by the parties on January 3, 1996; therefore, it is subject to Article 2A of the UCC."

INTERPRETATION A lease will be governed by Article 2A unless in compliance with the terms of the "lease" the lessee has the option to become the owner of the property for no additional or for a nominal consideration, in which case, the lease is deemed to be intended for security and governed by Article 9.

CRITICAL THINKING QUESTION Why might the parties attempt to disguise a security agreement as a lease?

Governing Law

Although **sales transactions** are governed by Article 2 of the Code, general contract law continues to apply where the Code has not specifically modified such law. Nevertheless, although principles of common law and equity may supplement provisions of the Code, they may not be used to supplant its provisions. Thus, the law of sales is a specialized part of the general law of contracts, and the law of contracts continues to govern unless specifically displaced by the Code.

General contract law also continues to govern all **contracts outside the scope of the Code.** Transactions not within the scope of Article 2 include employment contracts; service contracts; insurance contracts; contracts involving real property; and contracts for the sale of intangibles such as stocks, bonds, patents, and copyrights. For an illustration of the law governing contracts, see Figure 9-1. In determining whether a contract containing both a sale of goods and a service is a UCC contract or general contract, the majority of states follow the predominant purpose test. This test, as in *Pittsley v. Houser*, which follows, and in *Fox v. Mountain West Electric, Inc.* in Chapter 9 holds that if the predominant purpose of the whole transaction is a sale of goods, Article 2 applies to the entire transaction. If, on the other hand, the predominant purpose is the nongood or service portion, Article 2 does not apply. A few states apply Article 2 only to the goods part of a transaction and general contract law to the nongoods or service part of the transaction.

CISG

The United Nations Convention on Contracts for the International Sales of Goods (CISG), which has been ratified by the United States and more than forty other countries, governs all contracts for the international sales of goods between parties located in different nations that have ratified the CISG. Because treaties are federal law, the CISG supersedes the UCC in any situation to which either could apply. The CISG includes provisions dealing with interpretation, trade usage, contract formation, obligations and remedies of sellers and buyers, and risk of loss. Parties to an international sales contract may, however, expressly exclude CISG governance from their contract. The CISG specifically excludes sales of (1) goods bought for personal, family, or household use; (2) stocks, shares, investment securities, negotiable instruments, or money; (3) ships or aircraft; and (4) electricity. In addition, it does not apply to contracts in which the primary obligation of the party furnishing the goods consists of supplying labor or services.

Pittsley v. Houser

IDAHO COURT OF APPEALS, 1994
875 P.2D 232

FACTS Jane Pittsley contracted with Donald Houser, who was doing business as Hilton Contract Co. (Hilton), to install carpet in her home. The total contract price was $4,402. From this sum, Hilton paid the installers $700 to put the carpet in Pittsley's home. Following installation, Pittsley complained to Hilton that the installation was defective in several respects. Hilton attempted to fix the installation but was unable to satisfy Pittsley. Eventually, Pittsley refused any further efforts to fix the carpet. She sued for rescission of the contract and return of the $3,500 she had previously paid on the contract plus incidental damages. Hilton counterclaimed for the balance due on the contract. The magistrate determined that the breach was not so material as to justify rescission of the contract and awarded Pittsley $250 in repair costs plus $150 in expenses. The magistrate also awarded Hilton the balance of $902 remaining on the contract. Pittsley appealed to the district court, which reversed and remanded the case to the

magistrate for additional findings of fact and to apply the Uniform Commercial Code (UCC) to the transaction. Hilton appeals this ruling, asserting that application of the UCC is inappropriate because the only defects alleged were in the installation of the carpet, not in the carpet itself.

DECISION The judgment of the magistrate is vacated and the case remanded.

OPINION Swanstrom, J. The single question upon which this appeal depends is whether the UCC is applicable to the subject transaction. If the underlying transaction involved the sale of "goods," then the UCC would apply. If the transaction did not involve goods, but rather was for services, then application of the UCC would be erroneous.

Idaho Code § 2–105(l) defines "goods" as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale. ***" Although there is little dispute that carpets are "goods," the transaction in this case also involved installation, a service. Such hybrid transactions, involving both goods and services, raise difficult questions about the applicability of the UCC. Two lines of authority have emerged to deal with such situations.

