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## Uniform Commercial Code—Disclaimer Clause of Implied Warranties Extended to Leases Analogous to Sale

Pioneer Leasing Corporation<sup>1</sup> brought suit to recover the balance due from a lessee under a sixty-month, non-cancellable lease of an ice-making machine. The lease contained a general provision disclaiming any warranties or representations regarding the leased item.<sup>2</sup> Sawyer, the lessee, discontinued payments under the lease, asserting that the lease was procured by misrepresentation<sup>3</sup> and that the machine was not fit for its intended purpose. The trial court rejected this assertion and directed a verdict in favor of the lessor for the unpaid balance. *Held, reversed*: The provisions of the Arkansas Uniform Commercial Code governing disclaimer of implied warranty of merchantability and implied warranty of fitness are applicable to leases where the provisions of the lease are analogous to a sale. *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, 428 S.W.2d 46 (1968).

### I. THE DEVELOPMENT OF THE SALES CONCEPT—LEASE OR SALE

The basic concept of what constitutes a sale has been codified and refined since 1893, originally adopting as its basis the common law definition of a sale.<sup>4</sup> But the problem of whether or not a lease agreement is included within the definition of a sale has remained unsettled. As a general rule courts did not interpret the Uniform Sales Act to include a lease within its definition of sale because the term sale implied passage of absolute title.<sup>5</sup> Similar to the general rule under the Uniform Sales Act, most writers<sup>6</sup> apparently would agree that article 2 of the Uniform Commercial Code was intended to cover only traditional sales transactions. Indeed, one source has stated specifically that a lease is not within the scope of transactions intended to be covered by article 2,<sup>7</sup> reasoning that article 2

<sup>1</sup> Pioneer is a Delaware corporation engaged in the equipment leasing business. A sales agent of the supplier of the ice machine represented the machine to Sawyer and secured the signed lease. Thereafter, Pioneer purchased the machine from the supplier.

<sup>2</sup> Clause five of the lease provided that "No warranties or representations regarding the items herein leased or their condition, quality, or suitability, or their freedom from latent defects, have been made or shall be deemed to be made by the Lessor, and Lessee has selected the items leased and the same have been delivered to Lessee at Lessee's sole risk and discretion."

<sup>3</sup> The sales agent representing the supplier told Sawyer that the capacity of the machine was 400 pounds per day, and that it would function equally well inside or outside. In addition, literature produced by the agent substantiated this capacity and mentioned "winterized" features of the machine. Sawyer placed the machine outside and it functioned properly for about six months; then at the first cold spell it malfunctioned. Sawyer spent \$200 during the winter and spring attempting to correct the malfunction, but was unsuccessful. Shortly thereafter Sawyer stopped all lease payments.

<sup>4</sup> At common law a sale was defined as a transfer of property from one person to another for a consideration of value. *Howard v. Harris*, 8 Allen (Mass.) 297, 299 (1864). The Sales Act codified this reasoning and defined a sale as "an agreement whereby the seller transfers the property in goods to the buyer for a consideration called the price . . ." UNIFORM SALES ACT § 1(2); L. VOLD, *THE LAW OF SALES* 9 (1959). The Uniform Commercial Code superseded the Sales Act and defined the sale as "the passing of title from the seller to the buyer for a price." UNIFORM COMMERCIAL CODE § 2-106(1).

<sup>5</sup> *Arnold v. North Am. Chem. Co.*, 232 Mass. 196, 122 N.E. 283 (1919).

<sup>6</sup> J. RAPHAEL, *UNIFORM COMMERCIAL CODE SIMPLIFIED* 3 (1967); Minish, *The UCC in Minnesota: Articles 2 and 6—Sales and Bulk Transfers*, 50 MINN. L. REV. 103 (1965); Spies, *Article II*, 16 ARK. L. REV. 6-7 (1961).

<sup>7</sup> For example, if the lessee was by terms of the agreement to become owner or have the option of becoming owner, the courts tended to look through the form to the substance and treat the

applies only to business transactions where actual title is transferred. However, believing that a lease passes ownership of a limited right short of complete title, some courts have created exceptions treating a lease as a form of sale.<sup>8</sup>

## II. EXPRESS AND IMPLIED WARRANTIES

An express warranty at common law arose from a simple representation or affirmation regarding the sales property. The expression could be oral or written, and was not restricted by the limitations placed upon implied warranties.<sup>9</sup> An implied warranty, however, was a creation of the common law, designed to impose an obligation upon the seller under certain circumstances, without regard to the parties' intentions or the terms of any agreement.<sup>10</sup>

