankrupting the small entrepreneur, articulated in the older manufacturing cases,<sup>68</sup> has evidently disappeared. It is also significant that the vast majority of the cases involved some manner of ground-settling or ground-water drainage problems which caused the homes to be truly uninhabitable.<sup>69</sup>

Since the courts have created this warranty, it is not surprising that the phrasing of the standard has varied. The New Jersey Supreme Court has defined this warranty as an "implied obligation of reasonable workmanship and habitability,"<sup>70</sup> while the Colorado Supreme Court has stated that "[w]here, as here, a home is the subject of sale, there are implied warranties that the home was built in [a] workmanlike manner and is suitable for habitation."<sup>71</sup> Illinois has characterized the warranty as one

58. *Weck v. A:M Sunrise Constr. Co.*, 36 Ill. App. 2d 383, 184 N.E.2d 728 (1962), involved a sale of an incomplete dwelling.

59. *Crawley v. Terhune*, 437 S.W.2d 743 (Ky. 1969).

60. *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 207 A.2d 314 (1965).

61. *Waggoner v. Midwestern Dev., Inc.*, 83 S.D. 57, 154 N.W.2d 803 (1967).

62. *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968); *Moore v. Werner*, 418 S.W.2d 918 (Tex. Civ. App. 1967).

63. *Rothberg v. Olenik*, 262 A.2d 461 (Vt. 1970).

64. *House v. Thornton*, 76 Wash. 2d 428, 457 P.2d 199 (1969).

65. E.g., Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults Upon the Rule*, 14 Vand. L. Rev. 541 (1961); Dunham, *Vendor's Obligation as to Fitness of Land for a Particular Purpose*, 37 Minn. L. Rev. 108 (1953); Haskell, *The Case for an Implied Warranty of Quality in Sales of Real Property*, 53 Geo. L.J. 633 (1965); Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 Cornell L.Q. 835 (1967). Professor Jaeger's edition of *Williston on Contracts* also has had an influence upon the courts. See 7 S. Williston, *Contracts* §§ 926, 926A (3d ed. W. Jaeger 1963).

66. E.g., *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 207 A.2d 314 (1965).

67. E.g., *Carpenter v. Donohoe*, 154 Colo. 78, 388 P.2d 399 (1964).

68. E.g., *Burkett v. Studebaker Bros. Mfg. Co.*, 126 Tenn. 467, 150 S.W. 421 (1912).

69. E.g., *Wawak v. Stewart*, 449 S.W.2d 922 (Ark. 1970); *Carpenter v. Donohoe*, 154 Colo. 78, 388 P.2d 399 (1964) (by implication); *Rothberg v. Olenik*, 262 A.2d 461 (Vt. 1970).

70. *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 93, 207 A.2d 314, 327 (1965).

71. *Carpenter v. Donohoe*, 154 Colo. 78, 83-84, 388 P.2d 399, 402 (1964).

in which the builder warrants that it is "a house fit for habitation,"<sup>72</sup> and Texas holds that the builder-vendor "impliedly warrant[s] that such house was constructed in a good workmanlike manner and was suitable for human habitation[.]"<sup>73</sup> Some courts have been careful to stipulate that the builder-vendor does not warrant that he is selling a "perfect" house;<sup>74</sup> unfortunately, the concepts of "workmanlike" and "habitable" are not as precise as the word "perfect." In short, it is simple to express what the builder is not warranting, but it may be difficult to express what he is warranting. For example, if we assume that a house has settled and is continuing to settle with a resulting upheaval of floors, cracking of the walls and the roof structure, it is simple to hold that the house is not habitable and that it was not constructed in a workmanlike manner. The word "uninhabitable" necessarily includes the concept of unworkmanlike when construction defects are in issue. However, there may be unworkmanlike construction in the erection of a house which does not result in uninhabitability. The courts' joining of the concepts of "unworkmanlike manner" and "habitability" with the conjunction "and" has served to confuse the issue. If the case involves a house which is "habitable" in the dictionary sense of being "fit to live in," it may have many defects which could be characterized as the result of unworkmanlike construction, but this *might* not meet the definition of the builder-vendor's "implied obligation of reasonable workmanship and habitability." In brief, these two standards ought to be separated by the disjunctive "or," rather than the conjunctive "and," in order to avoid any inference that the builder-vendor's implied warranty of quality is considerably less than the merchant-seller's implied warranty of merchantability in the sale of goods.<sup>75</sup> For example, the Idaho Supreme Court's statement that "major defects which render the house unfit for habitation, and which are not readily remediable, entitle the buyer to rescission and restitution,"<sup>76</sup> seems too restrictive of the buyer's rights.

It has been suggested that the implied warranty of merchantability in the sale of homes should also be imposed against the owner-vendor of used homes.<sup>77</sup> Should an implied warranty be imposed against a non-pro-

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72. *Weck v. A:M Sunrise Constr. Co.*, 36 Ill. App. 2d 383, 388, 184 N.E.2d 728, 731 (1962).

73. *Humber v. Morton*, 426 S.W.2d 554, 555 (Tex. 1968).

74. E.g., *Bethlahmy v. Bechtel*, 91 Idaho 55, 68, 415 P.2d 698, 711 (1966); *Waggoner v. Midwestern Dev., Inc.*, 83 S.D. 57, 68, 154 N.W.2d 803, 809 (1967).

75. See U.C.C. § 2-314.

76. *Bethlahmy v. Bechtel*, 91 Idaho 55, 68, 415 P.2d 698, 711 (1966).

77. *Haskell*, *The Case for an Implied Warranty of Quality in Sales of Real Property*, 53 *Geo. L.J.* 633, 649-52 (1965). The argument seems to be based upon the notion that when a person pays what would be a large sum of money for a used home there is a basic

fessional who is selling a used product? Although the Code is neutral, many courts have held under pre-Code law that there is no implied warranty of merchantability in the sale of used goods by a non-merchant.<sup>78</sup> However, at least one court has held that a merchant who sells used merchandise will be deemed to have impliedly warranted its quality.<sup>79</sup>

It is all very well to worry about the layman-buyer whose pocketbook may be hurt by the purchase of a defective home, but one should also consider the pocketbook of the innocent layman-seller who may be subject to liability years after the sale of his house and who may have no effective recourse against a long defunct contractor-seller. If there is to be liability imposed, it ought to be imposed against an aware layman-seller who fails to disclose serious latent defects to an unwary buyer.<sup>80</sup> Liability should be confined to a fault basis.

The majority of the cases imposing an implied warranty upon the builder-vendor have involved suits between the builder and his buyer; only one case, *Schipper v. Levitt & Sons, Inc.*,<sup>81</sup> involved a non-buyer plaintiff. In *Schipper*, the original buyer leased his home and a young child of the lessees was scalded as a result of an allegedly defective water heater control device. The court, after holding that the builder-vendor may be liable on an implied warranty basis, also held that inasmuch as the necessity of privity is rapidly disappearing from the products liability area, it should not "revivify the requirement of privity"<sup>82</sup> in this area when a lessee sues the builder.

Cognizant of the above cases, some sophisticated building contractors in Miami, Florida (and probably elsewhere as well) have commenced using form home building contracts which carefully articulate certain express warranties and carefully disclaim all implied warranties in accordance with section 2-316 of the Code. These same contracts carefully negate any liability for consequential and incidental damages and paraphrase almost all applicable sections of Article 2. It would appear, therefore, that the courts will soon have to determine the limits of encroachment of Article 2 into the sale of new homes.

It has been suggested that there may be little practical effect of this new application of implied warranty concepts into the sale of homes due to

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assumption of quality that the vendee should and does expect to receive. The extent of the warranty should not be related to the purchase price of the house.

78. See 1 S. Williston, *Sales* §§ 232-33a (rev. ed. 1948).

79. *Brown v. Hall*, 221 So. 2d 454 (Fla. Dist. Ct. App. 1969); *Enix v. Diamond T. Sales & Serv. Co.*, 188 So. 2d 48, 52 (Fla. Dist. Ct. App.), cert. denied, 195 So. 2d 566 (Fla. 1966). Both of these cases involved pre-Code law.

80. See, e.g., *Fleming v. Stoddard Wendle Motor Co.*, 70 Wash. 2d 465, 467-68, 423 P.2d 926, 927-28 (1967); U.C.C. § 2-314, Comment 3.

81. 44 N.J. 70, 207 A.2d 314 (1965).

