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Construction Contracting: Building Better Law with the Uniform Commercial Code

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CONSTRUCTION CONTRACTING:

BUILDING BETTER LAW WITH THE
UNIFORM COMMERCIAL CODE

INTRODUCTION

The construction industry is the largest production sector in the United States economy, representing about thirteen percent of the gross national product with $500 billion in annual expenditures. While the volume and complexity of the business done in the industry calls for a definitive body of contract law, no such body of law exists. Construction contract law is a confusing mix of the common law and Article 2 of the Uniform Commercial Code ("UCC"), with no way to predict which will apply—or whether both will apply—to a particular case. Besides being confusing, the law does not adequately address two of the industry's biggest problems: (1) the unequal balance of power among the numerous parties to a construction contract, and (2) the large amount of time-consuming, costly litigation resulting from contract disputes.

In fact, since the law is unclear and unpredictable, the two problems are exacerbated. Parties have no clear statement regarding the proper balance of power, so those with more power can take advantage in contracting. In addition, parties continue to litigate because where there is no strong precedent, each party can be convinced that it will prevail. Because of the industry’s impact on the economy and on our lives, it is imperative that contract law be clarified in a way that responds to the industry’s unique problems. Applying Article 2 of the UCC to construction contracts can both clarify the law and make the law more responsive to construction disputes.

Part I of this Note describes the concerns in the construction industry that should be addressed by the law and surveys the law currently being applied to construction contracts. Part II proposes that to solve the problems with the current approaches and to address the concerns of the construction industry, the UCC should be applied universally to all construction contracts that combine goods and ser-

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vices. Part III demonstrates the ways in which the industry would be affected by application of the UCC, including the benefits and problems such an application would create. Overall, the benefits outweigh the problems, and consideration should be given to ways in which the UCC can become the body of law governing sales-service construction contracts.

I. THE PROBLEM

A. Construction Industry Concerns

A basic construction contract includes an owner who pays to have something built, an engineer or architect who designs what the owner wants, and a contractor who builds based on the design. Most projects also include subcontractors, and these subcontractors can hire their own subcontractors. Additionally, the contractors and subcontractors hire suppliers to provide the necessary materials. Each relationship requires a contract, and of course each party wants to protect its interests. The party with the greatest bargaining power and legal resources, usually the owner, has the upper hand when it comes to contract terms. The resulting imbalance of bargaining power and tendency for risk-shifting leads not only to unfair contracts, but also to poor working relationships between owners, contractors, subcontractors, and suppliers, most of whom work with the same company more than once.

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2 The definition of "construction" in this Note is a broad one. The word is used to refer to both commercial and residential construction, including the entire spectrum of associated work. See KEITH COLLIER, CONSTRUCTION CONTRACTS 25 (1979) ("Construction work may be described as the planned integration of materials and components on a permanent site by means of skilled labor using tools and equipment to produce a permanent fixture to the land according to a special design, including any fabrication which is done elsewhere according to the design of the work prior to its integration into the work at the site.").

3 See Stipanowich, supra note 1, at 474 ("[O]n a typical commercial construction project, at least half of the work will be performed by subcontractors.").

4 See JEREMIAH D. LAMBERT & LAWRENCE WHITE, HANDBOOK OF MODERN CONSTRUCTION LAW 27-28 (1982) ("Like commercial contracts in other fields, construction contracts are designed to achieve two goals: to define the practical and legal responsibilities of the contracting parties (often in cumbersome technical language that itself reflects generations of litigation and judicial precedent) and to shift common-law risks and liabilities in favor of the party with the greater amount of negotiating leverage."). See also Mark L. McAlpine & David A. Breuch, A Uniform Construction Law Code: Is There a Foundation to Build On?, 74 MICH. B.J. 554, 559 n.12 (1995) (pointing out that the excess of construction services in today’s economy leads to an owner’s market, allowing onerous contracts, and stating that these contracts, coupled with low profit margins, lead contractors to seek additional compensation in the courts).

5 See Stipanowich, supra note 1, at 478 (discussing a study by the Construction Industry Institute that showed evidence of "antagonism and mistrust" between owners and contractors).
Because the construction industry involves multiple parties and complex problems, disputes are inevitable, and litigation often results. Construction litigation is lengthy and expensive, with total litigation costs sometimes exceeding the amount in controversy.

B. The Current State of Construction Contract Law

Construction contracts are typically governed by common law contract principles. In addition to these common law rules, standard contract forms prepared by industry groups—most notably the American Institute of Architects ("AIA") and Associated General Contractors of America ("AGC")—can influence the formation of construction contracts. The industry-endorsed forms provide templates that can be used without changes as a project's contract or as a sample for language to be integrated into an original contract. The forms provide guidance on contract terms and conditions, making the process of drafting contracts less time-consuming and less costly. By creating standard forms, the construction industry has "demonstrate[d] that it is possible to achieve certain basic industry agreements on the standards for contractual risk allocations in various project settings." However, there is no uniformity in the use of the forms; they are not used on all projects. Nor do the forms provide rules for contract interpretation, the area in which the industry needs the most assistance. In addition, those implementing the standard contract forms must keep in mind that each one is sponsored by a specific industry group and may reflect the contracting preferences of that group.

The UCC, first published in 1951 and most recently amended in 2001, added to the potential body of construction contracting law. Of the ten articles dealing with specific subject matter, Article 2 (Sales) is most applicable to the construction industry. Article 2 "applies to

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6 Some of the most common sources of construction disputes include mistakes in bids, delays on the projects, and changes to the work. See H. Murray Horns, Preventing and Solving Construction Contract Disputes 7, 25 (1979); Lambert & White, supra note 4, at 223-24. See also Horns, supra, at 25 ("Nearly everyone in the construction industry is involved in a dispute today.").

