

## U.C.C. Article 2 Express Warranties and Disclaimers In the Twenty-First Century

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This symposium addresses whether current U.C.C. Article 2 governing the sale of goods can successfully resolve issues presented by our twenty-first century world. This is a tough question. On the one hand, Article 2 includes many flexible standards such as good faith and commercial reasonableness and looks to custom, usage, and the “bargain in fact” to fill gaps in agreements. This lack of rigidity means that Article 2 should be able to meet many new challenges. On the other hand, sales law that was developed for the world of paper and tangible goods ultimately may not be suited for the electronic age. The rise of software and other digital products is a good example of subject matters that the drafters did not foresee and that Article 2 does not successfully cover.<sup>1</sup>

In addition to the problem of technological change, which we return to shortly, more than 50 years of sale-of-goods litigation under Article 2 has revealed issues that Article 2 has failed to clarify; indeed Article 2 appears to have exacerbated the dysfunction of the law in these areas.<sup>2</sup> This essay focuses on one set of such issues that have engendered substantial litigation, mainly because Article 2 does address them clearly, namely the creation and disclaimer of express warranties. Specifically, section 2-313 adopts a “basis of the bargain” test for the creation of an express warranty.<sup>3</sup> A representation or promise constitutes an express warranty only if it was “part of the basis of the bargain.” But what exactly does this mean? The U.C.C. commentary, meant to explain the basis of the bargain test, is equally obtuse. Years of litigation, law review writing, and debates, including by the revisers of Article 2, have not successfully clarified the meaning of this test.<sup>4</sup>

Another vexing warranty issue involves the disclaimer of express warranties. Section 2-316(1) admonishes courts to interpret language or conduct that would create an express warranty and language or conduct that disclaims the warranty as “consistent” unless unreasonable.<sup>5</sup> Courts’ efforts to

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1. I am currently Reporter for the American Law Institute’s project called “Principles of the Law of Software Contracts” (hereinafter “ALI Principles”). See Tentative Draft #1 (May 2008). Many of the ideas expressed in this article apply both to software and hard-good contracts.

2. See Robert A. Hillman, *How to Create a Commercial Calamity*, 68 OHIO ST. L.J. 335 (2007).

3. See *infra* Part I.

4. *Id.* The Article 2 revision process took up much of the 1990s and was unsuccessful.

5. See *infra* Part II.

determine whether such seemingly inevitably inconsistent language or conduct can be reconciled has been equally unavailing.

These are serious problems. Consumers often reasonably rely on sellers' representations and promises, often in situations in which they cannot inspect the goods until after purchase. Even business purchasers may lack bargaining power or sophistication about the goods and therefore rely on seller representations and promises about their quality.

If Article 2 is going to be successful in the future, the "basis of their bargain" and "consistent unless unreasonable" tests of warranty and disclaimer should be eliminated and replaced with more coherent approaches. In this essay, I suggest solutions for each of these two warranty mysteries. First, Article 2 should drop the basis-of-the-bargain concept in favor of a test based on whether a buyer could reasonably rely on the words or conduct.<sup>6</sup> This idea is neither radical nor unworkable. In fact, the drafters of the U.C.C. probably thought this was the meaning of their basis-of-the-bargain test.<sup>7</sup> Second, Article 2 should clarify when disclaimers trump express warranties by enforcing an express warranty if a reasonable buyer would not expect a disclaimer.<sup>8</sup> Again, this is the approach the drafters probably had in mind.<sup>9</sup>

The dramatic technological advances exacerbate the issues of warranty and disclaimer. For example, buyers using the Internet have become accustomed to the speed and convenience of the Internet and can acquire goods only seconds after reading express warranties on websites that extol the virtues of their products. After clicking "I agree" to the terms of the sale, almost invariably without reading the electronic standard form, these purchasers may be surprised to learn that they have agreed to a disclaimer of all warranties, whether express or implied.<sup>10</sup> If Article 2 or any other body of law is to govern such arrangements effectively, a new approach to the problem of warranties and disclaimers that takes into account these new transaction types is necessary. The solutions presented here provide just such an approach.

