

COMMENTS

APPLICATION OF ARTICLE 2 OF THE UNIFORM COMMERCIAL CODE TO LEASES

Sawyer v. Pioneer Leasing Corp.,
244 Ark. 943, 428 S.W.2d 46 (1968).

Sawyer, an independent grocer, leased an ice machine from Pioneer Leasing Corporation for a non-cancellable term of five years. The lease provided, among other things, that the lessee was responsible for all repairs, that the machine was to be returned to the lessor at the end of the term, and that all warranties were expressly disclaimed.¹

During negotiation of the lease, an agent of Pioneer² told Sawyer that the apparatus was winterized and would produce 400 pounds of ice per day. Sawyer, who wished to buy the machine, was told that the leasing agreement was tantamount to a purchase.³ This statement was later confirmed by an officer of Pioneer. After functioning properly for about six months, the machine collapsed during the first period of cold weather. Sawyer twice summoned mechanics, but neither was able to

1. The lease set up a 60-month payment schedule of \$45.32 per month with the first and last four payments payable at the time of the signing of the contract in the amount of \$226.60.

Other relevant provisions of the agreement included:

[Section 8] “. . . At the expiration of the terms of this lease for any item(s) leased hereunder, Lessee shall immediately redeliver such item(s) at Lessor's place of business or such other reasonable place as Lessor may designate within the State where the item(s) was leased, in like condition as it was received, less normal wear, tear and depreciation; properly crated with freight prepaid.”

Section 9 [which provides] . . . , *inter alia*, that in case of default in payment for a period of ten days, lessor was authorized to take immediate possession of the leased property, and that the lessee shall remain liable for the payment of the total rental, all such rental being immediately due and payable.” Both pages of the instrument provide, “This lease cannot be cancelled.”

Sawyer v. Pioneer Leasing Corp., 244 Ark. 943, —, 428 S.W.2d 46, 48 (1968).

2. This case also raised an agency problem which the court resolved in Sawyer's favor. Pioneer alleged, both at the trial and appellate level, that as Barnett was not an employee of the corporation and as he had handled all the proceedings in connection with execution of the lease, Pioneer was not liable on the contract with Sawyer. The trial court found for Pioneer on this point, but the Supreme Court reversed, holding that as the lease was subsequently executed by the president of the lessor corporation and because the lessor had accepted over \$600 in payments from the lessee, the question as to whether Barnett was the agent of the lessor should have been submitted to the jury. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, 428 S.W.2d 46 (1968).

3. Sawyer testified that Barnett had explained to him that the transaction was “just like buying a car, after you make so many payments, it is your box.” *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, —, 428 S.W.2d 46, 48 (1968).

repair the machine. When Sawyer notified Pioneer of the breakdown and stopped making payments, it brought suit to recover the balance due on the lease.

Sawyer defended on the theory that, despite the broad disclaimer, the lease was accompanied by an implied warranty of fitness, upon which he had relied. He argued that the misrepresentation of the durability and capacity of the machine and its unfitness for its intended purpose constituted a breach of the warranty. The trial court directed a verdict for Pioneer, but the Supreme Court of Arkansas reversed on appeal.⁴

Although the court specifically held the transaction to be a lease rather than a sale, it concluded that Section 2-316 of the Uniform Commercial Code⁵ is applicable to leases which are analogous to sales. This section requires disclaimers of implied warranties of fitness to be made in writing and conspicuous.⁶ The court found that the disclaimer provision under examination was not conspicuous. This direct application to leases of the UCC sales provisions seems unjustified, both as a matter of interpretive technique and as adding unnecessary confusion to contract law.

Although it failed to unearth direct support for the application of UCC provisions to leases which are analogous to sales, the court bor-

4. *Id.*

5. ARK. STAT. ANN. § 85-2-316 (Add. 1961).

6. The Code provision, which was enacted without changes by the Arkansas legislature in 1961, reads in full:

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranties shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous and to exclude or modify any implied warranty of fitness the exclusion must be made in writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless circumstances indicate otherwise, all implied warranties are excluded by expression like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy.