Implied warranties at common law were divided into two main categories—implied warranty of fitness and implied warranty of merchantability. An implied warranty of fitness arose only where it could be implied from the circumstances of the sale; otherwise, the common law maxim of *caveat emptor* applied.<sup>11</sup> However, where the buyer indicated that he was purchasing the goods for a particular purpose and relied upon the seller's skill and judgment to assist him in his selection, an implied warranty arose that the goods would be fit for that particular purpose.<sup>12</sup> The Code continues the common law concepts, imposing an implied warranty that the goods are fit for the particular purpose for which the buyer sought the goods, provided the seller has reason to know of this purpose, and provided the buyer relies on the skill or judgment of the seller.<sup>13</sup>

The implied warranty of merchantability has been limited traditionally to sellers who dealt in goods of a particular description.<sup>14</sup> Under the Code,

lease as a conditional sale. See *First Nat'l Bank v. Phillips*, 261 F.2d 588 (5th Cir. 1958); *In re Press Printers & Publishers*, 4 F.2d 159 (D.N.J. 1924); *Imbesi v. Eastern Motor Co.*, 102 N.J.L. 193, 130 A. 611 (Ct. Err. & App. 1925); *Siffran v. Grillo*, 4 N.J. Misc. 618, 133 A. 772 (Sup. Ct. 1926). If the option was exercisable at a nominal price, some courts viewed the arrangement as a conditional sale. See *Kennedy-Van Saun Mfg. Co. & Eng'r Corp. v. Kinsella*, 72 F.2d 338 (3d Cir. 1934); *Burroughs Adding Mach. Co. v. Bogdon*, 9 F.2d 54 (8th Cir. 1925); L. VOLD, *THE LAW OF SALES* 328-9 (1959). However, if the option could only be exercised by paying a substantial additional amount, the courts usually considered the agreement a lease. See *In re Nat'l Eng'r & Equip. Co.*, 256 F. 985 (W.D. Wash. 1918); *Wellman v. Conroy*, 50 Cal. App. 141, 194 P. 728 (1921). Even if both parties intended not to form a sale and stipulated a lease arrangement, the courts nevertheless have treated the lease as a conditional sale if inexpensive lease options were present. See *Am. Can Co. v. White*, 130 Ark. 381, 197 S.W. 695 (1917). 1 F. MECHEN, *LAW OF SALE OF PERSONAL PROPERTY* 569 (1901), lists a long string of cases where such leases were held to be conditional sales contracts. Where the lessor reserved the right to resume possession upon default of the lease, the courts continued to treat the lease as a conditional sale. See *Hervey v. R.I. Locomotive Works*, 93 U.S. 664 (1876); *Hays v. Jordan*, 85 Ga. 741, 11 S.E. 833 (1890); *Smith v. Aldrich*, 180 Mass. 367, 62 N.E. 381 (1902); *Campbell v. Atherton*, 92 Me. 66, 42 A. 232 (1898).

<sup>8</sup> C. BUNN, H. SNEAD, & R. SPEIDEL, *AN INTRODUCTION TO THE UNIFORM COMMERCIAL CODE* 30 (1964).

<sup>9</sup> 77 C.J.S. *Sales* § 308 (1952).

<sup>10</sup> 46 AM. JUR. *Sales* § 332 (1943).

<sup>11</sup> *Barnard v. Kellogg*, 77 U.S. (10 Wall.) 383 (1870); *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298 (1863); F. TIFFANY, *LAW OF SALES* § 78 (1908).

<sup>12</sup> *Kellogg Bridge Co. v. Hamilton*, 110 U.S. 108 (1883); *Breen v. Moran*, 51 Minn. 525, 53 N.W. 755 (1892); F. TIFFANY, *LAW OF SALES* § 78 (1908).

<sup>13</sup> UNIFORM COMMERCIAL CODE § 2-315.

<sup>14</sup> UNIFORM SALES ACT § 15(2); W. MALCOLM, *THE UNIFORM COMMERCIAL CODE, UNIFORM COMMERCIAL CODE HANDBOOK* 36-7 (1964).

however, the requisite of sale by description is eliminated and if the seller is a merchant who deals with the goods sold, a warranty of merchantability is implied unless expressly excluded or modified by disclaimer.<sup>15</sup>

Authorities have long advocated the idea of extending the protection of implied warranties, both of fitness and merchantability, to leases as well as to sales transactions.<sup>16</sup> However, the courts have been willing thus far to extend the protection of implied warranties of fitness, but not implied warranties of merchantability.<sup>17</sup>

