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Sales

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This survey reviews significant recent case law under Article 2 (Sales of Goods) of the Uniform Commercial Code (U.C.C.). Revisions to Article 2 are being drafted for approval by The Joint Sponsoring Organizations of the U.C.C., The National Conference of Commissioners on Uniform State Laws (NCCUSL) and The American Law Institute (ALI). The latest draft of the revisions is available at a NCCUSL website.[1] It is anticipated that the sponsoring organizations will approve the revisions this year.

BREACH OF DUTY OF GOOD FAITH

Two courts addressed whether the duty of good faith under Article 1[2] gives rise to a separate claim for a breach of a sale contract. In *Northview Motors, Inc. v. Chrysler Motors Corp.*,[3] the U.S. Court of Appeals for the Third Circuit held that there was no independent cause of action for breach of the implied covenant of good faith under Pennsylvania's U.C.C.[4] Northview Motors, a dealership selling Eagle and Jeep vehicles, alleged that actions on the part of Chrysler and its regional employees after Chrysler acquired the Eagle and Jeep lines of vehicles through its acquisition of American Motor Company, breached the parties' contract for the sale of new vehicles and caused Northview severe financial problems, which ul-

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1. *See* U.C.C. REVISED ARTICLE 2, SALES (Tentative Draft May 2001) *available at* <http://www.upenn.edu/bll/ulc/ulc.htm>.

2. *See* U.C.C. § 1-203 (2000) (providing "[E]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.").

3. 227 F.3d 78, 42 U.C.C. Rep. Serv. 2d (West) 652 (3d Cir. 2000).

4. *Id.* at 91 & n.6, 42 U.C.C. Rep. Serv. 2d (West) at 664 & n.6. The court also considered and rejected the plaintiff's claim for breach of the duty of good faith found in the Automobile Dealers Day in Court Act (ADDCA), 15 U.S.C. §§ 1221-25 (1994), holding that the duty of good faith under this act was limited and required a finding of coercion or intimidation, which was not present in this case. 227 F.2d at 92-97.

timately resulted in the closure of the dealership. The district court had, among other rulings, granted Chrysler summary judgment on the count of the complaint which alleged a cause of action for breach of the implied duty of good faith under the U.C.C. The circuit court noted that Pennsylvania courts had recognized an independent cause of action for breach of the duty of good faith in only very limited situations, such as those involving insurance contracts and franchise agreements.[5] The court stated that the duty of good faith—both in the U.C.C. and in the Restatement (Second) of Contracts—is properly used as an interpretative tool to determine the parties' justifiable expectations, but that the duty is not separate from nor does it override specific duties and obligations as found in the parties' contract.[6] Rejecting the plaintiff's claim that the good faith duty supports a separate cause of action, the court affirmed the district court's grant of summary judgment on this claim.

In *Allapattah Services, Inc. v. Exxon Corp.*,[7] the plaintiff gas station dealers sought to recover punitive damages from Exxon for breach of its duty of good faith in carrying out gasoline supply contracts with the dealers. In order to warrant an award of punitive damages, the implied duty of good faith would have to constitute a tort independent from the alleged breach of contract.[8] The court explained that the underlying purpose of contract damages is to put the aggrieved party in the same position they would have occupied had the contract been performed.[9] Because of this, courts have consistently rejected plaintiffs' requests for punitive damages in contract actions, regardless of the motives of the breaching party.[10] Only if the defendant's conduct rises to the level of an independent tort, the court held, can punitive damages be recovered.[11]

The plaintiff dealers argued that the breach of the implied duty of good faith constituted such a tort. The court rejected this argument, noting that tort duties arise by law and social policy and are owed to an entire class of persons, while contractual duties are limited to the parties to the contract.[12] The duty of good faith arose between the parties by the exis-

5. *Id.* at 91, 42 U.C.C. Rep. Serv. 2d (West) at 665 (citing Creeger Brick & Bldg. Supply, Inc. v. Mid-State Bank & Trust Co., 560 A.2d 151, 153-54 (Pa. Super. Ct. 1989)).

6. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 665; *see also* U.C.C. § 1-203 cmt. (2000) ("This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power.").

7. 61 F. Supp. 2d 1326, 41 U.C.C. Rep. Serv. 2d (West) 184 (S.D. Fla. 1999).

8. *See* U.C.C. § 1-106 (2000) (prohibiting the award of punitive damages unless the Code or other law specifically provides for recovery of these damages).

9. *Allapattah*, 61 F. Supp. 2d at 1328, 41 U.C.C. Rep. Serv. 2d (West) at 185.

10. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 185.

11. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 185.

12. *Id.* at 1329-30, 41 U.C.C. Rep. Serv. 2d (West) at 186, 188 (quoting Splitt v. Deltona Corp., 662 F.2d 1142, 1145 (5th Cir. 1981)).

tence of the contract and thus did not constitute a separate duty on which a tort could be based. The court also recognized that an intentional breach of contract is not just tolerated by the law, but sometimes encouraged. Contracting parties are permitted, without penalty, to choose to breach a contract and pay damages if it is economically efficient to do so.[13]

The court also considered the Official Comment to section 1-203, which expressly provides that the section does not support an independent cause of action for a party's failure to act or perform in good faith, but rather failure to perform an obligation under a contract in good faith constitutes a breach of that contractual obligation.[14] Finding that its approach was consistent with other courts' interpretation of the duty of good faith,[15] the court denied plaintiff's request to assert a claim for punitive damages.

BATTLE OF THE FORMS AND TERMS ENCLOSED WITH THE GOODS

Two recent cases illustrate the split of authority over whether terms that the seller encloses with the goods are part of the parties' contract. The Washington State Supreme Court has affirmed the decision of the Court of Appeals in *M.A. Mortenson Co. v. Timberline Software Corp.*[16] The lower court's decision was reported in last year's survey.[17] The supreme court adopted the *ProCD*[18] layered contract theory and applied it to a battle of forms in which the software provider had signed the user's purchase

13. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 186; *see also* Thyssen, Inc. v. S.S. Fortune Star, 777 F.2d 57, 63 (2d Cir. 1985) (explaining that breaches of contract that are efficient and wealth-enhancing should be encouraged and imposition of punitive damages would prevent such "efficient breaches "); Reiver v. Murdoch & Walsh, P.A., 625 F. Supp. 998, 1015 (D. Del. 1985) (acknowledging that some contract breaches are intentional and efficient when a party chooses to pay damages because it is less costly than performing the contract and therefore, the breaches do not justify the imposition of punitive damages); Harris v. Atlantic Ritchfield Co., 17 Cal. Rptr. 2d 649, 653 (Cal. Ct. App. 1993) (noting that the goal of contract damages to compensate non-breaching party for loss, not to compel breaching party to perform); 3 RESTATEMENT (SECOND) OF CONTRACTS at 99-100 (1979) ("The traditional goal of the law of contract remedies has not been compulsion of the promisor . . . but compensation of the promisee . . . . 'Willful' breaches have not been distinguished from other breaches.").

14. U.C.C. § 1-203 cmt. (2000).

15. *Allapattah*, 61 F. Supp. 2d at 1330 (citing Charles E. Brauer Co., Inc. v. NationsBank of Va., N.A., 466 S.E.2d 382, 385, 28 U.C.C. Rep. Serv. 2d (CBC) 1354-57 (Va. 1996)) (holding breach of contractual duty of good faith does not amount to independent tort); *accord,* Duquesne Light Co. v. Westinghouse Elec. Corp., 66 F.3d 604, 617, 27 U.C.C. Rep. Serv. 2d (CBC) 823, 831 (3d Cir. 1995).

16. 998 P.2d 305, 41 U.C.C. Rep. Serv. 2d (West) 357 (Wash. 2000).

17. John D. Wladis et. al., *Sales*, 55 BUS. LAW. 1951, 1954 (2000).

18. ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 29 U.C.C. Rep. Serv. 2d (West) 1109 (7th Cir. 1996).

order.[19] This resulted in the software provider's shrinkwrap license terms being part of the contract.

In *Mortenson* a construction contractor ("Contractor") had used previous versions of Timberline's construction bid software. A computer system upgrade necessitated Contractor's acquiring several copies of the latest version of the software through Timberline's local dealer. Contractor issued a purchase order, which Timberline's dealer signed. The software arrived wrapped in Timberline's shrinkwrap licensing agreement. Contractor installed and used the software. Some weeks prior to the sale, Timberline had discovered what it considered to be a minor bug in the software. Consequently it did not notify users of the bug, although it did furnish updated software to some users who complained about the bug. The bug caused the software to prepare a bid for Contractor that was two million dollars below what the bid should have been. Contractor did not detect the error and submitted the incorrect bid. When it eventually discovered the bid error, Contractor sued Timberline for breach of warranty. Timberline defended by arguing that Contractor had agreed to Timberline's license terms, which included a limitation of liability clause.[20]

The parties engaged in a classic battle of forms with the added fact that one of the parties—Timberline—signed the other party's form. A court would normally analyze these facts under U.C.C. section 2-207. It would find that a contract was formed with the signing of the purchase order and that the license terms were additional terms proposed to modify the contract. Whether those terms were part of the contract would depend on subsection (2).[21] Courts generally find liability limitation clauses to materially alter the contract and thus not to be included in the contract under that subsection.[22] Therefore, under a normal battle of forms analysis Timberline's liability limitation clause would not be part of the contract. This was precisely Contractor's argument.

The trial court ruled for Timberline, however, and both the Washington Court of Appeals[23] and the Washington Supreme Court affirmed. One supreme court judge wrote a dissent.[24]

The Washington Supreme Court applied U.C.C. Article 2 and concluded that section 2-204, not section 2-207, governed for the reason that:

19. *See Mortenson*, 998 P.2d at 313, 41 U.C.C. Rep. Serv. 2d (West) at 370-71.

