January 1, 1999

# Sales

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This Article reviews recent case law under Article 2, Sales, of the Uniform Commercial Code (U.C.C.). Revised Article 2 has been approved by one of the co-sponsors of the U.C.C., the American Law Institute (ALI).[1] The other sponsor, the National Conference of Commissioners on Uniform State Laws (NCCUSL), has delayed consideration of Revised Article 2 until the summer of 2000.

## *SCOPE*

In *Princess Cruises, Inc. v. General Electric Co.*,[2] an admiralty case, the Fourth Circuit applied the predominant purpose test to a mixed contract for the sale of goods and services. Finding that the services portion of the contract predominated, the court applied the common law last shot rule[3] instead of U.C.C. section 2-207 and ruled that the contract had been made on the seller's terms, including its boilerplate terms and conditions.[4] In response to a purchase order requesting inspection and repairs on the buyer's cruise ship, the seller sent a price quote containing boilerplate clauses

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1. The latest draft of Revised Article 2 may be obtained at the following URL (visited July 3, 1999): <http://www.law.upenn.edu/library/ulc/ulc.htm>. After promulgation, the Official Text of a revised article may be obtained by contacting: National Conference of Commissioners on Uniform State Laws, 211 E. Ontario Street, Suite 1300, Chicago, IL 60611, Tel. 312-915-0195, Fax. 312-915-0187.

2. 143 F.3d 828, 35 U.C.C. Rep. Serv. 2d (West) 804 (4th Cir.), *cert. denied*, 119 S. Ct. 444 (1998).

3. The last shot rule is described in E. ALLAN FARNSWORTH, CONTRACTS 168-69 (3d ed. 1999).

4. *Princess Cruises, Inc.*, 143 F.3d at 832-35, 35 U.C.C. Rep. Serv. 2d (West) at 809-12.

limiting the seller's liability to the contract price and disclaiming liability for consequential damages. The buyer told the seller to proceed and eventually paid the price contained in the seller's quote. The seller improperly serviced a rotor. As a result, the buyer had to cancel several lucrative cruises and sued for breach of contract, breach of warranty, and negligence. The trial court drew on U.C.C. section 2-207 as a source of maritime law and allowed the jury to award $4.5 million in damages, far exceeding the $232,000 contract price.[5] On appeal, the Fourth Circuit reversed and remanded for entry of judgment in the amount of the contract price.[6] The court held the services portion of the contract predominated.[7] The court, therefore, applied the common law last shot rule, and held that the buyer had accepted the seller's price quote when it told the seller to proceed and later paid the amount contained in that quote.[8] As a result, the seller's damage limitation clauses contained in the quote were part of the contract.[9]

In *Micro Data Base Systems, Inc. v. Dharma Systems, Inc.*,[10] the Seventh Circuit, applying New Hampshire law, held that a contract to customize existing software was a "transaction in goods" contract subject to Article 2 and not a service contract subject to the common law.[11] The court noted a conflict of authority on this issue.[12]

## *CONTRACT FORMATION: BATTLE OF THE FORMS*

Lately courts seem to be finding ways to resolve the battle of the forms in favor of sellers. Several cases decided this year illustrate this trend. In *Brower v. Gateway 2000, Inc.*,[13] the New York Appellate Division followed *Hill v. Gateway 2000, Inc.*[14] and ruled that (i) Gateway 2000, Inc.'s (Gateway's) form arbitration clause was part of the contract, and (ii) the arbitration clause was substantively unconscionable.[15] The buyers had purchased computers by mail or phone order directly from Gateway. In each transaction, the computer arrived later in a box that also contained a document stating Gateway's standard terms and conditions. That document began with a statement that if the buyer kept the computer for more than thirty days after the date of delivery, the buyer accepted Gateway's standard terms. Paragraph 10 of those terms required arbitration of disputes in Chicago according to the rules of the International Chamber of

5. *Id.* at 831, 35 U.C.C. Rep. Serv. 2d (West) at 806-07.
6. *Id.* at 835, 35 U.C.C. Rep. Serv. 2d (West) at 813.
7. *Id.* at 833-34, 35 U.C.C. Rep. Serv. 2d (West) at 810-11.
8. *Id.* at 834-35, 35 U.C.C. Rep. Serv. 2d (West) at 811-12.
9. *Id.* at 835, 35 U.C.C. Rep. Serv. 2d (West) at 812.
10. 148 F.3d 649, 35 U.C.C. Rep. Serv. 2d (West) 747 (7th Cir. 1998).
11. *Id.* at 654, 35 U.C.C. Rep. Serv. 2d (West) at 752-53.
12. *Id.*, 35 U.C.C. Rep. Serv. 2d (West) at 753.
13. 676 N.Y.S.2d 569, 37 U.C.C. Rep. Serv. 2d (West) 54 (App. Div. 1998).
14. 105 F.3d 1147, 31 U.C.C. Rep. Serv. 2d (CBC) 303 (7th Cir. 1997).
15. *Brower*, 676 N.Y.S.2d at 572, 37 U.C.C. Rep. Serv. 2d (West) at 58.

Commerce (ICC). Gateway had also promised around-the-clock technical support and on-site services. The buyers, however, were unable to use these services because it was virtually impossible to contact Gateway technicians.

The buyers commenced a class action seeking compensatory and punitive damages for breach of warranty, breach of contract, fraud, and unfair trade practices. Gateway moved to dismiss based on its arbitration clause. The trial court granted the motion, holding that the arbitration clause was part of the contract and declining to rule on whether the clause was unconscionable.[16]

The appellate division agreed with the trial court that the arbitration clause was part of the contract. However, it held that clause to be substantively unconscionable. In concluding that the arbitration clause was part of the contract,[17] the court relied on *Hill* and another Seventh Circuit case, *ProCD, Inc. v. Zeidenberg*.[18] Consistent with *Hill* and *ProCD*, the court indicated that U.C.C. section 2-207 did not apply because only a single form had been used and that the contract had been formed, not when the buyer ordered and paid for the computer, but only when the buyer retained the computer beyond the thirty-day time limit set forth in Gateway's standard terms.[19] The court then held the arbitration provision to be substantively unconscionable because of the excessive cost of arbitration under ICC rules.[20] The case was remanded for appointment of an arbitrator under the Federal Arbitration Act.[21]

The conclusion that U.C.C. section 2-207 does not apply to one-form cases has been critiqued elsewhere.[22] The Drafting Committee to revise Article 2 is still struggling with the problems created by *ProCD* and *Hill*. Whether the final draft will include any provisions resolving these problems is still an open question.

In *Tupman Thurlow Co. v. Woolf International Corp.*,[23] the parties had done business on at least sixty-five separate occasions over twenty-four months. The court concluded that the buyer was bound to the seller's boilerplate arbitration clause because the seller had repeatedly sent its form to the buyer over those twenty-four months and the buyer had never objected to any of the terms.[24]

16. *Id.* at 571, 37 U.C.C. Rep. Serv. 2d (West) at 56.
17. *Id.* at 572, 37 U.C.C. Rep. Serv. 2d (West) at 57.
18. 86 F.3d 1447, 29 U.C.C. Rep. Serv. 2d (CBC) 1109 (7th Cir. 1996).
19. *Brower*, 676 N.Y.S.2d at 571, 37 U.C.C. Rep. Serv. 2d (West) at 57.
20. *Id.* at 574, 37 U.C.C. Rep. Serv. 2d (West) at 60. The ICC rules required advance fees of $4000 including a non-refundable $2000 registration fee. The court declined to find the arbitration clause to be procedurally unconscionable. *Id.* at 573-74, 37 U.C.C. Rep. Serv. 2d (West) at 59-60.
21. *Id.* at 575, 37 U.C.C. Rep. Serv. 2d (West) at 62.
22. *See, e.g.*, Thomas J. McCarthy et al., *Sales*, 53 BUS. LAW. 1461, 1465 (1998) (arguing that comments and case law under U.C.C. § 2-207 support its application to one-form cases).
23. 682 N.E.2d 1378, 33 U.C.C. Rep. Serv. 2d (West) 1053 (Mass. App. Ct. 1997).
24. *Id.* at 1381-82, 33 U.C.C. Rep. Serv. 2d (West) at 1058.