## I. THE "BASIS-OF-THE-BARGAIN" TEST OF EXPRESS WARRANTIES

The basis-of-the-bargain test of U.C.C. section 2-313 is a failure on any measure.<sup>11</sup> If a rule is supposed to be clear, it is unclear. If it is supposed to

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6. See *infra* Part I.

7. See *infra* notes 20-21, and accompanying text.

8. See *infra* Part II.

9. See *infra* notes 26-28, and accompanying text.

10. In the software context, see Robert A. Hillman & Ibrahim Barakat, *Warranties and Disclaimers in the Electronic Age*, 11 YALE L. & TECH. 1 (2008).

11. U.C.C. § 2-313(1) provides in part: "Express warranties by the seller are created as follows: (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the good shall conform to the affirmation or promise."

offer guidance to transactors and courts, it fails to do so. If it is supposed to produce results beneficial to society by measures such as efficiency or fairness, it fails to do that too.

One reason for the failure of the basis-of-the-bargain test is that it lacks clarity. For example, does the test require *actual* reliance by the buyer on the alleged express warranty or is it enough that the buyer could reasonably rely on the warranty?<sup>12</sup> If the test does not require actual or potential reliance, what is required? The U.C.C.'s comments only increase the confusion. Comment 3 to section 2-313, attempting to clarify the test, explains that "no particular reliance on [an affirmation of fact or promise] need be shown in order to weave them into the fabric of the agreement."<sup>13</sup> But what is meant by "no particular reliance" and how is something woven "into the fabric of the agreement?"<sup>14</sup>

Another measure of the failure of the basis-of-the-bargain test, not surprising in light of the above, is the number of cases that have wrestled with the concept and have failed to clarify the meaning of the test. Far from it, the case law adds to the confusion.<sup>15</sup> Without coherence, the test cannot guide transactors, lawyers, or courts.

A recent explanation of the basis-of-the-bargain test has fared no better. The Uniform Computer Information Transactions Act (UCITA) retained the test for computer information, but its gloss only adds to the confusion.<sup>16</sup> UCITA explains,

[I]n practice, affirmations of fact describing the [software] and made by the licensor about it during the bargaining are ordinarily part of the bargain unless they are mere puffing, predictions, or otherwise not an enforceable commitment. No specific reliance on the specific statement need be shown in order to weave it into the fabric of the agreement.<sup>17</sup>

But this explanation leads nowhere. A representation or promise requires an "enforceable commitment" to be part of the basis of the bargain, but we already know that. A good explanation needs to tell us what constitutes an "enforceable commitment." And what is the meaning of "specific" reliance?<sup>18</sup> Further, the "fabric of the agreement" language appears again to add to the confusion.

12. See ALI Principles, *supra* note 1, at § 3.02 cmt. b.

13. U.C.C. § 2-316, cmt. 3.

14. See also *infra* notes 15-19.

15. Many courts focus on comment 3 to § 2-313. But many of these courts look for reliance notwithstanding the admonition in the comment that "no particular reliance" is required. See, e.g., ALI Principles, *supra* note 1, at § 3.02, Reporters' Notes, cmt. a, and cases cited therein.

16. UCITA has been enacted in only two states.

17. UCITA § 402, cmt. 2 (2002).

18. A leading treatise on licensing law also stumbles over the "basis of the bargain" test:

The basis-of-the-bargain test is also neither fair nor efficient. Its obtuseness invites overreaching by sellers and manipulation by courts. Because of its mystery, sellers can claim that a promise or representation was not “part of the basis of the bargain” without hesitation and regardless of how distinct, verifiable, and specific the communication. Further, efficiency demands clear default rules that mimic the rules the parties would have agreed to had they contracted with respect to the issue.<sup>19</sup> The basis-of-the-bargain test obviously lacks in this department too.