20. The clause stated that Timberline would not be liable "for any damages of any type, including but not limited to, . . . consequential damages . . . ." 998 P.2d at 308-09, 41 U.C.C. Rep. Serv. 2d (West) at 363.

21. U.C.C. § 2-207(2) (2000).

22. *See, e.g.*, Transamerica Oil Corp. v. Lynes, Inc. 723 F.2d 758, 765, 37 U.C.C. Rep. Serv. (Callaghan) 1076, 1085-86 (10th Cir. 1983).

23. M.A. Mortenson Co., v. Timberline Software Corp., 970 P.2d 803, 813, 37 U.C.C. Rep. Serv. 2d (West) 892, 917 (Wash. Ct. App. 1999), *aff'd*, 998 P.2d 305, 41 U.C.C. Rep. Serv. 2d (CBC) 357 (Wash. 2000).

24. *Mortenson*, 998 P.2d at 316, 41 U.C.C. Rep. Serv. 2d (West) at 375 (Sanders, J., dissenting).

"[T]his is a case about contract formation, not contract alteration."[25] It then concluded that section 2-204 permitted formation of a "layered contract" similar to the contracts in *ProCD* and its progeny.[26] The court then held that Contractor had assented to Timberline's license terms by installing and using the software.[27] It also found that a course of dealing and a trade usage made the license terms part of the contract.[28]

Mortenson is remarkable because it is the first reported case to extend the *ProCD* theory of layered contracting to a battle of forms, and it did so on facts clearly showing that a contract had been formed before the license terms were sent. *ProCD* and its progeny all involved contracts in which only one party used a form. These cases declined to apply section 2-207 because, they said, that section covered a battle of forms, not a contract in which only one form was used.[29] There were thus formidable reasons for analyzing this case under section 2-207, but the *Mortenson* court declined to do so. Why was the usual battle of forms analysis not followed in this case?

The supreme court gave several reasons for concluding that Timberline's license terms were part of the contract. First, it indicated that section 2-207 does not apply to contract formation.[30] This unsupported conclusion is not particularly helpful. In fact, it seems patently wrong. Section 2-207 can govern contract formation[31] as well as contract alteration[32] issues when parties use non-matching forms.

Second, the court concluded that Contractor's installation and use of the software was assent to Timberline's license terms.[33] This conclusion is atypical, especially where, as here, Timberline's agent signed Contractor's purchase order.[34] When the parties exchange non-matching forms, courts tend to ignore or reject the argument that a buyer's acceptance and use of the goods is assent to the seller's form terms.[35]

Third, the supreme court concluded that the prior course of dealing between the parties, as well as uncontroverted evidence of trade usage,

25. *Id.* at 312, 41 U.C.C. Rep. Serv. 2d (West) at 369.

26. *Id.* at 313, 41 U.C.C. Rep. Serv. 2d (West) at 370-71.

27. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 371.

28. *Id.* at 313-14, 41 U.C.C. Rep. Serv. 2d (West) at 371.

29. *See, e.g.*, ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1452, 29 U.C.C. Rep. Serv. 2d (CBC) 1109, 1115 (7th Cir. 1996); Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569, 571, 37 U.C.C. Rep. Serv. 2d (West) 54, 56-57 (N.Y. App. Div. 1998).

30. *Mortenson*, 998 P.2d at 312, 41 U.C.C Rep. Serv. 2d (West) at 369.

31. U.C.C. § 2-207(1), (3) (2000); *see, e.g.*, Northrop Corp. v. Litronic Indus., 29 F.3d 1173, 1174-75, 24 U.C.C. Rep. Serv. 2d (CBC) 407, 408-09 (7th Cir. 1994).

32. U.C.C. § 2-207(2) (2000).

33. *Mortenson*, 998 P.2d at 313, 41 U.C.C. Rep. Serv. 2d (West) at 371.

34. *Id.* at 319-20, 41 U.C.C. Rep. Serv. 2d (West) at 381 (Sanders, J., dissenting).

35. *See, e.g.*, Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 99, 15 U.C.C. Rep. Serv. 2d (CBC) 1, 12-13 (3d Cir. 1991); Coastal Indus., Inc. v. Automatic Steam Prods. Corp., 654 F.2d 375, 379, 31 U.C.C. Rep. Serv. (Callaghan) 1566, 1571 (5th Cir. 1981).

established that the license terms were part of the contract.[36] If the prior transactions showed Contractor's actual assent to the license terms (not merely using the software) there would be a course of dealing and the license terms would be part of the agreement.[37] It may be, however, that Contractor simply purchased and used the software in the previous transactions. In that case, repeatedly sending the same form to a buyer over several transactions is generally held not to constitute a course of dealing that incorporates those terms in the contract.[38] It is not clear from the court's opinion exactly what were the facts characterized as a trade usage. It may have been simply that Timberline's license terms were the same as those offered by other software providers. However, the fact of industry-wide use by sellers of similar terms does not usually establish a trade usage unless there is some indication that those terms generally are acceptable to buyers or otherwise normally incorporated into agreements.[39]

In the final analysis, the *Mortenson* case fosters uncertainty in the battle of forms. After *Mortenson,* a battle of forms could be resolved one of two ways: (i) a contract on the seller's terms using the layered contract theory under section 2-204 if the buyer does not return the goods; or (ii) a contract on jointly-agreed terms plus the U.C.C.'s gap fillers using section 2-207. The *Mortenson* case does not clearly explain when each approach applies. Further, the extension of the *ProCD* layered contract approach to the battle of forms threatens to unsettle sales transactions between commercial parties. The *ProCD* approach has been a concern for consumers and small business buyers that do not use forms; *ProCD* now becomes a concern for large business buyers that draft and use their own forms in the contracting process.

In *Klocek v. Gateway, Inc.*[40] the U.S. District Court for the District of Kansas declined to enforce an arbitration provision in the Standard Terms document that the Gateway computer company enclosed with its product. The case was later dismissed for lack of subject matter jurisdiction.[41] It is reviewed here because the court's first opinion contains an interesting critique of the Seventh Circuit's reasoning in *Hill v. Gateway 2000, Inc.*[42]

Klocek purchased a computer from Gateway. Interestingly, the parties disagreed on how the computer had been delivered. Klocek alleged that

36. *Mortenson*, 998 P.2d at 314, 41 U.C.C. Rep. Serv. 2d (West) at 371.

37. *Id.* at 312-13, 41 U.C.C. Rep. Serv. 2d (West) at 369-71.

38. *Id.* at 320, 41 U.C.C. Rep. Serv. 2d (West) at 382 (Sanders, J., dissenting) (quoting *Step-Saver*, 939 F.2d at 104, 15 U.C.C. Rep. Serv. 2d (CBC) at 19); *see, e.g.*, PSC Nitrogen Fertilizer, L.P. v. Christy Refractories, L.L.C., 225 F.3d 974, 982, 42 U.C.C. Rep. Serv. 2d (West) 421, 431 (8th Cir. 2000).

39. *See, e.g.*, Cosden Oil & Chem. Co. v. Karl O. Helm Aktiengesellschaft, 736 F.2d 1064, 1076, 38 U.C.C. Rep. Serv. (Callaghan) 1645, 1662 (5th Cir. 1984).

40. 104 F. Supp. 2d 1332, 41 U.C.C. Rep. Serv. 2d (West) 1059 (D. Kan. 2000).

41. No. Civ. A. 99-2499-KHV, 2000 WL 1372886 (D. Kan. Sept. 6, 2000).

42. 105 F.3d 1147, 31 U.C.C. Rep. Serv. 2d (CBC) 303 (7th Cir. 1997).

he had purchased and taken delivery of the computer at a Gateway retail store. Gateway alleged that it had shipped the computer to Klocek. The court ultimately found this discrepancy to be immaterial to the outcome. Klocek was dissatisfied with the computer as well as Gateway's technical support service and filed suit.[43] Gateway moved for dismissal asserting that Klocek had agreed to arbitrate by failing to return the computer within five days of receipt as provided in the Standard Terms that Gateway included with the computer. The court concluded that the evidence was insufficient to show that Klocek had agreed to arbitrate. Accordingly it declined to dismiss the suit.[44]

The court noted that there was a split of authority on whether terms received with the goods become part of the parties' agreement.[45] It also noted that the cases turn, in part, on whether the court finds that the parties formed their contract before or after the seller communicated its terms to the buyer.[46] For several reasons the district court declined to adopt the reasoning of *Hill* and the case on which *Hill* relied, *ProCD, Inc. v. Zeidenberg*.[47] First, the district court disagreed with the conclusion of *Hill* and *ProCD* that U.C.C. section 2-207 does not apply when only one form is used.[48] The court noted that neither case offered any authority to support that proposition.[49] The court stated that nothing in the text of section 2-207 precluded its application when only one form was used.[50] It also noted that the official comment indicated that the section could apply to one form situations.[51] Finally the court noted that both Kansas and Missouri case law—one of which would be the applicable law—indicated that section 2-207 can apply to one form situations.[52]

43. Evidently Klocek had purchased a Hewlett Packard scanner that was not compatible with the computer.

44. *Klocek*, 104 F. Supp. 2d at 1341, 41 U.C.C. Rep. Serv. 2d (West) at 1073. Klocek had also sued Hewlett Packard. The court dismissed this part of the suit for lack of subject matter jurisdiction. *Id.* at 1343.