In *Tupman Thurlow Co.*, the buyer ordered meat by phone and failed to pay for it. The seller commenced arbitration under the terms of its confirmation form mailed before shipment of the meat. The buyer refused to participate, claiming it had not agreed to arbitration. The arbitrator disagreed and awarded damages to the seller. The award was confirmed by a New York court. On the seller's suit in Massachusetts to enforce the New York judgment, the trial court ruled that the arbitration clause in the seller's form was part of the contract.[25]

The appellate court affirmed. After noting that the buyer had received the same confirmation numerous times without objecting to it, the court concluded that this constituted a course of dealing between the parties, which incorporated the arbitration clause into the contract.[26] The court's statement that the repeated sending of a form over several transactions constitutes a course of dealing incorporating the terms of the form into the contract is controversial.[27]

Repeatedly sending a form does not appear to satisfy the code definition of "course of dealing" [28] unless a party's failure to object constitutes assent by silence. However, under U.C.C. section 2-207, silence does not constitute assent to a term that materially alters the contract.[29] Further, the finding that standard terms are incorporated by a course of dealing based on the repeated sending of a form is inconsistent with U.C.C. section 2-207.[30] The term in question, an arbitration clause, generally is held to materially alter the contract[31] and thus would not have been part of the initial contracts between the parties under U.C.C. section 2-207. At some point, the parties had sufficient prior dealings so that the course of dealing concept became applicable. Pursuant to U.C.C. section 2-207, however, none of the prior contracts comprising the course of dealing would have contained arbitration clauses. Thus, it is difficult to understand what exactly the course of dealing that incorporates the arbitration clause is.

The decision of *JOM, Inc. v. Adell Plastics, Inc.*[32] rejected the argument that the U.C.C.'s "gap filler" terms are to be implied in a form so as to

25. *Id.* at 1378, 33 U.C.C. Rep. Serv. 2d (West) at 1053.

26. *Id.* at 1381, 33 U.C.C. Rep. Serv. 2d (West) at 1057.

27. *Compare* Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 103-04, 15 U.C.C. Rep. Serv. 2d (CBC) 1, 18-20 (3d Cir. 1991) (holding that the repeated sending of forms can not constitute a course of dealing that incorporates the form's standard terms), *with* Schulze & Burch Biscuit Co. v. Tree Top, Inc., 831 F.2d 709, 713-15, 4 U.C.C. Rep. Serv. 2d (Callaghan) 641, 647-50 (7th Cir. 1987) (contra).

28. U.C.C. § 1-205(1) (1995).

29. *Id.* § 2-207(2) cmt. 3.

30. *Id.* § 2-207(3) (stating that while "[c]onduct by both parties which recognizes the existence of a contract is sufficient to establish a contract . . . the writings of the parties do not . . . ").

31. *See* William H. Danne, Jr., Annotation, *What Are Additional Terms Materially Altering Contract Within Meaning of U.C.C. 2-207(2)(b)*, 72 A.L.R.3d 479, 497-505 (1976 & Supp. 1998).

32. 151 F.3d 15, 36 U.C.C. Rep. Serv. 2d (West) 1 (1st Cir. 1998).

create an objection under U.C.C. section 2-207(2) to terms in the other party's form that differ from the "gap fillers."[33] In *JOM, Inc.*, the buyer ordered resin to be used in manufacturing casino chips by sending a purchase order form without a clause objecting to any terms not contained therein. The seller shipped the resin, enclosing its invoice, which contained a clause limiting damages to the purchase price. The buyer's customers complained about the chips manufactured from the seller's resin, and as a result, the buyer replaced the chips. The buyer sued the seller for the costs associated with replacing the chips and for lost profits. The seller defended relying on the damage limitation clause in its invoice. The trial judge excluded that clause, and the jury returned a verdict for the buyer.[34]

On appeal, the First Circuit reversed, holding that the damage limitation clause became part of the contract.[35] The buyer argued that it had, in effect, objected to the damage limitation clause under U.C.C. section 2-207(2)(c) because Article 2 provides for full remedies and such "gap fillers" are implied in the buyer's purchase order.[36] The court rejected this argument for several reasons. First, the buyer's silence on a particular topic is ambiguous; it does not necessarily mean the buyer is insisting on the gap-filler term.[37] Second, the implication of gap fillers conflicts with comment five to U.C.C. section 2-207.[38] This comment suggests that a reasonable remedy limitation clause would not be a material alteration.[39] If the implication of gap fillers is made, however, then any damage limitation clause would invariably be excluded by objection, thus rendering nugatory the conclusion in the comment. Third, case law does not support their implication.[40] The court further concluded that the buyer had waived the argument that the damage limitation clause was a material alteration.[41] It also held that the clause was neither unconscionable nor failed its essential purpose.[42]

33. *Id.* at 26, 36 U.C.C. Rep. Serv. 2d (West) at 13.

34. *Id.* at 17-18, 36 U.C.C. Rep. Serv. 2d (West) at 3.

35. *Id.* at 29, 36 U.C.C. Rep. Serv. 2d (West) at 18.

36. *Id.* at 23, 36 U.C.C. Rep. Serv. 2d (West) at 9; *see* U.C.C. §§ 2-714, 2-715 (1995) (permitting a buyer to recover, for breach in regard to accepted goods, the loss resulting from the seller's breach determined in any reasonable manner together with incidental and consequential damages).

37. *JOM, Inc.*, 151 F.3d at 25, 36 U.C.C. Rep. Serv. 2d (West) at 11-12.

38. *Id.*, 36 U.C.C. Rep. Serv. 2d (West) at 12.

39. U.C.C. § 2-207 cmt. 5.

40. *JOM, Inc.*, 151 F.3d at 25-26, 36 U.C.C. Rep. Serv. 2d (West) at 12-13.

41. *Id.* at 26-28, 36 U.C.C. Rep. Serv. 2d (West) at 14-16.

42. *Id.* at 28-29, 36 U.C.C. Rep. Serv. 2d (West) at 16-18. The court also reiterated that the terms of a contract formed by U.C.C. § 2-207(3) include terms incorporated under U.C.C. § 2-207(2), a position it had previously stated in *Ionics, Inc. v. Elmwood Sensors, Inc.*, 110 F.3d 184, 32 U.C.C. Rep. Serv. 2d (CBC) 1 (1st Cir. 1997). *JOM, Inc.*, 151 F.3d at 23, 36 U.C.C. Rep. Serv. 2d (West) at 9.

The *JOM, Inc.* case illustrates the importance of drafting a form to include a clause objecting to any terms not contained therein. The purpose of this kind of clause is to preclude any of the other side's terms from entering the contract via U.C.C. section 2-207(2). If the buyer had included in its purchase order a clause objecting to all terms not contained in the purchase order, the seller's damage limitation clause would not have entered the contract, and the buyer would have recovered full damages.

## *WARRANTIES AND REMEDY LIMITATION CLAUSES*

In *Lefebvre Intergraphics, Inc. v. Sanden Machine Ltd.*,[43] the court held an exclusion of consequential damages did not automatically fail when a limited remedy failed of its essential purpose and examined whether an exclusion of consequential damages was unconscionable.[44] The buyer purchased a commercial printing press that never worked properly. After the seller's unsuccessful attempts to repair it over a period of several months, the buyer filed a breach of warranty suit seeking rescission of the contract and consequential damages. The seller, relying on its contractual waiver of consequential damages, moved to dismiss those portions of the complaint seeking consequential damages. The buyer argued that such damages were recoverable because the limited repair or replace warranty in the contract had failed of its essential purpose and because the clause excluding consequential damages was unconscionable.

