

MEMORANDUM

To: Edwin Smith, Chair
Steven Harris, Reporter

From: Leianne Crittenden and Neil B. Cohen, Co-Chairs of Subcommittee on Bundled Hardware, Software, and Service Transactions

Re: Subcommittee Report

Date: January 27, 2020

This subcommittee engaged in one live group discussion and in further email discussions generated by questions posed to the subcommittee members. This memorandum describes the issues that arose in those discussions. Some individuals and groups have indicated that they intend to supplement the points made in those discussions with additional memoranda. We will pass along those memoranda when they arrive.

Discussions within the subcommittee focused on the observation that an increasing number of transactions include both goods and technology services (such as access/cloud services) and the implications of that trend for the transactional needs for predictability and certainty of rights. This observation led to several questions:

1. In a dispute arising out of such a contract (traditionally referred to as a “mixed” or “hybrid” contract and more recently often referred to as a “bundled contract”) in which the vendor provides both goods and non-goods (especially technological services, including support, consulting or cloud services), most states apply a “predominant purpose” test to determine whether (i) the contract is governed by the UCC Articles about goods (Article 2 or Article 2A, as applicable), or (ii) by non-goods law outside the UCC. But not all disputes are alike. In some cases, the dispute concerns the contract taken as a whole (such as whether an enforceable contract was formed), while in other cases the dispute may involve only one aspect of the transaction. Such a dispute may involve only the goods aspect of the transaction (such as when the claim is that the goods do not conform to contractual specifications) or only the non-goods aspect (such as a claim about support services). Many members of the subcommittee indicated that it would be preferable, in the case of a dispute involving only one aspect of the transaction, for the law governing the disputed issue to be the UCC law of goods when a dispute about the goods is the gravamen of the dispute, and for the law governing the disputed issue be non-UCC law when a dispute about the non-goods aspect of the transaction is the gravamen of the dispute. (The view was also expressed that, if the current practice of having one body of law govern the entire transaction is continued, consideration should

be given to having the UCC govern if matters within the scope of the UCC are a *substantial* aspect of the transaction even if they do not predominate.) In light of the prevalence of the predominant purpose test in most states, adopting a rule of the sort advocated by subcommittee members would probably require a change to the text of UCC Articles 2 and 2A.

2. A contract pursuant to which a vendor transfers the right to possession and use of goods for a term in return for consideration is a lease (see UCC § 2A-103(j)) and a record or records reflecting such a transaction evidence both a monetary obligation and lease of specific goods and, thus, constitute “chattel paper” (see UCC § 9-102(a)(11)). But consider a mixed/hybrid/bundled transaction that would be a lease if only goods were involved, but which also involves a significant amount of non-goods (especially technological services, including support, consulting or cloud services). Is that transaction a lease, so that the record or records reflecting the transaction constitute chattel paper, with the result that important Article 9 rules relating to chattel paper apply? Does the answer (or should the answer) depend on whether the goods or non-goods aspect of the transaction predominates? Do the record or records constitute chattel paper only to the extent of the portion of the monetary obligation attributable to the goods? The view was expressed that uncertainty with respect to this issue is harmful to the marketplace.
3. Consider a mixed/hybrid/bundled transaction that would be a finance lease if only goods were involved, but which also involves a significant amount of non-goods (especially technological services, including support, consulting or cloud services). Does the transaction constitute a finance lease, giving the lessor the benefit of the “hell or high water” protection of UCC § 2A-407? Is explicit “hell or high water” language enforceable? Does the answer (or should the answer) depend on whether the goods or non-goods predominate? Is the transaction a finance lease only to the extent of the portion of the monetary obligation attributable to the goods? The view was expressed that uncertainty with respect to this issue is harmful to the marketplace. It should be noted, however, that
 - a. Such potential harm is mitigated in transactions in which the agreement contains language providing that the lessee agrees not to assert against an assignee any claim that it may have against the assignor by the fact that, if the lessor assigns its rights to be paid under the contract, UCC § 9-403 will prevent most of the lessee’s defenses from being asserted against the assignee.
 - b. Nothing in Article 2A prevents giving effect between the parties to express “hell or high water” language in the contract. Rather, as noted in Comment 6 to UCC § 2A-407, that section does not address the enforceability of such express language and the “issue will continue to be determined by the facts of each case and other law which this section does not affect.”

In addition, during the subcommittee conference call, the issue was raised whether the provisions of Article 2 and Article 2A are sufficient to protect a consumer’s interest in “smart goods” (however defined). This did not generate much attention in response to the follow-up memorandum sent to subcommittee members. One member said that the matter should be

discussed further, while another stated that, while UCC provisions are not sufficient to protect a consumer's interest in hybrid "smart goods" transactions, the "UCC was never intended to be a statute one of whose purposes was to protect consumers, and it does not do so."