45. *Id.* at 1337-38, 41 U.C.C. Rep. Serv. 2d (West) at 1068-69. For the proposition that terms included with the goods are not part of the agreement the court cited *Step-Saver Data Sys. v. Wyse Tech.*, 939 F.2d 91, 15 U.C.C. Rep. Serv. 2d (CBC) 1 (3d Cir. 1991); *Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759, 22 U.C.C. Rep. Serv. 2d (CBC) 70 (D. Ariz. 1993) and *U.S. Surgical Corp. v. Orris, Inc.*, 5 F. Supp. 2d 1201, 37 U.C.C. Rep. Serv. 2d (West) 266 (D. Kan. 1998). For the converse proposition the court cited the *Hill* and *ProCD* cases and *M.A. Mortenson Co. Inc. v. Timberline Software Corp.*, 998 P.2d 305, 41 U.C.C. Rep. Serv. 2d (West) 357 (Wash. 2000). *Klocek*, 104 F. Supp. 2d at 1337, 41 U.C.C. Rep. Serv. 2d (West) at 1068-69.

46. *Id.* at 1338, 41 U.C.C. Rep. Serv. 2d (West) at 1068.

47. 86 F.3d 1447, 29 U.C.C. Rep. Serv. 2d (CBC) 1109 (7th Cir. 1996).

48. *Klocek*, 104 F. Supp. 2d at 1339, 41 U.C.C. Rep. Serv. 2d (West) at 1070.

49. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 1070.

50. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 1070.

51. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 1071 (citing U.C.C. § 2-207 cmt. 1 (2000)).

52. *Klocek*, 104 F. Supp. 2d at 1339-40, 41 U.C.C. Rep. Serv. 2d (West) at 1071.

The court also took issue with the Seventh Circuit's conclusion that the seller was master of the offer. It stated that in the typical consumer transaction the buyer, not the seller, makes the offer. It noted that Gateway had provided no evidence that this typical pattern was not followed in the Klocek sale. The court then assumed that Klocek had made the offer and that Gateway had accepted that offer by delivering the computer.[53]

The court then proceeded to analyze Gateway's Standard Terms under section 2-207. It stated that Gateway's terms were either an expression of acceptance or a written confirmation. If the terms were an expression of acceptance the court concluded that it was not expressly conditioned on Klocek's assent. The court then considered whether the additional terms in Gateway's Standard Terms document were part of the contract. Because Klocek was not a merchant, the court concluded that any additional terms in Gateway's Standard Terms (such as the arbitration clause) were not part of the agreement unless Klocek expressly agreed to them.[54] The court then held that Klocek's keeping the computer beyond the five day time limit stipulated in Gateway's Standard Terms document was not express agreement to the terms where, as here, Gateway presented no evidence that it informed Klocek of the five day review-and-return period as a condition to making the contract or that the parties contemplated additional terms to the agreement.[55] The court concluded that it was not unreasonable for a seller at the time of the sale to clearly communicate to the buyer either the complete terms of the sale or the fact that it will propose additional terms as a condition of the sale.[56] The court thus concluded that there was insufficient evidence to indicate that Klocek had agreed to Gateway's arbitration clause.[57]

The proposed revisions to Article 2 purposely take no position on the controversy of whether to apply section 2-207 or the layered contract approach to terms enclosed with the goods; this matter is left to the courts to sort out.[58]

BREACH OF INSTALLMENT CONTRACT

Two courts addressed the issue of breach with respect to installment contracts. In *Magic Valley Foods, Inc. v. Sun Valley Potatoes, Inc.*,[59] the Idaho

53. *Id.* at 1340, 41 U.C.C. Rep. Serv. 2d (West) at 1071-72.

54. *Id.* at 1341, 41 U.C.C. Rep. Serv. 2d (West) at 1073 (citing KAN. STAT. ANN. § 84-2-207, Kansas cmt. 2); *see also* U.C.C. § 2-207 cmt. 3 (2000).

55. *Klocek*, 104 F. Supp. 2d at 1341, 41 U.C.C. Rep. Serv. 2d (West) at 1073-74.

56. *Id.* at 1341 n.14, 41 U.C.C. Rep. Serv. 2d (West) at 1073 n.14.

57. *Id.* at 1341, 41 U.C.C. Rep. Serv. 2d (West) at 1074.

58. *See* U.C.C. § 2-207, preliminary cmt. 5 (Tentative Draft May 2001), *available at* <http://www.law.upenn.edu/bll/ulc/ucc2/art20501.htm>. This position was adopted evidently because the drafting committee and Gateway advocates were unable to reach an accommodation on the issue. *See* J. White and R. Summers, U.C.C. 7 (5th Stud. Ed. 2000).

59. 10 P.3d 734, 42 U.C.C. Rep. Serv. 2d (West) 999 (Idaho 2000).

Supreme Court had to determine whether a seller could withhold deliveries on upcoming installments when the buyer had failed to make timely payments on previous related contracts and was in arrears on invoices on both the current and prior installment contracts. Sun Valley Potatoes, a potato packer, entered into four different contracts, three written and one oral, to sell potatoes to Magic Valley Foods. The contracts generally mirrored the potato crop season, with each successive contract covering a season. Deliveries under each contract were made in installments. After each delivery, Sun Valley billed Magic Valley by invoice for the potatoes delivered and accepted, with payment due in thirty days.

Payment problems began with the first contract. Magic Valley did not pay the invoices on this first contract in a timely manner, however all were ultimately paid. On the second contract, Magic Valley also failed to pay Sun Valley's invoices in a timely manner. Magic Valley ultimately paid some of the invoices on the second contract, although at the time of the dispute, almost $110,000 was still unpaid on this contract.[60] Of the last two contracts, one was an oral agreement, which the parties agreed Sun Valley fulfilled, although Magic Valley failed to pay the amounts due under this contract. It was during the final written contract that Sun Valley decided to withhold deliveries several months into the contract based on Magic Valley's refusal to pay for potatoes already delivered.

Magic Valley argued that Sun Valley had waived its right to consider the late payments as a breach because it had continued to deliver potatoes under each of the contracts, despite Magic Valley's consistently late payments. The trial court agreed, holding that Sun Valley's failure to insist on strict compliance with the payment terms constituted a waiver of the terms.[61] The trial court reasoned that, therefore, Sun Valley could not unilaterally repudiate the contract based on Magic Valley's failure to make timely payments.[62] The court permitted Magic Valley to offset the losses it sustained as a result of Sun Valley's refusal to deliver against the balance Magic Valley owed Sun Valley.[63]

The Idaho Supreme Court disagreed on the waiver issue, holding that Magic Valley must show it reasonably relied on Sun Valley's waiver to its detriment before Sun Valley would be held to have waived its right to insist on timely payment.[64] Because Magic Valley was unable to demonstrate detrimental reliance, Sun Valley had not waived the payment term.[65]

60. On each of these contracts, Sun Valley did not deliver the exact number of potatoes for which Magic Valley had contracted, with fewer potatoes delivered on the first contract and more potatoes delivered on the second contract. However, the parties agreed that Sun Valley had fulfilled these contracts. *Id.* at 735, 42 U.C.C. Rep. Serv. 2d (West) at 1000.

61. *Id.* at 737, 42 U.C.C. Rep. Serv. 2d (West) at 1003-04.

62. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 1003-04.

63. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 1002.

64. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 1004.

65. *Id.* at 738, 42 U.C.C. Rep. Serv. 2d (West) at 1004.

The court proceeded to consider the case under section 2-612 to determine whether Sun Valley was justified in withholding deliveries under the contract based on Magic Valley's arrearage. The court looked at section 2-612(3), which provides that breach of an installment which substantially impairs the value of the entire contract to a party constitutes a breach of the entire contract.[66] The court considered Official Comment 7 to section 2-612, which recognizes that a seller may withhold delivery pending payment for previously delivered installments, while delaying a decision on whether to cancel the entire contract.[67] Before canceling the contract, however, the seller must give the buyer reasonable notice of its intent to cancel.[68] The court found that Sun Valley had made repeated requests for payment to Magic Valley, and had finally informed it that no further deliveries would be made until substantial payment was received. This was sufficient to meet the requirement of commercially reasonable notice.[69] Additionally, Magic Valley's arrearage, which totaled over $234,000, was a substantial breach which warranted Sun Valley's cancellation of the contract.[70]

Magic Valley attempted to justify its refusal to pay because Sun Valley had already begun to deliver potatoes to third parties, so it believed Sun Valley would not be able to deliver all the potatoes for which the parties contracted. Therefore, Magic Valley argued, it withheld payments to offset its losses caused by its need to cover for Sun Valley's future non-deliveries. The court correctly rejected these arguments. If Magic Valley had reasonable grounds for insecurity as to Sun Valley's future performance, its remedy was the use of section 2-609 to request adequate assurance of Sun Valley's performance.[71] Magic Valley did not make the request as required by this section and thus, could not use its perceived insecurity as a basis for withholding its own performance. Additionally, section 2-609 only permits a party with a reasonable ground for insecurity to withhold its performance for which it has not received the agreed upon consideration.[72] Here, Magic Valley had already received the consideration for its payments, the delivered and accepted potatoes, and therefore could not justifiably withhold payment. Having found that Magic Valley and not Sun Valley had breached the contract, the court reversed the decision of

66. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 1005 (citing IDAHO CODE § 28-2-612(3)); *see also* U.C.C. § 2-612(3) (2000).

67. U.C.C. § 2-612(3) cmt. 7 (2000).

68. *Id.*

69. *Magic Valley*, 10 P.3d at 738, 42 U.C.C. Rep. Serv. 2d (West) at 1005.

70. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 1005.

71. *Id.* at 739, 42 U.C.C. Rep. Serv. 2d (West) at 1007; *see also* U.C.C. § 2-609 (2000) (providing a procedure for making a written request for adequate assurance of continued performance when one party has reasonable grounds for insecurity as to the other party's performance).