The court, relying on *Smith v. Navistar International Transportation Corp.*,[45] held that a separate disclaimer of consequential damages contained in a contract does not automatically fail because a limited remedy fails of its essential purpose.[46] The *Lefebvre* court required the waiver of consequential damages to fail the unconscionability test of U.C.C. section 2-719(3) before it would be defeated. The court rejected the unconscionability argument because the buyer had a meaningful choice and the provision was not unreasonably favorable to the seller.[47] The parties were sophisticated commercial businesses of relatively equal bargaining power. The buyer had altered the contract prepared by the seller. The court also noted that the seller had not ignored its obligations under the contract; it was simply unable to accomplish the repairs.[48]

Under U.C.C. section 2-313, promises, descriptions and affirmations of fact become express warranties if they are part of the basis of the bargain.[49] Official Comment 3 to U.C.C. section 2-313 states that reliance

43. 946 F. Supp. 1358, 34 U.C.C. Rep. Serv. 2d (West) 385 (N.D. Ill. 1996).
44. *Id.* at 1370-72, 34 U.C.C. Rep. Serv. 2d (West) at 389-92.
45. 957 F.2d 1439, 17 U.C.C. Rep. Serv. 2d (CBC) 84 (7th Cir. 1992).
46. *Lefebvre Intergraphics, Inc.*, 946 F. Supp at 1370-71, 34 U.C.C. Rep. Serv. 2d (West) at 390-91.
47. *Id.* at 1371-72, 34 U.C.C. Rep. Serv. 2d (West) at 391-93.
48. *Id.* at 1372, 34 U.C.C. Rep. Serv. 2d (West) at 393.
49. U.C.C. § 2-313 (1995).

by the buyer need not be shown to make something part of the basis of the bargain.[50] Nevertheless, courts continually struggle with the relationship between basis of the bargain and reliance. In *Rogath v. Siebenmann*,[51] the Second Circuit held that a breach of an express warranty could be waived if the seller had informed the buyer of its doubts about the expressly warranted matter.[52] Siebenmann sold Rogath a painting, purportedly painted by Francis Bacon, for $570,000. The bill of sale stated the seller made the following warranty: "[T]hat the Seller has no knowledge of any challenge to Seller's title and authenticity of the Painting . . . ." [53] The seller had known that there was some question of authenticity and the buyer had been aware of the seller's uncertainty. Shortly after the purchase, the buyer sold the painting to Acquavella Contemporary Art, Inc. (Acquavella) for $950,000. When Acquavella learned of the challenge to the painting's authenticity, it demanded and received a refund from the buyer. The buyer sued the seller for breach of warranty and was granted summary judgment.[54]

The Second Circuit asserted that New York law required reliance on an express warranty as part of the bargain between the parties. The court understood this to mean that while a buyer need not believe the truth of the warranted statement, the buyer did need to believe that the seller was warranting the statement.[55] The court held that if the seller had disclosed his doubts about authenticity to the buyer, the breach of warranty would be waived unless the buyer expressly reserved his rights.[56] The court found that the buyer had not expressly reserved his rights under the warranty.[57] The court remanded the case to resolve the factual question of whether the seller disclosed to the buyer, before closing the transaction, the challenges to authenticity known to the seller.[58]

Following a distinction made in *Galli v. Metz*,[59] the court contrasted this waiver scenario with a buyer knowing, from another source, the warranted statement was false, but relying on the seller's warranty in proceeding with the purchase.[60] This distinction between disclosure by the seller and independent knowledge is interesting from a theoretical perspective. However, the distinction is based entirely on parol evidence. Moreover, the relevant evidence is extremely difficult to ascertain with accuracy. *Rogath*

50. *Id.* § 2-313 cmt. 3.
51. 129 F.3d 261, 34 U.C.C. Rep. Serv. 2d (West) 63 (2d Cir. 1997).
52. *Id.* at 266, 34 U.C.C. Rep. Serv. 2d (West) at 69.
53. *Id.* at 263, 34 U.C.C. Rep. Serv. 2d (West) at 65.
54. *Id.*, 34 U.C.C. Rep. Serv. 2d (West) at 64.
55. *Id.* at 264, 34 U.C.C. Rep. Serv. 2d (West) at 66.
56. *Id.* at 266, 34 U.C.C. Rep. Serv. 2d (West) at 69.
57. *Id.*
58. *Id.* at 266-67, 34 U.C.C. Rep. Serv. 2d (West) at 69-71.
59. 973 F.2d 145, 151 (2d Cir. 1992).
60. *Rogath*, 129 F.3d at 265, 34 U.C.C. Rep. Serv. 2d (West) at 66-67.

*v. Siebenmann* involved parties of apparently equal bargaining power, yet the holding could protect a seller who delivered a bill of sale making an express warranty the seller knew to be false because the buyer did not expressly reserve rights when the seller disclosed the falsehood. The holding in this case has greater potential for generating litigation and controversy than it has potential for achieving just results.

The court in *Moore v. Coachmen Industries, Inc.*[61] held that the manufacturer of a component can rely on the warranty limitation made by the manufacturer of the final product.[62] The Moores purchased a recreational vehicle in 1989 covered by the manufacturer's one-year or 15,000 mile warranty. That warranty limited implied warranties to one year and disclaimed consequential damages. MagneTek, Inc. (MagneTek) had manufactured a power converter unit incorporated into the vehicle, which was identified as the likely cause of a fire that destroyed the vehicle and its contents. Neither MagneTek nor its product was specifically referred to in the manufacturer's limited warranty.

The court blocked the buyers' attempt to rely on relaxed privity requirements to sue MagneTek for breach of an implied warranty. The court proffered several justifications for the refusal to extend the relaxed privity requirements to this situation. First, the court observed that large manufacturers of major component parts have and often exercise the power to require the manufacturer of the end product to include a warranty limitation or a warranty disclaimer when selling the product to the ultimate user.[63] Smaller manufacturers or manufacturers of less significant components expect the same protection, but do not necessarily have the clout to require the inclusion of such a limitation or disclaimer. Second, purchasers are not buying a conglomeration of components, but a finished integrated product.[64] Their expectations are to look to the manufacturer of the final product for satisfaction. Third, the remote manufacturer should be entitled to the same level of protection as the manufacturer of the final product.[65] The court's analysis of this interesting legal question seems intuitively correct. A contrary holding would place strong and counter-productive pressures on component manufacturers to find effective ways to control their exposure to purchasers of end products.

Judge Calabresi attempted to differentiate between a warranty claim and a strict liability claim in *Castro v. QVC Network, Inc.*[66] Mrs. Castro was injured when her roasting pan containing a twenty-pound turkey tipped as she removed it from the oven and spilled hot grease on her ankle and foot. She had purchased the pan based upon a QVC Network home shop-

61. 499 S.E.2d 772, 35 U.C.C. Rep. Serv. 2d (West) 758 (N.C. Ct. App. 1998).
62. *Id.* at 779-80, 35 U.C.C. Rep. Serv. 2d (West) at 765.
63. *Id.*, 35 U.C.C. Rep. Serv. 2d (West) at 764.
64. *Id.* at 780, 35 U.C.C. Rep. Serv. 2d (West) at 765.
65. *Id.* at 779-80, 35 U.C.C. Rep. Serv. 2d (West) at 765.
66. 139 F.3d 114, 34 U.C.C. Rep. Serv. 2d (West) 946 (2d Cir. 1998).

ping channel advertisement claiming that the pan could roast a twenty-five-pound turkey. After QVC Network and U.S.A. T-Fal Corp. (T-Fal), the manufacturer, had developed the advertising campaign, they asked the manufacturer's parent company to provide a suitable roasting pan. T-Fal modified a pan originally manufactured for another purpose by simply adding two small handles, which apparently were inadequate to properly balance the pan. The trial court allowed a jury instruction on the strict liability cause of action but excluded a jury instruction on the warranty cause of action on the grounds that the two causes of action were the same.[67]

In writing the opinion of the court, Judge Calabresi equated plaintiff's strict liability cause of action with the "risk/utility" theory of defective product design in products liability law and equated plaintiff's warranty cause of action with the "consumer expectation" theory of defective product design in products liability law.[68] The court relied on *Denny v. Ford Motor Co.*[69] as support for the proposition that the two causes of action were distinct, that strict liability was not inherently broader than breach of warranty, and that both the "risk/utility" and the "consumer expectation" theories applied in New York.[70] The court stated that in some cases the two causes of action may in fact be redundant. Judge Calabresi articulated a dual-purpose rule for determining when strict liability and warranty claims are distinct causes of action.[71] If the product is a multiple-use product, both strict liability and warranty jury instructions are appropriate. In such cases, the "risk/utility" and "consumer expectation" standards may result in divergent outcomes.[72] Because the roasting pan in this case may pass the "risk/utility" test as an all-purpose cooking dish, but may fail to pass the "consumer expectation" test as a roasting pan, the trial court should have given both instructions.

