Contract Law
I. ARCHITECT NOT ENTITLED TO FEES UNLESS DESIGNED BUILDING CAN BE CONSTRUCTED FOR AMOUNT NOT SUBSTANTIALLY GREATER THAN THAT STIPULATED BY PROPERTY OWNER

In *Peteet v. Fogarty*¹ the South Carolina Court of Appeals reaffirmed a 1950 supreme court decision² that an architect cannot recover compensation on a contract when the probable cost of construction substantially exceeds the agreed maximum cost of the building. The court found that a $307,000 bid for construction substantially exceeded an agreed upon $150,000 maximum cost.³

Bill and Regina Fogarty contracted with Frank Peteet, an architect, to design a new house. The maximum cost of the building was to be $150,000. The Fogartys agreed to pay Peteet a total fee of ten percent of the construction costs, payable in increments, with forty percent of the total fee due upon completion of the design phase. By the time the plans for the house had been completed, the Fogartys had paid Peteet $10,000. Peteet then demanded an additional $5,000 fee.⁴

Mr. Fogarty complained the additional $5,000 fee was unreasonable because the cost of the house was not to exceed $150,000. Peteet then revealed that he had received a bid of $307,000 on the plans. The parties subsequently ceased negotiations and Peteet sought to foreclose on an architect's lien on the property. The Fogartys asserted a counterclaim for breach of contract. A special referee heard the case and dismissed Peteet's complaint, instead awarding the Fogartys $10,000 in damages (the amount of fees paid to Peteet) plus costs. Peteet appealed the special referee's order.⁵

The court of appeals affirmed the order of the special referee and re-emphasized South Carolina's traditional application of the relaxed version of the rule concerning architects' entitlement to compensation.⁶

Nationwide, two rules exist regarding an architect's breach of a contractual limitation on the cost of a building.⁷ The minority rule is strict

---

4. Id., 375 S.E.2d at 528.
5. See id.
6. Id., 375 S.E.2d at 528-29.
7. See Annotation, Effect on Compensation of Architect or Building Contractor of Express Provision in Private Building Contract Limiting the Cost of the Building, 20
and absolute, requiring that "an architect cannot recover compensation on the contract if the actual or probable cost of construction exceeds the agreed maximum cost." The majority rule is more relaxed. It provides that "an architect cannot recover compensation on the contract if the actual or probable cost of construction substantially exceeds the agreed maximum cost."

In 1950, the South Carolina Supreme Court decided in Beacham v. Greenville County that the strict rule of architect compensation was too restrictive and adopted the more relaxed majority rule. Peteet v. Fogarty reaffirms South Carolina's adherence to this rule. Thus, South Carolina continues to follow the majority view on this issue.

The court in Peteet, however, declined to address a question unanswered by South Carolina law: Is the architect entitled to compensation when the substantial cost excess is due to the owner's actions? Since Peteet failed to raise this point by exception, and the court found no evidence in the record indicating the cost excess was attributable to the Fogartys, the court did not decide the issue.11 Other jurisdictions have decided the point and the majority view is that an architect is entitled to compensation if the cost excess is caused by the owner's change in plans.12

South Carolina courts probably will have to address this issue in the near future and are likely to join the majority of jurisdictions which do not penalize the architect for actions of the owner. In Gallivan Building Co. v. S.H. Kress & Co., an early case interpreting an architect's contract, the South Carolina Supreme Court considered actions of an owner that resulted in excess costs of construction. The court allowed the architect to recover compensation even though the actual cost of construction was greater than the agreed maximum. This, however, was not the main issue in Gallivan and the recovery was permitted only because the architects price was merely an estimate; the owner did not object in time; the owner had already paid more than the agreed percentage of the agreed maximum and, there-

8. Id. at 782.
9. Id. (emphasis added).
11. See Peteet, 297 S.C. at 230, 375 S.E.2d at 529.
13. 120 S.C. 502, 113 S.E. 342 (1922).
fore, was deemed to have been aware that the construction costs were going to exceed the agreed price.\textsuperscript{14} Since the court in Gallivan established precedent for considering the owner's actions, it is probable that in future cases courts will consider owners' actions along with those of architects when evidence indicates an owner caused the costs to exceed the agreed maximum.