The solution out of this quagmire is to eliminate the basis-of-the-bargain test completely. Instead, section 2-316(1) should adopt what the U.C.C. drafters probably had in mind when they created the test; mainly that a promise or representation constitutes an express warranty if it is the type on which reasonable buyers could rely.<sup>20</sup> A buyer could rely on a promise or representation that is specific, clear, and unconditional. Such a rule would clarify that the U.C.C.’s “no particular reliance need be shown” language really means that no actual reliance must be shown.<sup>21</sup>

## II. DISCLAIMING EXPRESS WARRANTIES

U.C.C. § 2-316(1) governs the exclusion or modification of express warranties. The section calls for courts to construe “[w]ords or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty . . . as consistent” if reasonable, but a seller’s attempt to exclude or modify a warranty fails “to the extent that such construction is unreasonable.”<sup>22</sup> As with section 2-313, this section creates confusion. Language creating warranties and disclaiming them can hardly be “consistent.” Courts understandably throw up their hands in despair when applying this section too and often decide solely by weighing the specificity and conspicuousness of the disclaimer.<sup>23</sup> Some courts even suggest that an inconsis-

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The comments to the Article 2 section indicated that [the basis of the bargain test] was intended to supplant the pure reliance standard, but the language used in effect merely reduces the need for a finding of ‘explicit,’ ‘but for’ reliance in the sense that it is the reason that the contract was formed. . . . The basis of the bargain test requires that a *nexus of influence* between warranty and bargain exist. The issue is what that nexus must be. Since the advent of Article 2, debate has raged in both the academy and the courts as to whether the phrase “part of the basis of the bargain” was intended to abrogate the reliance requirement that the predecessor to Article 2 . . . explicitly imposed.

RAYMOND T. NIMMER & JEFF DODD, MODERN LICENSING LAW § 8:33 (2005).

19. See, e.g., R. POSNER, ECONOMIC ANALYSIS OF LAW 105 (5th ed. 1998).

20. See ALI Principles, *supra* note 1, § 3.02(c) and cmt. f.

21. See *supra* text accompanying note 13.

22. U.C.C. § 2-316(1) states more fully: “Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent . . . but . . . negation or limitation is inoperative to the extent that such construction is unreasonable.”

23. See, e.g., ALI Principles, *supra* note 1, § 3.06, Reporters’ Notes, cmt. a, and cases cited therein.

tent disclaimer can trump an express warranty.<sup>24</sup> Most decisions nonetheless seem to favor the express warranty over any disclaimer.<sup>25</sup>

As with section 2-313, a clearer and more workable approach is buried in the comment to section 2-316. According to comment 1, section 2-316(1) “protect[s] a buyer from unexpected and unbargained language of disclaimer . . . .”<sup>26</sup> This approach, focusing on what a buyer should or should not expect, should be tested objectively, meaning that if a reasonable buyer would not expect the disclaimer, it should not be enforceable.<sup>27</sup> Courts should compare the clarity and distinctiveness of the language of warranty and disclaimer and the context in which the seller presents each to determine whether a buyer should be surprised by the seller’s disclaimer. For example, if a seller’s agent very distinctly “guarantees” that a car will get 30 miles per gallon, a reasonable buyer would expect the seller to stand behind the claim. However, if a seller clearly states that its promises or representations are not legally binding, and the seller includes a disclaimer in the written contract, a reasonable buyer should understand that there are no express warranties. In addition, a reasonable buyer would not be surprised by a disclaimer if the buyer was involved in drafting the contract.<sup>28</sup>

### III. TECHNOLOGICAL EXACERBATIONS

Recall that the goal of this symposium is to evaluate the likelihood of the success of Article 2 in the twenty-first century. At least with respect to the warranty-disclaimer issues focused on here (and I suspect with many other issues as well), this century’s digital technology exacerbates the problems and creates an even greater need for reform.

In the typical Internet shopping environment, a buyer surfs the web looking for an item, or perhaps even more frequently, simply shops for fun, browsing for things to acquire.<sup>29</sup> After reading a description of the goods

24. See, e.g., ALI Principles, *supra* note 1, § 3.06, Reporters’ Notes, cmt. a, citing *Ekizian v. Capurro*, 444 N.Y.S.2d 361, 362 (N.Y. Just. Ct. 1981) (“inconsistent” disclaimer may be enforceable); *Bernstein v. Sherman*, 497 N.Y.S.2d 298, 300-01 (N.Y. Just. Ct. 1986) (same).