By equating a warranty cause of action to a particular theory of product liability, *Castro* raises at least as many questions as it answers. Judge Calabresi characterized warranty actions as involving the "consumer expectation" theory.[73] However, because he recognized that in certain circumstances a court need not give both instructions, warranty causes of action may also involve the "risk/utility" theory.[74] How do we know which theory applies? The court's dual-purpose rule, which leads to the need for both instructions, sounds like it is referring to cases involving the warranty of

67. *Id.* at 116, 34 U.C.C. Rep. Serv. 2d (West) at 947-48.
68. *Id.* at 118-19, 34 U.C.C. Rep. Serv. 2d (West) at 951-53.
69. 662 N.E.2d 730, 28 U.C.C. Rep. Serv. 2d (CBC) 15 (N.Y. 1995), *aff'd*, 79 F.3d 12 (2d Cir. 1996).
70. *Castro*, 139 F.3d at 117-19, 34 U.C.C. Rep. Serv. 2d (West) at 950-53.
71. *Id.* at 118-19, 34 U.C.C. Rep. Serv. 2d (West) at 951-52.
72. *Id.*
73. *Id.* at 118, 34 U.C.C. Rep. Serv. 2d (West) at 951.
74. *Id.* at 118-19, 34 U.C.C. Rep. Serv. 2d (West) at 951-53.

fitness for a particular purpose, i.e., a purpose different from the primary purpose for which the product is manufactured. "Consumer expectation" certainly could be viewed as an attempt to describe the buyer's reliance element of the warranty of fitness for a particular purpose.[75] That would involve a subjective expectation. It is less clear that "consumer expectation" describes an element of the warranty of merchantability. U.C.C. section 2-314, which establishes the warranty, describes the warranty in very different terms.[76] Even if merchantability could be said to be determined by "consumer expectation," the expectation is objective. The *Castro* court never clarified which warranty was involved. It discussed the product's fitness for the "particular use"[77] covered in the advertisement, which seemed to implicate the warranty of fitness for a particular purpose, but relied on the *Denny* case which involved the warranty of merchantability.[78] Was the court suggesting that breach of the two warranties were to be analyzed identically in product liability actions? This case seems to further confuse, rather than clarify, the interaction of tort and contract concepts in product liability cases.

## *NOTICE REQUIREMENTS*

In *Cole v. Keller Industries, Inc.*,[79] the Fourth Circuit joined the list of courts holding that a non-buyer need not give notice under U.C.C. section 2-607 for breach of warranty if the claim is for personal injuries rather than economic loss.[80] The plaintiff was an apartment maintenance man who was injured while using a ladder manufactured by Keller Industries, Inc. (Keller). He fell and was injured when one of the bolts holding the stair tread to the ladder side rails broke. The trial court granted summary judgment to Keller on the grounds that a three and one-half month delay between the time the plaintiff's expert delivered a report saying the ladder was defective (and the defect had caused the injury) and the plaintiff's notice of claim was too long as a matter of law.[81]

The Fourth Circuit reversed, holding that neither U.C.C. section 2-607 nor the official comments require a non-buyer plaintiff to give notice of a breach of warranty under this section.[82] The court noted that to require

75. U.C.C. § 2-315 (1995).

76. U.C.C. § 2-314(2) uses terms like "without objection in the trade," "fair average quality," and "ordinary purposes" as well as references to the contract. *Id.* § 2-314(2). The contract would reflect seller's expectations as much as buyer's expectations.

77. *Castro,* 139 F.3d at 119, 34 U.C.C. Rep. Serv. 2d (West) at 952.

78. *Id.* at 116 n.4, 117 n.7 & 119, 34 U.C.C. Rep. Serv. 2d (West) at 949 n.4, 950 n.7 & 952.

79. 132 F.3d 1044, 34 U.C.C. Rep. Serv. 2d (West) 401 (4th Cir. 1998).

80. *Id.* at 1048, 34 U.C.C. Rep. Serv. 2d (West) at 404.

81. *Id.* at 1046, 34 U.C.C. Rep. Serv. 2d (West) at 403.

82. *Id.* at 1047-48, 34 U.C.C. Rep. Serv. 2d (West) at 403-05.

such notice would reintroduce the privity requirement, which has been abolished in Virginia law.[83]

The Fourth Circuit noted that the district court relied on *Ratkovich v. Smithkline,*[84] a Northern District of Illinois case that required a non-buyer to give notice.[85] The Fourth Circuit believed that case relied improperly on precedents requiring notice from a buyer.[86]

## *REVOCATION OF ACCEPTANCE*

In *Fode v. Capital RV Center, Inc.*,[87] the North Dakota Supreme Court held that a manufacturer was the seller and subject to an action for revocation of acceptance under U.C.C. section 2-608 because its dealer had, with authorization from the manufacturer, passed through the manufacturer's warranty.[88] The buyers purchased a motor home manufactured by Coachman Industries, Inc. (Coachman) from its dealer, Capital RV Center Inc. (Capital). The dealer disclaimed all warranties but passed along the manufacturer's warranty. The warranty remedy was to make necessary repairs caused by defects in material or workmanship and to replace defective parts. The buyers experienced a number of problems. A year later, the buyers sought to revoke acceptance and return the vehicle to the dealer. The dealer refused. After the buyers sued, summary judgment was granted to the dealer on the warranty claim, but denied on the revocation of acceptance claim. The manufacturer asserted that revocation of acceptance was not available as a matter of law because it was not the seller. The court concluded that the buyers had established that there were substantial defects in the vehicle which substantially impaired its value to them.[89] The buyers recovered damages from both the selling dealer and the manufacturer on the revocation of acceptance claim. They also recovered damages from the manufacturer on the breach of warranty claim.[90]

The court's reasoning is somewhat convoluted, but the result is consistent with a line of cases establishing an exception to the privity require-

83. *See* VA. CODE ANN. § 8.01-223 (Michie 1992) (providing lack of privity is not a defense where recovery is sought for personal injury or property damage resulting from negligence); *id.* § 8:02-618 (Michie 1991) (providing, in Virginia's non-uniform version of U.C.C. § 2-318, lack of privity is not a defense for breach of warranty or negligence action against manufacturer or seller if the plaintiff is a person whom the manufacturer or seller might reasonably expect to use, consume, or be affected by the goods).

84. 711 F. Supp. 436, 9 U.C.C. Rep. Serv. 2d (Callaghan) 118 (N.D. Ill. 1989).

85. *Id.* at 438, 9 U.C.C. Rep. Serv. 2d (Callaghan) at 121-22.

86. *Cole,* 132 F.3d at 1048 n.3, 34 U.C.C. Rep. Serv. 2d (West) at 404 n.3.

87. 575 N.W.2d 682, 36 U.C.C. Rep. Serv. 2d (West) 696 (N.D. 1998).

88. *Id.* at 687-88, 36 U.C.C. Rep. Serv. 2d (West) at 703.

89. *Id.* at 688, 36 U.C.C. Rep. Serv. 2d (West) at 704-05.

90. *Id.* at 689, 36 U.C.C. Rep. Serv. 2d (West) at 706.

ment in consumer vehicle cases.[91] The revocation of acceptance claim is apparently based on the premise that the warranty remedies failed of their essential purpose, but the court failed to discuss how the facts fit the criteria for revocation of acceptance. The case also does not address other possible remedies, such as an award of damages for a breach with respect to accepted goods under U.C.C. section 2-714.

The decision hinged on the court's finding that the manufacturer was the seller because, ordinarily, revocation of acceptance was available only against a direct seller.[92] The court elected to follow the exception created by a few other courts allowing revocation of acceptance against a manufacturer, when the manufacturer has warranted the goods directly to the consumer.[93]

The *Fode* court also affirmed revocation of acceptance against the direct seller, the dealer. The dealer asserted that because the revocation was based on breach of warranty and it had made no warranty, it should not be subject to revocation of acceptance. The court held that because the dealer described the motor home as " 'sold new with sportscoach' manufacturer warranty" and the manufacturer's warranty was registered in the seller's name as the dealer, that the sales contract and the manufacturer's warranty were so closely linked in time of delivery and subject matter as to constitute a single transaction.[94] In an interesting characterization, the court held that regardless of the dealer's effective disclaimer of warranties, the "motor home was not sold 'as is.' Rather, Capital passed Coachman's warranty to [the] Fodes."[95] The warranty "pass-through" formed the basis of the dealer's exposure to a revocation of acceptance claim based on the manufacturer's breach of warranty. The court did not actually say the warranty disclaimer was ineffective, but that was the result.