82. *Id.* at 95, 207 A.2d at 328.

the limited financial resources of so many home builders in the United States;<sup>83</sup> for every Levitt & Sons, there are probably hundreds of small builders. In addition to this fact, it is simple for the more solvent builder to create a number of "thin" corporations and to have each development built by one of these modestly endowed entities. By the time the dust has settled, the disgruntled homeowner will discover that he has a worthless judgment.

An additional problem presented by this judicial creation of an implied warranty is what is the statute of limitations for the action and what are its *termini*? Section 2-725 of the UCC provides a limitation period of four years (which may be reduced by contract to no less than one year). The period begins to run from the date of tender of delivery "except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered."<sup>84</sup> In none of the cases mentioned thus far have the courts had to directly confront this problem. One case has stated that the imposition of implied warranty liability upon the builder-vendor does not make him an insurer "of all who thereafter come upon the premises,"<sup>85</sup> but the plaintiff has the burden of showing that the house was defective when it was constructed and sold. Another court noted that the duration of liability is determined by the standard of reasonableness.<sup>86</sup> It is ventured that the majority of the courts will adopt the view of the UCC and hold that the statute of limitations begins to run from the tender of possession of the house to the first buyer by the builder-vendor. The question of the length of the statutory period will present a more difficult problem. The courts will have to either adopt the four year period specified in section 2-725, or characterize a breach of warranty case as either a "tort" or a "contract" action and then follow the applicable tort or contract limitation statute of the jurisdiction.<sup>87</sup>

#### IV. IMPLIED WARRANTIES OF HABITABILITY AND FITNESS IN THE LEASE OF RENTAL PROPERTY

It has been the general rule for centuries that the tenant of real property has been subject to the illegitimate maxim of *caveat emptor*.<sup>88</sup> The tenant was supposed to examine the premises; if he was in doubt about

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83. Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 Cornell L.Q. 835, 868 (1967).

84. U.C.C. § 2-725(2).

85. Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 92, 207 A.2d 314, 326 (1965).

86. Waggoner v. Midwestern Dev., Inc., 83 S.D. 57, 68, 154 N.W.2d 803, 809 (1967).

87. See, e.g., Barfield v. United States Rubber Co., 234 So. 2d 374 (Fla. Dist. Ct. App. 1970).

88. Hamilton, *The Ancient Maxim Caveat Emptor*, 40 Yale L.J. 1133, 1156-87 (1931).

the condition, he was to secure an express warranty or assume the risk of all defects, latent or patent. A few Anglo-American courts have held in relatively old cases that a short term lease for a furnished dwelling may contain an implied warranty of habitability.<sup>89</sup> These cases failed to produce any viable offspring until the 1961 Wisconsin case of *Pines v. Perssion*.<sup>90</sup> In *Pines*, a lessor leased an uninhabitable house (uninhabitable because of filth and defective plumbing, heating and wiring systems) to a number of college students who vacated the furnished residence within a few days after their initial occupancy. The lessees knew of the obvious filth, but they did not know of the plumbing, heating and wiring defects. The lessees brought suit to recover their rental deposit, and the Wisconsin Supreme Court held that they were entitled to a return of the deposit (less the reasonable rental value for the period of actual occupancy) on the basis of the lessor's breach of an implied warranty of habitability in the lease. The court, in reasoning for the creation of this implied warranty, made no reference to the law of sales. Rather, it noted that legislative enactments and administrative rules, building codes and health regulations all impose certain duties on a property owner with respect to the condition of the leased premises, and that to follow the old common law rule of no implied warranty in leases would be inconsistent with this legislative policy. This view was expressly followed in 1967 by a lower California court, which apparently held that a California statute (requiring the lessor to put and maintain the leased premises in a condition fit for occupancy) required the court to hold that a lease contains an implied warranty of habitability which would be breached when the evidence showed the apartment to be infested with vermin.<sup>91</sup> In the same year, the Supreme Judicial Court of Massachusetts held in *Horton v. Marston*,<sup>92</sup> that the lease of a furnished summer cottage for a term of nine months contained an implied covenant that the cottage "and its furnishings were then suitable for their intended use."<sup>93</sup> The lessor was held liable for breach of this covenant when the stove exploded injuring the tenant. The court had to contend with the case of *Ingalls v. Hobbs*,<sup>94</sup> which had held that when a lessor leased a dwelling for a *short term* (the summer season), the landlord would be held to an implied agreement that the dwelling was suitable for immediate occupancy, with-

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89. The history is succinctly reviewed in *Reste Realty Corp. v. Cooper*, 53 N.J. 444, 251 A.2d 268 (1969) and *Pines v. Perssion*, 14 Wis. 2d 590, 111 N.W.2d 409 (1961).

90. 14 Wis. 2d 590, 111 N.W.2d 409 (1961). *Pines v. Perssion* has been followed in *Bonner v. Beechem*, 2 CCH Pov. L. Rep. ¶ 11,098 (Denver County Ct. 1970).

91. *Buckner v. Azulai*, 251 Cal. App. 2d 1013, 59 Cal. Rptr. 806 (Super. Ct. 1967).

92. 352 Mass. 322, 225 N.E.2d 311 (1967)

93. *Id.* at 326, 225 N.E.2d at 313.

94. 156 Mass. 348, 31 N.E. 286 (1892).



out any necessity for the lessee's undergoing any expense in preparing the dwelling for use. Moreover, the lessor would have breached this implied covenant if he leased a dwelling which was infested with vermin. In *Horton* the court was of the view that a nine month lease would fall within the *Ingalls* holding.

*Horton* is an example of a court attempting to appear consistent by the slight extension of precedent which in itself was a "sleight-of-hand" effort to evade the common law caveat emptor rule without giving the appearance of failing to follow precedent. It would have been more forthright for the court simply to have held that every lease of a dwelling contains an implied warranty that the premises are suitable for occupancy. Courts, however, must often legislate through the charade of following precedent in order to soften the blow to a well established principle.

The Wisconsin view received a dramatic adoption and extension in New Jersey, where the supreme court of that state imposed an implied warranty "that the premises are suitable for the leased purposes and conform to local codes and zoning laws"<sup>95</sup> in a lease for a commercial office building. The New Jersey court recognized that the Wisconsin case of *Pines v. Persson* dealt with dwelling quarters, but apparently saw no difficulty in extending the rule to commercial property. Within one year after this decision, the same court, in the case of *Marini v. Ireland*,<sup>96</sup> implied a covenant against latent defects—that the premises were habitable and fit for living—in a lease of residential property. The court was careful to articulate that a dwelling lease impliedly contains a covenant that at the inception of the lease there are no latent defects in facilities vital to the use of the premises for residential purposes because of faulty original construction or deterioration from age or normal usage. This implied covenant further provides that the rented facilities will remain in usable condition during the entire term of the lease. If the landlord fails to maintain the premises, the tenant may either claim a constructive eviction or, as in

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95. *Reste Realty Corp. v. Cooper*, 53 N.J. 444, 452, 251 A.2d 268, 272 (1969). The evidence in this case disclosed that the tenant was initially unaware that the office was subject to water seepage (through the foundation) during rain storms. The court stated that "at the inception of the original lease in the present case, an implied warranty against latent defects existed." *Id.* at 455, 251 A.2d at 274. The tenant soon discovered this defect, and the manager of the premises repeatedly attempted to correct the leak without complete success. The tenant renewed the lease in reliance upon the manager's promises to correct; unfortunately, the manager died without correcting the leak and the lessee vacated the premises. The court held that the implied warranty against latent defects was breached, that the lessor breached its covenant of quiet enjoyment, and that the lessee was constructively evicted and was not responsible for payment of rent subsequent to the eviction.

96. 56 N.J. 130, 265 A.2d 526 (1970). See also *Garcia v. Freeland Realty, Inc.*, 63 Misc. 2d 937, 314 N.Y.S.2d 215 (Civ. Ct. 1970).

this case, repair the defect and then deduct the reasonable cost of repairs from the rental payments. The unusual approach of this court is noteworthy—the warranty of habitability is not confined to the notion of constructive eviction. To the ghetto dweller who lacks the mobility indigenous to the middle and the upper classes, constructive eviction is not an effective remedy. The only pragmatic enforcement of the warranty lies in the court-created right to repair and to deduct the cost from the rent.