25. See, e.g., ALI Principles, *supra* note 1, § 3.06, Reporters’ Notes, cmt. a, and cases cited therein.

26. U.C.C. § 2-316, cmt.1. Many cases follow the comment. See, e.g., *Manitowoc Marine Group, LLC v. Ameron Intern. Corp.*, 424 F. Supp. 2d 1119, 1132-33 (E.D. Wis. 2006); *Morningstar v. Hallett*, 858 A.2d 125, 130 (Pa. Super. 2004); *Southern Energy Homes, Inc. v. Washington*, 774 So.2d 505, 512-13 (Ala. 2000).

27. If a disclaimer is unexpected it is also “unbargained for,” so a court need not tinker with the latter language. White and Summers report that an early U.C.C. Article 2 draft denied enforcement to disclaimers of express warranties. See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 425 (5th ed. 2000). Further, according to the commentators, “[i]f the factfinder determines that a seller’s statement created an express warranty, words purportedly disclaiming that warranty will still be ‘inoperative,’ for the disclaiming language is inherently inconsistent.” *Id.*

28. See, e.g., ALI Principles, *supra* note 1, at § 3.06 Reporters’ Notes, cmt. a, and cases cited therein.

29. For example,

and specific and verifiable promises and representations touting their quality and capabilities, the buyer almost instantaneously clicks the “purchase” and “I agree” icons while bypassing the electronic standard form.<sup>30</sup> This environment is ripe for seller opportunism. In short, technology has made it too easy for sellers to bombard buyers with promises and representation and for buyers to rely on them and to commit to a purchase without reading the warranty disclaimer.<sup>31</sup> These buyers will be surprised to learn that sellers do not intend to make enforceable promises concerning the quality of their goods but, instead, intend to disclaim all liability.<sup>32</sup>

Some sellers generally stand behind their products regardless of their disclaimers. But many cases document that this is far from a universal practice.<sup>33</sup> Further, the argument that buyers do not need legal protection because sellers stand behind their products proves too much. As I have said about this argument elsewhere in the context of software contracts, “[i]f accepted, the argument means that we do not need contract law at all. Let’s just trust in the good faith of all businesses.”<sup>34</sup>

Thus, technology creates new worries that buyers face an unfair playing field. In the software context, the ALI Software Principles require software licensors to present terms, including disclaimers, on their websites *prior* to a

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Analysis of [Internet] shopping is still relatively novel . . . . One study identifies two major types of shoppers on the Internet. One type, the ‘convenience’ shopper has a particular purchase in mind and rationally uses the Internet to reduce search costs, such as by using a search engine to gather information on and to compare prices and by reading product reviews online. The ‘recreational’ shopper, on the other hand, shops for the sheer enjoyment of the experience and, stimulated by the interactive nature of the Internet, often purchases impulsively. Recreational shoppers ‘may be driven by *need to purchase* rather than *need for a product*.’ Analysts report that recreation may be ‘more important than convenience for online shoppers.’ Even shoppers who begin their shopping experience rationally to reduce the costs of their transaction may ultimately engage in impulse buying. The Internet environment apparently contributes to impulse purchasing because of its anonymity (people purchasing impulsively prefer privacy), availability 24 hours a day, and other ‘recreational shopping features,’ such as ‘email alerts of new products . . . [and] special offers.’

Robert A. Hillman, *Online Boilerplate: Would Mandatory Website Disclosure of E-Standard Terms Backfire*, 104 MICH. L. REV. 837, 851 (2006) (quoting Junghyun Kim & Robert LaRose, *Interactive E-Commerce: Promoting Consumer Efficiency or Impulsivity?* 10 J. COMPUTER-MEDIATED COMM., Nov. 2004, [http://jcmc.indiana.edu/vol10/issue1/kim\\_larose.html](http://jcmc.indiana.edu/vol10/issue1/kim_larose.html)).

30. See, e.g., Robert A. Hillman, *On-Line Consumer Standard-Form Contracting Practices: A Survey and Discussion of Legal Implications*, IS CONSUMER PROTECTION AN ANACHRONISM IN THE INFORMATION ECONOMY? 283 (2006).