Prior to the Code a disclaimer of any warranty in the agreement, either express or implied, was valid if it appeared anywhere in the contract, and if its existence and nature were understood as a term of the bargain.<sup>18</sup> The effect of such a disclaimer was to make inoperative and invalid any affirmations or representations on a sale.<sup>19</sup> Under the Code, disclaimers of an implied warranty of merchantability and an implied warranty of fitness must be conspicuous,<sup>20</sup> so that reasonable persons "ought to have noticed it."<sup>21</sup>

### III. SAWYER V. PIONEER LEASING CORP.

In *Sawyer* the court was faced with the problem of deciding whether the lessor of an ice-making machine could recover the balance due from a lessee who refused to make further payments when the machine proved to be unfit for its intended purpose. The *Sawyer* court concluded that no express warranties had been made by the salesman<sup>22</sup> who negotiated the lease. However, the court rejected the contention that proper functioning of the machine for six months (approximately one-tenth of the total lease period) would satisfy any implied warranty, reasoning that an implied warranty would extend beyond this fractional period. The court also felt that the disclaimer clause in the lease agreement did not comply with the

<sup>15</sup> UNIFORM COMMERCIAL CODE § 2-314.

<sup>16</sup> 2 F. HARPER & F. JAMES, TORTS § 28.19 (1956); L. VOLD, THE LAW OF SALES § 94 (1959); Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653, 673-4 (1957); Annot. 68 A.L.R.2d 850 (1959).

<sup>17</sup> *Interstate Grocery Co. v. Southern Shell & Fish Co.*, 228 Ark. 118, 305 S.W.2d 850 (1957); *Cintrone v. Hertz Truck Leasing*, 45 N.J. 434, 212 A.2d 769 (1965); *Demos Constr. Co. v. Service Supply Corp.*, 153 Pa. Super. 623, 34 A.2d 828 (1943); *Hartford Battery Sales Corp. v. Prine*, 119 Pa. Super. 165, 181 A. 95 (1935); *Simpson v. Powder Prod., Inc.*, 24 Conn. Super. 409, 192 A.2d 555 (1963); *Henry v. Hostetler*, 3 U.C.C. REP. 614 (1966).

<sup>18</sup> *Asphaltic Enterprises, Inc. v. Baldwin-Lima-Hamilton Corp.*, 39 F.R.D. 574 (1966); *Buckley v. Shell Chem. Co.*, 32 Cal. App. 2d 209, 89 P.2d 453 (1939); *Belt Seed Co. v. Mitchelhill Seed Co.*, 236 Mo. App. 142, 153 S.W.2d 106, 108-9 (1941); *Railroad Winterproofing Corp. v. Memphis Supply, Inc.*, 303 N.Y. 849, 104 N.E.2d 486 (1952).

<sup>19</sup> 77 C.J.S. *Sales* § 312(c) (1952).

<sup>20</sup> UNIFORM COMMERCIAL CODE § 2-316(2). For fitness the disclaimer may be in general language as long as it is in writing and is conspicuous; for merchantability the disclaimer must mention merchantability and be conspicuous if in writing.

<sup>21</sup> UNIFORM COMMERCIAL CODE § 1-201(10).

<sup>22</sup> *Barnett*, the person with whom *Sawyer* initially dealt in purchasing the machine, was a sales agent for the supplier of the equipment, Tri-State Ice Machine Company. The court, in resolving *Pioneer's* contention that *Barnett* was not an agent of *Pioneer*, reiterated its holding in *Mark v. Maberry*, 222 Ark. 357, 260 S.W.2d 455 (1953), where it had held that one who accepts the fruit of another's agency in the sale of property cannot subsequently be heard to disclaim such agency. Applied to the facts of this case, the agency was established because *Pioneer* had accepted the fruits of the lease.

disclaimer clause requirements of the Code because it was not conspicuous.<sup>23</sup>

Although the Arkansas supreme court recognized that the lease agreement was not a sale,<sup>24</sup> it relied upon four authorities to justify extension of the disclaimer clause of the Code to this lease. The first authority<sup>25</sup> substantiated the practice of extending implied warranties to non-sale cases including leases, contending that transactions similar to sales should and could enjoy the protection of implied warranties by a process of analogy. The second authority<sup>26</sup> advocated a similar process of analogy reasoning that article 2 could be applicable to those leases which have terms similar to a sale. Based upon these two authorities, the court drew its conclusion that "there is respectable authority for applying code provisions in some instances where the transaction is analogous to a sale."<sup>27</sup>

Recognizing that the two authorities discussed above did not discuss the exact point in issue, the disclaimer clause, the court cited two cases to point out that application of the disclaimer provisions to a lease agreement had received judicial recognition. First, the court relied upon a New York case<sup>28</sup> in which the lessee had contended that a lease was unconscionable and within section 2-302 of the Code. The Arkansas court reasoned that the issue of Code disclaimer provisions in the New York case had been urged as applicable to leases, and would have merited a point of reversal. Secondly, a tort case<sup>29</sup> involving breach of warranty of fitness, but decided under common law, was noted as authority for application of implied warranties to leases. There the court held that a contract for leasing a truck gave rise to an implied warranty that it was fit for contemplated use by the injured plaintiff's employer. The Arkansas court felt the same rationale for applying the warranty to leases in tort cases also justified application in contract cases.