Eleven days prior to the decision of the New Jersey Supreme Court in *Marini v. Ireland*, the United States Court of Appeals for the District of Columbia decided that an implied warranty of habitability is contained in all leases of residential property.<sup>97</sup> The court expressly followed the consumer warranty cases and extended their rationale by analogy to reshape much of the law of landlord and tenant. The housing regulations of the District of Columbia were used by the court as a standard for determining the meaning of the concept of “habitability.” This court also reached the conclusion that the normal remedies for a breach of contract should be applicable in the event of a breach of the warranty and that the tenant should not be limited solely to constructive eviction.

The Supreme Court of Hawaii, in the recent case of *Lemle v. Breeden*,<sup>98</sup> has enunciated a sound rationale for the judicial imposition of a warranty of habitability in a lease of real property. The lessor leased a home (apparently furnished) which had a thatched roof and unscreened doors and windows. An advanced state of rat infestation required abandonment of the premises three days after the lessee’s initial occupancy. After reviewing the historical background negating the implication of warranties in the lease of real estate, the court stated:

In the law of sales of chattels, the trend is markedly in favor of implying warranties of fitness and merchantability. *See* W. Prosser, *Torts* §§ 95, 97 (3d ed. 1964). The reasoning has been (1) that the public interest in safety and consumer protection requires it, and (2) that the burden ought to be shifted to the manufacturer who, by placing the goods on the market, represents their suitability and fitness.<sup>99</sup>

The court then continued:

The manufacturer is also the one who knows more about the product and is in a better position to alleviate any problems or bear the brunt of any losses. . . . This reasoning has also been accepted by a growing number of courts in cases involving sales of new homes. . . . The same reasoning is equally persuasive in leases of real property.<sup>100</sup>

97. *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071 (D.C. Cir. 1970).

98. 51 Hawaii 426, 462 P.2d 470 (1969).

99. *Id.* at —, 462 P.2d at 473.

100. *Id.* at —, 462 P.2d at 474.

Within a month after the decision in *Lemle*, the same court held that there was an implied warranty of habitability in a lease of an unfurnished home: "Today we hold that an implied warranty of habitability exists in unfurnished as well as furnished dwellings."<sup>101</sup>

It may be interesting to speculate as to why some courts have had to use legislative enactments and building codes as the predicate for, or source of, the implied warranty of habitability in a lease of real property. The common law development of the implied warranty in the sale of goods was not grounded upon legislation setting minimum standards of quality for manufactured goods. Why should the courts (or at least some of them) require a legislative source when dealing with real estate? Are some of these courts stating in an inarticulate manner that they are not now "making" law but rather implementing the law created by legislative or quasi-legislative bodies? To a certain extent this view may be justified. Most building codes do not give any cause of action to the aggrieved citizen; enforcement is left in the hands of a city or county building department and "enforcement" is of little moment to the tenant if the violation is discovered subsequent to his occupancy of the building. In effect, this creation of an implied warranty of habitability is putting a civil enforcement weapon in the hands of the one who really has an interest in enforcing the building codes and who would have little redress without it.

On the other hand, the interweaving of the building codes into an implied warranty (or vice versa) may be a mistake. For example, it is quite possible for a building to be a massive example of bad workmanship without violating the applicable building code or regulations. The house may be "unmerchantable" in the sense that it is not of fair average quality but not "unsafe" in the building code sense. If the building codes are used as a floor rather than a ceiling, then there may not be any objection to this approach. In addition, some of the courts may have been too restrictive in defining the lessor's warranty in terms of "inhabitability." It is true that not all the cases reviewed in this article involve "inhabitability" as the central issue, and, of course, courts tailor their decisions to the facts. However, what will result when cases arise involving leased premises which are in disrepair but which fall short of the description of uninhabitable? The courts may hold that since the premises are not uninhabitable, the lessee has not been constructively evicted and that he is liable for the rental payments under the lease. The latter result is the logical outgrowth of interlinking "uninhabitability" with "constructive eviction"—it is an all or nothing approach which results when one attempts to infiltrate a new principle into an old legal structure without

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101. *Lund v. MacArthur*, 51 Hawaii 473, —, 462 P.2d 482, 483 (1969).

discarding some of the old principles.<sup>102</sup> This approach would continue the distinction between the buyer of a chattel who can revoke his acceptance and recapture his purchase price in the event that material latent defects subsequently appear even though the chattel may have some utility,<sup>103</sup> and the lessee who is not able to revoke his acceptance of a leasehold and recapture his rent or resist paying additional rent in the event that material latent defects subsequently appear unless they render the premises uninhabitable. It would be rather difficult to explain this practical inconsistency to anybody but a lawyer who is acclimated to distinctions.

Courts which wish to avoid this indefensible position have two alternate routes: (a) in order to maintain a mantle of consistency and to reach the "right" result, some courts may stretch the definition of "uninhabitability" to include most defects, but this might in turn place a higher standard upon landlords than upon suppliers of chattels; or, (b) courts may forthrightly admit that they are imposing some hybrid species of a warranty of merchantability-fitness upon lessors which will enable lessees to recover damages (normally in the form of a diminution of rent) from the lessor or a complete elimination of the lessee's liability for rent in the event that the premises are uninhabitable. The New Jersey Supreme Court and the Court of Appeals for the District of Columbia have evidently adopted the latter approach.<sup>104</sup>

#### V. SERVICE CONTRACTS AND ARTICLE 2

Although it is relatively ancient law that there is an implied warranty of merchantability in an orthodox sale of goods by a merchant to a consumer,<sup>105</sup> there is no definitive answer when the contract is a hybrid composed of a "sale" of goods and a "service" such as delivering the goods to a consumer or applying the goods to the body of a consumer. Many courts held under the common law and the Uniform Sales Act that the "sale" of food in a restaurant was not a sale, but rather the rendering of a service with the result that an injured patron of the restaurant could not recover for injuries caused by impurities in the food.<sup>106</sup> As a result of this "sale-service" dichotomy it was quite possible that a patron who ate impure food in a restaurant could not recover on an implied warranty theory, while his neighbors who purchased the same food for consumption at home could recover; in the former case the "service" aspect was deemed to

102. See *Pines v. Persson*, 14 Wis. 2d 590, 111 N.W.2d 409 (1961); note 95 *supra*.

103. U.C.C. § 2-608.

104. See *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071 (D.C. Cir. 1970); note 95 *supra*.

105. Murray, *Implied Warranty Against Latent Defects: A Historical Comparative Law Study*, 21 La. L. Rev. 586 (1961); see Hamilton, *The Ancient Maxim Caveat Emptor*, 40 Yale L.J. 1133 (1931).

106. U.C.C. § 2-314, Comment 5.

predominate, while in the latter case, the "sale" aspect predominated.<sup>107</sup> This artificial distinction was fortunately obliterated in the sale of food cases by the UCC, which provides that "the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale."<sup>108</sup>

Unfortunately, this abolition of the sale-service distinction in food cases was not expressly extended by the Code to include cases involving the application of products to the exterior or interior of the human body, even though the situations are analogous.<sup>109</sup> For example, if the sale of a bottle of permanent wave hair lotion imposes an implied warranty of merchantability upon the retailer, should not the application of the same lotion by a beauty parlor impose the same kind of warranty upon the beauty parlor? The basic problem is the same whether it is food or hair wave lotion; however, many courts have not seen the parallel. These courts have held that when the transfer of title (the sale) to products such as hair lotion is incidental to the service which is the predominant aspect of the transaction, there cannot be an implied warranty under the Code.<sup>110</sup>

It is hoped that the case of *Newmark v. Gimbel's Inc.*<sup>111</sup> will put the quietus to these ill-considered "beauty parlor" cases. In this case the plaintiff relied upon a Gimbel's beautician's recommendation of a permanent wave lotion. The lotion caused harm, and the plaintiff based her suit upon breach of warranty of fitness for a particular purpose. The court stated that any distinction between a sale and the rendition of services is a highly artificial one. The court rejected the argument of Gimbel's that the effect of applying the lotion served to lessen its liability as compared with an outright sale of the lotion in its original container.

The transaction, in our judgment, is a hybrid partaking of incidents of a sale and a service. It is really partly the rendering of service, and partly the supplying of goods for a consideration. Accordingly, we agree with the Appellate Division that an implied warranty of fitness of the products used in giving the permanent wave exists with no less force than it would have in the case of a simple sale. Obviously in permanent wave operations the product is taken into consideration in fixing the price of the

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107. See discussion in *Friend v. Childs Dining Hall Co.*, 231 Mass. 65, 120 N.E. 407 (1918); L. Vold, *Sales* § 94, at 453-54 (2d ed. 1959).