72. U.C.C. § 2-609(1) (2000).

the trial court and remanded the case for a determination of Sun Valley's damages, including prejudgment interest.[73]

In *S.N.A. Nut Co. v. The Haagen-Dazs Co. (In re S.N.A. Nut Co.)*,[74] the U.S. Bankruptcy Court for the Northern District of Illinois found that the ice cream giant had breached various contracts to purchase nuts from S.N.A. Nut Company, causing damages exceeding $920,000. Judgment was entered against Haagen-Dazs for the full amount of the damages, plus prejudgment interest.[75] The parties had entered into five different contracts for the sale of almonds, walnuts, and three different types of macadamia brittle.[76] Under the contracts, SNA processed the nuts and produced the brittle only after receiving usage forecasts supplied by Haagen-Dazs. The goods were then delivered based on delivery orders from Haagen-Dazs plants. During the course of these contracts, SNA experienced financial difficulties, resulting in numerous creditors of SNA filing an involuntary insolvency petition against it, which SNA converted to a voluntary reorganization petition under Chapter 11 of the Bankruptcy Code. Haagen-Dazs, with other customers of SNA, was informed of these developments.

Shortly after the bankruptcy filing, SNA advised Haagen-Dazs that SNA would temporarily be unable to process almonds for it. SNA suggested Haagen-Dazs locate an alternative supplier for almonds during this time. Within several weeks, SNA had rebuilt its almond inventories and was capable of supplying the almonds under the contract. By this time, Haagen-Dazs had located a new supplier and continued to use that supplier as its principal supplier even after SNA was able to resume deliveries under the contract. Haagen-Dazs tried to negotiate a reduction in the required quantities under the contracts with SNA, but SNA was unwilling to do so. SNA sent a written demand to Haagen-Dazs, demanding it take the required amount of almonds. Haagen-Dazs also started falling behind in the quantities of nuts it was ordering on the other contracts. SNA also notified Haagen-Dazs of this perceived breach of the walnut and macadamia brittle contracts.

In subsequent conversations between representatives of Haagen-Dazs and SNA, SNA demanded that Haagen-Dazs take delivery on the contracts and pay for the products it had accepted. Haagen-Dazs refused and advised SNA that it feared employees of SNA would sabotage its products because of SNA's impending bankruptcy. Haagen-Dazs ordered no more products from SNA. Because the nuts were perishable and unique to the

73. *Magic Valley*, 10 P.2d at 741, 42 U.C.C. Rep. Serv. 2d (West) at 1009-10.

74. 247 B.R. 7, 41 U.C.C. Rep. Serv. 2d (West) 834 (Bankr. N.D. Ill. 2000), *recommendation accepted as amended*, Nos. 94 B 5993, 00 C 2820, 2000 WL 988528 (N.D. Ill. July 17, 2000).

75. *Id.* at 23, 41 U.C.C. Rep. Serv. 2d (West) at 854.

76. Although there was some dispute as to whether all five contracts were entered into, the court as fact finder determined that they were. *Id.* at 12-13, 17, 41 U.C.C. Rep. Serv. 2d (West) at 837, 839, 845.

Haagen-Dazs contract, most of them could not be resold and had to be destroyed.

The court considered whether Haagen-Dazs could cancel the entire almond contract and the four other nut contracts because SNA was unable to deliver almonds for a relatively short period of time after the bankruptcy filing. The court ruled that while Haagen-Dazs was entitled to cover for the almonds that SNA was unable to deliver, it was not entitled to cancel the entire contract.[77] The court concluded that SNA had not repudiated the entire contract. This was evidenced by its ability to perform the contract after the several weeks it experienced difficulties and its repeated communication of its willingness to perform. In order to cancel the contract based on repudiation, Haagen-Dazs was required to show an unequivocal statement by SNA that it was unable or unwilling to perform.[78] This was expressly contradicted by SNA's conduct and communications with Haagen-Dazs. Therefore, the court found Haagen-Dazs breached the contracts with SNA by failing to take deliveries of the nuts as required.[79]

Although the court based its decision on the concept of repudiation, because that was how Haagen-Dazs framed its defense, the court should also have considered Haagen-Dazs' conduct under section 2-612.[80] In determining whether there has been a breach of an installment contract, section 2-612 provides the appropriate standards. The contracts at issue were clearly installment contracts, which provided for delivery of the nuts in separate lots.[81] Because this was an installment contract, Haagen-Dazs could consider the breach with respect to individual installments—here, seller's failure to deliver certain installments—as a breach of the entire contract only if the failure substantially impaired the value of the entire contract to Haagen-Dazs.[82] Because Haagen-Dazs could and did cover for the non-delivered installments by obtaining the almonds elsewhere and was entitled to offset these amounts against its contract with SNA, it would have been difficult for Haagen-Dazs to prove "substantial impairment" of the entire contract.[83] Thus, the provisions of section 2-612 also would have prevented Haagen-Dazs from canceling all of the contracts.[84]

77. *Id.* at 18, 41 U.C.C. Rep. Serv. 2d (West) at 847.

78. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 846-47 (citing RESTATEMENT (SECOND) OF CONTRACTS § 250 cmt. B (1981)).

79. *Id.* at 18-19, 41 U.C.C. Rep. Serv. 2d (West) at 847-48.

80. Although the court acknowledged that the contracts were installment contracts under section 2-612, it did not consider the issue of breach under that section. *Id.* at 17, 41 U.C.C. Rep. Serv. 2d (West) at 845.

81. *See* U.C.C. § 2-612(1) (2000).

82. U.C.C. § 2-612(3) (2000).

83. *In re S.N.A. Nut*, 247 B.R. at 17-18, 41 U.C.C. Rep. Serv. 2d (West) at 846-47.

84. For a discussion of the damage calculation portion of this case, see *infra* text accompanying notes 110-121.

EXCUSED PERFORMANCE (IMPRACTICABILITY; SUBSEQUENT UNCONSCIONABILITY)

Courts must at times face the issue of when a party should be excused from performing obligations under the contract based on changed circumstances. Generally, it is the seller who is unable to perform due to situations such as destruction of the specific goods to be sold,[85] the unavailability of the agreed upon transportation, delivery or storage method,[86] or the occurrence of a situation, unanticipated by either party at the time of contracting, that prevents the seller from delivering the goods as promised.[87] The U.S. District Court for the Western District of Pennsylvania faced such a question when a seller, who was reclaiming and selling goods that had been previously leased, was unable to acquire the goods for delivery to the buyer because of the lessee's unanticipated refusal to turn over the goods.

In *Specialty Tires of America, Inc. v. The CIT Group/Equipment Financing, Inc.*,[88] the court held that the lessee's unexpected refusal to surrender the goods to the lessor-seller constituted an unforeseeable risk which the seller could not be expected to bear or contract against. CIT, a major equipment leasing company, had leased eleven tire presses to Condere in 1993 under a sale-leaseback agreement. In 1997, Condere filed for reorganization under Chapter 11 of the Bankruptcy Code. Several months later, Condere rejected the executory portion of the lease. Condere's president advised CIT that it wanted the presses removed quickly from Condere's premises. After CIT brought two buyers to the Condere premises to inspect the presses, Condere's president and CIT attempted to negotiate a purchase of the presses. Unable to do so, CIT advertised the presses for sale. Specialty Tires responded, inspected the presses at Condere's premises and agreed to purchase the presses from CIT for $250,000. At the time of the inspection, Condere's representative told Specialty Tires and CIT that CIT had an immediate right to the presses and the right to sell them.

Unexpectedly, Condere changed its attitude after the contract for sale between Specialty and CIT was signed. When CIT attempted to enter Condere's premises to take possession and ship the presses, Condere re-

85. *See* U.C.C. § 2-613 (2000) (excusing seller's performance where there is casualty to the good identified to be sold in the contract and the loss is not the fault of either party).

86. *See* U.C.C. § 2-614(1) (2000) (permitting seller to substitute commercially reasonable method when agreed berthing, loading, or unloading facilities or agreed manner of delivery fail or become commercially impracticable).

87. *See* U.C.C. § 2-615(a) (2000) (excusing seller's performance when delay or non-delivery is made impracticable by occurrence of contingency which was not contemplated by the parties at the time of the contracting).

88. 82 F. Supp. 2d 434, 40 U.C.C. Rep. Serv. 2d (West) 691 (W.D. Pa. 2000), *aff'd*, 248 F.3d 1131 (table) (3d Cir. Nov. 20, 2000).

fused to permit the equipment to be removed.[89] CIT sued Condere in replevin, however Condere posted a bond, which permitted the case to be delayed for a number of months. At this point, it became unclear as to whether CIT would be able to obtain the presses to seasonably fulfill its contract with Specialty Tires. CIT and Specialty were unable to negotiate a satisfactory resolution of CIT's contractual obligations, and Specialty sued CIT for breach of contract.

Although the court noted the general rule that promises under a contract are to be performed,[90] it explained there are limited instances in which unexpectedly changed circumstances permit a court to refuse to enforce otherwise enforceable promises, in particular, situations involving impossibility and impracticability.[91] The court, looking at section 2-615(1), noted the primary inquiry in an impracticability analysis is whether there was the occurrence of a contingency, through no fault of either party, which, at the time of the contracting, the parties assumed would not occur.[92] The court explained, while some courts and commentators focus on whether the contingency was foreseeable, foreseeability alone is not enough to adequately determine the applicability of the impracticability doctrine.[93] Another important factor, in the court's view, is whether the obligor should reasonably have guarded against it.[94] The court also noted that the test under this doctrine is an objective one, whether the promise can be performed, not simply whether the obligor has the capability of performing it.[95]

The court then decided that under either the foreseeability or the risk-exposure methodology, Condere's decision to convert the presses to its own use, without warning, warranted the application of the impracticability doctrine to excuse CIT from performing.[96] Neither CIT nor Specialty Tires had any reason to think that Condere would prevent CIT from delivering the presses as agreed. Comparing CIT's inability to obtain the presses with other instances where the specific good contracted for failed to come into existence, was destroyed or deteriorated,[97] the court held that

89. The basis for the refusal was a tender of a check by Condere, without approval of the bankruptcy court, for $224,000, the amount it alleged was necessary to cure its default under its lease with CIT. *Id.* at 436, 40 U.C.C. Rep. Serv. 2d (West) at 693.