Until the issue of owners' actions as a cause of excess construction costs is properly raised, the court of appeals has indicated it will not consider the issue.\textsuperscript{15} Instead, the court will adhere to the rule established in Beacham v. Greenville County and reaffirmed in Peteet v. Fogarty. Architects are not entitled to compensation unless the buildings they are hired to design can be constructed for an amount not substantially greater than that stipulated by the property owner.

Margaret A. Chamberlain

II. COURT RELIES ON COMMON LAW TO FIND IMPLIED WARRANTY IN CHATTEL LEASE

The South Carolina Court of Appeals found implied warranties of merchantability and fitness for a particular purpose in a lease of earth moving equipment in C. Ray Miles Construction Co. v. Weaver.\textsuperscript{16} The court held that under the South Carolina common law doctrine of caveat venditor, implied warranties are effective in leases of personal property.\textsuperscript{17} The decision follows a growing trend among courts to imply warranties in leases.

The dispute arose over the lease of earth moving equipment by Weaver from C. Ray Miles Construction Company. Miles Construction sued to collect rent due under the lease. Weaver counterclaimed, alleging breach of express and implied warranties that the equipment was reasonably fit for the purpose for which the Miles Construction knew it would be used.\textsuperscript{18} The circuit court struck the warranty allegations from the counterclaim, explaining that the Uniform Commercial Code (UCC) only applies to contracts for sale.\textsuperscript{19} Weaver appealed.

The court of appeals readily disposed of the express warranty issue by maintaining that "there is no reason why the parties should be prohibited from contracting for an express warranty on the personal

\textsuperscript{14} See id. at 506-10, 113 S.E. at 343-44.
\textsuperscript{15} See Peteet, 297 S.C. at 230, 375 S.E.2d at 529.
\textsuperscript{16} 296 S.C. 466, 373 S.E.2d 905 (Ct. App. 1988).
\textsuperscript{17} Id. at 472-73, 373 S.E.2d at 908.
\textsuperscript{18} Id. at 467, 373 S.E.2d at 905.
\textsuperscript{19} Record at 5-6.
property which was the subject of the lease." The court concluded that the trial court erred in striking the express warranty claim.

To deal with the implied warranty claims, the court of appeals looked to South Carolina's common law. Unlike England and every other state, South Carolina imposes a warranty of soundness in sales: a sound price warrants a sound commodity. This warranty of soundness is South Carolina's forerunner of the UCC's implied warranty of merchantability. South Carolina common law also implies a warranty of fitness for a particular purpose in a sales transaction. These implied warranties were established prior to drafting of the UCC and remain valid despite this state's adoption of the Code.

The court relied on Colcock v. Goode for the proposition that the implied warranties need not be restricted to sales. In Colcock Goode hired six slaves from Colcock, but one of the slaves was ill and could work only part time. The South Carolina Supreme Court held that "the doctrine of implied warranty arises as well from a contract of hire as on the sale of slaves." Applying that reasoning to the facts of Weaver, the court found "[t]here is no logical reason for any distinction between contracts of sale and leases insofar as the recognition of implied warranties is concerned." The court remanded the case for a determination as to whether the elements of the implied warranties were met.