The court cited *Troutman v. Pierce, Inc.*,[96] which permitted, on similar facts, revocation of acceptance against the direct seller, giving the seller a right of indemnity from the manufacturer.[97] The *Fode* opinion and its

91. *See, e.g.*, Durfee v. Rod Baxter Imports, Inc., 262 N.W.2d 349, 357-58, 22 U.C.C. Rep. Serv. (Callaghan) 945, 957-58 (Minn. 1977) (holding manufacturer benefited from sales and warranties, a significant factor in encouraging sales, therefore there was no distinction between revocation of acceptance and enforcement of warranty remedies); Ventura v. Ford Motor Corp, 433 A.2d 801, 809-12, 32 U.C.C. Rep. Serv. (Callaghan) 57, 67-71 (N.J. Super. Ct. App. Div. 1981) (finding dealer's disclaimer of warranties ineffective because its implementation of the service aspect of the warranty was inconsistent with waiver); Gochey v. Bombardier, Inc., 572 A.2d 921, 924, 11 U.C.C. Rep. Serv. 2d (Callaghan) 870, 874 (Vt. 1990) (holding manufacturer in effect created direct contract with ultimate buyer).

92. *Fode*, 575 N.W.2d at 687-88, 36 U.C.C. Rep. Serv. 2d (West) at 703.

93. *Id.* at 686-88, 36 U.C.C. Rep. Serv. 2d (West) at 700-03.

94. *Id.* at 687, 36 U.C.C. Rep. Serv. 2d (West) at 703.

95. *Id.* at 688, 36 U.C.C. Rep. Serv. 2d (West) at 704.

96. 402 N.W.2d 920, 4 U.C.C. Rep. Serv. 2d (Callaghan) 479 (N.D. 1987).

97. *Id.* at 924, 4 U.C.C. Rep. Serv. 2d (Callaghan) at 483-84; *see Fode*, 575 N.W.2d at 686-87, 36 U.C.C. Rep. Serv. 2d (West) at 700-02.

companions are inconsistent in their reasoning and make no attempt to reconcile the results in the cases with traditional Article 2 analysis. The line of cases probably has limited precedential weight outside of the particular fact patterns, but it is interesting to note this court-created consumer fairness exception to the established privity requirement of U.C.C. section 2-608.[98]

## *OUTPUT CONTRACTS*

In *Canusa v. A & R Lobosco, Inc.*,[99] the court interpreted an output contract. The buyer was a broker of recycled newspapers. The seller had a contract with New York City to accept material to be recycled. The sales contract required the seller to supply a high grade of recycled newspaper with low levels of outthrows, which are unacceptable materials mixed in with the newspapers. The contract did not require a fixed output quantity, but the seller provided estimates of its output. The seller was required to give the buyer its entire output of ONP8 grade paper, but was not prohibited from dealing with other parties. The seller never produced the estimated output of grade ONP8 paper. The buyer sued, alleging that the seller had failed to provide the minimum quantities of ONP8 paper required by the parties' agreement.

The seller countered by asserting the majority rule that, in an output contract, when less than anticipated quantities are produced, the only requirement is that the seller act in good faith. The court agreed that U.C.C. section 2-306, which provides that takings under an output or requirements contract cannot be "unreasonably disproportionate" to the estimated quantities, applies only to takings in excess of expected quantities.[100] The court held that the sole test for less than anticipated quantities is the seller's good faith.[101]

The court went on to conclude that the seller had acted in bad faith.[102] The baseline for measuring the seller's good faith was its own estimate of what could be produced. The court found that its attempts to meet that standard failed the good faith test.[103] The seller's reason for failing to produce the higher grade paper was that the material received from the city contained higher amounts of garbage and other lower quality recyclables than it had anticipated based on its participation in suburban programs. The seller's president testified that it would have taken longer and been more expensive to sort the city's waste, but did not allege that the contract would have been unprofitable. The court relied on the fact that

98. U.C.C. § 2-608 (1995).
99. 986 F. Supp. 723, 35 U.C.C. Rep. Serv. 2d (West) 73 (E.D.N.Y. 1997).
100. *Id.* at 729, 35 U.C.C. Rep. Serv. 2d (West) at 80-81; *see* U.C.C. § 2-306(2).
101. *Canusa,* 986 F. Supp. at 730, 35 U.C.C. Rep. Serv. 2d (West) at 82.
102. *Id.*
103. *Id.*

the seller had opted to supply the materials to a different recycled newspaper broker who bought a lower grade paper for export and permitted much higher levels of outthrows.

Another interesting aspect is the court's allowance of the buyer's lost sales as a measure of consequential damages. The court analogized the situation to sellers who claim lost volume under U.C.C. section 2-708(2).[104] The court distinguished those cases, however, and relied instead on cases stating that when a buyer is a broker in the business of reselling products, the breaching seller has "reason to know" that lost sales are a foreseeable consequence of its breach, thus compensable as consequential damages.[105]

## *STATUTE OF LIMITATIONS*

Courts continue to struggle with determining when a cause of action accrues for purposes of U.C.C. section 2-725. This section requires that an action for breach of a sales contract be commenced within four years of the accrual of the cause of action.[106] The cause of action accrues on a breach of warranty claim upon tender of delivery, unless the warranty explicitly extends to future performance of the goods.[107]

Three cases addressed the relationship between tender of delivery and accrual of the cause of action.[108] The Connecticut Supreme Court, in *Flagg Energy Development Corp. v. General Motors Corp.*,[109] held that breach of warranty occurs at time of tender of delivery of the goods themselves

104. *Id.* at 732 n.8, 35 U.C.C. Rep. Serv. 2d (West) at 85-86 n.8; *see* U.C.C. § 2-708(2).

105. *Canusa,* 986 F. Supp. at 732-33, 35 U.C.C. Rep. Serv. 2d (West) at 85-86; *see* U.C.C. § 2-715 (defining consequential damages).

106. U.C.C. § 2-725(1).

107. *Id.* § 2-725(2).

108. There are two meanings of "tender": a narrow meaning, which requires the tender of conforming goods, and a broader meaning, which merely requires the offer of goods, even if nonconforming, by the seller in fulfillment of the obligations of the contract. *Compare* U.C.C. § 2-503(1) (requiring, for tender of delivery, that "the seller put and hold conforming goods at the buyer's disposition"), *with id.* § 2-503 cmt. 1 (explaining that tender, at times, means an offer of goods "as if in fulfilment of its conditions even though there is a defect when measured against the contract obligation"). The courts agreed that U.C.C. § 2-725 uses the broader definition of "tender"; so long as the seller offered goods, even if defective, in fulfillment of the seller's contract obligations, tender was complete. *See* Flagg Energy Dev. Corp. v. General Motors Corp., 709 A.2d 1075, 1080-81, 35 U.C.C. Rep. Serv. 2d (West) 138, 146-47 (Conn. 1998); Washington Freightliner, Inc. v. Shantytown Pier, Inc., 719 A.2d 541, 545-46, 36 U.C.C. Rep. Serv. 2d (West) 425, 431-33 (Md. 1998); Baker v. DEC Int'l, 580 N.W.2d 894, 896-97, 36 U.C.C. Rep. Serv. 2d (West) 413, 415-17 (Mich. 1998). This view is consistent with that of other courts and commentators. *See, e.g.*, Standard Alliance Indus. v. Black Clawson Co., 587 F.2d 813, 819, 25 U.C.C. Rep. Serv. (Callaghan) 65, 75 (6th Cir. 1978); Navistar Int'l Corp. v. Hagie Mfg. Co., 662 F. Supp. 1207, 1210, 4 U.C.C. Rep. Serv. 2d (Callaghan) 1096, 1101 (N.D. Ill. 1987); 5 RONALD A. ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-725:103, at 269-70 (rev. 3d ed. 1994).