90. *Id.* at 437, 40 U.C.C. Rep. Serv. 2d (West) at 694 (noting the general rule of *pacta sunt servanda*, or colloquially, "a deal's a deal").

91. *Id.* at 437-38, 40 U.C.C. Rep. Serv. 2d (West) at 694-95.

92. *Id.* at 438, 40 U.C.C. Rep. Serv. 2d (West) at 696.

93. *Id.*, 40 U.C.C. Rep. Serv. 2d (West) at 696.

94. *Id.*, 40 U.C.C. Rep. Serv. 2d (West) at 697 (citations omitted).

95. *Id.* at 439, 40 U.C.C. Rep. Serv. 2d (West) at 697 (citing 2 E. ALLEN FARNSWORTH, FARNSWORTH ON CONTRACTS § 9.6, at 619 (2d ed. 1998)).

96. *Id.* at 441, 40 U.C.C. Rep. Serv. 2d (West) at 699.

97. *See* Olbum v. Old Home Manor, Inc., 459 A.2d 757, 762 (Pa. Super. Ct. 1983) (finding contract for royalty payments in a mining operation depended on the continued existence of mineable coal); Selland Pontiac-GMC, Inc. v. King, 384 N.W.2d 490, 492-93, 1 U.C.C.

CIT had proven its defense of impracticability.[98] Noting that the impracticability was only temporary, until CIT could successfully reclaim the goods in its replevin action against Condere, the court denied Specialty's request for damages for delay, but held that CIT's obligation to perform under the contract was suspended only until it was able to obtain possession of the presses.[99]

The Kentucky Court of Appeals took another approach to altering the terms of the parties' contract based on changed circumstances in *Kentucky West Virginia Gas Co. v. Interstate Natural Gas Co.*[100] In the 1930s, Kentucky West had entered into gas lease and gas purchase agreements with several parties covering a parcel of land. A natural gas well was drilled on the land. The provisions of the contracts did not provide for price increases for the gas produced. Kentucky West occasionally increased the amount paid for the natural gas on one of the contracts. In 1987, however, when it had increased the price it paid under similar fixed price contracts to other independent producers, it did not raise the price it paid on the contracts at issue. Additionally, in 1982, Kentucky West had the well classified by the government as a high cost natural gas well, which increased the price Kentucky West could collect for the gas. Kentucky West did not pass any portion of this increase on to the other parties to the agreements. In 1997, one of the successors in interest on the agreements sued Kentucky West and a related company for breach of fiduciary duty and underpayment of royalties on the contracts. The other parties to the contracts were joined in the action.

The court considered whether a contract, fair and reasonable at the time of contract formation, could be rendered unconscionable by changed circumstances. Kentucky West argued that the provisions of section 2-302 regarding unconscionability permitted voiding a contract or its provisions only if it was unconscionable at the time of the contracting.[101] The court agreed that the section does not address any issues of unconscionability

Rep. Serv. 2d (Callaghan) 463, 466-67 (Minn. Ct. App. 1986) (holding third party's bankruptcy which prevented delivery to seller of the specific goods contracted for discharged the seller's promise to resell them to plaintiff buyer); Litman v. Peoples Natural Gas Co., 449 A.2d 720, 725 (Pa. Super. Ct. 1982) (deciding gas company was excused on its promise to install gas into apartment building when state utility commission unexpectedly prohibited defendant from making any new gas connections).

98. *Specialty Tires*, 82 F. Supp. 2d at 442, 40 U.C.C. Rep. Serv. 2d (West) at 701.

99. *Id.*, 40 U.C.C. Rep. Serv. 2d (West) at 701.

100. Nos. 1998-CA-001460-MR, 1998-CA-002037-MR, 1999-CA-000186-MR, 1998-CA-001953-MR, 1998-CA-002038-MR, 1998-CA-002036-MR, 1998-CA-003186-MR, 2000 WL 1228222, 42 U.C.C. Rep. Serv. 2d (West) 706 (Ky. Ct. App. Aug. 25, 2000).

101. U.C.C. § 2-302 (2000) provides, in relevant part, "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable *at the time it was made* the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." (emphasis added).

which arise subsequent to the time of the contracting,[102] but ruled that section 1-103 permitted the trial court to both use equitable principles to decide the issue and reform the contract.[103]

The court noted the paucity of cases on this issue, but relied on a somewhat similar Kansas case.[104] That case involved sharing of production costs—which had risen substantially—and a low fixed sale price. The court ruled that the contract had become both "a substantial hardship" and "unjust," and was therefore unconscionable.[105] The *Kentucky West* court acknowledged that there might have been no "substantial hardship" in the case before it, but the court nevertheless ruled that the terms of the contract had become unjust and therefore unconscionable.[106] The court reasoned, that while some increase in price was foreseeable by the parties, they could not reasonably foresee, at the time the contracts were entered into, the tremendous increase in gas prices that had occurred.[107] The court expressed concern over the defendant's argument that the court was rewriting the contract for the parties, but explained that it was only providing a remedy where subsequent, unforeseeable changes occurred that rendered the contract unconscionable.[108] The court, therefore, upheld the trial court's reformation of the contract and its decision to award damages.[109]

DAMAGES

In *S.N.A. Nut Co. v. The Haagen-Dazs Co. (In re S.N.A. Nut Co.)*,[110] the court stumbled when calculating damages, both as to the result and to the method employed. SNA had sued Haagen-Dazs for its abandonment of various contracts to supply nut products for ice cream. As discussed earlier,[111] the court held the various contracts breached by Haagen-Dazs and proceeded to the calculation of damages. The court found that these goods were specially manufactured for Haagen-Dazs and had little or no value

102. *Kentucky West*, 2000 WL 1228222, at *6, 42 U.C.C. Rep. Serv. 2d (West) at 710.

103. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 710. *See* U.C.C. § 1-103 (2000) (providing the principles of law and equity supplement the Code unless displaced by particular provisions of the Code).

104. Kansas Baptist Convention v. Mesa Operating, 864 P.2d 204 (Kan. 1993).

105. *Id.* at 218.

106. *Kentucky West*, 2000 WL 1228222, at *8, 42 U.C.C. Rep. Serv. 2d (West) at 712.

107. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 712.

108. *Id.*, 42 U.C.C. Rep. Serv. 2d (West) at 712.

109. The case was remanded for a recalculation of damages because the appellate court determined the date from which damages should have been awarded was different than that used by the trial court. *Id.* at *9, 42 U.C.C. Rep. Serv. 2d (West) at 713.

110. 247 B.R. 7, 41 U.C.C. Rep. Serv. 2d (West) 834 (Bankr. N.D. Ill. 2000), *recommendation accepted as amended*, Nos. 94 B 5993, 00 C 2820, 2000 WL 988528 (N.D. Ill. July 17, 2000).

111. *See supra* text accompanying notes 74-84.

for anyone else, making section 2-708(2) the appropriate measure.[112] In so finding, the court cited to a line of cases applying section 2-708(2) for specially-manufactured goods, given the unavailability of a market for calculating damages under section 2-708(1).[113] The bankruptcy court calculated these lost profits by giving SNA the contract-resale difference for goods resold, the full contract price for goods manufactured and not resold, and the lost profit for goods neither manufactured nor resold.[114] On review, the district court corrected an error in calculation but otherwise adopted the bankruptcy judge's proposed findings of fact and conclusions of law.[115]

One serious error was the court's use—or misuse—of section 2-708(2) for all the damage calculations. Its use was perfectly appropriate for the goods not manufactured. There is an established class of cases dealing with incomplete goods that treats lost profits as the proper measure of damages.[116] Even so, the court should formally have established that the seller was justified in stopping manufacture, as the U.C.C. requires.[117] Section 2-708(2) was also applicable to the raw materials SNA had purchased but then withdrawn from its manufacturing process. Indeed, this is the case for which section 2-708(2) was intended. Unfortunately, the court misapplied the section, allowing damages only for the difference between the cost of the nuts purchased under the contract and the resale price of the nuts.[118] It should also have allowed the profit that SNA would have earned had the nuts been processed, which is the vital element of the lost profits formula. Otherwise, the court is in fact giving only a reliance measure, rather than the expectation measure intended under the U.C.C.[119]

The court also erred in applying section 2-708(2) to the goods SNA resold and the goods it destroyed. Resale is governed by section 2-706; though the result would have been the same, the path would have been different. SNA's recovery of the contract price for unsalable goods should have been analyzed under section 2-709, rather than section 2-708(2). The result might ultimately have been the same, but section 2-709 puts in place

112. *In re S.N.A. Nut*, 247 B.R. at 19-20, 41 U.C.C. Rep. Serv. 2d (West) at 849-50.

113. *Id.* at 20, 41 U.C.C. Rep. Serv. 2d (West) at 849.

114. *Id.* at 20-22, 41 U.C.C. Rep. Serv. 2d (West) at 850-53.

115. *S.N.A. Nut II*, 2000 WL 988528 at *3, *5.

116. *See, e.g.*, Kvassay v. Murray, 808 P.2d 896, 902, 14 U.C.C. Rep. Serv. 2d (CBC) 1093, 1099 (Kan. Ct. App. 1991); USX Corp. v. Union Pac. Resources Co., 753 S.W.2d 845, 848-49, 7 U.C.C. Rep. Serv. 2d (Callaghan) 100, 105 (Tex. Ct. App. 1988); 1 ROY RYDEN ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 5.05 (1992).