7 See Brian M. Samuels, Construction Law 1 (1996).

8 McAlpine & Breuch, supra note 4, at 556.

9 See id. at 559 n.6 (citing an AGC survey showing that the AIA general conditions form was always modified in 30% to 40% of projects, sometimes or often modified in 35% to 55%, and never modified in less than 20%).

transactions in goods,” and defines goods as “all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale.” All construction contracts include goods, but they also involve services. Courts label such mixed goods/services contracts as “hybrid” contracts. While the UCC does not explicitly state that Article 2 is inapplicable to hybrid contracts, courts have strictly adhered to the common law separation of goods and services and have assumed that since hybrid contracts involve an element of service, the UCC is not directly applicable.

Since courts do not view hybrid contracts as UCC contracts per se, they have struggled to interpret the contracts on a case-by-case basis to determine whether the UCC should apply. As stated by Professors White and Summers, “[j]udges and litigants frequently face difficulty and uncertainty in determining whether the Code applies to such hybrid transactions. Areas of continuous dispute include construction contracts . . . .” Courts have developed three different approaches in an effort to provide guidelines for the application of Article 2 to hybrid contracts: the predominant factor test, contract bifurcation, and comparison to the UCC by analogy. As detailed in the sections that follow, each approach has problems with predictability and uniformity; however, the mere existence of the approaches demonstrates that courts are quite willing to apply Article 2 to hybrid contracts.

1. The Predominant Factor Test

The predominant factor test is the most frequently used approach to hybrid contracts. In applying the test, the court first determines whether goods or services predominate in the transaction. Some fac-

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12 Id. § 2-105(1).
13 The discussion in this Note excludes architectural, engineering, and design work done on construction projects, because such work does not include goods.
14 See Diane J. Ault, Note, Contracts for Goods and Services and Article 2 of the Uniform Commercial Code, 9 Rutgers-Cam. L.J. 303, 308 (1978) (“Nowhere is it stated in Article 2 that that article of the UCC is inapplicable to contracts involving goods and services.”).
16 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 343 (5th ed. 2000). See also Stipanowich, supra note 1, at 512 (explaining that the interpretation of a hybrid contract is “likely to lead to unpredictable or irrational results”).
17 Legal scholars have defined other tests used by courts, such as the goods supplied test, in which the UCC applies if goods are part of the contract, and the final product test, in which the UCC applies if the final product is a good. These tests are similar to the predominant factor test in that they involve a preliminary distinction between goods and services. See Ault, supra note 14, at 303.
tors taken into consideration include: the percentage of the contract cost dedicated to goods compared with that dedicated to services, whether the contract price was listed in one sum or whether costs for services were separated, and contract language. If the court determines that services predominate, common law principles apply. If the court determines that goods predominate, Article 2 of the UCC applies to the entire contract.

Perlmutter v. Beth David Hospital\textsuperscript{18} is often cited as the source of the predominant purpose test. This pre-UCC Sales Act case involved a blood transfusion provided as part of the plaintiff’s treatment in the hospital. The blood was infected with hepatitis, and the plaintiff became ill. The plaintiff sought warranty protection under the Sales Act, arguing that the transaction between the hospital and patient was a sale. The court disagreed, holding that the contract was "clearly one for services."\textsuperscript{19} The court went on to say: "It has long been recognized that, when service predominates, and transfer of personal property is but an incidental feature of the transaction, the transaction is not deemed a sale within the Sales Act."\textsuperscript{20} This statement by the court is the one on which other courts have focused in applying the predominant factor test to other contracts under the UCC.\textsuperscript{21}

While grasping onto the sales-service distinction wholeheartedly, courts have ignored the underlying rationale of the Perlmutter court, which was unique to the medical setting and sought to protect hospitals from strict liability for outcomes that cannot be predicted.\textsuperscript{22} Courts have applied the test to many contracts outside the medical realm, without regard to policy. This approach results in an overemphasis on the sales-service distinction and not enough emphasis on the facts of each individual case:

Subsequent courts, bound by their jurisdiction’s version of the Perlmutter sales-service distinction, may well be forced to either mechanically follow that test or to conceal policy-based decisions in their subjective factual analysis of the

\textsuperscript{18} 123 N.E.2d 792 (N.Y. 1954).

\textsuperscript{19} Id. at 794.

\textsuperscript{20} Id.

\textsuperscript{21} Construction contracts are often evaluated under the Perlmutter test. See A. Mark Segreti, Jr., Note, The Application of Implied Warranties to Predominantly "Service" Transactions, 31 OHIO ST. L.J. 580, 589 (1970) (stating that the sales-service distinction from Perlmutter "has been followed in construction contract cases where the furnishing of materials is held to be only incidental to the work and labor performed").

\textsuperscript{22} Perlmutter, 123 N.E.2d at 795 ("If, however, the court were to stamp as a sale the supplying of blood—or the furnishing of other medical aid—it would mean that the hospital, no matter how careful, no matter that the disease-producing potential in the blood could not possibly be discovered, would be held responsible, virtually as an insurer, if anything were to happen to the patient as a result of 'bad' blood.").
primary purpose of the contract in question. An approach that
forces a court to mask the real reason for its decision or re-
quires unnecessary manipulation of the facts cannot be
viewed as a particularly valid method of decisionmaking.23

The predominant factor test was applied to a construction contract
in Bonebrake v. Cox,24 in which Article 2 was found to be applicable
to a contract for the purchase and installation of used bowling alley
equipment. The court articulated the test for hybrid contracts: "The
test for inclusion or exclusion is not whether [the contracts] 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 . . . or is a transaction of a
sale, with labor incidentally involved."25 Because the purpose of the
contract was to replace equipment lost in a fire, the court determined
that goods predominated and applied Article 2 to the contract.26

The test provided by the Bonebrake court is still used in construc-
tion contract cases today.27 The test is clear, but its application is not.
When a contract involves a combination of goods and services, there
is usually no precise boundary determining where goods end and ser-
vice begins; in such a conglomeration of activities, it is difficult to
point to the "predominant" factor. What one person may classify as a
predominant factor, another person may just as reasonably classify as
incidental to the transaction. Thus, there is little predictability in the
predominant factor test.28

