

Mass. Bill May Alter Deals Involving Both Goods And Services

By **Michael Ferdman, Brian Rich and Martine Wayne** (October 23, 2023)

Last year, the American Law Institute and the Uniform Law Commission approved amendments to the model Uniform Commercial Code.

Several states, including Massachusetts, have adopted or proposed adoption of these amendments. In February, Massachusetts proposed H.B. 1112,[1] which would adopt several of the model UCC amendments. The bill is currently before the Joint Committee on Financial Services.

Among the new model UCC provisions is a new rule for hybrid transactions, which are transactions involving both the sale of goods and the sale of services. The amendments would make the UCC applicable to the sales of goods portion of the hybrid transaction, thereby making UCC warranty provisions applicable.

These amendments could affect risk assessments made by lenders in determining whether to make loans that involve materials and equipment, especially in the context of construction projects.

A lender's risk assessment could also affect critical terms of the loan, such as interest rates, what kind of guaranties are required, and the length of the term. It could also affect the lender's decision of whether to replace the construction loan with permanent financing and the terms of the permanent financing.

If the UCC does not apply, then the transaction is governed by the common law of contracts. The contrast between UCC transactions and common law contract transactions is particularly stark with respect to warranties on goods that are sold.

The UCC imposes a defined set of warranties on the goods sold, including implied warranties of merchantability (2-314) and fitness for a particular purpose (2-315), and provides the mechanism for limiting, modifying or excluding warranties (2-316).

Implied and express warranties ensure that the risk of failure of the product or that the product does not function in the environment in which it is installed is borne by the seller not the purchaser. However, under common law — other than consumer transactions — there are typically no warranty requirements and the warranties, if any, must be specified in the contract of sale.

In Massachusetts, and in many other states that have not yet enacted the amendments, Articles 2 and 2A of the UCC apply only to the sale and lease of goods, respectively, but not to contracts for services. Therefore, in order for UCC provisions to apply to a transaction, a court must at the outset decide whether a transaction is for the sale and lease of goods or for services.



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If the transaction is predominantly for services, the UCC and its warranty provisions will not apply even though millions of dollars may have been spent on the materials and equipment portion of the contract. The line between these types of transactions is sometimes difficult to discern and could lead to unfair results.

For example, currently in Massachusetts and other states that have not yet enacted the amendments, UCC warranties would not apply to an air conditioning system that is installed in a building if the cost of that transaction is predominantly for labor to install the equipment, which would be services, rather than for the AC equipment itself, which would be goods.

Pre-amendment, states were using different tests to make this determination. However, according to the official comments published by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, "most courts used some version of a 'predominant purpose' test. Under those tests, Article 2 applied either in full or not at all, depending on whether the hybrid transaction, at its inception, was predominantly about the goods." [2]

The 2022 amendments to the model UCC address this issue by including new language in Sections 2-102 and 2-106, which provides that, absent the parties' agreement otherwise, the UCC will apply to the portion of the transaction that relates to the goods sold notwithstanding whether the transaction is predominantly for services.

This is the new language provided by the amendment to the model UCC, Section 2-102:

(1) Unless the context otherwise requires, and except as provided in subsection (3), this Article applies to transactions in goods and, in the case of a hybrid transaction, it applies to the extent provided in subsection (2).

(2) In a hybrid transaction:

(a) If the sale-of-goods aspects do not predominate, only the provisions of this Article which relate primarily to the sale-of-goods aspects of the transaction apply, and the provisions that relate primarily to the transaction as a whole do not apply.

(b) If the sale-of-goods aspects predominate, this Article applies to the transaction but does not preclude application in appropriate circumstances of other law to aspects of the transaction which do not relate to the sale of goods.

(3) This Article does not:

(a) apply to a transaction that, even though in the form of an unconditional contract to sell or present sale, operates only to create a security interest; or

(b) impair or repeal a statute regulating sales to consumers, farmers, or other specified classes of buyers.

And the amendment to 2-106 defines a hybrid transaction as follows:

(5) "Hybrid transaction" means a single transaction involving a sale of goods and:

- (a) the provision of services;
- (b) a lease of other goods; or
- (c) a sale, lease, or license of property other than goods.

If the amendments to the model UCC were enacted into law, in the above example of a hybrid transaction, the AC system would be subject to UCC warranties even if the labor component is the predominant cost of the transaction.

The amendments would ensure that, absent contractual warranty disclaimers, a seller of a significant component of a construction project — such as AC systems, roofing materials, concrete, steel beams, etc. — would be responsible for the component's failure even if the contract for the sale of the component includes installation of the component and the installation costs predominate over the cost of the materials.

Thus, the risk of such failure would fall on the seller rather than on the project owner. Lenders would therefore be able to lower the risk profile of the project when analyzing the propriety of granting a construction loan to the project owner.

As the official comments point out, the benefit of this new approach is that it "ensur[es] that a person acquiring ownership of goods in a transaction in which the sale-of-goods aspects do not predominate is a buyer that benefits from the warranty provisions of this Article."^[3]

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[1] H.B. 1112, 193rd Gen. Ct. (Ma. 2023). <https://malegislature.gov/Bills/193/H1112>.

[2] MODEL UNIFORM COMMERCIAL CODE Article 2, cmt. 2 (2022).

[3] Id.