117. *See* U.C.C. § 2-704(2) (2000).

118. *In re S.N.A. Nut*, 247 B.R. at 20-22, 41 U.C.C. Rep. Serv. 2d (West) at 850-53. It appears that the plaintiff did not request anything else. If so, the plaintiff made a costly error. To avoid overreliance on this aspect of the opinion, though, the court should have made clear that the plaintiff could have requested, and received, significantly more.

119. *See* U.C.C. § 1-106 (2000).

some procedural hurdles left unaddressed by the court—most importantly, whether the seller undertook reasonable effort to resell them at a reasonable price or, if not, whether this attempt would have proved unavailing.[120] The court was aware of section 2-709, as it brushed aside an objection under section 2-709(2) that the goods had not been held for Haagen-Dazs.[121] This conclusion was correct only if one accepts the court's faulty premise that section 2-708(2) governed.

LIMITATION OF REMEDIES

One limitation of remedies case, holding a consequential damages exclusion unconscionable, is of particular interest.[122] In *Pierce v. Catalina Yachts, Inc.*,[123] Catalina sold a sailboat to the Pierces with a promise to repair or pay to repair blisters occurring below the water line to the boat's gel coat. This promise expressly excluded consequential damages. Blisters formed, but Catalina refused the Pierces' request to pay to remove and replace the gel coat below the waterline. Catalina instead offered to perform some minor patching. The Pierces then sued Catalina for the cost of repair plus consequential damages. Before trial, the trial court ruled that the liability limitation was not unconscionable and thus barred the Pierces from going to the jury on consequential damages. The jury found for the Pierces on breach of warranty, finding as well that Catalina denied the Pierces' claim in bad faith.

On appeal, the Supreme Court of Alaska vacated the judgment of the trial court. It first ruled that the limited warranty failed of its essential purpose because Catalina failed to repair the defective gel coat, despite the Pierces' timely notice.[124] This did not entitle the Pierces to conse-

120. U.C.C. § 2-709(1)(b) (2000).

121. *In re S.N.A. Nut*, 247 B.R. at 23, 41 U.C.C. Rep. Serv. 2d (West) at 854. The bankruptcy court called the notion that SNA might have to hold rotten goods for several years "ridiculous." *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 854. This observation is true, but irrelevant. The issue is whether SNA held the goods for a reasonable time after breach. One assumes so, or the opinion might have reflected a failed demand by Haagen-Dazs. Nevertheless, if SNA had destroyed the goods while they were still usable, it would have done so at its peril; had Haagen-Dazs then demanded them, SNA would have been severely limited of its ability to recover damages for breach. *See, e.g.*, The Colonel's, Inc. v. Cincinnati Milacron Mktg. Co., 910 F. Supp. 323, 327, 29 U.C.C. Rep. Serv. 2d (CBC) 189, 194-95 (E.D. Mich. 1996) (denying a clam for the price under § 2-709 because the seller did not hold the goods for the buyer), *aff'd*, 149 F.3d 1182 (6th Cir. 1998).

122. There were others worth some mention this year. *See* Southwest Pet Prods., Inc. v. Koch Indus., Inc., 89 F. Supp. 2d 1115, 41 U.C.C. Rep. Serv. 2d (West) 520 (D. Ariz. 2000) (finding law remedies limitation does not fail of its essential purpose because defect in goods was discoverable by buyer); Eastman Chem. Co. v. Niro, Inc., 80 F. Supp. 2d 712, 40 U.C.C. Rep. Serv. 2d (West) 1032 (S.D. Tex. 2000) (noting that even if limitation of remedies provision fails of its essential purpose, consequential damages limitation still valid unless unconscionable).

123. 2 P.3d 618, 41 U.C.C. Rep. Serv. 2d (West) 737 (Alaska 2000).

124. *Id.* at 621, 41 U.C.C. Rep. Serv. 2d (West) at 740.

quential damages, though, as the Alaska court aligned itself with the majority view that a finding of failure of essential purpose under section 2-719(2) is independent of the test for the validity of a consequential damages limitation under section 2-719(3).[125] That test validates consequential damages limitations unless they are unconscionable.[126] Using a multi-factor test, the court then held the clause unconscionable.[127] It noted that this was "a consumer sale, not a commercial transaction between sophisticated businesses with equivalent bargaining power."[128] The limitation was part of a form contract.[129] The size of the award of direct damages showed that the Pierces were deprived of much of the benefit of their bargain, well beyond the sort of losses one might ordinarily expect. Most important was Catalina's bad faith. The court found this to be outside normal contractual risk allocation, given the duty of good faith required in all contracts governed by the Code.[130] The court refused to allow the defendant to shelter itself behind one segment of the warranty when it repudiated and ignored its limited obligations under another segment, and it was these actions that caused the plaintiffs' loss.[131]

This case is interesting because it is rare to find consequential damages disclaimers invalidated on the ground of unconscionability outside the personal injury realm.[132] Ordinarily it is fitting to give effect to the risk allocation of the parties, which should normally prove efficient. It may not prove so efficient when a seller systematically underestimates the frequency or magnitude of consequential damages. This is especially problematic in consumer cases. Even there, it may normally make sense to validate these clauses outside of personal injury because of the relative rarity of noncommercial consequential damages and the costs and uncertainty that attend their proof. Bad faith is, however, another matter entirely, as it

125. *Id.* at 622-23, 41 U.C.C. Rep. Serv. 2d (West) at 741-43. Though this is the majority rule, it is less clear that it should be so. For a fuller discussion of the issue, see John D. Wladis et al., *Sales,* 55 BUS. LAW. 1951, 1966-68 (2000). (Note that the word "*Rheem*" in the ninth line on the first full paragraph on page 1968 should read "*Sunny.*").

126. U.C.C. § 2-719(3) (2000). The limitations are presumed unconscionable in the case of consumer goods that caused personal injury and are presumed not for commercial loss. *Id.* This case was in neither category.

127. 2 P.3d at 623-24, 41 U.C.C. Rep. Serv. 2d (West) at 143-45.

128. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 744.

129. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 744.

130. *Id.* at 624, 41 U.C.C. Rep. Serv. 2d (West) at 116 (quoting U.C.C. § 1-203 (2000)).

131. *Id.*, 41 U.C.C. Rep. Serv. 2d (West) at 744-45.

132. Exceptions include *Morris v. Chevrolet Motor Div. of Gen. Motors Corp.*, 114 Cal. Rptr. 747, 752, 14 U.C.C. Rep. Serv. (Callaghan) 1294, 1297 (Cal. Ct. App. 1974); *Schroeder v. Fageol Motors, Inc.*, 528 P.2d 992, 996, 16 U.C.C. Rep. Serv. (Callaghan) 332, 337-38 (Wash. Ct. App. 1974), *aff'd in part, rev'd in part,* 544 P.2d 20, 18 U.C.C. Rep. Serv. (Callaghan) 584 (Wash. 1975). More usual, even outside the commercial context, are cases validating limitations. *See, e.g.*, Hornberger v. Gen. Motors Corp., 929 F. Supp. 884, 890-92, 30 U.C.C. Rep. Serv. 2d (CBC) 483, 492-94 (E.D. Pa. 1996); Fiat Auto U.S.A., Inc. v. Hollums, 363 S.E.2d 312, 314, 5 U.C.C. Rep. Serv. 2d (Callaghan) 969, 971-72 (Ga. Ct. App. 1987).

reflects an undoing of the underlying bargain and indeed suggests that the promisor has sought to unjustly enrich itself at the expense of even informed promisees.[133] Hence several cases treat bad faith as critical or even decisive.[134]

STATUTE OF LIMITATIONS

This year saw a wide range of statute of limitations cases.[135] Two turned on the appropriate statute for repair or replace promises. In *Nebraska Popcorn, Inc. v. Wing*,[136] the buyer purchased a motor truck scale bearing a one-year limited warranty and a promise to repair or replace defective load cells supplied with truck scales that were defective in materials or workmanship for two years from the original shipment. In *Joswick v. Chesapeake Mobile Homes, Inc.*,[137] the buyer purchased a mobile home bearing a warranty that it would be free from defect for twelve months from the date of delivery to the first retail purchaser, and that the exclusive remedy for breach of this warranty would be repair or replacement of defective parts. In both cases the courts held that these warranties did not extend to future performance and thus did not fall within the Article 2 discovery rule.[138] These warranties, the courts held, merely guaranteed that if the goods did not work, the manufacturer would replace them.[139] Accordingly, the warranties fell under the usual Article 2 rule providing for accrual of the cause

133. *Cf., e.g.*, Barry Perlstein, *Crossing the Contract-Tort Boundary: An Economic Argument for the Imposition of Extracompensatory Damages for Opportunistic Breach of Contract*, 58 BROOK. L. REV. 877 (1992).

134. *See, e.g.*, Potomac Plaza Terraces, Inc. v. QSC Prods., Inc., 868 F. Supp. 346, 353, 26 U.C.C. Rep. Serv. 2d (CBC) 1069, 1078 (D.D.C. 1994); Long Island Lighting Co. v. Transamerica Delaval, Inc., 646 F. Supp. 1442, 1459, 2 U.C.C. Rep. Serv. 2d (Callaghan) 1333, 1341 (S.D.N.Y. 1986). *But see* Zurn Constructors, Inc. v. B.F. Goodrich Co., 746 F. Supp. 1051, 1057, 13 U.C.C. Rep. Serv. 2d (Callaghan) 763, 767 (D. Kan. 1990) (subsequent bad faith irrelevant to finding of unconscionability).