The disagreement between the majority and the dissent in
McDowell v. Atco Rubber Products Inc.29 demonstrates how the test
can be applied to support either goods or services. The contract in
question was one in which the plaintiff purchased stainless steel ducts
from the defendant. The majority held that the transaction was for
goods. Even though the defendant had to perform services to manu-
facture the ducts, the court held that the contract was not "service ori-

23 Ault, supra note 14, at 307.
24 499 F.2d 951 (8th Cir. 1974).
25 Id. at 960.
26 Id. In this case, the application of Article 2 meant that the buyer could pursue a remedy
for breach in accordance with § 2-607 since the buyer notified the seller of the breach within a
reasonable time.
27 As of March 1, 2002, there were 251 cases citing Bonebrake on www.westlaw.com.
28 The predominant factor test may also keep courts from addressing all of the issues in a
case. See Ault, supra note 14, at 305 ("After making the initial, and often dispositive,
determination as to whether the service element or the goods element predominates, the court
does not have to address any further issues or policy questions that may be present. Since the
initial factual determination forecloses further analysis, application of the predominantly service
test may result in the sacrificing of an equitable and well-reasoned decision for simplicity.").
mented." The dissenting judges reasoned that the entire contract was for a service, because the plaintiff supplied the steel and the defendant’s only job was to process the steel into ducts. Just as the judges in this case could easily disagree about the application of the predominant factor test, so do judges in cases nationwide.

In McDowell, the UCC’s warranty provisions protected the buyer. Courts often seek to apply UCC warranties in cases where buyers have no other remedy. So it seems courts using the predominant factor test either follow Perlmutter and Bonebrake strictly, looking at sales and service aspects without regard to policy, or they decide on a policy-based outcome and manipulate the sales-service distinction to achieve it. Whatever the reason, case law shows that where courts are willing to consider a contract under the predominant factor test, the likely result will be the application of Article 2 of the UCC.

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30 Id. at 556.
31 Id. at 557 (Mercure, J., dissenting).
33 See WHITE & SUMMERS, supra note 16, at 344 (“Whether the court applies the Code depends to some extent on the area of coverage at issue. Sympathetic plaintiffs often bring breach of warranty suits, and these litigants may have greater success in invoking Code protection than parties to non-warranty suits.”).
2. Contract Bifurcation

Instead of trying to determine whether goods or services predominate in a contract, some courts bifurcate the contract and apply Article 2 to only that portion involving goods. This was the approach taken in Foster v. Colorado Radio Corp. The court in that case held that the UCC applied to the sale of office supplies and furniture, but not to real estate, licenses, and good will in a contract for the sale of a radio station. Therefore, when the seller became aware of the buyer's breach, it was obligated to notify the buyer that it would resell the office supplies and furniture to a third party under section 2-706 of the UCC. However, the seller was not similarly obligated under the UCC as to the sale of the intangibles. The seller argued that the goods were incidental to the purpose of the contract, and therefore, under the predominant factor test, the UCC was inapplicable. The court did not follow the predominant factor test; instead it split the contract, citing section 2-102 as support that the UCC applies to every sale involving goods.

Another case in which the court relied on bifurcation, Stephenson v. Frazier, involved the sale of a modular home, the construction of a foundation, and the installation of a septic system. Since the home itself was a good, Article 2 applied to that portion of the contract. The UCC was not applicable to the foundation or septic system work, however, because the court determined that portion of the contract to be for services. Section 2-508 of the UCC grants sellers the right to cure as long as notice is given, and the seller in Stephenson wrote a letter notifying the buyer of its intention to remedy the defects in the home. The buyer refused to allow the seller cure the defects, so the buyer could not rescind the contract for reasons related to the home. The services provided in laying the foundation were covered by common law, but the result was the same as applying the UCC. Because the seller's letter did not indicate an intention to cure the defects in the foundation, the buyer was entitled to rescind that portion

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34 English courts adhere to the bifurcation approach when applying warranties to hybrid contracts. See E. Allan Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653, 664 (1957).
35 381 F.2d 222 (10th Cir. 1967).
36 Id. at 225.
37 Id. at 226.
38 "Unless the context otherwise requires, this article applies to transactions in goods..." U.C.C. § 2-102 (2001).
39 See Foster, 381 F.2d at 226 ("We see no reason not to view the Foster contract in two parts as effecting the sale of goods and non-goods.").
41 Id. at 797.
42 Id.
of the contract. The court then determined that the breach related to the services was sufficient to establish a prima facie case of breach, justifying rescission of the entire contract.

The bifurcation approach is an attempt at strict adherence to the UCC's definition of goods, but it is difficult to apply, especially in construction contracts. When dealing with projects that involve an endless number of goods and services, it is often impossible to separate the goods from the services related to them. For example, in a case such as Stephenson, foundation defects could just as likely be due to problems with the concrete as to problems with the services rendered. The more complex the project, the more difficulty there is in separating the goods from the services that make the goods into a finished product. Perhaps it is this difficulty in application that makes the bifurcation approach much less popular with courts than the predominant factor test.

3. Comparison to the UCC by Analogy

In some cases, courts reason by analogy that Article 2 should apply to a hybrid contract for the same reasons it would apply to a pure transaction in goods. This approach is based on a comment to section 1-102 of the UCC, which recognizes that courts often make use of analogies to apply useful laws to situations not expressly provided for and encourages courts to continue that practice when construing the UCC. English courts typically apply statutes by analogy, and Dean Roscoe Pound thought American courts would eventually do the same, viewing statutes "to be reasoned from by analogy the same as any other rule of law." When dealing with hybrid contracts, many courts have done exactly as Dean Pound predicted. The UCC is particularly well suited for analogy because it is "designed both to take

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43 Id. at 798.
44 Id. at 799.
45 Another approach similar to contract bifurcation is the use of the gravamen test, in which the court determines whether the dispute is based on the goods or services. If based on goods, Article 2 applies; if based on services, Article 2 does not apply. See Henry D. Gabriel & Linda J. Rusch, The ABC's of the UCC: Article 2: Sales 4 (1997) (comparing the concepts for the sale of goods to transactions in goods); J.O. Hooker & Sons, Inc. v. Roberts Cabinet Co., 683 So. 2d 396 (Miss. 1996) (holding that the common law parol evidence rule, not the UCC version, applied to a contract for cabinet installation because the dispute involved the parties' duties under the contract, not the goods).
46 See U.C.C. § 1-102 cmt. 1 (2001) ("Courts . . . have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act . . . . They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general.") (citations omitted).
47 See id. ("This Act is drawn to provide flexibility . . . . Nothing in this Act stands in the way of continuance of such action by the courts.").
account of rapidly changing customs and to achieve a satisfactory accommodation between diverse competing interests.