The court of appeals did not suggest an analogy between Article 2 of the UCC and the lease in Weaver. This option was foreclosed by its

20. Weaver, 296 S.C. at 468, 373 S.E.2d at 905-06.
21. Id., 373 S.E.2d at 906.
22. Id. at 468-69, 373 S.E.2d at 906; see also Southern Iron & Equip. Co. v. Bamberg, E. & W. Ry., 151 S.C. 506, 149 S.E. 271 (1929) (warranty of soundness implied when locomotive purchaser relies on seller for representations about the engine's condition); Smith v. McCell, 12 S.C.L. (McCord) 220 (1821) (implied warranty of soundness does not cover moral qualities of a slave); Barnard v. Yates, 10 S.C.L. (Nott & McC.) 142 (1818) (warranty of soundness implied when buyer entitled to rely on seller's expertise); Lester v. Graham, 8 S.C.L. (1 Mill) 182, 183 (1817) (sound price implies sound product is the "settled law of the land"); Timrod v. Shoolbred, 1 S.C.L. (Bay) 324 (1793) (warranty of soundness implied in slave who died of smallpox the day after sale).
24. See Reliance Varnish Co. v. Mullins Lumber Co., 213 S.C. 84, 48 S.E.2d 653 (1948) (implied warranty exists when seller knows purpose of purchase); Liquid Carbonic Co. v. Coclin, 161 S.C. 40, 159 S.E. 461 (1931) (warranty will be implied that article is suitable for its purpose); Walker, Evans & Cogswell Co. v. Ayer, 80 S.C. 292, 61 S.E. 557 (1908) (warranty exists that product will be fit for ordinary purpose).
26. See Weaver, 296 S.C. at 472, 373 S.E.2d at 908.
27. Colcock, 14 S.C.L. (McCord) at 516.
earlier decision in *Henderson v. Gould, Inc.* In *Henderson* the lessor did not cite as error the circuit court's decision to strike the warranty allegations. As a result, the court focused exclusively on the direct applicability of the UCC, and held that UCC implied warranties arise only upon a sale. *Henderson* effectively ruled out future applications of the UCC to leases by analogy, although it left open the option of categorizing the lease as a sale subject to the UCC.

Many courts that have found implied warranties in leases have done so by analogy to the UCC. For example, in *Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House,* a New York court determined that since a large number of commercial transactions are conducted through lease arrangements similar to contracts of sale, it would be inconsistent to treat leases differently than sales contracts.

Another way in which courts, including the South Carolina Supreme Court, have applied the UCC to leases has been to interpret the lease as a contract for sale. In *Mid-Continent Refrigerator Co. v. Way* the South Carolina Supreme Court considered a lease agree-

---

30. See id. at 267, 341 S.E.2d at 810.
31. For a discussion of application of Article 2 of the UCC to leases and the categorization of leases as contracts of sale, see Farnsworth, *Implied Warranties of Quality in Non-Sales Cases,* 57 COLUM. L. REV. 653 (1957). Farnsworth discusses different approaches courts have taken in applying implied warranties to non-sale cases. He determines the application of the sales rules by analogy "is preferable to categorization of the contract as one of sale and direct application of the sales statute." Id. at 667. The author identifies five advantages to reasoning by analogy. The first is that analogy does not place a court in the position of completely changing long-standing positions concerning the definition of sales. "[I]t is awkward and misleading for a court to explain that what yesterday was not a sale, is today a sale." Id. Second, analogy avoids applying other sales rules which have no place in the transaction. These rules include the provisions requiring the buyer to notify the seller of a breach within a reasonable time after he knows or should know of it. Third, analogy can extend implied warranties to transactions which should logically have them, but which could not be defined as sales. Fourth, with direct application of the sales act, subsequent cases in which policy may prohibit a court from implying warranties may be indistinguishable as sales, leading to artificial lines of reasoning. Fifth, use of analogy enables court decisions to rest on the real reasons for implying warranties, rather than on characterization of the transaction. Id. at 667-69.
33. Id.
34. Id. at 229, 298 N.Y.S.2d at 395; see also *Barco Auto Leasing Corp. v. PSI Cosmetics Inc.*, 125 Misc. 2d 68, 478 N.Y.S.2d 505 (Civ. Ct. 1984) (applying by analogy UCC implied warranty provisions, including those of disclaimer and procedural unconscionability, to a corporate lease of an automobile).
ment in which the lessor could buy back refrigeration equipment merely by paying sales tax after thirty-six monthly payments by the lessee. The court found the lease to be a contract for sale. 38 "The true and real consideration for the sale of the goods, with interest thereon, was obviously embodied in the so-called rental payments required by the document purporting to be only a lease." 39 The court in Way proceeded to apply the implied warranty provisions of the UCC to the "lease." 38