135. Several would merit discussion were space unlimited. *See, e.g.*, Gladhart v. Oregon Vineyard Supply Co., 994 P.2d 134, 40 U.C.C. Rep. Serv. 2d (West) 722 (Or. Ct. App. 1999) (warranty that grape plants phylloxera-free did not explicitly extend to future performance, so the action for breach of the warranty accrued on delivery, rather than on discovery of breach), *review allowed*, 6 P.3d 1103 (Or. 2000). Holbrook, Inc. v. Link-Belt Constr. Equip. Co., 12 P.3d 638, 42 U.C.C. Rep. Serv. 2d (West) 1022 (Wash. Ct. App. 2000) (rejecting claim that repair tolled statute of limitations); Giraud v. Quincy Farm & Chem., 6 P.3d 104, 42 U.C.C. Rep. Serv. 2d (West) 743 (Wash. Ct. App. 2000) (finding buyers asserting fraudulent concealment exception to Article 2 accrual rule failed to show that they were reasonably diligent in their efforts to discover concealed information, given that they knew when the product was applied and constructively knew that this violated instructions on the label).

136. 602 N.W.2d 18, 40 U.C.C. Rep. Serv. 2d (West) 227 (Neb. 1999).

137. 747 A.2d 214, 40 U.C.C. Rep. Serv. 2d (West) 937 (Md. Ct. App. 2000), *aff'd*, 765 A.2d 90, 43 U.C.C. Rep. Serv. 2d (West) 479 (Md. 2001).

138. *Joswick*, 747 A.2d at 220, 40 U.C.C. Rep. Serv. 2d (West) at 945; *Nebraska Popcorn*, 602 N.W.2d at 24, 40 U.C.C. Rep. Serv. 2d (West) at 233; *see* U.C.C. § 2-725(2) (2000).

139. *Joswick*, 747 A.2d at 220, 40 U.C.C. Rep. Serv. 2d (West) at 945; *Nebraska Popcorn*, 602 N.W.2d at 25-26, 40 U.C.C. Rep. Serv. 2d (West) at 234-35, 237.

of action at the time of breach, that is, on the sale of the goods; as these actions were filed more than four years from the time of sale, they were time-barred.[140]

Both decisions are problematic, though *Nebraska Popcorn* at least is more internally consistent. Most courts hold that warranties to repair or replace do not explicitly extend to future performance.[141] These cases rest precariously on the notion of a warranty as a promise going only to the quality or nature of the goods. As these courts point out, a promise to repair does not promise that the goods will work.[142] It would seem better, however, to treat these as remedial promises.[143] Actions on these promises would accrue on breach, as Article 2 provides.[144] The breach of a promise to repair comes when the seller fails to repair, as a number of courts have held, rather than at the time of sale, which is pertinent only when the promise goes to the quality of the goods.[145]

The *Joswick* decision is also questionable with regard to its interpretation of the facts. The promise in *Joswick* did extend to future performance; it stated that the mobile home would be free from defect for one year. It then limited the remedy to repair or replacement. This is, of course, permissible under Article 2.[146] But remedies are what you get when warranties are breached; they are not warranties. A limitation on remedies does not affect the warranty one whit, though it may vitiate its effect, a point that seemed to confuse the court here. The distinction is not merely formal; a seller's ability to disclaim warranties differs greatly from its ability to limit remedies.[147] The *Joswick* court conflated warranties and remedies and thus applied the wrong statute of limitations.

140. *Joswick*, 747 A.2d at 220, 40 U.C.C. Rep. Serv. 2d (West) at 945; *Nebraska Popcorn*, 602 N.W.2d at 23-24, 40 U.C.C. Rep. Serv. 2d (West) at 232, 237.

141. *See, e.g.*, Boyd v. A.O. Smith Harvestore Prods., Inc., 776 P.2d 1125, 1128, 9 U.C.C. Rep. Serv. 2d (Callaghan) 571, 574 (Colo. Ct. App. 1989) (citing Ontario Hydro v. Zallea Sys., Inc., 569 F. Supp. 1261, 1266, 36 U.C.C. Rep. Serv. (Callaghan) 1222, 1228 (D. Del 1983)); Voth v. Chrysler Motor Corp., 545 P.2d 371, 376-78, 18 U.C.C. Rep. Serv. (Callaghan) 954, 959-63 (Kan. 1976); Painter v. General Motors Corp., 974 P.2d 924, 926-27, 40 U.C.C. Rep. Serv. 2d (West) 491, 494-96 (Wyo. 1999).

142. *Nebraska Popcorn*, 602 N.W.2d at 24, 40 U.C.C. Rep. Serv. 2d (West) at 233; *Joswick*, 747 A.2d at 219, 40 U.C.C. Rep. Serv. 2d (West) at 943.

143. This is the approach of the Proposed Revisions to U.C.C. Article 2, §§ 2-725(2)(c), 2-103(1)(p) and Preliminary Comment (ALI Annual Meeting Draft, May, 2001) *available at* <http://www.upenn.edu/bll/ulc/ulc.htm>.

144. *See* U.C.C. § 2-725(2) (2000).

145. *See, e.g.*, Long Island Lighting Co. v. Imo Indus., Inc., 6 F.3d 876, 888-90, 22 U.C.C. Rep. Serv. 2d (CBC) 205, 218-21 (2d Cir. 1993); Versico, Inc. v. Engineered Fabrics Corp., 520 S.E.2d 505, 509-10, 39 U.C.C. Rep. Serv. 2d (West) 1112, 1114-15 (Ga. Ct. App. 1999); Cosman v. Ford Motor Co., 674 N.E.2d 61, 66, 68, 33 U.C.C. Rep. Serv. 2d 1118, 1122-23, 1125-26 (Ill. App. Ct. 1996).

146. U.C.C. § 2-719(1)(a) (2000).

147. *Compare* U.C.C. § 2-316 (2000) (disclaimer of warranties) *with* U.C.C. § 2-719 (2000) (limitation of remedies).

Finally, one vexing issue, the appropriate statute of limitations for indemnity actions arising from contracts for the sale of goods, arose in *Titanium Metals Corp. v. Elkem Management, Inc.*[148] Titanium Metals, a buyer of contaminated chromium powder, used it in manufacturing alloys and sold the contaminated alloys to a customer, which in turn used them to make forgings which it sold to one of its customers. When the defect was ultimately found, a chain of demands for compensation began. The end customer recovered from the immediate customer; the immediate customer recovered from Titanium Metals. Titanium Metals then filed suit against the seller, Elkem, seeking recovery of its payment as part of its damages. Elkem defended by asserting the statute of limitations, as more than four years had passed since it had sold the defective goods. Titanium Metals argued that the proper statute of limitations to use was that for actions in indemnity, which accrue when judgment is entered or when the underlying claim is settled.[149] The court, noting that authority is split on this issue, ultimately ruled that the indemnity period governed because it was "hesitant in the absence of guidance from the courts of Pennsylvania to adopt a rule that would leave an innocent party without any remedy for claims that may be asserted beyond the original statute of limitations."[150]

This seems both descriptively and prescriptively correct. The courts in fact are badly split over which limitations period to apply, though most seem to apply the general indemnification statute.[151] In the indemnitor's defense, it might well have been possible for the defendant in the action giving rise to the call for indemnification to implead the indemnitor and resolve both matters at once—even in a case such as this, where the supplier was a few steps up the distribution chain. But each party adds greatly to the complexity and cost of litigation, costs borne not just by the indemnitor but by all involved. Furthermore, if the underlying breach action is uncertain, impleading the putative indemnitor may prove unnecessary and wasteful. It also seems odd, as the *Titanium Metals* court observed,[152]

148. 87 F. Supp. 2d 429, 41 U.C.C. Rep. Serv. 2d (West) 855 (W.D. Pa. 1998).

149. *Id.* at 430-31, 41 U.C.C. Rep. Serv. 2d (West) at 857. *See generally* 1 CALVIN W. CORMAN, LIMITATION OF ACTIONS § 7.5 (1991).

150. *Titanium Metals*, 87 F. Supp. 2d at 433, 41 U.C.C. Rep. Serv. 2d (West) at 860.

151. *See* Central Wash. Refrigeration, Inc. v. Barbee, 946 P.2d 760, 764 & n.11, 34 U.C.C. Rep. Serv. 2d (West) 273, 277-78 & n.11 (Wash. 1997). For cases using the general indemnification period, see, for example, Carrier Corp. v. Detrex Corp., 6 Cal. Rptr. 2d 565, 569, 17 U.C.C. Rep. Serv. 2d (CBC) 460, 463-65 (Cal. Ct. App. 1992); Garcia v. Edgewater Hosp., 613 N.E.2d 1243, 1252, 21 U.C.C. Rep. Serv. 2d (CBC) 595, 606 (Ill. App. Ct. 1993); *Central Wash. Refrigeration*, 946 P.2d at 763-65, 34 U.C.C. Rep. Serv. 2d (West) at 267-79. For cases applying the Article 2 statute of limitations, see for example, PPG Indus., Inc. v. Genson, 217 S.E.2d 479, 480, 17 U.C.C. Rep. Serv. (Callaghan) 785, 787 (Ga. Ct. App. 1975); R.N. Thompson & Assocs., Inc. v. Wickes Lumber Co., 687 N.E.2d 617, 621 (Ind. Ct. App. 1997); Perry v. Pioneer Wholesale Supply Co., 681 P.2d 214, 219, 38 U.C.C. Rep. Serv. (Callaghan) 1274, 1279 (Utah 1984).

152. *Titanium Metals*, 87 F. Supp. 2d at 432, 41 U.C.C. Rep. Serv. 2d (West) at 859-60.

to extinguish an indemnification action before the potential indemnitee knows that it will need to seek indemnification—indeed, before such an action could be brought.

ECONOMIC LOSS DOCTRINE

Confusion surrounding the proper application of the "economic loss doctrine" continues to create problems for the courts and litigants. To understand the problem, it is perhaps helpful to briefly review some of the background.