The following is the process courts use when applying the UCC by analogy:

The first step is to decide whether the goods involved fall within the scope of the UCC definition of goods, that is, whether Article 2 could be applied. [The court] then examines the interests present in the particular fact situation and determines, on the basis of the equities involved, whether the case should be governed by Article 2.

Some cases from outside the construction realm indicate that the service aspect of a transaction need not hinder the application of the UCC. These cases provide the model for the analogy approach.

Beauty salon treatments have been analogized to sales of goods. In Newmark v. Gimbel’s Inc., the New Jersey Supreme Court applied the UCC to a transaction involving the application of a permanent wave solution at a beauty salon. The patron was injured by the chemical solution and sought recovery under the warranty provisions of the UCC. The court pointed out that the framers of the UCC intended the code to be applied in analogous situations, unlimited by technicalities and strict definitions. The court went on to say: “It seems to us that the policy reasons for imposing warranty liability in the case of ordinary sales are equally applicable to a commercial transaction such as that existing in this case . . . .” The decision to apply the UCC warranty was based on a belief that the salon, as the profit-maker, should bear the risks, especially given the patron’s reliance on the salon’s skill. The court noted that the salon had a remedy in bringing an action against the manufacturer of the permanent wave solution.

The same concepts apply to construction contracts: the contractor is the profit-maker and should therefore bear the risk, the owner relies on the contractor’s skill, and contractors have remedies against suppliers and subcontractors for defective equipment and services. After the Newmark decision, the U.S. District Court for the District of New Jersey decided to apply the UCC to hybrid contracts without going

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50 Ault, supra note 14, at 314-15 (emphasis in original). See also WHITE & SUMMERS, supra note 16, at 27 (advocating a similar approach for non-sales contracts in which a court first considers the policy behind the applicable UCC section and then decides whether the case lends itself to the application of the UCC by analogy).


52 Id. at 701.

53 Id. at 702.
through any analysis: "Because of the New Jersey Supreme Court's decision, it is irrelevant whether the hybrid transaction at issue is predominantly one for goods or one for services . . . since either way, New Jersey courts apply UCC warranty principles." Thus, at least one court is willing to apply the UCC to hybrid contracts without regard to tests, bifurcation, or analogies.

After being analogized to a sale of goods, the selling of food is now explicitly defined as a sale of goods under section 2-313. Before the sale of food was added to the UCC, there was a circuit split, with the majority adhering to the old rule that innkeepers did not sell food, but instead provided a service and therefore were not covered by warranties. Now section 2-314 provides: "Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale." This movement from common law analogizing to codification signals the path construction contracts could take.

_Aced v. Hobbs-Sesack Plumbing Co._ is an example of the application of the Sales Act (the UCC's precursor) by analogy to a construction case. The _Aced_ court held that the warranty of merchantability was implied in a subcontract to install tubing for a heating system on a home, despite the fact that the contract was service-oriented. The court acknowledged that the contract was not a sales contract, but explained that "[t]here is no justification for refusing to imply a warranty of suitability for ordinary uses merely because an article is furnished in connection with a construction contract rather than one of sale." Applying the UCC by analogy, unlike the other two tests, allows a court to focus on the issues in a case, instead of on the factual determination regarding goods and services. For this reason, application of the UCC by analogy is probably the most rational and equitable of the current approaches to hybrid contracts. Unfortunately, like the

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55 For a case involving the supply of electricity analogized to the sale of goods, see _Wivagg v. Duquesne Light Co._, 73 Pa. D. & C.2d 694 (C.P. 1975).
56 See Segreti, supra note 21, at 582-83.
58 See Segreti, supra note 21, at 584 (discussing the addition of the sale of food to the UCC and explaining that "it seems to be an a priori matter that the 'serving' aspect of the transaction does not keep it from being a sale covered by the law of implied warranty").
60 Id. at 902.
61 See Ault, supra note 14, at 322 ("In light of the Code's mandate that its provision [sic] be applied liberally in an attempt to modernize commercial law, the policy approach is clearly the best method as it permits these concepts to be implemented in a thoughtful and well-reasoned manner."); Comments and Casenotes, _Dual Nature Contracts and the Uniform Com_
other approaches, analogizing has difficulties in application. Parties cannot know if the court will be willing to analogize in their particular case. If a court does decide to analogize, that does not mean it will necessarily find a reason to apply the UCC.

As agreed by commercial law and construction law scholars, no matter what approach a court takes—and in part because courts have so many approaches—there is no predictability in hybrid transaction cases. It is likely that many cases are brought to court just because the parties are unsure whether common law or the UCC applies. If the law were clearer, allowing parties to contract with the knowledge of what law governed, there would be less uncertainty and less litigation.