108. U.C.C. § 2-314(1).

109. The court in *Lovett v. Emory Univ., Inc.*, 116 Ga. App. 277, 278, 156 S.E.2d 923, 924 (1967) (a case dealing with blood and serum hepatitis) noted that "we think it is significant that the General Assembly expressly provided that the 'serving for value of food or drink . . . is a sale' of goods . . . without expressly including other service-type transactions as covered by any implied warranty."

110. E.g., *Epstein v. Giannattasio*, 25 Conn. Supp. 109, 197 A.2d 342 (C.P. 1963); *Cassina v. Morris M. Taylor & Sons, Inc.*, 2 UCC Rep. Serv. 1148 (Conn. Cir. Ct. 1964).

111. 54 N.J. 585, 258 A.2d 697 (1969).

service. The no-separate-charge argument puts excessive emphasis on form and downgrades the overall substance of the transaction.<sup>112</sup>

The service-sale distinction reaches its full development in the cases involving blood transfusion and the medical use of surgical nails and appliances. It was the majority view prior to the Code that when blood transfusions were administered by a hospital as part of the medical treatment of a patient, the service aspect of the medical treatment predominated over the incidental transfer of title to the blood even though the blood may have been separately itemized. In effect, the transfer of title to the blood was merely incidental to the medical service contract which was a contract for work, labor and materials. Hence there was no sale, and without a sale, there could not be any implied warranty of the quality of the blood.<sup>113</sup> Inasmuch as the Code does not expressly touch upon the problem, it is not surprising that the majority of courts have continued to adhere to this service-sale dichotomy since the adoption of the Code, and have continued to deny that there is any implied warranty in the sale of blood whether it be by a hospital or by a blood bank to a hospital.<sup>114</sup> Florida,<sup>115</sup> California,<sup>116</sup> Massachusetts,<sup>117</sup> and Arizona<sup>118</sup> have provided by statute that blood (including blood plasma) shall not be considered as an object subject to sale but as a medical service. Florida and Massachusetts further provide that the implied warranties of merchantability and fitness shall not be applicable.

The Florida statute was adopted because two Florida district courts of appeal<sup>119</sup> and the Florida Supreme Court<sup>120</sup> had held that the furnishing of blood by a blood bank was a "sale" and the sales transaction would be subject to an implied warranty *if* medical testimony showed that serum

112. *Id.* at 593, 258 A.2d at 701 (citation omitted).

113. The New York case of *Perlmutter v. Beth David Hosp.*, 308 N.Y. 100, 123 N.E.2d 792 (1954) is the landmark case for the court-created rule immunizing hospitals. It has been followed by a majority of the cases and criticized by most legal writers. See *Jackson v. Muhlenberg Hosp.*, 96 N.J. Super. 314, 232 A.2d 879 (Super. Ct. 1967), *rev'd per curiam*, 53 N.J. 138, 249 A.2d 65 (1969); *Hoffman v. Misericordia Hosp.*, 439 Pa. 501, 267 A.2d 867 (1970) for a list of the authorities.

114. E.g., *Lovett v. Emory Univ., Inc.*, 116 Ga. App. 277, 156 S.E.2d 923 (1967); *Carter v. Inter-Faith Hosp.*, 60 Misc. 2d 733, 304 N.Y.S.2d 97 (Sup. Ct. 1969).

115. Fla. Stat. Ann. § 672.2-316(5) (Supp. 1970).

116. Cal. Health & Safety Code § 1606 (West 1970).

117. Mass. Ann. Laws ch. 106, § 2-316(5) (Supp. 1969).

118. Ariz. Rev. Stat. Ann. § 36-1151 (Supp. 1970).

119. *Hoder v. Sayet*, 196 So. 2d 205 (Fla. Dist. Ct. App. 1967); *Russell v. Community Blood Bank, Inc.*, 185 So. 2d 749 (Fla. Dist. Ct. App. 1966), modified, 196 So. 2d 115 (Fla. 1967). Both cases stated the furnishing of blood by a hospital would be a "service" while the furnishing of blood by a blood bank would be a "sale."

120. *Community Blood Bank v. Russell*, 196 So. 2d 115 (Fla. 1967).

hepatitis could have been detected. Conversely, the courts stated that if serum hepatitis could not have been detected then there would not be a breach of warranty. The Florida statute states that "the implied warranties of merchantability and fitness for a particular purpose shall not be applicable as to a defect that cannot be detected or removed by reasonable use of scientific procedures or techniques."<sup>121</sup> This statutory theme that warranty liability should not be imposed when it is impossible for the supplier of the blood (whether blood bank or hospital) to detect the defect can be found in numerous cases in other states<sup>122</sup> and is the real reason why the courts have held that the furnishing of blood is a service and not a sale. The courts have had to devise a method of protecting the blood suppliers from legal liability incurred in the supplying of this essential commodity, and this judicial reasoning of "no sale but a service" was the only avenue open. If the courts had characterized the furnishing of blood as a sale, then liability in implied warranty would seemingly have followed as an inevitable consequence, since the law is well established that the inability of the supplier (whether manufacturer or retailer) to detect the defect in his product is no defense to a breach of warranty action.<sup>123</sup> In effect, the courts have said to manufacturers and retailers: "You supply most products at your own risk and you will be liable for defects regardless of fault. If, however, you supply blood or blood plasma you will be liable only if you are in fact at fault."

It would appear that only courts in Florida,<sup>124</sup> New Jersey,<sup>125</sup> and New York<sup>126</sup> have characterized the furnishing of blood for a consideration as a "sale." (But then Florida, as noted above, by judicial legislation followed by orthodox legislative enactment, has exonerated blood suppliers from the usual rule of liability in implied warranty without fault.) In New Jersey, an appellate court found in favor of a supplier, on the grounds that the supplier had probably disclaimed, under section 2-316 of the Code, any implied warranty of merchantability even though the court held that the furnishing of the blood was a "sale."<sup>127</sup> On appeal to the Supreme Court of New Jersey,<sup>128</sup> that court held that the record in the

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121. Fla. Stat. Ann. § 672.2-316(5) (Supp. 1970).

122. See discussion in *Jackson v. Muhlenberg Hosp.*, 96 N.J. Super. 314, 232 A.2d 879 (Super. Ct. 1967), rev'd per curiam, 53 N.J. 138, 249 A.2d 65 (1969); 2 L. Frumer & M. Friedman, *Products Liability* 3-49 (1970).

123. 1 S. Williston, *Sales* §§ 237 & 237-a (rev. ed. 1948).

124. See cases cited notes 119 & 120 supra.

125. *Jackson v. Muhlenberg Hosp.*, 96 N.J. Super. 314, 232 A.2d 879 (Super. Ct. 1967), rev'd per curiam, 53 N.J. 138, 249 A.2d 65 (1969).

126. *Carter v. Inter-Faith Hosp.*, 60 Misc. 2d 733, 304 N.Y.S.2d 97 (Sup. Ct. 1969).

127. *Jackson v. Muhlenberg Hosp.*, 96 N.J. Super. 314, 232 A.2d 879 (Super. Ct. 1967), rev'd per curiam, 53 N.J. 138, 249 A.2d 65 (1969).

128. *Jackson v. Muhlenberg Hosp.*, 53 N.J. 138, 249 A.2d 65 (1969).

lower courts was inadequate and that a full trial and the preparation of an adequate record would be needed before the court could decide if an implied warranty would arise in the supplying of blood. Although it is not entirely clear, it would appear that the court tacitly assumed that the transfer of the blood for a consideration constituted a "sale." It must be noted, however, that the Appellate Division of the New Jersey Superior Court recently interpreted this decision of the New Jersey Supreme Court as holding that there could not be a "sale" in the transfer of blood by a hospital, and, as a result, there could not be any implied warranty liability of a hospital for furnishing blood allegedly mismatched as to type by the hospital causing the death of the patient.<sup>129</sup> This court misread the New Jersey Supreme Court decision and also failed to distinguish between a case involving serum hepatitis and mismatched blood.<sup>130</sup> Finally, the court was overly conservative in requiring that there be a "sale" before there can be a warranty. The dissenting opinion<sup>131</sup> correctly noted that the New Jersey Supreme Court had not held that there could not be a sale in the transfer of blood. The dissent further stated that if a beauty parlor could be held liable on the basis of an implied warranty for a defective hair lotion, as held by the New Jersey Supreme Court in *Newmark v. Gimbel's Inc.*,<sup>132</sup> then a hospital should be held liable on the same basis for the furnishing of mismatched blood. The dissent further noted that the New Jersey Supreme Court's dictum in *Newmark* that the doctrine of strict liability will not be extended to doctors and dentists would not be applicable to immunize a hospital. One New York court has aligned itself with the New Jersey and Florida courts in holding that the supplying of blood to a hospital by a commercial blood bank is a "sale" under section 2-106(1) of the UCC.<sup>133</sup> The court, however, then proceeded to "legislate" its holding out of existence by stating:

While on the face of the pleadings in the instant case there seems to exist a cause of action for breach of warranty, this court feels that the approach taken by the New Jersey Supreme Court in *Jackson v. Muhlenberg Hosp.* is correct. All factors in regard to public policy must be considered and there must be a weighing of interest between the unfortunate patients who contract the disease and the general public who are in constant need of blood from these commercial blood banks. There should be a record developed at trial . . . before this court can say whether there should or should not be liability cast upon commercial blood banks in serum hepatitis cases.