The court of appeals in Weaver did not categorize the lease as a sales contract since the lessor did not have to repurchase the equipment from the lessee. The court also did not address how such an analogy would be affected by the imposition of implied warranties on lease agreements. Since the court's previous decision in Henderson precluded application of the UCC to leases, and since the lease in Weaver was not in the nature of a sale, its finding of implied warranties necessarily was based on old South Carolina common law doctrines originally applied in slave dispute cases.

Although not cited by the court of appeals in Weaver, the supreme court in Pioneer Manufacturing Co. v. Columbia Equipment Rentals, Inc. 39 arguable acknowledged that implied warranties may attach to leases. In that case the lessee of a truck successfully sued the lessor for breach of implied warranty. The lessee appealed the trial court's denial of his motion for directed verdict. The South Carolina Supreme Court recognized that the plaintiff's "action [was] predicated upon the contention that when the defendant rented the truck, an obligation or warranty, similar to the implied warranty of fitness in the sale of personal property, was imposed, as a matter of law, upon the defendant." 40

The court in Pioneer acknowledged that as a general rule other jurisdictions hold that a warranty is implied by law on the bailor of leased chattels, but stated that even "[a]ssuming the soundness . . . of the general rule of law relied upon by plaintiff," the court could not determine that the plaintiff was entitled to a directed verdict. 41 The court stated that while it was "unnecessary to fully consider the general rule relied upon by plaintiff, . . . a jury issue was presented as to whether the damages sustained by the plaintiff were proximately caused by any breach of such implied warranty on the part of the de-

36. Id. at 108, 208 S.E.2d at 34.
37. Id.
38. See id. at 108-09, 208 S.E.2d at 34; see also Sawyer v. Pioneer Leasing Corp., 244 Ark. 943, 428 S.W.2d 46 (1968) (five-year lease found analogous to a sales contract).
40. Id. at 458, 148 S.E.2d at 49.
41. Id.
fendant.” The Pioneer court did not cite any South Carolina cases, including Colcock v. Goode, which was relied upon by the court of appeals in Weaver, to support the plaintiff’s contention. In fact, no court prior to Weaver had ever cited Colcock for the proposition that a warranty may be implied in a non-sales transaction. To resurrect a case which lay dormant for 162 years demonstrates the lengths to which the court had to go to justify its decision.

The South Carolina common law rule of caveat venditor was applied earlier, however, to the sale of real property. In Lane v. Trenholm Building Co. the court imposed implied warranties of quality to the seller of new buildings, regardless of the identity of the builder. In that case, as in Weaver, the court did not apply the UCC by analogy. Instead, the court based its decision on the common law rule of caveat venditor. The Lane court acknowledged that UCC implied warranties may not have been applicable, since the seller of the home may not have been a merchant. Nonetheless, it indicated that the uniformity of the UCC was not essential to the question presented, since the sale of buildings was a local concern.

The application of implied warranties to leases also has been addressed by the American Law Institute. Proposed Article 2A to the UCC applies implied warranties of merchantability and fitness for a particular purpose to leases. The requirements for application of the implied warranties to leases are the same as those for sales in Article 2. The implied warranty of merchantability for leases includes the requirement that the lessor be a merchant as defined by the UCC. South Carolina may adopt Article 2A in the future. This action would codify the Weaver decision with regard to implied warranties in leases and thus establish uniform application of warranties in both lease and sales transactions.