ARK. STAT. ANN. §§ 85-2-718, -719 (Add. 1961).

rowed arguments from three sources to bolster its conclusion. The opinion quotes extensively from "Implied Warranties in Non-Sales Cases," an article by Professor E. A. Farnsworth,⁷ and finds this to be "respectable authority" for its holding.⁸ Professor Farnsworth argues that the existence of a sale is not a prerequisite to the implication of a warranty, asserting that such warranties are justified when goods are supplied under non-sale conditions if the reliance upon the supplier of the goods is similar to that in sales.⁹ The writer concludes that:

. . . there is respectable authority for the extension of implied warranties to non-sales cases, in spite of a tendency to overlook the possibility. In borderline cases reasoning by analogy to sales law . . . is preferable to categorization of the contract as one of sale and direct application of the sales statute.¹⁰

It seems clear that, rather than advocating application of code provisions to non-sales transactions, Farnsworth is urging recognition of the advantages of reasoning by analogy from uniform acts in order to provide criteria for the resolution of non-sales cases.¹¹ Indeed, it would appear that the author's primary concern is that the codification of sales laws might have a deadening effect on the development of case law in non-sales areas.¹²

After noting that the precise issue involved had been previously raised but had gone undecided,¹³ the court next sought support in dictum from the New Jersey case of *Cintrone v. Hertz Truck Leasing*.¹⁴ The *Cintrone* case—an action in tort, not contract—held that the common law doctrine of implied warranties applied to leases. The New Jersey court recognized that a drafters' Comment to UCC Section 2-313 disavows any intent to disturb case law holding that warranties need not be confined to sales transactions.¹⁵ From this, however, it does not

7. Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653, 656-57 (1957) [hereinafter cited as Farnsworth].

8. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, —, 428 S.W.2d 46, 52 (1968).

9. Farnsworth at 669-74.

10. *Id.* at 667.

11. *Id.* at 667-69.

12. Farnsworth at 654. This article has been extensively cited in cases extending provisions of uniform laws, especially the Uniform Negotiable Instruments Law and the Uniform Commercial Code, to areas in which they do not technically apply. *See, e.g.*, *Cintrone v. Hertz Truck Leasing & Rental Serv.*, 45 N.J. 434, 212 A.2d 769 (1965).

13. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, —, 428 S.W.2d 46, 53 (1968). The case referred to was *Fairfield Lease Corp. v. Colonial Aluminum Sales, Inc.*, 3 UCC Rep. 858, 859 (N.Y. Sup. Ct. 1966).

14. 45 N.J. 434, 447, 212 A.2d 769, 775 (1965).

15. *Cintrone v. Hertz Truck Leasing & Rental Serv.*, 45 N.J. 434, 447, 212 A.2d 769, 775 (1965). It should be noted that the position suggested in this case has not been fol-

follow that the UCC provisions affecting warranties were intended to apply with equal force to non-sales situations. More tenable is the position that the authors of the Code intended that the development of leasing warranties be left to case law, with the recognition that the policies of the UCC would be useful in the resolution of such cases.

Finally, the court observed that Section 2-102 delineates the scope of Article 2 in terms of "*transactions in goods*"¹⁶ and that Section 2-202 avoids direct reference to sales.¹⁷ The court then reasoned that, since a lease of a chattel is a transaction in goods, such leases should fall within the provisions of the Code. It should be noted, however, that Section 2-105(1) defines "goods" in terms of a contract for sale.¹⁸ Thus, the requirement of a sale is indirectly incorporated into permissible scope of application. Other weaknesses inhering in the majority's position are emphasized in Justice Fogleman's dissent.¹⁹ The sections in ques-

lowed in New Jersey. See *Magrine v. Krasnica*, 94 N.J. Super. 228, 227 A.2d 539 (1967); *Jackson v. Muhlenberg Hosp.*, 96 N.J. Super. 314, 232 A.2d 879 (1967); *Conroy v. 10 Brewster Ave. Corp.*, 97 N.J. Super. 75, 234 A.2d 415 (1967). U.C.C. § 2-313, comment 2 states in part:

Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, 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 either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. . . . Beyond that, the matter is left to the case law with the intention that the policies of this Article may offer useful guidance in dealing with further cases as they arise.

16. The relevant portion of U.C.C. § 2-102 (ARK. STAT. ANN. § 85-2-102 (Add. 1961)) reads:

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell . . . is intended to operate only as a security transfer nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

17. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, —, 428 S.W.2d 46, 52 (1968). U.C.C. § 2-202 (ARK. STAT. ANN. § 85-2-202 (Add. 1961)) reads:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of dealing or usage of trade (Section 1-205) or by the course of performance (Section 2-208); and (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

18. U.C.C. § 2-105(1) (ARK. STAT. ANN. § 85-2-105(1) (Add. 1961)), the relevant portion of which reads:

"Goods" means all things . . . which are movable at the time of identification to the *contract of sale*. . . . (Emphasis added).

19. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, —, 428 S.W.2d 46, 54 (1968).

tion refer specifically to contracts of sale and to buyers and sellers;²⁰ this wording would seem to render these sections inapplicable to leasing contracts. Moreover, at least three sections of the Code refer specifically to leases,²¹ fostering the conclusion that, where the drafters intended that it should apply to leases, such intent is expressly stated.

This analysis suggests that the Arkansas court has expanded the application of a specific statutory provision to encompass a class of cases which the legislature never intended it to include. Before discussing the practical problems left in the wake of this decision, it is appropriate to consider alternative methods by which a similar but sounder result could have been achieved.

Commercial transactions which bear the undeniable flavor of a sale can in some cases be held to be sales in fact. Courts are not bound by the labels which businessmen assign to their contracts,²² and they will attempt to ascertain the true intent of the parties.²³ A sale by any name will be subject to Article 2 of the UCC, for any other rule would allow evasion of the statute simply by retitling the documents involved.

The provisions for non-cancellation²⁴ and the lessee's responsibility for maintenance²⁵ contained in the *Sawyer* contract have sometimes been viewed as evidence of a sale rather than a lease. This is especially persuasive when, as here, the aggregate rental costs approximate the sale price of the chattel. On this basis, the Arkansas court could have considered the transaction a sale. In this case, however, such a conclusion would be attenuated for two reasons. First, non-cancellation and lessee's responsibility for maintenance are neither solely referable to a sale nor incompatible with a lease. In those cases where these elements aided the finding of a sale, other factors were present which are absent in the instant case.²⁶ Secondly, the *Sawyer* lease stated that the

20. U.C.C. §§ 2-313 to -316 (ARK. STAT. ANN. §§ 85-2-313 to 85-2-316 (Add. 1961)).

21. U.C.C. §§ 1-201(37), 9-102(2), 9-105(1)(h).

22. See *Tishman Equipment Leasing, Inc. v. Levin*, 152 Conn. 23, 28, 202 A.2d 504, 507 (1964).

23. *Id.* at 29, 202 A.2d at 507, wherein the court states that:

In the determination of actual intent and purpose of the transaction, the negotiations surrounding it may properly be considered. . . .

24. See *Southwestern Truck Sales & Rental Co. v. Johnson*, 165 Neb. 407, 416, 85 N.W.2d 705, 710 (1957).

25. See *American Can Co. v. U.S. Canning Corp.*, 12 Misc. 2d 750, 755, 170 N.Y.S.2d 727, 732 (Manhattan Mun. Ct. 1958).

26. *American Can Co. v. U.S. Canning Corp.*, 12 Misc. 2d 750, 170 N.Y.S.2d 727 (Manhattan Mun. Ct. 1958) (responsibility for maintenance coupled with a written attached conditional sales contract); *Southwestern Truck Sales & Rental Co. v. Johnson*, 165 Neb. 407, 85 N.W.2d 705 (1957) (dominant theme of agreement was lessor getting full benefits of lease coupled with no set term for the lease to run).

machine was to be returned to the lessor upon the expiration of the term.²⁷ This suggests that equitable title, the passage of which is essential to a finding of a conditional sale,²⁸ did not pass to Sawyer under this instrument. Judicial rhetoric notwithstanding, courts should be loath to recast an agreement on the basis of isolated promises which only arguably change the character of the contract.²⁹ Therefore, it is submitted that, while the *Sawyer* court could have held this agreement to be a sale, it was correct in refusing to do so.

A second alternative route by which the *Sawyer* result could have been reached is reasoning by analogy from the UCC provisions, as advocated by the Farnsworth article.³⁰ This technique recognizes that uniform code legislation presents unusually fertile ground in which search for broad legislative policies need not be confined to the scope of statutes which manifest them. The liberal warranty provisions of the Code³¹ and the requirement that effective disclaimers must be written and conspicuous³² were engendered by the realization that the recipient of goods in a commercial transaction must often rely on the supplier's skill and judgment in providing goods suited for their intended purpose.³³ Legal niceties in this area, such as the allowance of vague "fine print disclaimers," would bait many traps for the unwary businessman. The fact that law makers have chosen to codify this policy with regard to sales contracts should encourage, rather than dissuade, courts to apply similar reasoning when faced with identical dangers in non-sales situations. The courts which have adopted this technique are to be applauded.³⁴ This, however, is not reasoning by

27. See note 1 *supra*.

28. See *Tishman Equipment Leasing, Inc. v. Levin*, 152 Conn. 23, 28, 202 A.2d 504, 507 (1964).

29. *Id.*; *Burton v. Tatelbaum*, 240 Md. 280, 213 A.2d 875 (1965).