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129. *Baptista v. St. Barnabas Medical Center*, 109 N.J. Super. 217, 262 A.2d 902 (Super. Ct. 1970).

130. It may be impossible to detect serum hepatitis, but the matching of blood is a routine laboratory activity.

131. 109 N.J. Super. at 225, 262 A.2d at 907 (Conford, J., dissenting).

132. 54 N.J. 585, 258 A.2d 697 (1969).

133. *Carter v. Inter-Faith Hosp.*, 60 Misc. 2d 733, 304 N.Y.S.2d 97 (Sup. Ct. 1969). But cf. *Heitner v. City of New York*, 5 UCC Rep. Serv. 485 (N.Y. Sup. Ct. 1968).



Although the Legislature should express the State's policy in this area . . . the courts are also capable of considering public policy in reaching decisions.<sup>134</sup>

The Supreme Court of Pennsylvania, in a recent case, has perceived that the true issue in these blood cases is not whether the furnishing of blood is a sale or a service, but rather whether courts should impose some kind of implied warranty of quality in this "non-sales" setting. In *Hoffman v. Misericordia Hospital*,<sup>135</sup> the complaint alleged that a patient received a transfusion of blood partially supplied by a blood bank and that this blood contained serum hepatitis which eventually caused the patient's death. The complaint was dismissed as failing to state a cause of action on the ground that the furnishing of blood is not a sale. The supreme court reversed, noting that it had held in numerous pre-Code cases that implied warranties would exist in non-sales cases and that the Code was not designed to impede this development. The court stated that:

We therefore do not feel obligated to hinge any resolution of the very important issue here raised on the technical existence of a sale. . . . In view of our case law implying warranties in non-sales transactions, it cannot be said with certainty that no recovery

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134. 60 Misc. 2d at 737, 304 N.Y.S.2d at 101-02 (citations omitted).

135. 439 Pa. 501, 267 A.2d 867 (1970). Subsequent to the writing of this article, the Supreme Court of Illinois in *Cunningham v. MacNeal Mem. Hosp.*, — Ill. —, — N.E.2d — (1970), applied Restatement (Second) of Torts § 402A (1966) and held that a hospital which supplies blood for a charge is strictly liable to its patient for injuries resulting from blood which contains serum hepatitis virus. Section 402A provides for liability of one who sells a defective product if the seller is engaged in the business of selling such a product. The court decided that a hospital which furnishes blood to its patients and charges them for it is selling blood within the meaning of section 402A. The court further rejected any distinction between the liability of blood banks and hospitals in the supplying of defective blood, and stated that the fact that serum hepatitis is impossible to detect in blood would not be a defense under section 402A. Although this case was predicated upon section 402A of the Second Restatement of Torts, rather than any implied warranty cause of action, it is interesting to observe that the court used an implied warranty analogy in reaching its conclusion: "Although we do not specifically here deal with the applicability of implied warranties in connection with this transaction, but rather whether the strict tort liability theory may properly be employed by plaintiff, . . . it cannot be gainsaid that the policy considerations marshalled by Pearlmutt and its progeny are relevant to our decision. [H]owever, we are unable to accept the reasoning of the Pearlmutt majority and those cases from other jurisdictions following it. [It is unrealistic] to assert that the transfusion of whole blood by a hospital into a patient, for which a charge is made does not give rise to implied warranties because no 'sale' is involved. . . . We have . . . frequently distinguish[ed] between medical and administrative acts, even when performed by the same person, recognizing that the contract is divisible, and, while we have held hospitals immune when they have carefully selected persons supplying the human skill, we have never extended that doctrine to physical material which was bad, as the impure morphine solution 'unfit for use' in *Volk v. City of New York*, 284 N.Y. 279, 30 N.E.2d 596, 597 . . ." *Id.* at —, — N.E.2d at — (citations omitted & emphasis deleted).

is permissible upon the claim here made, even if it should ultimately be determined that the transfer of blood from a hospital for transfusion into a patient is a service.<sup>136</sup>

Because of the sketchy trial court record, the supreme court refused to decide if the furnishing of blood would be labeled as a sale or service and then carefully limited the holding by stating:

Nevertheless, recognizing that the law in the area of products liability is in a state of flux, we wish to make clear what this decision does *not* mean. We do not decide that the extent of the warranties implied at common law in non-sales situations need necessarily be the same as those given statutory sanction in sales transactions under the Uniform Commercial Code. Nor do we decide that all types of sales transactions in all situations necessarily give rise to warranties of the same extent . . . .<sup>137</sup>

It should be noted that the Arizona and California statutes<sup>138</sup> which provide that the furnishing of blood is not a sale could easily be circumvented under the holding of this case.

The "service rather than sale" approach of the blood plasma cases might be acceptable if limited to the narrow area of defective blood, but, unfortunately, the rationale has been extended to cases involving defective hypodermic needles,<sup>139</sup> surgical nails,<sup>140</sup> and heart pacemakers.<sup>141</sup> This approach has been motivated by a desire to protect the hospital and doctor, or dentist, from liability on an absolute basis. The opinions have been clouded, if not confused, by rhetoric explaining that hospitals and doctors do not insure their treatment,<sup>142</sup> and that any extension of warranty liability to doctors would be socialistic.<sup>143</sup>

The judicial refusal to extend implied warranty concepts to the "sale" of blood by blood banks and hospitals and the "sale" of surgical devices by physicians and hospitals is wrong for the following reasons:

1. Private blood banks which sell blood for profit should be liable for harm caused by defective blood in the same way any other profit-making enterprise should bear responsibility, with the risk being defrayed by insurance. Statistically, the incidence of serum hepatitis is relatively

136. 439 Pa. at 507, 267 A.2d at 870 (citation omitted).

137. *Id.* at 508-09, 267 A.2d at 871 (citations omitted).

138. See Ariz. Rev. Stat. Ann. § 36-1151 (Supp. 1970); Cal. Health & Safety Code § 1606 (West 1970).

139. *Magrine v. Spector*, 100 N.J. Super. 223, 241 A.2d 637 (Super. Ct. 1968), *aff'd per curiam*, 53 N.J. 259, 250 A.2d 129 (1969).

140. *Dorfman v. Austenal, Inc.*, 3 UCC Rep. Serv. 856 (N.Y. Sup. Ct. 1966); cf. *Cheshire v. Southampton Hosp. Ass'n*, 53 Misc. 2d 355, 278 N.Y.S.2d 531 (Sup. Ct. 1967).

141. *Cutler v. General Elec. Co.*, 4 UCC Rep. Serv. 300 (N.Y. Sup. Ct. 1967).

142. See *Magrine v. Spector*, 100 N.J. Super. 223, 225, 241 A.2d 637, 638 (App. Div. 1968) (dissenting opinion); *Dorfman v. Austenal, Inc.*, 3 UCC Rep. Serv. 856, 857 (N.Y. Sup. Ct. 1966).

143. *Dorfman v. Austenal, Inc.*, 3 UCC Rep. Serv. 856, 857 (N.Y. Sup. Ct. 1966).

high,<sup>144</sup> and the expensive consequences ought to be defrayed by pooling the risk through insurance coverage.

2. At first blush, it is an appealing argument to say that warranty liability should not be imposed on blood, which is an absolute necessity furnished to preserve life; however, this same argument could be made to exonerate suppliers of food and drink who are now subject to warranty liability regardless of fault.