The Arkansas supreme court was confronted with a lessee seemingly unjustly harmed, but without any apparent remedy because the lease disclaimer clause would have satisfied the common law elements of effective waiver.<sup>30</sup> Thus the lessee would have had no remedy unless the court could bring the arrangement within the protective umbrella of the Code, or interpret the arrangement to be a sale. The court did not interpret the lease as a sale because of the redelivery provision, but pursued the idea of bringing the lease within the Code by the process of analogy. The court applied only the disclaimer provision of the Code to leases because it was the only issue necessarily before the court, and apparently because the

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<sup>23</sup> UNIFORM COMMERCIAL CODE § 2-316(2) requires that the disclaimer clause be conspicuous, and the clause in this lease was noted by the court to be in very small print.

<sup>24</sup> Clause eight called for immediate redelivery of the leased goods to the lessor at termination of the lease term, thus under the terms of the agreement no sale was involved.

<sup>25</sup> Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653 (1957).

<sup>26</sup> F. HART & W. WILLIER, *FORMS AND PROCEDURES UNDER THE UNIFORM COMMERCIAL CODE* § 12.02(1) (1966).

<sup>27</sup> *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, 428 S.W.2d 46, 52 (1968).

<sup>28</sup> *Fairfield Lease Corp. v. Colonial Aluminum Sales, Inc.*, 3 U.C.C. REP. 858 (1966).

<sup>29</sup> *Cintrone v. Hertz Truck Leasing*, 45 N.J. 434, 212 A.2d 769 (1965).

<sup>30</sup> 77 C.J.S. *Sales* 312(c) (1952).

application of Code provisions to leases was an unusual and somewhat unprecedented practice.

The court seemed to be using the Code as a vehicle to reach a desired result by applying only one section of the Code to the lease. If Sawyer were made subject to the duties of the Code, in addition to enjoying its protection, it is possible that his conduct would have constituted an effective waiver of any breach of warranty, either under common law or under the Code, because he may not have rejected the goods within a reasonable time after discovery of the breach.<sup>31</sup>

Justice Fogleman, in his dissent, raised the question of whether the authority cited by the majority warranted the extension of the Code disclaimer provision to leases. He pointed out that only the accepted practice of extending the common law implied warranty doctrine to leases had been fully established by the majority opinion.<sup>32</sup> He further asserted that if this doctrine had been applied in this case a different result would have been reached since the printed disclaimer clause in the lease would have constituted an effective disclaimer of all warranties and representations.<sup>33</sup> In accusing the court of acting "legislatively,"<sup>34</sup> he was critical of the failure of the majority opinion to establish workable guidelines for determining when a lease is sufficiently analogous to a sale to justify extension of the disclaimer provision of the Code.

#### IV. CONCLUSION

In its extension of the disclaimer clause provisions to leases which are analogous to sales, the Arkansas supreme court has made a noteworthy application of the Uniform Commercial Code. Partial justification for this action may be found in the accepted practice of extending the common law implied warranty doctrine to leases, and the past line of cases, not involving the Code, where the courts have imposed strict liability either in warranty or tort on various non-sale transactions.<sup>35</sup> Further support might be found in one recent extension of the Code where the implied warranty provisions were made applicable to a beauty operator applying a permanent wave treatment.<sup>36</sup> But aside from this partial justification this court has ignored a long line of cases requiring a basic contract of sale in

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<sup>31</sup> Such contentions were expressed by Pioneer upon petition for rehearing before the Arkansas supreme court, relying upon UNIFORM COMMERCIAL CODE § 2-606, and *Green Chevrolet Co. v. Kemp*, 241 Ark. 62, 406 S.W.2d 142 (1966). It is interesting to note that this same Arkansas court did apply the waiver conditioned upon failure to give timely notice to a case similar to *Sawyer*. See *Ingle v. Marked Tree Equip. Co.*, 244 Ark. 1166, 428 S.W.2d 286 (1968), also appearing in 5 U.C.C. REP. 466 (1968). There the buyer attempted to raise the defense of breach of warranty but was precluded because of a two-month delay in giving notice of the breach. In *Sawyer* six months lapsed after initial discovery of the malfunction until notice was given of intent not to be bound by the terms of the lease.