109. 709 A.2d 1075, 35 U.C.C. Rep. Serv. 2d (West) 138 (Conn. 1998).

without regard to subsequent inspection, testing, or acceptance.[110] Relying on U.C.C. section 2-503, which provides that the manner for tender is determined by the parties' agreement,[111] the buyer argued that tender of delivery was not complete until testing was performed pursuant to a contract provision requiring the seller to test the goods at the buyer's work site.[112] Reasoning that the U.C.C. expressly ties inspection to the buyer's acceptance and not to tender, the court rejected the buyer's argument.[113]

In *Washington Freightliner, Inc. v. Shantytown Pier, Inc.*,[114] a divided Maryland Court of Appeals also held that inspection and testing are not generally required for tender of delivery and thus do not delay the beginning of the four-year limitation period.[115] The court distinguished cases decided on contracts that made pre-delivery testing an express condition of the seller's performance from the more common cases that provide for post-delivery inspection.[116] In the former cases, tender would occur, and hence the cause of action accrue, when testing was completed; while in the latter, tender would be complete and the cause of action accrue upon actual delivery of the goods with the right to inspect only relevant as to the buyer's acceptance or rejection of the goods.[117] This court, while recognizing that inspection could be required for tender, insisted that such a requirement be explicit in the contract.[118]

The close decision of the court generated a vigorous dissent, which rejected the majority's distinction between pre-delivery inspection and post-delivery inspection.[119] Because the seller had agreed to deliver and test the goods, the seller's delivery of the goods alone could not be in fulfillment of the contract as required for tender of delivery. The dissent saw no difference between the contract before the court, which required testing, and contracts requiring installation, in which courts have routinely found that installation is required for tender.[120]

110. *Id.* at 1080-81, 35 U.C.C. Rep. Serv. 2d (West) at 146-47.

111. U.C.C. § 2-503(1).

112. *Flagg Energy Dev. Corp.*, 709 A.2d at 1078-79, 35 U.C.C. Rep. Serv. 2d (West) at 142-44.

113. *Id.* at 1080-81, 35 U.C.C. Rep. Serv. 2d (West) at 146-47; *see* U.C.C. § 2-606 (providing acceptance occurs after the buyer has a reasonable opportunity to inspect and the buyer signifies acceptance or fails to reject).

114. 719 A.2d 541, 36 U.C.C. Rep. Serv. 2d (West) 425 (Md. 1998).

115. *Id.* at 551, 36 U.C.C. Rep. Serv. 2d (West) at 440-41.

116. *Id.* at 548-51, 36 U.C.C. Rep. Serv. 2d (West) at 436-41.

117. *Id.*

118. *Id.* at 548-50, 36 U.C.C. Rep. Serv. 2d (West) at 436-39.

119. *Id.* at 553-55, 36 U.C.C. Rep. Serv. 2d (West) at 445-47 (Eldridge, J., dissenting). The dissent also argued the contract requirements for tender and the seller's completion of those obligations were questions of fact, which should not be decided by the court as a matter of law. *Id.* at 553, 36 U.C.C. Rep. Serv. 2d (West) at 443-44.

120. *Id.* at 555, 36 U.C.C. Rep. Serv. 2d (West) at 447.

In *Baker v. DEC International*,[121] the Michigan Supreme Court followed the general rule and held that if the contract requires installation, tender of delivery is complete and the cause of action accrues upon installation.[122] The court recognized, however, that tender is not generally contingent upon inspection unless there is a clear contractual obligation to the contrary.[123] The court reasoned that tender required conformity with the contract provisions, including the provision that required installation.[124] The three dissenting justices would not even require installation for tender and would find that tender of delivery, for the purposes of U.C.C. section 2-725, only requires the actual physical delivery of the goods to the buyer.[125] The dissent reasoned that the finality purpose of the statute of limitations was best served by a bright-line rule.[126] Additionally, the requirement in U.C.C. section 2-503 is only that the goods conform to the contract.[127] Because installation did not impact on the characteristics of the goods, conforming the seller's performance to the contract obligations was irrelevant to determining when tender of delivery occurred.[128] In calling for a bright-line rule that ignores the parties' contractual performance obligations, the dissent appears to overlook the express provision in U.C.C. section 2-503 that the agreement of the parties sets the manner of tender of delivery.[129]

In *Central Washington Refrigeration, Inc. v. Barbee*,[130] the Washington Supreme Court considered when the cause of action accrued on an indemnity claim based on an alleged breach of warranty under Article 2. The court determined that the cause of action was an equitable one implied from the contractual relationship between the parties and not a contract action for breach of warranty.[131] Accordingly, the court refused to apply U.C.C. section 2-725 to determine when the cause of action accrued. The court instead looked to settled law that indemnity actions accrue when the party seeking indemnity either pays or becomes legally obligated to pay damages to the third party.[132] The dissent challenged the distinction be-

121. 580 N.W.2d 894, 36 U.C.C. Rep. Serv. 2d (West) 413 (Mich. 1998).

122. *Id.* at 897-98, 36 U.C.C. Rep. Serv. 2d (West) at 417.

123. *Id.* at 898, 36 U.C.C. Rep. Serv. 2d (West) at 417.

124. *Id.* at 897-98, 36 U.C.C. Rep. Serv. 2d (West) at 417.

125. *Id.* at 899, 36 U.C.C. Rep. Serv. 2d (West) at 419 (Weaver, J., dissenting).

126. *Id.* at 900-01, 36 U.C.C. Rep. Serv. 2d (West) at 422-23; *see* Chris Williams, *The Statute of Limitations, Prospective Warranties, and Problems of Interpretation in Article Two of the U.C.C.*, 52 GEO. WASH. L. REV. 67, 69 (1983) (discussing the purpose of the U.C.C. statute of limitations to provide finality for businesses).

127. U.C.C. § 2-503(1) (1995).

128. *Baker*, 580 N.W.2d at 899-900, 36 U.C.C. Rep. Serv. 2d (West) at 420.

129. U.C.C. § 2-503(1).

130. 946 P.2d 760, 34 U.C.C. Rep. Serv. 2d (West) 273 (Wash. 1997).

131. *Id.* at 764, 34 U.C.C. Rep. Serv. 2d (West) at 278.

132. *Id.* at 764-65, 34 U.C.C. Rep. Serv. 2d (West) at 279. The court did not determine, but suggested, that U.C.C. § 2-725 might be inapplicable *in toto* to this equitable cause of action. *Id.* at 765 n.14, 34 U.C.C. Rep. Serv. 2d (West) at 279 n.14.

tween a claim for indemnity arising from a breach of warranty and a direct action for breach of warranty. In the dissenting justice's view, both claims arose from the same facts and contract, and as such both should be controlled by Article 2, including its statute of limitations.[133] The dissent was concerned that the majority's rule hinders the purpose of U.C.C. section 2-725 to provide a uniform statute of limitations for the sale of goods.[134]

Courts have long struggled with determining when a warranty "explicitly extends to future performance of the goods" so that the cause of action accrues when the breach of warranty is or should have been discovered.[135] In *Cosman v. Ford Motor Co.*,[136] the court held that although buyers of a mobile home with a six-year/60,000 mile warranty could not recover for Article 2 warranties more than four years after date of delivery, the buyers could recover under the Magnusson-Moss Act.[137] Determining that Illinois courts have taken a narrow view of the future performance exception, the court required explicit language in the contract that warrants future performance of the goods.[138] Because the language in the warranty ("Ford warrants that your selling dealer will repair, replace or adjust all parts (except tires) that are found to be defective in factory-supplied materials or workmanship" during the six-year/60,000 mile warranty period) did not promise a level of performance of the goods, the future performance exception was inapplicable.[139] Realizing, however, that this result would create a situation wherein the buyer had a six-year warranty that was unenforceable for the last two years, the court found that the meaning of warranty under the Magnusson Moss Act was broader and included promises to repair. Thus, the cause of action under the Act would not accrue until the seller breached its promise to repair.[140]

Several courts considered the issue of the tolling of the statute of limitations under Article 2. U.C.C. section 2-725 leaves the issue of tolling of the statute of limitations to other law.[141] In *State Farm Mutual Automobile Insurance Co. v. Ford Motor Co.*[142] and *JN Exploration & Production v. Western*

133. *Id.* at 765-66, 34 U.C.C. Rep. Serv. 2d (West) at 280-81 (Guy, J., dissenting).