3. When a court refuses to impose implied warranty liability upon a doctor or hospital on the ground that administering an injection with a needle with a latent defect does not constitute a "sale," it does so upon the rationale that a professional man or hospital does not warrant his treatment. The court has missed the mark; the doctor or hospital is not being sued because his professional treatment was defective, rather he is being sued because an implement that he used was subject to a latent defect. No moral blame is being asserted against the doctor or hospital just as no moral blame is being asserted against a grocery store which is sued on an implied warranty in the sale of a can of food which was subject to a latent defect. The use of the words "sale" and "professional services" simply cloud the issue. Basically, is there any real difference between suing a beautician on an implied warranty for defects in a hair lotion and suing a doctor or a hospital on an implied warranty for defects in a hypodermic needle or in a surgical nail?

4. When courts exonerate hospitals and doctors from any kind of warranty liability for defects in medical devices, whether needles, surgical pins, or medicines, they may be directly depriving the patient of any remedy against the manufacturer or making the remedy extremely difficult. For example, if the jurisdiction in which the medical treatment occurred still persists in the antiquated notion that there must be privity of contract in order to activate the warranty,<sup>145</sup> then the holding that there is no sale between the doctor or hospital and patient also has the result of destroying the "step-by-step" process of developing privity. If there is a "sale" between doctor and patient, then the patient sues the doctor who vouches in the manufacturer.<sup>146</sup> In effect, the doctor is merely a conduit through whom liability is assessed against the manufacturer. Conversely, if there is no sale between doctor and patient there

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144. For some discouraging statistics see *Fischer v. Wilmington Gen. Hosp.*, 51 Del. 554, 149 A.2d 749 (Super. Ct. 1959); P. Keeton & M. Shapo, *Products and the Consumer: Defective and Dangerous Products* 733-34 (1970).

145. See, e.g., *Whitaker v. Harvell-Kilgore Corp.*, 418 F.2d 1010 (5th Cir. 1969); *Blankenship v. Morrison Mach. Co.*, 255 Md. 241, 257 A.2d 430 (1969); *Necktas v. General Motors Corp.*, — Mass. —, 259 N.E.2d 234 (1970).

146. U.C.C. § 2-607.

may not be privity of contract between patient and manufacturer of the device and the patient will not have an implied warranty remedy. The reader may object that even if there is no implied warranty remedy, there may be a negligence or strict liability remedy by application of section 402A of the Second Restatement of Torts. Unfortunately, this latter answer overlooks the jurisdictional problem presented if the manufacturer has no sales office or agent within the state of the plaintiff-patient sufficient under such state's long-arm statute for service of process.<sup>147</sup> Under the Code's "vouching-in" procedure, almost all jurisdictional problems are eliminated, but this vouching-in process is seemingly limited to an action under the Code for a breach of warranty.

## VI. MISCELLANEOUS CONTRACTS AND MISCELLANEOUS SECTIONS OF ARTICLE 2

### A. *Contracts for the Sale of Corporate Stock-Investment Securities*

Corporate stocks and bonds are expressly excluded from the classification of "goods" under Article 2,<sup>148</sup> with Article 8 supposedly governing these securities. However, Article 8 does not have a parol evidence rule governing contracts for the sale of securities. This gap has been filled, fortunately, by Comment 1 to section 2-105, which notes that the exclusion of investment securities from the coverage of Article 2 is not intended to prevent the application of a particular section of Article 2 when it is sensible to do so, if Article 8 does not cover the situation.<sup>149</sup> In direct response to this invitation of the Code's commentator, two courts have applied section 2-202—the parol evidence section for the sale of goods—to contracts calling for the sale of corporate stock.<sup>150</sup>

In a somewhat similar vein, another court has applied sections 2-106 and 2-304 of the Code to determine if a contract called for the sale of common stock purchase warrants.<sup>151</sup> If the contract did call for the common stock purchase sale of warrants, then section 8-319, the Statute of Frauds, would have required the contract to be in writing in order to

147. See, e.g., *Tetco Metal Prod., Inc. v. Langham*, 387 F.2d 721 (5th Cir. 1968).

148. U.C.C. § 2-105(1).

149. *Id.*, Comment 1.

150. *Stern & Co. v. State Loan & Fin. Corp.*, 238 F. Supp. 901 (D. Del. 1965); *Hunt Foods & Indus., Inc. v. Doliner*, 49 Misc. 2d 246, 267 N.Y.S.2d 364 (Sup. Ct.), *rev'd* on other grounds, 26 App. Div. 2d 41, 270 N.Y.S.2d 937 (1st Dep't 1966) (both the trial and appellate courts agreed that U.C.C. § 2-202 applied).

151. *Moritmer B. Burnside & Co. v. Havener Sec. Corp.*, 25 App. Div. 2d 373, 269 N.Y.S.2d 724 (1st Dep't 1966). See also *Cohn, Ivers & Co. v. Gross*, 56 Misc. 2d 491, 289 N.Y.S.2d 301 (App. T. 1968), which held that a "call" was not a security; hence U.C.C. § 8-319, the Statute of Frauds section, was not applicable. However, the court noted that the trial court had held that the Statute of Frauds section of Article 2 (§ 2-201) did not apply because the sales price was less than \$500, while the appellate court held that U.C.C. § 1-206 would apply to the sale of these "calls." *Id.* at 495, 289 N.Y.S.2d at 305.

be enforceable. The court held that, when the plaintiff and defendant agreed that if the plaintiff would purchase stock from a third party the defendant would transfer stock purchase warrants to the plaintiff, this was an agreement contemplating a transfer of title of the stock warrants to the plaintiff. Hence, there would be a sale under section 2-106 if the transfer was for a "price." The court then held that inasmuch as the "price" under section 2-304 "can be made payable in money or otherwise," the word "otherwise" would include the plaintiff's purchase of stock from the third party since this was sufficient consideration to support a contract. As a result, the oral contract for purchase of the warrants came within section 8-319 and was not enforceable when this defense was asserted. The dissenting judge was of the view that the word "otherwise" would not "include the doing or refraining from performance of an act as within what may constitute 'price,'"<sup>152</sup> and, even if it did, the doing of that act which assumedly would constitute the payment of the price would take the case out of the Statute of Frauds. It is to be noted that both the majority and dissenting opinions agreed on the applicability of selected sections of Article 2 to a transaction encompassed within Article 8 of the Code.

On the other hand, the Supreme Court of Pennsylvania, in *Edwin J. Schoettle Co. Appeal*,<sup>153</sup> held that Article 2 was not applicable to a contract involving the purchase of capital stock of a corporation. The plaintiff purchased all of the stock of a corporation pursuant to a highly detailed purchase contract which provided, in part, that as a condition precedent, the financial condition of the corporation at the time of closing was not to be less favorable than "the financial condition shown on the statements of said corporations dated June 30, 1954 and warranted to be true and complete in paragraph 5(e) hereof . . .'"<sup>154</sup> The buyer subsequently alleged that the financial condition was less favorable on the date of purchase of the stock and brought arbitration proceedings claiming that he was entitled to reimbursement in accordance with the purchase agreement. The court held that the seller did not expressly warrant the financial condition, and that since the contract was integrated, no implied warranties under Article 2 would be considered. The court quoted Comment 1 to section 2-105(1), but flatly held that Article 2 (particularly sections 2-714, 2-717 and 2-720) was not applicable to this situation involving a sale of capital stock. It would appear from this not altogether clear opinion that the court believed that it was not sensible to apply the cited sections of Article 2 because of the facts of

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152. *Mortimer B. Burnside & Co. v. Havener Sec. Corp.*, 25 App. Div. 2d 373, 377, 269 N.Y.S.2d 724, 728 (1st Dep't 1966).

153. 390 Pa. 365, 134 A.2d 908 (1957).

154. *Id.* at 369. 134 A.2d at 911.

this particular case. This case does not mean that the Pennsylvania Supreme Court has rejected the use of Article 2 by analogy in future cases involving different facts.

B. *Recovery of Overhead Expenses as Damages for Breach of a Processing Contract*

It is the general rule that when one party contracts to perform construction work or processing work for another party and the latter party is guilty of an anticipatory breach, the aggrieved party may sue the breaching party for loss of profits. The rule becomes less general when the courts attempt to define what is meant by the word "profit;" does it mean net profit (the contract price less the sum of direct costs and overhead costs) or gross profit (the contract price less direct costs)? The choice between these two rules is of more than academic interest because if the aggrieved party is denied the right to recover his overhead costs, his overhead must then be allocated against other jobs or contracts, which will reduce his net profit per job or contract and therefore reduce his total net profit for the fiscal year.