<sup>32</sup> The support for this doctrine appears in cases and authorities cited notes 17, 18, and 25 *supra*.

<sup>33</sup> 77 C.J.S. *Sales* § 312(c) (1952).

<sup>34</sup> *Sawyer v. Pioneer Leasing Corp.*, 244 Ark. 943, 428 S.W.2d 46, 55 (1968).

<sup>35</sup> 11 AM. TRIAL LAWYERS ASS'N NEWS LETTER 424-5 (1968). In discussing the Newmark case, note 36 *infra*, it cites a long line of cases holding that strict liability of warranty is properly applicable to certain non-sale transactions.

<sup>36</sup> *Newmark v. Gimbel's Inc.*, 102 N.J. Super. 279, 246 A.2d 11 (Super. Ct. 1968).

order to apply the warranty Code provisions upon which section 2-316(2) rests.<sup>37</sup>

Whether other state courts follow the Arkansas precedent will depend upon their willingness to extend the application of the Code to such cases. In Texas the separation of sale and lease has been well defined by the courts.<sup>38</sup> However, a recent Texas case<sup>39</sup> has held that the nature of an agreement, whether a lease or a conditional sale, is to be determined by the intention of the parties. It seems plausible that this test could be applied to *Sawyer*-like facts to determine that the transaction was a conditional sale under the Code. Thus Texas could possibly accord protection to leases analogous to sales by changing their title to conditional sales through the intention test without having to distort the Code.

The *Sawyer* court appears to have reached an equitable result in extending the disclaimer provision of the Code to this lease. With the frequency and acceptability of lease arrangements in today's commercial and economic society, justice might very well be best served by bringing leases analogous to sales within the Code. But such expansion of the Code could best be accomplished by legislative enactments in the various states designed to make all provisions of article 2 applicable to the lease analogous to a sale, and thus help preserve the nation-wide uniformity of commercial law under the Code.

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<sup>37</sup> As pertains to the implied warranty of merchantability, UNIFORM COMMERCIAL CODE § 2-314, see *Cheshire v. Southhampton Hosp. Ass'n*, 53 Misc. 2d 355, 278 N.Y.S.2d 531 (Sup. Ct. 1967); *Aegis Prod., Inc. v. Arriflex Corp. of America*, 25 App. Div. 2d 639, 268 N.Y.S.2d 185 (1966); *Victor v. Barzaleski*, 19 Pa. D. & C.2d 698 (1960). As pertains to the implied warranty of fitness, UNIFORM COMMERCIAL CODE § 2-315, see *Amacorp Indus. Leasing Co. v. Robert C. Young Ass'n*, 237 Cal. App. 2d 724, 47 Cal. Rptr. 294 (1965); *Sylvia Coal Co. v. Mercury Coal & Coke Co.*, 151 W. Va. 818, 156 S.E.2d 1 (1967).

<sup>38</sup> Although Texas did not adopt the Uniform Sales Act, it has long been recognized in Texas that an agreement for lease of personal property which requires the lessee to return and redeliver the property at the expiration of the lease term is a form of bailment, and not a sale. See *Hamilton v. Willing*, 73 Tex. 603, 11 S.W. 843 (1889); *Lang v. Rickmers*, 70 Tex. 108, 7 S.W. 527 (1888); *Mitchell v. Eagle Creek Oil Co.*, 275 S.W. 211 (Tex. Civ. App. 1925); *McElwrath & Rogers v. Alexander*, 250 S.W. 1051 (Tex. Civ. App. 1923), *error dismissed*; *Farmers Nat'l Bank v. Henderson*, 29 S.W. 562 (Tex. Civ. App. 1895). It has been equally well established in Texas that in order to constitute a sale there must be a vesting of title in the buyer. See *J.C. Engleman, Inc. v. Sanders Nursery Co.*, 140 S.W.2d 500 (Tex. Civ. App. 1940), *error ref.* The Uniform Commercial Code became law in Texas on 1 July 1966, and now comprises Tex. Bus. & COMM. CODE §§ 1.101-9.507 (1967).

<sup>39</sup> *Security Life Ins. Co. v. Executive Car Leasing Co.*, 433 S.W.2d 915 (Tex. Civ. App. 1968). This case cites as support for its intention test *Purity Creamery Co. v. Hays*, 4 S.W.2d 1056 (Tex. Civ. App. 1928), where the holding was reversed because the lower court had construed the contract as a sale in the face of the parties' intention not to form a sale, but a rental contract.