The first line of authority, and the majority position, utilizes the "predominant factor" test. The Ninth Circuit, applying the Idaho Uniform Commercial Code to the subject transaction, restated the predominant factor test as:

> The test for inclusion or exclusion is not whether they are mixed, but, granting that they are mixed, whether their predominant factor, their thrust, their purpose, reasonably stated, is the rendition of service, with goods incidentally involved (e.g., contract with artist for painting) or is a transaction of sale, with labor incidentally involved (e.g., installation of a water heater in a bathroom).

[Citations.] This test essentially involves consideration of the contract in its entirety, applying the UCC to the entire contract or not at all.

The second line of authority, which Hilton urges us to adopt, allows the contract to be severed into different parts, applying the UCC to the goods involved in the contract, but not to the nongoods involved, including services as well as other nongoods assets and property. Thus, an action focusing on defects or problems with the goods themselves would be covered by the UCC, while a suit based on the service provided or some other nongoods aspect would not be covered by the UCC. ***

We believe the predominant factor test is the more prudent rule. Severing contracts into various parts, attempting to label each as goods or nongoods and applying different law to each separate part clearly contravenes the UCC's declared purpose "to simplify, clarify and modernize the law governing commercial transactions." § 1–102(2)(a). As the Supreme Court of Tennessee suggested in [citation], such a rule would, in many contexts, present "difficult and in some instances insurmountable problems of proof in segregating assets and determining their respective values at the time of the original contract and at the time of resale, in order to apply two different measures of damages."

Applying the predominant factor test to the case before us, we conclude that the UCC was applicable to the subject transaction. The record indicates that the contract between the parties called for "165 yds Masterpiece No. 2122–Installed" for a price of $4319.50. There was an additional charge for removing the existing carpet. The record indicates that Hilton paid the installers $700 for the work done in laying Pittsley's carpet. It appears that Pittsley entered into this contract for the purpose of obtaining carpet of a certain quality and color. It does not appear that the installation, either who would provide it or the nature of the work, was a factor in inducing Pittsley to choose Hilton as the carpet supplier. On these facts, we conclude that the sale of the carpet was the predominant factor in the contract, with the installation being merely incidental to the purchase. Therefore, in failing to consider the UCC, the magistrate did not apply the correct legal principles to the facts as found.

INTERPRETATION If the predominant purpose of the whole transaction is a sale of goods, then Article 2 applies to the whole transaction; if the predominant purpose is the nongood or service component, then Article 2 does not apply.

CRITICAL THINKING QUESTION Which test do you prefer? Explain.

Although Article 2 governs sales, the drafters of the article have invited the courts to extend Code principles to nonsale transactions in goods. To date, a number of courts have accepted this invitation and have applied Code provisions by analogy to other transactions in goods not expressly included within the Act, most frequently to leases and bailments. The Code has also greatly influenced the revision of the Restatement, Second, Contracts, which, as previously discussed, has great effect upon all contracts.

Although **lease transactions** are governed by Article 2A of the Code, general contract law continues to apply where the Code has not specifically modified such law. In other words, the law of leases is a specialized part of the general law of contracts, and the law of contracts continues to govern unless specifically displaced by the Code.

Practical Advice

Because it is unclear which law will govern certain contracts, be careful to specify the particulars of your agreement in your written contract.

Fundamental Principles of Article 2 and Article 2A

The purpose of Article 2 is to modernize, clarify, simplify, and make uniform the law of sales. Furthermore, the article is to be interpreted according to these principles and not according to some abstraction such as the passage of title. The Code

> is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason. (*General Provisions* in Comment to Section 1–102)

This open-ended drafting includes the following fundamental concepts.

CISG

The CISG governs only the formation of the contract of sales and the rights and obligations of the seller and buyer arising from such contract. It does not cover the validity of the contract or any of its provisions. In addition, one of the purposes of the CISG is to promote uniformity of the law of sales.

Good Faith

All parties who enter into a contract or duty within the scope of the Code must perform their obligations in good faith. The Code defines **good faith** as "honesty in fact in the conduct or transaction concerned." For a merchant, good faith also requires the observance of reasonable commercial standards of fair dealing in the trade. Revised UCC Section 1–201(20) provides that "good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing," thus adopting the broader definition of good faith and making it applicable to both merchants and nonmerchants. For instance, if the parties agree that the seller is to set the price term, the seller must establish the price in good faith.

CISG

The CISG is also designed to promote the observation of good faith in international trade.