II. THE PROPOSAL: APPLY THE UCC WITHOUT REGARD TO THE SALES-SERVICE DISTINCTION

As suggested by courts applying the UCC by analogy, there may no longer be a reason to distinguish between sales and services in a hybrid contract because UCC principles apply to both. Due to the prevalence of hybrid contracts and contracts for services, more contracts are excluded from the UCC today than are directly covered by it. Given the fact that the current economy is much more service-oriented than the economy of the 1950s in which the UCC was drafted, perhaps the sales-service distinction is no longer necessary:

When we discuss commercial law, many of us assume that we are talking about transactions involving goods. Yet, in our economy, the commercial services sector has already surpassed the goods sector in both the dollars involved and the potential for future economic growth. The assumption that...
commercial practice emphasizes transactions in goods mis-
reads where we are and where we are heading as a society
and a legal system.\textsuperscript{64}

All of the approaches to hybrid contracts show a willingness by
the courts to consider the application of Article 2 to sales-service
transactions. Courts have also applied the UCC without predominance
tests, bifurcation, or analogy. The Article 2 definition of goods in-
cludes “specially manufactured goods,”\textsuperscript{65} and all hybrid construction
projects have as their goal a specially manufactured good—a finished
product that is “not suitable for sale to others in the ordinary course of
the seller’s business.”\textsuperscript{66}

Courts have applied the UCC to hybrid contracts through use of
the “specially manufactured” clause, based on the rationale that the
definition of goods should be broad so as to achieve greater uniform-
ity in transactions. This approach has a limitation, though, because the
UCC also defines goods as “movable at the time of identification to
the contract for sale.”\textsuperscript{67} Therefore, courts have not often relied on the
section 2-105 definition for the construction of permanent structures,
although courts have found galvanized steel buildings on concrete
foundations \textsuperscript{68} and a one million gallon water tank \textsuperscript{69} to be “movable.”

These cases illustrate that the explicit language of Article 2 can
be applied to construction contracts without regard to the sales-
services distinction. The section 2-105 definition of goods allows the
UCC to be applied to many hybrid construction contracts, but ex-
cludes those contracts that result in what the court considers an im-
movable good. The same types of goods and services, and the same
contracting concerns, are involved in building structures considered
movable as in building those considered immovable. If the UCC ap-
plies to one type of contract, it should apply to the other.

The principles underlying the UCC are just as applicable to con-
struction law as they are to sales: “(a) to simplify, clarify and modern-
ize the law governing commercial transactions; (b) to permit the con-
tinued expansion of commercial practices through custom, usage and

\textsuperscript{64} Raymond T. Nimmer, \textit{Uniform Codification of Commercial Contract Law}, 18 RUT-

\textsuperscript{65} U.C.C. § 2-105(1) (2001).

\textsuperscript{66} Id. § 2-201(3)(a).

\textsuperscript{67} Id. § 2-105(1).

\textsuperscript{68} Robertson Cos. v. Kenner, 311 N.W.2d 194, 200 (N.D. 1981) (“Although the storage
facilities are not ‘goods’ to be taken from the shelf, they are, in the words of the UCC, a mov-
able thing specially manufactured . . . These buildings . . . are capable of being detached from
their foundations and are thus ‘movable.’”).

\textsuperscript{69} Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572, 580
(7th Cir. 1976) (stating that the court is “unaware of any authority that specially manufactured
small dies should be goods and a very large tank not so classified”).
agreement of the parties; (c) to make uniform the law among the various jurisdictions.\textsuperscript{70}

The law would be clarified and uniform if Article 2 were applied to all construction contracts. Some courts are already moving towards straight application of the UCC to hybrid construction contracts, without regard to sales and services.\textsuperscript{71} Application of Article 2 also solves the problems of balance of power and excessive litigation.\textsuperscript{72} This could be accomplished by court action using the language of section 2-105, with a revision to the definition of “goods”\textsuperscript{73} or court action holding that Article 2 applies by analogy to all construction contracts, without need for analysis on a case-by-case basis.

Application of Article 2 could also be accomplished by adding a new section to the UCC,\textsuperscript{74} similar to Article 2A for leases. The progression of leases from uncodified transactions into Article 2A transactions mirrors developments in the construction industry. Before Article 2A, some courts applied Article 2 to leases by analogy, some held that Article 2 applied directly because leases are transactions in goods, and other courts refused to apply Article 2 because leases are not sales. Now leases are governed by a uniform set of principles within the UCC.\textsuperscript{75} The UCC could also be applied to construction contracts by the hub and spoke approach, in which the “hub” sets forth general contract formation and interpretation rules, and the

\textsuperscript{70} U.C.C. § 1-102 (2001).


\textsuperscript{72} See Justin Sweet, The American Institute of Architects: Dominant Actor in the Construction Documents Market, 1991 Wis. L. Rev. 317, 318 (“Construction, a complex process that can span a lengthy period of time and encounter many disruptions and unexpected conditions, needs extensive rules.”).

\textsuperscript{73} The term “movable” would need to be redefined or eliminated. For a proposed amendment to section 2-105, see Disengaging Sales Law, supra note 62, at 488 (“‘Goods’ should be defined to include any property interest (other than a security interest) in goods.”).

\textsuperscript{74} The criteria for adding a new section to the UCC are applicable to construction contracts: the construction industry has economic significance, codification would benefit the industry, the industry is national, it is unique from areas already codified, and codification is reasonably achievable. See Nimmer, Service Contracts, supra note 63, at 729; Nimmer, Uniform Codification, supra note 64, at 480-81 (“Codification projects in commercial law are reserved for areas of commercial practice regarded as important economically or legally, . . . Volume, importance and uniqueness are reasonably considered potential elements that support a decision to codify an area of contract law.”). See also Sweet, supra note 72, at 340 (describing a 1982 report from an ABA task force, which suggested that the definitions in the UCC be modified so as to broaden the coverage of hybrid transactions).

\textsuperscript{75} See U.C.C. art. 2A (2001). See also U.C.C. Foreword to 2000 Official Text and Comments at xiii (explaining that lease law prior to inclusion in the UCC was “uncertain in consequence”); GABRIEL & RUSCH, supra note 45, at 4-5 (discussing the non-uniform approach of courts applying Article 2 to leases prior to the enactment of Article 2A); Nimmer, Service Contracts, supra note 63, at 726 (stating that Article 2A is an exception to the stringent application of the UCC and courts’ unwillingness to revisit previous UCC decisions).
“spokes” provide rules for specific types of transactions. Alternatively, the construction industry could draft its own code, separate from the UCC, but including basic UCC principles.