After Weaver, lessees will be concerned with what they must prove to establish the implied warranties of quality. Since the court did not base its decision on the UCC, the warranty elements set out in Article 2 are inapplicable. For instance, unlike the UCC, the common law warranty of soundness, which is analogous to the warranty of merchantability, does not require the lessor/seller to be a merchant. The supreme court in Lane specifically concluded the plaintiff need

42. Id. at 456, 148 S.E.2d at 50.
43. 14 S.C.L. (3 McCord) 513 (1826).
44. 267 S.C. 497, 229 S.E.2d 728 (1976).
45. See id. at 502, 229 S.E.2d at 730 (citing Timrod v. Shoolbred, 1 S.C.L. (1 Bay) 324 (1793)).
46. Id. at 503-04, 229 S.E.2d at 731.
not prove the defendant is a merchant as defined by the UCC.\textsuperscript{48} This conclusion, however, was based largely on the nature of the item sold (realty), not on the theory of implied warranty.\textsuperscript{49}

South Carolina courts in the future probably will be required to look to the UCC to answer questions concerning implied warranties in leases. The court of appeals simply should have overruled \textit{Henderson} and applied the UCC to leases by analogy. If the court had chosen this route it would have reached the same result, aligned this state with most other jurisdictions that have considered the issue, and avoided inevitable confusion by creating identical standards for implied warranties, whether for leases or sales.

Although the court reached its decision by way of at least questionable reasoning, the decision itself was the right one. There is no justification for distinguishing between purchasers and lessees with regard to implied warranties. This case creates a new cause of action for lessees who receive defective property and also creates a defense to a suit by the lessor for non-payment of rent.

\textit{Charles Russell Rogers, Jr.}

\section*{III. Court Awards Offsetting Judgments to Consumer and Installment Contract Assignee When Consumer Refused Continuation of Payments for Defective Product}

When a consumer finances a purchase of an automobile, discovers his new vehicle is a "lemon," and after numerous attempts to have the defects corrected refuses to make further payments on the loan, what happens? In \textit{American Federal Bank v. White}\textsuperscript{50} the consumer and the bank, who was the assignee on the retail installment sales contract, discovered that neither party really wins nor loses.

Ray White purchased a new truck from an automobile dealer pursuant to a retail installment sales contract. The dealer subsequently assigned the contract to American Federal Bank. White made a down payment of \$3,200 on the truck, purchased a vehicle service contract for \$588, and contracted to make forty-eight monthly payments of \$327 to pay off the loan. The new truck developed transmission problems several days after White purchased it. White also discovered the truck's paint was defective. He returned the truck to the dealer to repair the defects, but after numerous attempts at repair, the defects

\textsuperscript{48} See \textit{Lane}, 267 S.C. at 503-04, 229 S.E.2d at 731.

\textsuperscript{49} See \textit{id}.

\textsuperscript{50} 296 S.C. 165, 370 S.E.2d 923 (Ct. App. 1988).
still existed. After eight months of making monthly payments and driving a defective truck, White refused to make further payments. American Federal repossessed the truck after three monthly payments had not been received. At the time of repossession White had paid $4,510.56 (amount of down payment plus monthly payments paid). The truck was sold for $3000.51

American Federal brought an action for deficiency judgment against White for $2,871.28. White counterclaimed for breach of warranty, asking for damages of 4,510.56 (the amount he had paid for the truck). The trial judge found the truck was defective on the date of sale, the dealer had failed to cure the defects in the truck, and the failure to cure was a breach of the express warranty and the service contract. The court denied American Federal its deficiency judgment and awarded White $4,510.56. American Federal appealed.

On appeal, American Federal argued it was error for the trial judge to find there was a breach of the service contract, since the dealer repeatedly tried to repair the defect. The court of appeals rejected the argument that a service contract merely calls for "service" and not results. It reasoned that while a seller may limit a buyer's remedy to repair or replacement, such a limitation may fail the "essential purpose" of a service contract.