Unconscionability

The courts may scrutinize every contract of sale to determine whether in its commercial setting, purpose, and effect it is unconscionable. The reviewing court may refuse to enforce a contract (or any part of it) found to be unconscionable or may limit its application to prevent an unconscionable result. The Code does not define ***unconscionable***; however, the term is defined in the *New Webster's Dictionary* (Deluxe Encyclopedic Edition) as "contrary to the dictates of conscience; unscrupulous or unprincipled; exceeding that which is reasonable or customary; inordinate, unjustifiable."

The Code denies or limits enforcement of an unconscionable contract for the sale of goods to promote fairness and decency and to correct harshness or oppression in contracts resulting from the unequal bargaining positions of the parties.

The doctrine of unconscionability permits the courts to resolve issues of unfairness explicitly on that basis without recourse to formalistic rules or legal fictions. In policing contracts for fairness, the courts have demonstrated their willingness to limit freedom of contract to protect the less advantaged from the overreaching of dominant contracting parties.

The doctrine of unconscionability has evolved through its application by the courts to include both procedural and substantive unconscionability. **Procedural unconscionability** involves scrutiny for the presence of "bargaining naughtiness." In other words, was the negotiation process fair? Or were there procedural irregularities such as burying important terms of the agreement in fine print or obscuring the true meaning of the contract with impenetrable legal jargon?

In the search for **substantive unconscionability**, the court examines the actual terms of the contract, seeking oppressive or grossly unfair provisions such as an exorbitant price or an unfair exclusion or limitation of contractual remedies. An all-too-common example involves a necessitous buyer in an unequal bargaining position with a seller who consequently has obtained an exorbitant price for his product or service.

Practical Advice

Refrain from entering into contracts with provisions that are oppressively harsh or that were negotiated under unfair circumstances.

As to all leases, Article 2A provides that a court faced with an unconscionable contract or clause may refuse to enforce either the entire contract or just the unconscionable clause or may limit the application of the unconscionable clause to avoid an unconscionable result. This is similar to Article 2's treatment of unconscionable clauses in sales contracts. A lessee under a consumer lease, however, is provided with additional protection against unconscionability. In the case of a consumer lease, if a court as a matter of law finds that any part of the lease contract has been induced by unconscionable conduct, the court is expressly empowered to grant appropriate relief. The same is true when unconscionable conduct occurs in the collection of a claim arising from a consumer lease contract. The explicit availability of relief for consumers subjected to unconscionable conduct (procedural unconscionability)—in addition to a provision regarding unconscionable contracts (substantive unconscionability)—represents a departure from Article 2. An additional remedy that Article 2A provides for consumers is the award of attorneys' fees. If the court finds unconscionability with respect to a consumer lease, it shall award reasonable attorneys' fees to the lessee.

The following case illustrates the application of the doctrine of unconscionability, as does *Sanchez v. Western Pizza Enterprises, Inc* in Chapter 13.

Construction Associates, Inc. v. Fargo Water Equipment Co.

NORTH DAKOTA SUPREME COURT, 1989
446 N.W.2D 237

FACTS Construction Associates (CA) was the successful bidder to construct a water supply line for the city of Breckenridge, Minnesota. CA purchased a large amount of polyvinyl chloride pipe manufactured by the Johns-Manville Sales Corporation (J-M) in order to construct the pipeline. CA, however, did not have any direct contact with J-M; instead, it purchased the pipe through a supply company (Fargo Water Equipment). J-M shipped the pipe directly to the work site, and included with each shipment an installation guide written for those who actually directed the installation of the pipe. On page three of the installation guide, J-M expressly warranted the pipe to be free from defects in workmanship and materials. In addition, J-M set forth a limitation of liability clause, which stated there would be no liability except for breach of the express warranty, and that J-M would be responsible only for resupplying a like quantity of nondefective pipe. J-M stated that it would not be liable for any incidental, consequential, or other damages.

Eventually the Breckenridge pipeline developed more than seventy leaks. The only way these leaks could be repaired was to remove the defective joints and replace them with stainless steel sleeves. After incurring more than $140,000 in repairs to the pipeline, CA sued J-M and Fargo. CA won a jury award of more than $140,000 in damages from J-M. J-M appealed, claiming that the limitation of liability clause should be enforced.

DECISION Judgment for CA affirmed.

OPINION Ericksted, J. [UCC § 2–719] specifically allows the parties to an agreement to limit the remedies available upon breach and to exclude consequential damages:

***

By its terms § 2–302 [unconscionable contract or clause] applies to any clause of the contract. Courts thus have construed §§ 2–302 and 2–719 together in holding that a general limitation of remedies clause, including those limiting liability to repair or replacement, may be subject to unconscionability analysis under the Code. [Citations.]