III. APPLICATION OF THE PROPOSAL

A. Article 2 Addresses Industry Concerns

The UCC balances power among the parties to a contract, providing an equal playing field between “merchants” who know the business. Comment 1 to section 2-104 states the purpose of the merchant concept: “This Article assumes that transactions between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer.” In addition, because of its focus on fairness and industry standards, the UCC places the process of construction contracting in the setting of general business principles. All contracts under the UCC impose an obligation of good faith; however, the UCC focuses on interpretation of good faith within the con-

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76 The hub and spoke concept was proposed by the drafting committee of the National Conference of Commissioners on Uniform State Laws in March 1995 for application to the software industry. However the executive committee rejected the concept out of concern that, because one of the “spokes” would be for leases, and Article 2A already exists for leases, state uniformity would be difficult to maintain. The current thinking by the drafting committee is that there will likely be a new Article 2C for software licensing. See Henry J. Reske, UCC Rewrite is Shot Down, A.B.A. J., Nov. 1995, at 50 (explaining the rejection of the hub and spoke concept by the executive committee of the National Conference of Commissioners on Uniform State Laws). For an argument in support of the hub and spoke approach, see Henry J. Reske, Software Publishers Take Interest in UCC, A.B.A. J., July 1995, at 22 (quoting Professor Nimmer: “While sales of goods are a major facet of modern commercial practice, intangibles, information, and services contracting are more and more important. In this respect, a hub-and-spoke approach can be contrasted to the Balkanization that may follow in an effort to adopt separate articles for each major field.”).

77 See McAlpine & Breuch, supra note 4, at 554 (reporting that the ABA forum committee on the construction industry is considering creating a uniform code for construction, and the AGC has shown an interest in assisting in the drafting); Stipanowich, supra note 1, at 540-41 (“What is needed is a systematic and polycentric approach, informed by the latest empirical information, aimed at development of a cohesive matrix of legal principles .... The establishment of a single, straightforward set of legal rules governing construction contracts should make the law more accessible and reduce transaction costs associated with contract formation and dispute resolution, as well as help identify and sharpen risks .... ”).

78 U.C.C. § 2-104(1) (2001). See Hiram Thomas, The Proposed Uniform Revised Sales Act, Bus. Law., July 1947, at 18 (“The Act recognizes ... that contracts between merchants should be construed in the light of the skill and knowledge which they presumably possess and that for like reason merchants should be held to rather stricter standards than other people.”).


80 See William L. Beers, The New Commercial Code, Bus. Law., July 1947, at 17 (“In trying to get beyond some of the antiquated rules of the common law, contracts running into pages of fine print have been devised, nearly all of which go too far in favor of one side or the other .... The Code will take account of actual, real life customs and needs.”).

text of the particular industry. Additionally, an exact codification of good faith can have greater influence on parties than a generally understood, uncodified principle.

Also in accordance with common law, the UCC provides remedies for unconscionable contracts. But just as with the obligation of good faith, the UCC relates unconscionability directly to the industry. The drafters provide the following test for unconscionability: “[W]hether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable . . . at the time of the making of the contract.” This codification of common law through a precise definition, tailored to objective industry standards, will be beneficial to those working in the construction industry.

Under the UCC, the parties’ course of dealing with each other and the usage of the trade both supplement agreements. These supplementary concepts can benefit the interpretation of contracts in an industry like construction, where companies work with each other often and where there are numerous well-established ways of conducting business. Under the UCC, “the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances.” The UCC allows for new industry standards, doing away with the strict common law requirements of custom. The UCC would therefore recognize current advances in the industry, as well as the standards set forth in standard contract forms like those promulgated by the AIA and AGC.

Of course parties can contract around the UCC provisions and continue to draft contracts that are weighted in their favor. But the UCC will still provide a model of a professional, evenhanded contract relationship. At the very least, applying the UCC to all construction contracts can make parties aware that the one-sided contracts now common in the industry are not the default. Contractors, subcontractors, and suppliers may use the UCC concepts of merchants, good faith, unconscionability, course of dealing, and usage of trade in negotiating contract terms.

Applying the UCC allows for fair, understandable, uniform decisions. However, these benefits are weakened by the current case-by-case...
case court determinations; there is no way for a party to predict if the UCC will apply to its particular dispute. With the varied approaches to hybrid contracts and court decisions that can be used to justify application, as well as non-application, of the UCC, both parties can find support for their positions and are less likely to settle disputes before resorting to litigation. Even in cases that go to trial, litigation will be more straightforward, and perhaps less time- and cost-prohibitive, with the application of clear contracting rules.

Related to balancing power and reducing the need for litigation, application of the UCC would make project planning less uncertain and risky. Parties will be aware of the contract interpretation rules applicable to the project before the project gets underway. Uncertainty and risk is inherently prevalent in the industry; there is no need to add more through the law. Since courts across jurisdictions are already applying Article 2 to construction contract disputes, the industry and the law would be better served if the standard were to apply Article 2 in all hybrid construction contract cases.

The words of William L. Beers writing about the "new" UCC in 1947 summarize why it makes sense for use by the construction industry today: "It is in the commercial field that the uncertainties of the common law may do the most harm and a statutory codification the most good." The construction industry could benefit from the balance of power provided by the UCC. In addition, if Article 2 were the standard, parties could better settle disputes on their own without resorting to litigation. Moreover, the clarity and predictability of the UCC would make project planning and risk assessment more certain.

89 See Nimmer, Uniform Codification, supra note 64, at 465 ("The advantages need to be seen in contrast to codification’s primary alternative - deriving commercial contract law through scattered court decisions or unlitigated traditions.").

90 Application of the UCC will assist construction industry professionals in doing business. See Karl N. Llewellyn, Why We Need the Uniform Commercial Code, 10 U. FLA. L. REV. 367, 378-79 (1957) ("The rules between seller and buyer are stated in terms of the issues and of the facts which sellers and buyers do think about; technical traps are eliminated; good faith interpretation and action are protected so far as circumstances will permit; and if it does come to litigation the remedies are made flexible and are freed from delay, trickery, and technicality.").