134. *Id.* at 766, 34 U.C.C. Rep. Serv. 2d (West) at 282; *see* U.C.C. § 2-725 cmt. 1; Williams, *supra* note 126, at 100 (discussing uniformity purpose of U.C.C. § 2-725).

135. U.C.C. § 2-725(2); *see* Henry D. Gabriel et al., *General Provisions and Sales*, 50 BUS. LAW. 1461, 1477 (1995); Thomas McCarthy et al., *Sales*, 52 BUS. LAW. 1493, 1512 (1997) (stating determination of when warranty extends to future performance is a recurring issue under U.C.C. § 2-725(2)).

136. 674 N.E.2d 61, 33 U.C.C. Rep. Serv. 2d (West) 1118 (Ill. App. Ct. 1996).

137. *Id.* at 67-68, 33 U.C.C. Rep. Serv. 2d (West) at 1124-26.

138. *Id.* at 65, 33 U.C.C. Rep. Serv. 2d (West) at 1122.

139. *Id.* at 66, 33 U.C.C. Rep. Serv. 2d (West) at 1122-23.

140. *Id.* at 67-68, 33 U.C.C. Rep. Serv. 2d (West) at 1125-27.

141. U.C.C. § 2-725(4) (1995).

142. 572 N.W.2d 321, 36 U.C.C. Rep. Serv. 2d (West) 719 (Minn. Ct. App. 1997).

*Gas Resources, Inc.*,[143] the courts held that the doctrine of fraudulent concealment could be used to toll the statute of limitations under U.C.C. section 2-725.[144] To rise to the level which would toll the statute, the concealment must be intentional or fraudulent and requires an affirmative act, which is designed to and does, prevent the claimant from discovering the cause of action.[145]

## *ECONOMIC LOSS DOCTRINE*

### *SCOPE*

In a number of recent cases, courts have found it necessary to grapple with the nature and scope of the "economic loss doctrine." The doctrine, which was originally articulated by Justice Traynor in *Seely v. White Motor Co.*,[146] has more recently been adopted by the U.S. Supreme Court in an admiralty case, *East River Steamship Corp. v. Transamerica Delaval Inc.*,[147] and has been endorsed by the ALI.[148]

The doctrine asserts that, in products liability cases based on negligence or strict liability in tort, in the absence of personal injury or property damage, economic loss is not recoverable.[149] This rule is applicable to "direct economic loss," i.e., damage to the product itself, whether the result of gradual deterioration or sudden catastrophic failure or destruction, as well as consequential economic loss.[150]

The rationale underlying the doctrine is that parties to a sales transaction (particularly commercial actors) can structure their transaction as they see fit, including or omitting the U.C.C.'s warranty provisions and limitations. Having done so, they are thereafter bound and the courts should not permit a party to better its bargain by pursuing tort remedies.

Thus, for example, in *Rodman*, the parties entered a contract under the terms of which G & S Mill agreed to retrofit a boiler owned by the plaintiff in order to bring the boiler into compliance with Wisconsin environmental emissions standards. Notwithstanding extensive efforts, the defendant was never able to bring the boiler into compliance.

Apparently in hopes of bringing the case within the insuring provisions of a liability policy, the plaintiff brought a negligence action against G & S Mill. Alleged damages included the costs of obtaining natural gas

143. 153 F.3d 906, 36 U.C.C. Rep. Serv. 2d (West) 649 (8th Cir. 1998).

144. *State Farm*, 572 N.W.2d at 325, 36 U.C.C. Rep. Serv. 2d (West) at 723; *JN Exploration*, 153 F.3d at 914, 36 U.C.C. Rep. Serv. 2d (West) at 660.

145. *State Farm*, 572 N.W.2d at 325, 36 U.C.C. Rep. Serv. 2d (West) at 723; *JN Exploration*, 153 F.3d at 914, 36 U.C.C. Rep. Serv. 2d (West) at 660.

146. 403 P.2d 145, 151, 2 U.C.C. Rep. Serv. (Callaghan) 915, 921-22 (Cal. 1965).

147. 476 U.S. 858, 870, 1 U.C.C. Rep. Serv. 2d (Callaghan) 609 (1986).

148. *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 cmt. a (1997).

149. *See* Rodman Indus., Inc. v. G & S Mill, Inc., 145 F.3d 940, 943, 35 U.C.C. Rep. Serv. 2d (West) 877, 879 (7th Cir. 1997) (applying Wisconsin law).

150. *Id.*

for a substitute boiler, the cost of land filling dust that could not be burned by the boiler, the cost of renting replacement boilers, and the cost of related/ancillary systems.

Although noting that Wisconsin law was unclear as to the applicability of the economic loss doctrine to service contracts, the Seventh Circuit characterized the "main thrust of the deal [as] the purchase of a retrofitted boiler."[151] Therefore, the doctrine clearly applied. The court reasoned that:

> allowing Rodman to seek tort remedies to compensate for its frustrated expectations under the contract would obviate the distinction between the realm of tort—and its "concerns with unreasonably dangerous products or public safety", . . . —and the realm of contract, which serves to "protect the expectancy interests of parties to private bargained-for agreements."
>
> . . . .
>
> [Additionally, p]ermitting a tort suit under these circumstances would also frustrate the ability of commercial parties to rely on their contracts to allocate risks. [The defendant] had every reason to believe that its contract with Rodman—and particularly the limited warranty provisions—limited its liability in the event that the boiler did not perform as expected. Rodman's negligence suit, if allowed to stand, would make the contractual allocation of risk between [the parties] virtually meaningless, as Rodman would merely seek in tort those remedies denied under the contract.[152]

Finally, as between the two parties, the plaintiff "was in [a] better position to identify its risk of economic loss in the event that the boiler did not work as expected . . . [and] safeguard[ ] against it by purchasing insurance, arranging for a temporary boiler or taking other precautions, or negotiating a more favorable contract . . . ."[153]

The doctrine's scope in Wisconsin was clarified in *Daanen & Janssen, Inc. v. Cedarapids, Inc.*[154] In that case, the Wisconsin Supreme Court decided that the economic loss doctrine was not limited to those cases in which the parties were in privity of contract.[155]

Cedarapids, Inc. (Cedarapids) manufactured and sold a component for a rock-crushing machine to a distributor from which the plaintiff purchased the machine. The component failed to operate properly and the plaintiff filed suit based on strict liability and negligence alleging some $400,000 in economic damages, including repair cost and lost revenue.

151. *Id.* at 943, 35 U.C.C. Rep. Serv. 2d (West) at 880.
152. *Id.* at 944-45, 35 U.C.C. Rep. Serv. 2d (West) at 882 (citation omitted).
153. *Id.* at 945, 35 U.C.C. Rep. Serv. 2d (West) at 882.
154. 573 N.W.2d 842, 35 U.C.C. Rep. Serv. 2d (West) 856 (Wis. 1998).
155. *Id.* at 850, 35 U.C.C. Rep. Serv. 2d (West) at 866-67.

In responding to the question certified by the Seventh Circuit, the court held that the lack of privity between Daanen & Janssen, Inc. and Cedarapids did not matter. The court noted that the purpose of the doctrine is to protect "commercial parties' freedom to contract."[156] The court reasoned that permitting a tort action against the manufacturer would result in the entire economic risk being borne by the manufacturer. However, without a tort action, the manufacturer, distributors, and purchasers would be free to allocate the risk of economic loss by contract.[157]

The Seventh Circuit also had occasion to deal with two other recurring problems in the application of the economic loss doctrine. The first dealt with the viability of the "calamitous occurrence" exception to the doctrine. The second dealt with the problem of just what is the "product" for purposes of the doctrinal distinction between damage to "the product" (economic loss) and damage to "other property" (property damage).