The determination whether a particular contractual provision is unconscionable is a question of law for the court. [Citations.] The court is to look at the contract from the perspective of the time it was entered into, without the benefit of hindsight. ***

Courts and commentators have generally viewed the Code's unconscionability provisions within a two-pronged framework: procedural unconscionability, which encompasses factors relating to unfair surprise, oppression, and inequality of bargaining power, and substantive unconscionability, which focuses upon the harshness or one-sidedness of the contractual provision in question. [Citations.]

Procedural Unconscionability We initially note that this case presents a commercial, rather than a consumer, transaction. Although courts have generally been more reluctant to find unconscionability in purely commercial settings,

[citation], under appropriate circumstances a contractual provision may be found unconscionable even in a commercial setting. [Citations.]

***

The circumstances presented in this case demonstrate a substantial inequality in bargaining power between J-M and Construction Associates. Construction Associates is a relatively small local construction firm, while J-M is part of an enormous, highly diversified, international conglomerate. The limitation of remedies and exclusion of damages were part of a pre-printed installation guide included with all shipments of J-M Pipe. J-M has continually stressed on appeal that those limitations and exclusions are included in all of its brochures and guides. It is obvious that there is no room for bargaining or negotiation as to the warranty provisions.

We also note that the facts in this case demonstrate an actual lack of negotiation coupled with elements of unfair surprise. ***

The limitations and exclusions clause in this case can hardly be described as "bargained for." The clauses were included on page three of a pre-printed installation guide expressly directed to the worker in the field, rather than to officers of Construction Associates. Construction Associates was not apprised at the time of contracting that their remedies under the Code were being limited or excluded. It would be within J-M's control to do so by, for example, requiring its dealers to accept orders for pipe only upon a J-M form which included the limitations and exclusions and which required the purchaser's signature. Clearly an element of procedural unconscionability is present where through a pre-printed guide which was not provided to Construction Associates (and then only to field workers) until long after the sales contract had been finalized.

Substantive Unconscionability Substantive unconscionability focuses upon the harshness of the particular contractual terms:

***

The clause at issue here would limit Construction Associates' remedy for J-M's breach to a like quantity of replacement pipe, with no recovery of consequential damages. Construction Associates argues, with support in the evidence, that replacement pipe is not used when making repairs to leaking joints on a completed underground water pipeline. Because the accepted method of repair is to cut out the leaking joint and repair it with a stainless steel sleeve, Construction Associates argues, the replacement pipe would be useless in effecting repairs upon the line. The trial court determined that J-M's limited remedy "amount[ed] to nothing whatsoever." ***

Numerous courts, in a variety of commercial and consumer contexts, have held limitations and exclusions unconscionable when they leave the non-breaching party with no effective remedy. [Citations.] This is particularly true where the defect in the product is latent, so that the buyer is unable to discover the defect until additional damages are incurred. [Citations.]. In this case, Construction Associates did not discover the defects until the pipe was assembled and placed underground.

INTERPRETATION A court can override a term of a contract if it finds that term to be unconscionable or the result of an unconscionable negotiation process.

ETHICAL QUESTION Is unconscionable conduct always unethical? Explain.

CRITICAL THINKING QUESTION How active should courts be in finding contracts or clauses to be unconscionable? Explain.

Expansion of Commercial Practices

An underlying policy of the Code is "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties." In particular, the Code emphasizes the course of dealing and the usage of trade in interpreting agreements.

A **course of dealing** is a sequence of previous conduct between the parties that may fairly be regarded as establishing a common basis of understanding for interpreting their expressions and agreement.

A **usage of trade** is a practice or method of dealing regularly observed and followed in a place, vocation, or trade. To illustrate: Connie contracts to sell Ward 1,000 feet of San Domingo mahogany. By usage of dealers in mahogany, known to Connie and Ward, good-figured mahogany of a certain density is known as San Domingo mahogany, though it does not come from San Domingo. Unless otherwise agreed, the usage is part of the contract.

CISG

The parties are bound by any usage or practices that they have agreed to or established between themselves. In addition, the parties are considered, unless otherwise agreed, to be bound by any usage of international trade that is widely known and regularly observed in the particular trade.

Sales By and Between Merchants

The Code establishes some separate rules that apply to transactions between merchants or to transactions