91 Lawyers and judges will also benefit from application of the UCC. See Daniel E. Murray, Under the Spreading Analogy of Article 2 of the Uniform Commercial Code, 39 FORDHAM L. REV. 447 (1971). "Busy lawyers ... 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 ... . 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." Id. at 480.

92 Beers, supra note 80, at 14.

93 See Nimmer, Uniform Codification, supra note 64, at 475.
B. UCC Provisions Are a Good Fit for Construction Contracts

As explained in reference to the concepts of good faith and unconscionability in the previous section, many UCC provisions are codifications of existing common law principles. Part of the advantage in applying the UCC to hybrid construction contracts is not related to differences between the UCC and common law, but to the fact that the UCC sets forth general contracting principles in a clear, organized way with a body of law that is recognized across jurisdictions. It makes no difference that some of these principles are identical to common law; construction industry professionals, their lawyers, and judges all can refer to the UCC with greater ease than to the current amalgamation of common law principles.

In addition to codification of common law principles, the UCC includes some provisions that depart from common law in a way that benefits parties to a hybrid construction contract. Although these provisions can be avoided, they nonetheless set a good framework for contract interpretation.

1. The UCC Focuses on Intentions Rather Than Formalities

When dealing with the creation and modification of contracts, the UCC departs from formal, stilted common law rules and instead approaches contracts with practical, often timesaving methods. The UCC approach to contract formation and modification fits today’s construction industry practices.

Instead of requiring communications of formal offer and acceptance, the UCC allows contract formation “in any manner sufficient to show agreement.” As long as there is evidence that the parties intend to contract, terms can be left open without the contract failing for indefiniteness. Signed firm offers do not require consideration to be held open. In addition, the UCC does away with the common law

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94 For a discussion of other UCC provisions that are the same as common law rules, including the parol evidence rule, see Premise for Judicial Reasoning, supra note 49, at 886, 890-91.
95 See Disengaging Sales Law, supra note 62, at 484 (“This style of drafting enhances article 2’s adaptability to transactions embodying the same basic structure as that of the sale paradigm.”).
96 U.C.C. § 2-204(1) (2001). See J. Lee Gregory, Inc. v. Scandinavian House, 433 S.E.2d 687, 690 (Ga. Ct. App. 1993) (holding that the UCC applied to the supply and installation of windows in an apartment complex, so a letter by the owner stating its intent to hire the contractor, coupled with the conduct of the contractor in taking measurements for the windows, was “sufficient to show an agreement” under § 2-204). See also WHITE & SUMMERS, supra note 16, at 28 (explaining the ways in which the UCC has made contract formation simpler than under the common law).
98 Id. § 2-205.
mirror-image rule, allowing acceptance “in any manner and by any medium reasonable in the circumstances.”99 These formation principles make it easier for parties to create contracts through the exchange of bids, purchase orders, firm offers,100 and confirmatory documents. A contract exists where there is an intent to be bound, regardless of whether the bid/purchase order and confirmation letter contain different terms. The formation provisions of the UCC also allow parties who intend to contract to continue with a transaction despite the fact that the terms of a complex project might not all be specified.101

The UCC also departs from strict common law concepts when addressing contract modifications. Section 2-209(1) provides that modifications to a contract do not require consideration to be binding. This is a departure from the common law pre-existing duty rule, which requires new consideration for each contract modification. While the absence of consideration could be a problem if one party decided to make a false claim based on a non-existent modification, section 2-209(2) allows the parties to stipulate that all modifications be made by signed agreement. Modifications without consideration can be particularly useful in the construction setting, where changes are inevitable and frequent.102

2. The UCC Provides Implied Warranties

Under the common law, if a product does not conform to the representations of the seller and there is no express warranty, the buyer can pursue an action for negligence. The UCC provides two types of implied warranties that attach to a sale. A plaintiff can recover under these warranties instead of resorting to a negligence claim. The first implied warranty is the warranty of merchantability. It states that merchants who deal in goods of a certain kind warrant the goods as “merchantable.”103 The second type of implied warranty

99 Id. § 2-206.
100 But see Premise for Judicial Reasoning, supra note 49, at 889 (explaining that § 2-205 could be problematic in construction contracts when a contractor supplies a firm bid and cannot revoke it). It can be argued that the UCC reliance on industry standards and good faith would prevent bids from being kept open where mistake or other inequities were involved, so the contractor’s bargaining position would be protected. In addition, under § 2-205 such a bid would remain open only for a reasonable time, not to exceed three months.
101 When terms are left open, UCC gap-filling provisions apply, as does reliance on course of dealing and usage of trade. The gap-fillers relate to price, delivery, time, termination, payment, and performance terms. See U.C.C. §§ 2-305, 2-306, 2-307, 2-308, 2-309, 2-310, 2-311. See also Nimmer, Uniform Codification, supra note 64, at 477 (“Codification enacts principles grounded in commercial understanding that supply parts of an agreement if the contract is silent. This is important in the setting where the parties cannot devote huge resources to making a deal. It also levels out disparities caused by diversity of expertise and resources in negotiation.”).
102 See J & R Elec. Div. of J.O. Mory Stores, Inc. v. Skoog Constr. Co., 348 N.E.2d 474 (Ill. App. Ct. 1976) (holding that a contract for electrical work was not governed by the UCC; the subcontractor could not recover money due on modified work because there was no consideration).
"merchantable." The second type of implied warranty is the warranty of fitness for a particular purpose. It states that when a seller "has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment . . . there is . . . an implied warranty." 104

Both of the warranties are applicable to the construction setting, and both have been applied to construction contracts by courts. Warranties have been implied in contracts for the manufacture of a roofing system, 105 the installation of a water heater, 106 the manufacture of ducts, 107 the construction of an amusement park ride component, 108 the construction of a cable television system, 109 the manufacture and installation of an energy system, 110 and the manufacture of building components. 111