The calamitous occurrence exception was first enunciated by the Third Circuit in *Pennsylvania Glass Sand Corp. v. Caterpillar Tractor Co.*[158] The court distinguished between the gradual deterioration of a product, a warranty issue, and sudden, violent destruction of the product, which appeared more "tort-like," and thus would support negligence or strict liability in a tort action.[159] A number of courts followed.[160] The distinction has since been rejected by most courts, including the U.S. Supreme Court and the Third Circuit.[161] Thus, recently, in *Trans States Airlines v. Pratt & Whitney Canada, Inc.*,[162] a case involving lost revenue from canceled flights following a catastrophic aircraft engine failure, the court found the economic loss doctrine applicable notwithstanding the manner in which the product failed.[163]

Perhaps more importantly, the *Trans States Airlines* case forced the court to grapple with the question of just what the product is for purposes of the doctrine. In the *Trans States Airlines* case, the engine failure resulted not only in damage to the engine itself, but to the airframe in which it was housed. Although the court acknowledged that "a claim to recover for injury to the product itself is essentially a complaint about disappointed expectations—a contract notion,"[164] the Illinois Supreme Court, in an-

156. *Id.* at 847, 35 U.C.C. Rep. Serv. 2d (West) at 863.

157. *Id.* at 847-48, 35 U.C.C. Rep. Serv. 2d (West) at 863.

158. 652 F.2d 1165, 33 U.C.C. Rep. Serv. 2d (West) 521 (3d Cir. 1981).

159. *Id.* at 1174-75.

160. *See, e.g.,* Vaughn v. General Motors Corp., 454 N.E.2d 740 (Ill. App. Ct. 1983), *aff'd*, 466 N.E.2d 195, 38 U.C.C. Rep. Serv. (Callaghan) 1619 (Ill. 1984).

161. *See* East River S.S. Corp. v. Transamerica Delaval Inc., 476 U.S. 858, 870, 1 U.C.C. Rep. Serv. 2d (Callaghan) 609, 621 (1986); Aloe Coal Co. & Commerical Union Ins. Co. v. Clark Equip. Co., 816 F.2d 110, 111-12, 3 U.C.C. Rep. Serv. 2d (Callaghan) 966 (3d Cir. 1987).

162. 130 F.3d 290, 34 U.C.C. Rep. Serv. 2d (West) 328 (7th Cir. 1997).

163. *Id.* at 292, 34 U.C.C. Rep. Serv. 2d (West) at 331.

164. *Id.* at 291, 34 U.C.C. Rep. Serv. 2d (West) at 329.

swering a certified question, determined that it was a single product. The court's analytic focus was on the nature of the bargain between the parties. Under the contract, Trans States Airlines had received a fully integrated aircraft, complete with engine. Thus, the engine and airframe should be viewed as one product, not two separate bargained-for products.[165]

Finally, the breadth of the doctrine was extended (arguably overextended) by the Eighth Circuit in *AKA Distributing Co. v. Whirlpool Corp.*,[166] which moved the rule beyond its product liability origin. *AKA Distributing* involved a distribution contract for vacuum cleaners. The contract, by its terms, was for a period of one year. According to the plaintiff, Whirlpool Corp. (Whirlpool) representatives repeatedly assured the plaintiff that their relationship would be a long one. When Whirlpool terminated the distributorship, the plaintiff sued alleging that

> Whirlpool fraudulently told distributors they would be selling Whirlpool products for a long time, concealing its secret plan to manufacture private label cleaners for Sears . . . [and] thereby lured AKA and others into signing distributor contracts . . . so it could capture their engineering talents in developing a product line acceptable to Sears.[167]

The case cannot be characterized as a product liability case for purposes of the application of the economic loss doctrine. Nevertheless, the district court found (and the Eighth Circuit agreed) that the contract was a contract for the sale of goods governed by Article 2 and thus, time-barred by Article 2's four-year statute of limitations.[168]

Significantly, the court's decision that the applicability of Article 2 necessarily precluded not only negligence and strict liability actions, but all tort actions seems questionable. Fraudulent misrepresentation (common law deceit) is, after all, a cause of action under which pure economic loss can be recovered.[169]

Furthermore, while the court was careful to limit its holding to misrepresentations which were not collateral to the contract,[170] it is hard to see how a party to a contract can contractually guard against the possibility of fraud. Thus, the case seems distinct from the normal economic loss rule case where the denial of a negligence or strict liability action is grounded on the fact that a party to a contract can guard against possible product disappointment.

165. *Id.* at 292, 34 U.C.C. Rep. Serv. 2d (West) at 331.

166. 137 F.3d 1083, 35 U.C.C. Rep. Serv. 2d (West) 45 (8th Cir. 1998).

167. *Id.* at 1085, 35 U.C.C. Rep. Serv. 2d (West) at 46.

168. *Id.* at 1085-87, 35 U.C.C. Rep. Serv. 2d (West) at 47-50.

169. U.C.C. § 1-103 provides that principles of law and equity, including fraud and misrepresentation, supplement the U.C.C. unless displaced by particular provisions. U.C.C. § 1-103 (1995).

170. *AKA Distrib. Co.*, 137 F.3d at 1087, 35 U.C.C. Rep. Serv. 2d (West) at 50.

## *INDEMNITY/CONTRIBUTION CASES*

In two recent decisions, courts were faced with the question of whether the economic loss doctrine was applicable where the plaintiff was pursuing what was, in essence, an indemnity or contribution claim against a tortfeasor who was also in privity with the claimant. In *Maynard Cooperative Co. v. Zeneca, Inc.*,[171] the court mischaracterized the problem as presenting a negligent misrepresentation case resulting in pure economic loss, and, having thus mischaracterized the case, applied the doctrine to deny recovery.[172]

The case arose when the McSweeneys employed Maynard Cooperative Co. (Maynard) to assist them in destroying a failed alfalfa crop so that the field could be replanted. Maynard consulted with Osborne, Zeneca, Inc.'s (Zeneca's) area representative. Osborne advised Maynard to apply Gramoxone (manufactured by Zeneca) and an herbicide manufactured by another company. Osborne further advised Maynard that the field could be planted seven days after the application of the herbicides. In fact, it was necessary to wait twenty-one days before planting, and the new crop failed apparently because of the presence of the herbicide residue.

Maynard then settled the claim asserted by the McSweeneys, and brought an action against Zeneca. The action asserted claims for negligence, negligent misrepresentation, and breach of warranty in addition to the indemnity and contribution claims. Because Maynard had paid the McSweeneys, the correct characterization of the case was one for indemnity or contribution with the underlying action predicated on negligent misrepresentation which resulted in damage to tangible property (the replanted crops).

It seems clear that the court erred in holding that the economic loss doctrine barred the indemnity and contribution claims. Indemnity and contribution claims asserted by a settling tortfeasor against a non-settling tortfeasor will always be economic loss claims. That should not bring the economic loss rule into play where the underlying action is one for personal injury or property damage (with or without parasitic economic loss). To rule otherwise, as the Eighth Circuit has, would be to abolish third party actions and discourage settlement. This cannot be the result the court intended or desired.

A similar issue confronted a California appellate court in *North American Chemical Co. v. Superior Court.*[173] In that case, the plaintiff contracted with Trans Harbor, Inc. and Pac III (Harbor Pac) to bag boric acid and ship it to the plaintiff's customer. Harbor Pac permitted the boric acid to become contaminated in the process of bagging it. As a result, the plaintiff was

171. 143 F.3d 1099, 35 U.C.C. Rep. Serv. 2d (West) 871 (8th Cir. 1998).
172. *Id.* at 1102-03, 35 U.C.C. Rep. Serv. 2d (West) at 875.
173. 69 Cal. Rptr. 2d 466, 34 U.C.C. Rep. Serv. 2d (West) 332 (Ct. App. 1997).

forced to settle a claim asserted by its customer by granting a credit of $203,550.

While the suit filed against Harbor Pac alleged negligence and breach of the contract to provide services, it would be more properly characterized as an indemnity action. In any event, the defendant demurred to the negligence count of the complaint and the trial court sustained the demurrer based on the economic loss rule. The plaintiff then petitioned the appellate court for a writ of mandate to overturn the trial court's ruling on the complaint.

The petition was granted, the appellate court ruling that "until such time as an election may be required by law," the plaintiff could pursue a count based on negligence.[174] While the outcome may have been correct, the court's ruling would have been less apt to cause future doctrinal confusion had it simply acknowledged that the economic loss rule has no application in an indemnity action where the underlying case is one involving property damage.

174. *Id.* at 467, 34 U.C.C. Rep. Serv. 2d (West) at 332.