30. Farnsworth, *supra* note 7.

31. See U.C.C. §§ 2-312 to -318.

32. U.C.C. § 2-316.

33. See, e.g., U.C.C. § 2-315, comment 1.

34. See *Stern & Co. v. State Loan & Fin. Corp.*, 238 F. Supp. 901 (D. Del. 1965) (holding that U.C.C. § 2-105 which embodies the parol evidence rule may be applied by analogy in order to interpret contracts for the sale of investment securities, although such securities are not specifically mentioned in the section); *Transatlantic Financing Corp. v. United States*, 363 F.2d 312 (D.C. Cir. 1966) (holding that the principles set out in U.C.C. §§ 2-614 and 2-615 as to impossibility or improbability and substituted performance in sales contracts may be applied to analogous situations such as transport charters); *Hunt Foods & Indus., Inc. v. Doliner*, 49 Misc. 2d 246, 267 N.Y.S.2d 364, *rev'd on other grounds*, 26 App. Div. 2d 41, 270 N.Y.S.2d 937 (1966) (holding that the principles set out in U.C.C. §§ 2-102 and 2-202 which, in terms, are only applicable to goods, have policy

analogy as the Arkansas court understood it. The analogies in *Sawyer* were drawn between sales contracts and the lease in question, and once the similarity was verified, the court applied the specific Code provision rather than the policy underlying it. True, many broadly stated sections of the UCC are little more than the enunciation of a policy, but other sections are phrased with great specificity. The fact that parties to a non-sales transaction have not met the letter of the sales provisions of the UCC should not give courts cause to declare the agreement a nullity if the parties have conducted their business in a manner which serves the policies as well. Certainly, an extension of common law based on an expression of legislative intent is preferable to inclusion by judicial legislation.

As is often the case when judicial action is unsupported by theoretical justification, two problems of a more practical nature now confront Arkansas lessors. The court held that Section 2-316(2) will apply to leases "where the provisions of the lease are analogous to a sale,"³⁵ but it failed adequately to discuss what kinds of provisions will cause the analogy to be drawn. The factors most influential on the court were (1) the imposition upon the lessee of the duty to repair and maintain the machine, (2) the non-cancellable term, and (3) a vague oral option to buy. When these are present, the court finds that "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."³⁶ Whether all of these are required and whether the same result would obtain if other provisions were substituted are questions which the lessor must resolve at his peril.

After stating that its holding leaves all other Code provisions unaffected, the court inquired, "After all, what legitimate objection can be made to using type (for the disclaimer) that is conspicuous?"³⁷ But

considerations underlying them that are an appropriate criterion in determining other contract situations, in that case, an option for the sale of stock).

These "analogy cases" seem to share two basic premises. First, that while the Code does not provide all the answers to the multitude of intricacies which may possibly arise in commercial transactions, one of the uniform laws' intended purposes is to serve as a guide in resolving disputes not within its express provisions. And, secondly, that the process of reasoning by analogy lays bare the real reasons for the existence of the Code, reasons which could be too easily obscured if judicial decisions came to rest ultimately upon the denomination of a particular business transaction.

These cases, unlike *Sawyer*, also attempt to offer additional support for their decisions by reasoning from basic contract law.

35. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, —, 428 S.W.2d 46, 54 (1968).

36. *Id.*

37. *Id.*

the justice of this result should not be allowed to obscure its shortcomings. Not only must the lessor now be appraised that a single Code provision—not apposite on its face—will be applied to his contract, he must protect himself by attempting to divine which additional provisions of the sales law the courts may later feel constrained to superimpose upon his transactions. To answer that this lessor may fully protect himself merely by complying with the relevant sections of Article 2 begs the question. The businessman should not legally be held to a higher standard than the legislature requires of him.

It is submitted that the Arkansas court, while reaching what was surely a just result, did so at the sacrifice of the clarity and stability which uniform commercial laws were designed to promote. It is possible that the *Sawyer* decision could lead to the indiscriminate application of Uniform Commercial Code provisions to leases—a result having the potential to introduce chaos into commercial transactions in Arkansas. It is more likely that this decision will herald the selective application of Code sections to non-sales transactions—a result almost equally burdensome upon Arkansas businessmen. The alternatives suggested present problems of their own, but they would afford remedies to those in Sawyer's situation without seriously undermining the purpose and effectiveness of the uniform commercial laws.