While the contract forms drafted by industry groups such as the AIA and AGC contain express warranties, 112 the UCC provides warranty remedies where there is no express language. The implied warranty of merchantability attaches when the party providing the goods deals in goods of that kind, which will typically be the case in a construction contract. The implied warranty of fitness for a particular purpose will also be in effect in most construction contracts, because the owner or contractor relies on the skill of the contractor, subcontractor, or supplier, and the party doing the work has reason to know the purpose for which it is required. Therefore, if all hybrid construction contracts were covered by the UCC, all would likely be covered by implied warranties. Just as with other UCC provisions, implied

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103 U.C.C. § 2-314(1) (2001). See id. §2-314(2) for the elements involved in merchantability: "Goods to be merchantable must be at least such as (a) pass without objection in the trade . . . (b) . . . are of fair average quality . . . (c) are fit for the ordinary purposes . . . (d) run . . . of even kind, quality and quantity . . . (e) are adequately contained, packaged, and labeled . . . (f) conform to the promise . . . on the container . . . ."

104 Id. § 2-315.


108 See Aluminum Co. of Am. v. Electro Flo Corp., 451 F.2d 1115 (10th Cir. 1971).


112 See CHARLES M. SNEK & MARK D. PETERSEN, THE A201 DESKBOOK: UNDERSTANDING THE REVISED GENERAL CONDITIONS 13 (1998) (providing the text of the AIA form: "The Contractor warrants . . . that materials and equipment . . . will be of good quality and new . . . that the Work will be free from defects . . . and that the Work will conform to the requirements of the Contract . . . .").
warranties can be disclaimed;\textsuperscript{113} however, just like those other provisions, the warranties at least provide a clear default rule.

3. The UCC Excuses Performance Based on Impracticability

It is common for a construction contract to contain a force majeure clause, excusing the contractor from liability for delay caused by events out of its control, such as acts of God. Section 2-615 of the UCC provides a similar allowance for cases in which the contract does not contain a force majeure clause. While common law and many construction contracts require the strict standard of impossibility, the UCC excuses performance for impracticability.\textsuperscript{114} Given the expenses involved in construction projects, the most logical approach is to excuse impracticability. Though more realistic, the standard is not lax. Under the UCC, a seller still has to prove impracticability, and increased cost alone is insufficient.\textsuperscript{115}

Suppliers are usually covered by section 2-615 because they deal in goods. However, contractors working with the suppliers are likely to be held to more restrictive standards. Two parties working in the same industry on the same project should not be held to two different performance standards. Application of the UCC would yield a rational standard for excused performance and would hold all parties in the industry to an identical standard.


Not all of the UCC provisions are beneficial to the construction industry. While section 2-725 provides a uniform statute of limitations of four years, the statute starts running when the breach occurs, regardless of the buyer's knowledge.\textsuperscript{116} Most state rules and the Federal Rules of Civil Procedure start the statute running at the time the plaintiff knows or reasonably should know of the breach. Especially

\textsuperscript{113} U.C.C. § 2-316 (2001).

\textsuperscript{114} Id. § 2-615(a) (stating that delayed delivery or non-delivery is excused if "made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made"). See COMMON SENSE CONSTRUCTION LAW, supra note 62, at 61 (stating that the UCC provides a "broader ground for excusing performance than is available under the common law").

\textsuperscript{115} U.C.C. § 2-615 cmt. 4 (2001). See Sachs v. Precision Prods. Co., 476 P.2d 199 (Or. 1970) (holding that the UCC applied to the manufacture of a hoist, but since the impracticability definition was not met, the manufacturer was liable for damages).

in complex construction projects, it may take more than four years to discover a breach. As such, parties could be unreasonably foreclosed from pursuing claims. In order to apply the UCC to all construction contracts, the statute of limitations could be amended to require a “knowledge” standard for hybrid construction contracts, while keeping the “occurrence” standard for goods.

Section 2-601 gives buyers the remedy of rejecting the goods if they “fail in any respect to conform to the contract.”117 This “perfect tender” rule is impractical in the construction setting. Just because a structure fails to meet every contract specification, the owner should not be able to reject the entire structure. The perfect tender rule has been limited by the seller’s right to cure defective goods and by the UCC’s adherence to good faith, industry standards, and course of dealing between parties. Because of these restrictions and the courts’ reluctance to apply the perfect tender rule, Professors White and Summers state “the law would be little changed if 2-601 gave the right to reject only upon ‘substantial’ non-conformity.”118 So, while daunting on its face, the perfect tender rule might not be a tremendous obstacle to application of the UCC to hybrid construction contracts.

Not every provision of the UCC is a perfect fit with the construction industry, but the benefits in applying the UCC outweigh the problems. One of the greatest advantages in applying the UCC is not the innovation the UCC brings to common law concepts, but instead the way the UCC records common law concepts in their original state. Many of the industry’s contracting concerns could be addressed by giving the industry some well-defined rules to follow. Where the UCC does alter the common law, the effects are for the most part beneficial. And where there is a detriment to the industry, problems can be solved in whatever approach is taken to apply the UCC—by courts, by a new section, in the “spokes” of the hub and spoke approach, or in a construction code.

CONCLUSION

The construction industry has the economic significance, the volume of work, and the complexity of projects deserving of a distinct body of governing law. Moreover, a clearer statement of the law would accomplish needed improvements in the industry, such as equalizing bargaining power among parties and reducing litigation. Courts have recognized the applicability of the UCC to construction contracts by utilizing predominance tests, bifurcating contracts, and

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118 WHITE & SUMMERS, supra note 16, at 314.
comparing the UCC to the contract in question. These approaches demonstrate that the UCC can be a useful approach, yielding rational decisions; yet the way in which the UCC is applied lacks the predictability necessary to properly benefit the industry. By applying the UCC to all hybrid construction contracts without resorting to the distinction between sales and services, the clarity, uniformity, and predictability necessary in the industry can be achieved.

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