In short, it is not a question, as is sometimes stated, of merely good accounting practice; it is often a question of profit or loss for the year. Section 2-708 of the Code provides that in the event of a non-acceptance or repudiation by the buyer in a case involving the sale of goods, the measure of damages for the vendor is the difference between the market price (at the time and place of tender) and the unpaid contract price, together with any incidental damages. However, if this standard "is inadequate to put the seller in as good a position as performance would have done"<sup>155</sup> then the standard "is the profit (including reasonable overhead) which the seller would have made from full performance . . . together with any incidental damages . . ."<sup>156</sup>

In *Vitex Manufacturing Corp. v. Caribtex Corp.*,<sup>157</sup> a federal district court held that when Caribtex failed to deliver any wool for processing to Vitex in accordance with the parties' contract, Vitex was entitled to recover for loss of profits. The court stated that it was not required "to consider Vitex's overhead costs"<sup>158</sup> in the sense that the court was not required to add these costs to the direct costs and then deduct the sum from the contract price. In a rather complicated fashion, the court was saying that the aggrieved plaintiff was entitled to recover "gross profit" from the defaulting defendant. The court of appeals, after admitting that the processing contract was not controlled by section 2-708 of the Code,

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155. U.C.C. § 2-708.

156. *Id.*

157. 377 F.2d 795 (3d Cir. 1967).

158. *Id.* at 796.

stated that the Code was persuasive because it embodies the foremost modern legal thought concerning commercial transactions, and affirmed the district court.

C. *Breach of Warranty as a Defense in an Action for the Price in a Processing Contract*

Another cloth processing problem arose in *Vitromar Piece Dye Works v. Lawrence of London, Ltd.*<sup>159</sup> Here, the plaintiff contracted to waterproof thousands of yards of materials supplied by the defendant in accordance with a sample furnished by the plaintiff. The plaintiff waterproofed the material and returned it to the defendant, who failed to pay the contract price. The plaintiff sued, and the defendant affirmatively stated that the plaintiff's waterproofing was defective, resulting in material which was tacky and which required the defendant to expend money in attempting to cure the tackiness. The defendant further asserted that some of the materials, which had been made into coats, could not be sold and that some could only be sold at a lesser price. The defendant then counterclaimed for damages which allegedly occurred as a result of the plaintiff's defective work. The trial court ruled in favor of the defendant upon the complaint and in favor of the plaintiff upon the counterclaim of the defendant. The plaintiff appealed and the Illinois court held that the parties had agreed that New York law should apply. The plaintiff asserted that the defendant should be liable for payment of the purchase price because the defendant had accepted the goods under sections 2-606(1)(a) and 2-607 of the UCC and was liable for the price under section 2-709(1)(a). The appellate court affirmed the judgment and held that the principles articulated in the above-cited sections of the Code should be applied even though the facts did not involve a sale. "We note . . . that courts have recognized the policies embodied in the Uniform Acts as applicable in reason to subject matter which was not expressly included in the language of the Act."<sup>160</sup>

D. *Article 2 and Ship Charter Contracts*

Article 2 pertains to the sale of goods which may be carried by ship. Article 7 covers bills of lading, which control the title to these goods, and deals with other aspects of their transportation. Article 9 deals with the financing of the purchase-sale of these goods. However, do any of these articles deal expressly with the situation considered in *Transatlantic Financing Corp. v. United States*?<sup>161</sup> The United States chartered a private vessel to transport goods from the United States to a port in Iran. The

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159. 119 Ill. App. 2d 301, 256 N.E.2d 135 (1969).

160. Id. at 307, 256 N.E.2d at 138.

161. 363 F.2d 312 (D.C. Cir. 1966).

ship left the United States within a few days of the closing of the Suez Canal by Egypt in 1956, and, as a result, the ship had to make the longer journey around the Cape of Good Hope. The United States paid the original charter price and then the shipowner brought suit against the United States on a *quantum meruit* basis for the increased costs of shipment. The main thrust of the shipowner's case was that the original contract became legally impossible to perform and the shipowner's delivery by a different and more expensive route conferred a benefit upon the United States. This case arose in 1956, when only Pennsylvania had adopted the Code. Hence, the Code was not binding upon the shipowner, nor would it have been binding upon the United States even if it had been universally adopted. Furthermore, no section of the Code expressly deals with the question of impossibility vis-à-vis charter contracts. The court of appeals cited sections 2-614 and 2-615 as authority, without articulating the basis for the Code's applicability. Although it may be subject to dispute,<sup>162</sup> it would appear that the ultimate holding of the court—that performance was not rendered legally impossible—was based on Comment 4 to section 2-615, to the effect that increased cost alone does not excuse performance of a contract unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. In this case the shipowner claimed an added expense of \$43,972 over and above the contract price of \$305,842.92. The court was careful to note:

While it may be an overstatement to say that increased cost and difficulty of performance never constitute impracticability, to justify relief there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case, where the promisor [the shipowner] can legitimately be presumed to have accepted some degree of abnormal risk, and where impracticability is urged on the basis of added expense alone.<sup>163</sup>

#### E. *The Parol Evidence Rule and Contracts for Services*

Section 2-202, the parol evidence section of the Code, has received a rather unusual application in a recent case.<sup>164</sup> A manufacturer of hair-dressing lotions operated an instruction center where it employed technicians to give instruction to hairdressers. The manufacturer used models in the course of this instruction, and these models, in return for free hairdressing services, had to sign cards which purported to release the manufacturer from all liability incurred as a result of the hair treatment. A model signed this card, received hair treatment and suffered injury to her ear as a result of it. The model sued and during the trial the parties stipulated that if the model testified, she would testify that an employee

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162. 3 UCC Rep. Serv. 401 (1966) (Editors' Note).

163. 363 F.2d at 319 (emphasis added & footnotes omitted).

164. *Ciunci v. Wella Corp.*, 26 App. Div. 2d 109, 271 N.Y.S.2d 317 (1st Dep't 1966).



of the manufacturer had told her on three occasions that the form was designed to immunize the company for harm caused to the model's hair, while the manager of the manufacturer would testify that he had no knowledge of any alleged conversation with the model relative to the meaning of the form. The court held that this stipulation could not be admitted because it did not express any agreement as to facts; however, the court noted that the card did not refer to the ear and the testimony of the parties would be necessary to ascertain the intent of the parties. "Such testimony would be admissible, for it would not contradict the writing, but would be evidence of a consistent additional term to the writing."<sup>165</sup> It has been asserted that it is clear that this agreement was not one for the sale of goods, hence it was not within the scope of Article 2 of the Code.<sup>166</sup> It is therefore difficult to see why the court applied, in effect, section 2-202, unless the court was of the unexpressed view that warranty liability would be applicable in a service transaction. Therefore, by extension, the parol evidence rule of the same article could be used to determine the meaning of a form purportedly designed to release the manufacturer from liability. If it is permissible to extend liability by analogy, then it ought to be permissible to reduce it by analogy.

#### VII. THE CONSTRUCTION OF FEDERAL STATUTES IN LIGHT OF ARTICLE 2

The use of the Code by analogy in administrative proceedings under the Packers and Stockyards Act of 1921<sup>167</sup> was illustrated in *Stratton Sale Barn, Inc. v. Reed*.<sup>168</sup> Stratton Sale Barn, Inc., a livestock market agency, sold 152 head of cattle to Christian (a cattle company), which gave its check in payment. Christian then sold 52 of the steers to Reed (a livestock dealer) in return for Reed's crediting the price of the steers as payment of an antecedent debt owed to Reed by Christian. Reed also gave Christian a check for a small amount as the difference between the debt and the sales price of the steers. Unfortunately, Christian's check to Stratton was dishonored and Stratton brought reparation proceedings against Reed. The judicial officer in the proceedings stated that Stratton, as a defrauded seller, retained an equitable right of rescission which it could exercise against anyone but a bona fide purchaser for value without notice, and that the prior view had been that the purchaser of chattels in payment of an antecedent debt did not acquire them for value. The officer held, however, that the UCC does provide that an antecedent

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165. *Id.* at 111, 271 N.Y.S.2d at 319.

166. 3 UCC Rep. Serv. 811 (1966) (Editors' Note).

167. 7 U.S.C. §§ 181-231 (1964).