31. For example, in a new study of 54 best-selling software products in which the licensor made its End User License Agreement (EULA) available on its website without a purchase, 53 contain express warranties on the website and e-disclaimers in the EULAs that may erase all or much of this quality protection. See Hillman and Barakat, *supra* note 10. On the lack of reading of e-standard forms, see Hillman, *supra* note 30; Chang-Hoan Cho, Jaewon Kang, & Hongsik John Cheon, *Online Shopping Hesitation*, 9 CYBERPSYCHOLOGY & BEHAVIOR 261 (2006).

32. The more formalities and processes required to make a commitment, the more likely a party will be cautioned about the seriousness of what she is doing. See Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799 (1941).

33. See, e.g., *Inter-Mark USA, Inc. v. Intuit*, 2008 U.S. Dist. LEXIS 18834 (N.D. Cal. Feb. 27, 2008) (software disclaimer); see also *supra* notes 22-25, and accompanying text.

34. See Hillman and Barakat, *supra* note 10, at 12.

particular transaction and again when a licensee initiates a transaction.<sup>35</sup> I discuss the mechanics of these requirements, their importance, and their shortcomings fully elsewhere.<sup>36</sup> Suffice it to say that better disclosure gives buyers a greater opportunity to inform themselves before the excitement of a particular purchase decreases the chances that they will read their standard form. Further, watchdog groups can research unfair terms and broadcast them over the Internet, thereby creating incentives for sellers to write fair terms. On the other hand, greater disclosure makes it more difficult for a buyer to claim that a particular disclaimer is a surprise and therefore procedurally unconscionable.<sup>37</sup> As a result, buyers may be stuck with disclaimers that they fail to read. Disclosure may therefore put these buyers in a worse position. Disclosure's checkered past as a strategy of consumer protection intensifies this concern.<sup>38</sup>

Another response would be for the U.C.C. or other law to require sellers to create a conspicuous notice on their website, informing buyers that website representations and promises are not legally enforceable.<sup>39</sup> Alternatively, Article 2 could outlaw all electronic disclaimers of otherwise enforceable website express warranties based on the view that such disclaimers are always unexpected and misleading.<sup>40</sup> But sellers can argue with some justification that if the disclosure process is reasonable, blunderbuss notice requirements or wholesale exclusion of disclaimers denies them freedom of contract.<sup>41</sup> In short, disclosure seems the best of a host of problematic solutions to the e-commerce warranty-disclaimer issue.<sup>42</sup>

#### IV. CONCLUSION

The suggestions here—redefining the nature of an express warranty to eliminate the “basis of the bargain” test, preserving warranties if disclaimers are unexpected, and requiring better disclosure of disclaimers—will help even the playing field between sellers and buyers both in traditional paper sales transactions and twenty-first century digital transactions.

On a larger scale, this discussion suggests Article 2, with some refinement, can be successful in the new century. Lawmakers should determine

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35. *Id.* at 23; ALI Principles *supra* note 1, at § 2.02. Thirty-four percent of the Top 100 software titles in a recent survey did not make their EULAs available before a consumer engaged in a transaction. See Hillman and Barakat, *supra* note 10.

36. See Hillman and Barakat, *supra* note 10, at 24-26; ALI Principles, *supra* note 1, at § 2.02 and comments.

37. See Hillman, *supra* note 29, at 853-55.

38. *Id.* at 849-50 (“Many commentators seem to have lost faith in disclosure as a remedy for market failures in standard-form contracting partly because they have seen the relative failure of laws such as Truth in Lending, and partly because they now better understand the reasons people sometimes fail to respond to information.”)

39. Hillman and Barakat, *supra* note 10, at 26-27.

40. *Id.*

41. *Id.* at 27.

42. For additional discussion see *Id.* at 22-27.

what major issues are held over from twentieth century litigation due to poor drafting and what major issues arise because of technological changes in this new century.<sup>43</sup> Attention to these issues should be enough. Most of Article 2 still works.

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43. See generally Robert A. Hillman, *Standards for Revising Article 2 of the U.C.C., The NOM Clause Model*, 35 WM. & MARY L. REV. 1509 (1994).