American Federal further argued that White did not give proper notice pursuant to the South Carolina Consumer Protection Code, that the amount awarded to White was improper, and that the trial court erred in not awarding the amount of deficiency to American Federal, since it was proved that a deficiency existed. The court of appeals relied on South Carolina Code section 37-2-404 in its determination that both the judgment against American Federal and the amount awarded to White were error. Section 37-2-404 provides the consumer a statutory right to assert any claims and defenses against the assignee that the consumer has against the seller. This right, however, is accompanied by the following limitation:

51. Id. at 166-67, 370 S.E.2d at 925.
52. Id. at 167, 370 S.E.2d at 925-26.
53. Id., 370 S.E.2d at 925.
54. See id. at 169, 370 S.E.2d at 925-26.
55. Id. at 169-70, 370 S.E.2d at 926. The court relied on South Carolina Code section 36-2-719(2) to support its holding that the service contract failed in its essential purpose, and thus allowed a remedy beyond repair and replacement of nonconforming goods or parts. Id. (citing S.C. CODE ANN. § 36-2-719(2) (Law. Co-op. 1976)).
56. See id. at 170-71, 370 S.E.2d at 927.
58. White, 296 S.C. at 171, 370 S.E.2d at 927.
A claim or defense of a consumer . . . may be asserted against the assignee . . . only if the consumer has made a good faith attempt to obtain satisfaction from the seller . . . and then only to the extent of the amount owing to the assignee with respect to the sale . . . of the property . . . at the time the assignee has written notice of the claim or defense. . . . Written notice is any written notification other than notice on a coupon, billing statement or other payment medium or material supplied by the assignee.60

The only written notice of White’s claims or defenses against the assignee, American Federal, was the counterclaim. Nonetheless, the court adopted a broad reading of the statute and found the counterclaim to be sufficient notice.61 The statute clearly requires the consumer to assert the claims and defenses against the assignee in writing and limits the claim to the amount owed to the assignee at the time such notice is given.62 After the sale of the repossessed truck, White owed American Federal $2,871.28. Thus, the maximum judgment White could obtain against American Federal was $2,871.28. It is equally clear, however, that White still owed American Federal that same amount. Therefore, the court affirmed the trial judge’s finding of liability against American Federal, reversed the decision denying American Federal’s claim against White, and remanded the case for entry of offsetting judgments in the amount of $2,871.28.63

Other jurisdictions have permitted recovery beyond the limited right to repair or replacement when the essential purpose of a service contract has been found to have failed.64 The only defense available to the seller appears to be a showing that the defect was cured before the action was brought, regardless of how long it took to repair the vehicle.65

The White court indicated additional recovery also is possible in

60. Id. § 37-2-404(2).
61. See White, 296 S.C. at 171, 370 S.E.2d at 927.
63. White, 296 S.C. at 172, 370 S.E.2d at 927.
this state, noting, "White may seek to recover any damages in excess of those recoverable from American from the seller . . . since the seller is liable on the underlying sales contract and warranty." If the seller is judgment proof, however, consumers will be unable to recover, and will have to suffer the loss. Cautious assignees should create for themselves similar contractual rights to recover for losses due to the wrongdoing of assignors. Of course, they will face the same problem as consumers if the seller is judgment proof.

The effect of American Federal Bank v. White is that neither party loses and neither party wins. South Carolina Code section 37-2-404 prevents the consumer from actually receiving an award against the assignee, but at the same time protects him from the assignee due to the offsetting judgments. Based on this section and under facts similar to those in White, assignees often will be unable to collect on deficiency judgments. This loss, however, is countered by the fact that assignees will be protected from paying judgments based on contractual breaches by assignors. Although the court established no firm guidelines as to when a breach of a service contract occurs, it indicated from its holding that eight months is a reasonable amount of time within which to have completed repairs, and that dissatisfied consumers will be entitled to the remedy enunciated in this case after that time.

O. Carlisle Edwards, Jr.

66. White, 296 S.C. at 172, 370 S.E.2d at 927.