168. 28 Agri. Dec. 677, 6 UCC Rep. Serv. 922, *aff'd*, 28 Agri. Dec. 1418, 7 UCC Rep. Serv. 192 (1969).

debt constitutes value and that under section 2-403 of the Code "one taking from a person with voidable title, without notice, and in total or partial satisfaction of a pre-existing claim, is entitled to protection as a bona fide purchaser,"<sup>169</sup> and that "[a]lthough we are not bound by the Code in deciding whether a person subject to the Act has engaged in any proscribed practice for which reparation may be awarded, the Code is a factor to be considered in determining what is 'unfair' in the context of the livestock industry."<sup>170</sup>

In reparation proceedings instituted under the Perishable Agricultural Commodities Act,<sup>171</sup> based upon the breach of an oral contract to purchase a crop of apples, the Department of Agriculture's judicial officer ruled that the Statute of Frauds of the Code (section 2-201) would not be applicable because the Statute of Frauds is procedural. However, the judicial officer cited sections 2-706 and 2-610 as controlling in determining the questions of anticipatory breach and the measure of damages.<sup>172</sup>

#### VIII. CONTRACTS OF THE UNITED STATES GOVERNMENT

The Supreme Court of the United States held in 1943 that legal questions dealing with negotiable instruments in which the United States is a party are to be decided by federal "common law" and not by the Negotiable Instruments Law, which was then the "uniform" law of the various states.<sup>173</sup> This decision may be justified upon the basis of a supposed need for uniformity, preservation of federal rights and the fact that the government is a non-profit enterprise which has a greater difficulty in insuring the honesty of its employees than does the enterprise which deals with the government.<sup>174</sup> However, it would appear that this decision was merely one facet of the broader view that the validity and construction of contracts of the United States government "through which the United States is exercising its constitutional functions, their consequences on the rights and obligations of the parties, the titles or liens which they create or permit, all present questions of federal law not controlled by the law of any State."<sup>175</sup> In spite of this approach to a federal common law, many federal courts and administrative tribunals adopted the provisions of the Uniform Sales Act as "common law."<sup>176</sup> This adoption of statutes

169. *Id.* at 681, 6 UCC Rep. Serv. at 925.

170. *Id.*

171. 7 U.S.C. §§ 499(a)-(s) (1964).

172. *Aura Orchards v. A. Peltz & Sons, Inc.*, 27 *Agri. Dec.* 1546, 6 UCC Rep. Serv. 149 (1968).

173. *Clearfield Trust Co. v. United States*, 318 U.S. 363, modified, 318 U.S. 744 (1943).

174. See *United States v. Philadelphia Nat'l Bank*, 304 F. Supp. 955 (E.D. Pa. 1969).

175. *United States v. County of Allegheny*, 322 U.S. 174, 183 (1944).

176. For a listing of the authorities, see *Appeal of Federal Pac. Elec. Co.*, 71 *Interior Dec.* 384, 389-90 nn.5 & 6, 2 UCC Rep. Serv. 225, 231 nn.5 & 6 (1964).

as common law has accelerated with the adoption of the UCC, and now numerous federal courts<sup>177</sup> and administrative tribunals<sup>178</sup> have adopted Article 2 as a source for the federal law of sales. It would now appear that it does not matter whether the United States is the complaining party or the defendant, or what the nature of the case may be—the provisions of Article 2 will control. For example, the Board of Contract Appeals of the Atomic Energy Commission has ruled that parol evidence relating to the negotiations leading to a contract between a private company and the AEC is admissible to aid the Board in interpreting the contract.<sup>179</sup> “The admission of such evidence is in accord with the provisions of the Uniform Commercial Code which is an appropriate source of Federal law.”<sup>180</sup> The Armed Services Board of Contract Appeals has also used Article 2 of the Code in a case in which a government contractor sought the contract price for magnetic tape sold to the Army, while the Army sought to defeat the claim and to recover the costs of buying substitute tape.<sup>181</sup> The Board held that the parol evidence rule of the Code permitted parol evidence to show a breach of an implied warranty of merchantability, and to show the vendor’s knowledge of the purpose for which the buyer made the purchase, in order to show an implied warranty of fitness for a particular purpose. However, parol evidence of an express warranty could not be introduced because the contract was integrated. The Board relied on sections 2-314 and 2-315 as creating the warranties and then followed section 2-316 in holding that since the Government had examined a sample of the magnetic tape prior to entering into the contract and the defects in the tape were of a kind that the Government ought to have discovered, there was no warranty of fitness for a particular purpose. The Board of Contract Appeals of the Department of the Interior has held in two cases that the legal principle of cumulation of warranties articulated in the UCC forms part of the general federal common law applicable to government supply contracts.<sup>182</sup> The question now arises: if general UCC law is to govern the rights and duties of the United States in sales questions, why should there be a special federal common law—a law which

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177. *E.g.*, *United States v. Wegematic Corp.*, 360 F.2d 674 (2d Cir. 1966); *Everett Plywood & Door Corp. v. United States*, 419 F.2d 425 (Ct. Cl. 1969).

178. *Appeal of General Elec. Co.*, 72 Interior Dec. 278, 2 UCC Rep. Serv. 1036 (1965); *Appeal of the Carpenter Steel Co.*, 3 AEC Rep. 317, 2 UCC Rep. Serv. 775 (1965); *Appeal of Federal Pac. Elec. Co.*, 71 Interior Dec. 384, 2 UCC Rep. Serv. 225 (1964).

179. *Appeal of the Carpenter Steel Co.*, 3 AEC Rep. 317, 2 UCC Rep. Serv. 775 (1965).

180. *Id.* at 319, 2 UCC Rep. Serv. at 776.

181. *Appeals of Reeves Soundcraft Corp.*, ASBCA Nos. 9030, 9130, 2 UCC Rep. Serv. 210 (Armed Services Bd. of Contract Appeals 1964).

182. *Appeal of General Elec. Co.*, 72 Interior Dec. 278, 2 UCC Rep. Serv. 1036 (1965); *Appeal of Federal Pac. Elec. Co.*, 71 Interior Dec. 384, 2 UCC Rep. Serv. 225 (1964).

may be terribly confused in certain aspects of the law of negotiable instruments<sup>183</sup>

### IX. CONCLUSION

The spread of Article 2 concepts into areas other than sale of goods has just begun, and within the next decade much of the present-day law of contracts will be of merely historical interest. Three interrelated, yet disparate catalytic forces will accelerate the infiltration of Code concepts into the common law of contracts.

1. Busy lawyers, and both trial and appellate courts, are in desperate need of a relatively simple, quickly available source of law for the majority of cases where the amount in controversy cannot justify countless hours of research and analysis of conflicting case law. The UCC fills this need, and if the problem does not deal with sale of goods contract, then the Code has to be stretched a bit in order to fill this need.

2. Many of the professional and academic experts who have helped draft, shape and criticize the Code are also engaged in drafting, shaping and criticizing the growth of the law of contracts. For example, if one looks at the latest tentative draft of the Restatement of the Law of Contracts,<sup>184</sup> it will be obvious that Article 2's notions of good faith<sup>185</sup> and unconscionability<sup>186</sup> have been adopted to apply to all contracts.<sup>187</sup> It does seem unfortunate, however, that most of the illustrations of the draftsmen are drawn from the sale of goods area; bad faith and unconscionability are not unique to merchants. Article 2's parol evidence and integration of contract rules have also been interwoven into the Restatement's more complex approach to an ever-present and troubling problem.<sup>188</sup> The Code's concepts of usage, trade usage and course of dealing have also been adopted.<sup>189</sup>

3. The use of particular sections of the Code lends an aura of authority and may justify a judge in doing forthrightly something that he has had to do in the past by twisting the law, or doing something that he has been afraid to do in the past because of a lack of enough clear authority to support his position.

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183. Compare *United States v. Philadelphia Nat'l Bank*, 304 F. Supp. 955 (E.D. Pa. 1969) and *United States v. Bank of America Nat'l Trust and Sav. Ass'n*, 288 F. Supp. 343 (N.D. Cal. 1968), with *United States v. Bank of America Nat'l Trust & Sav. Ass'n*, 274 F.2d 366 (9th Cir. 1959) and *Atlantic Nat'l Bank v. United States*, 250 F.2d 114 (5th Cir. 1957).

184. Restatement (Second) of Contracts § 231 (Tent. Draft No. 5, 1970).

185. U.C.C. §§ 1-201(19) & 2-103(1)(b).

186. U.C.C. § 2-302.

187. Restatement (Second) of Contracts § 231 (Tent. Draft No. 5, 1970).

188. *Id.* §§ 235-44.

189. *Id.* §§ 246, 248-49.