Most courts and commentators seem to agree that the doctrine has its origin in *Robins Dry Dock & Repair Co. v. Flint.*[153] "*Robins* . . . applied a principle, then settled both in the United States and England, which refused recovery for negligent interference with 'contractual rights.'"[154]

Although, arguably, *Robins* represented nothing more than a refusal to expand the tort of intentional interference with contractual relations to include negligent interference, subsequent decisions interpreted *Robins* to stand for the broader principle which "denied a plaintiff recovery for economic loss if that loss resulted from physical damage to property in which he had no proprietary interest."[155] In other words, there could be no recovery for "pure economic loss" in an action based on negligence. In a negligence action, economic loss was recoverable only if it was piggybacked on the plaintiff's personal injury damages or suffered as a consequence of damage to property in which the plaintiff had a proprietary interest.

A number of limited exceptions to the pure economic loss rule remained. If the plaintiff and defendant were in privity, negligence resulting in pure economic loss was actionable. Thus, for example, there is no doubt that a client may maintain an action for the pure economic loss caused by his attorney's negligence. Along the same lines, the traditional rule has been that negligent misrepresentation is actionable if the parties are in privity or in a relationship "so close as to approach" privity.[156]

Notwithstanding the limitation developed in negligent misrepresentation cases, pure economic loss has long been recoverable in fraudulent misrepresentation cases. In fact, most common law deceit cases involve economic loss which is unrelated to personal injury and/or property damage. The only real question is whether the courts will use the contract measure of damages (benefit of the bargain) or the tort measure (out of pocket).[157]

153. 275 U.S. 303 (1927) (Holmes, J.).
154. Louisiana *ex rel.* Guste v. M/V Testbank, 752 F.2d 1019, 1022 (5th Cir. 1985).
155. *Id.*
156. Ultramares Corp. v. Touche, 174 N.E. 441, 446 (N.Y. 1931).
157. *See, e.g.*, Hinkle v. Rockville Motor Co., Inc., 278 A.2d 42, 44 (Md. 1971).

The doctrine took another twist following the development of strict liability in tort for defective products in the 1960s. Immediately following Justice Traynor's decision in *Greenman v. Yuba Power Products, Inc.*[158] in 1963 and the ALI's adoption of Restatement (Second) of Torts section 402 A[159] in 1964, there remained a substantial question of whether a plaintiff would be able to recover for pure economic loss in an action alleging strict liability in tort.

To a large extent the question was answered by Justice Traynor in *Seely v. White Motor Co.*[160] *Seely* held that, in the absence of personal injury or property damage, economic loss was not recoverable in a strict liability action.[161] The court reasoned that

> [t]he distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the consumer's demands. A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will.[162]

Thus, as the majority rule currently stands, in both negligence and strict liability cases, one can recover for economic loss only if it is accompanied by personal injury or property damage. Remedies for pure economic loss are left either to contract actions or some other theory of tort liability. Although this rule is applicable both to "direct economic loss" (i.e. damage to the product itself) and consequential economic loss,[163] there remains a substantial question as to what constitutes damage to the product itself.

Two recent cases have addressed this question in the context of a defective component that caused damage to the product into which the com-

158. 377 P.2d 897 (Cal. 1963).

159. RESTATEMENT (SECOND) OF TORTS § 402 A (1964).

160. 403 P.2d 145, 2 U.C.C. Rep. Serv. (Callaghan) 915 (Cal. 1965).

161. *Id.* at 152, 2 U.C.C. Rep. Serv. (Callaghan) at 922.

162. *Id.* at 151, 2 U.C.C. Rep. Serv. (Callaghan) at 921.

163. East River Steamship Corp. v. Transamerica Delaval Inc., 476 U.S. 858, 1 U.C.C. Rep. Serv. 2d (Callaghan) 609 (1986). *See also* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 cmt. a (1997).

ponent had been incorporated. In *State Farm Mutual Automobile Insurance Co. v. Ford Motor Co.*,[164] a leaking oil seal allegedly permitted oil to spill onto the hot exhaust manifold causing the vehicle's destruction in the ensuing fire. State Farm paid its insured (less the deductible) and then, together with the insured, brought a subrogation action against Ford.

Relying on the economic loss rule, the trial court granted the defendant's motion for summary judgment on the strict liability and negligence counts.[165] The counts alleging breach of express warranty and breach of the implied warranty of merchantability were allowed to stand. In upholding the trial court's decision, the appellate court recognized that

> even if we were to take as true that the seal was defective that does not mean the rest of the car should be considered "other property" to which the resulting damage could be recoverable under theories of tort. We are unconvinced by any type of characterization of the remainder of the car as "other property." An oil seal is an integral component part of a car. "Component parts are not 'other property.'"[166]

Along the same lines, the court in *Wausau Tile, Inc. v. County Concrete Corp.*,[167] had to decide how to treat damaged concrete pavers. The concrete paving stones were made by combining cement produced by one defendant and aggregate sold by another. Among other allegations in the case was the claim that high levels of alkalinity in the cement and a high concentration of silica in the aggregate resulted in the plaintiff's production of an end product that was prone to "excessive expansion, deflecting, curling, cracking and/or buckling."[168]

In rejecting the claim that this constituted damage to property other than the product itself and was thus the appropriate basis of a tort action, the court held that "[d]amage by a defective component" to the product as a whole is "not damage to 'other property' which precludes the application of the economic loss doctrine."[169]

In a somewhat more questionable and disturbing decision, in *Palmetto Linen Service, Inc. v. U.N.X., Inc.*[170] the Fourth Circuit expanded the scope of the economic loss doctrine to cover property which was clearly separate because the damage to it was a necessary result of the defect in the product sold. In that case, Palmetto Linen Service, the operator of a commercial laundry that supplied linens to hotels, restaurants, and hospitals, brought

164. 736 So. 2d 384, 41 U.C.C. Rep. Serv. 2d (West) 783 (Miss. Ct. App. 1999).

165. This is codified in Mississippi at MISS. CODE ANN. § 11-1-63 (Supp. 1999).

166. *East River Steamship*, 736 So. 2d at 388, 41 U.C.C. Rep. Serv. 2d (West) at 788 (quoting Virginia Transformer Corp. v. P.D. George Co., 932 F. Supp. 156, 162 (W.D. Va. 1996)).

167. 593 N.W.2d 445, 40 U.C.C. Rep. Serv. 2d (West) 417 (Wis. 1999).

168. *Id.* at 449, 40 U.C.C. Rep. Serv. 2d (West) at 421.

169. *Id.* at 452, 40 U.C.C. Rep. Serv. 2d (West) at 425 (citing RESTATEMENT (THIRD) OF TORTS § 21 cmt. e (1997).

170. 205 F.3d 126, 40 U.C.C. Rep. Serv. 2d (West) 996 (4th Cir. 2000).

suit against Nova Controls, the manufacturer of a computerized pump that regulated the injection of chemicals used in the cleaning process, and U.N.X., the supplier of chemicals used in the cleaning process and installer of the Nova pump.

Palmetto alleged that the cleaning system malfunctioned causing $200,000 worth of damage to its linens. Although damage to the linens would seem to satisfy the other property damage requirement of tort law, the court held that it did not, choosing instead to reject the plaintiff's negligence claim by purportedly applying South Carolina's version of the economic loss rule.[171] Rejecting the plaintiff's claim, the court ruled that

> [a]lthough the economic loss rule generally "does not apply where other property damage is proven, courts have tended to focus on the circumstances and context giving rise to the injury" in determining whether alleged losses qualify as "other property" damage. Specifically, in the context of a commercial transaction between sophisticated parties, injury to other property is not actionable in tort if the injury was or should have been reasonably contemplated by the parties to the contract. In such cases the "failure of the product to perform as expected will necessarily cause damage to other property," rendering the other property damage inseparable from the defect in the product itself.[172]

The implications of the court's decision are not entirely clear. Nevertheless, it is conceivable that the decision in *Palmetto Linen* and the cases on which the Fourth Circuit relied represent the precise opposite of the original privity doctrine. Under the Nineteenth Century rule, one could not recover on a negligence claim against another unless the parties were in privity of contract. Under the reasoning of *Palmetto Linen*, "sophisticated" parties are barred from bringing negligence claims because they are in privity.

In fact, while one can understand and even sympathize with the court's inclination to restrict commercial actors engaged in face-to-face dealings with one another to remedies which they have negotiated, making the U.C.C. the parties' exclusive remedy seems more suited to legislative action than judicial. And, even if one thinks this is an appropriate exercise of judicial rulemaking power, there must be a better way to achieve the goal than by stretching the economic loss doctrine beyond all recognition.

ECONOMIC LOSS DOCTRINE AND TORT ACTIONS FOR FRAUD

The notion that resort to remedies available under the U.C.C. should be a commercial actor's exclusive option seems to underlie the recent cases

171. *Id.* at 129, 40 U.C.C. Rep. Serv. 2d (West) at 999.
172. *Id.* at 129-30, 40 U.C.C. Rep. Serv. 2d (West) at 999-1000 (citations omitted).

which utilize the economic loss doctrine not only to bar negligence and strict liability actions, but use it to bar fraud (and other tort) actions as well. As we noted two years ago,[173] a determination that a case is governed by the U.C.C. provides little basis for refusing to allow deceit actions. This is particularly true in view of the fact that pure economic loss is traditionally recoverable in a deceit action, not to mention that the U.C.C. itself provides that "principles of law and equity, including . . . fraud . . . [and] misrepresentation," supplement the U.C.C. unless displaced by particular provisions.[174]

Nevertheless, in a substantial number of cases, courts have been willing to find that the economic loss doctrine bars recovery even in fraud actions, at least under some circumstances.[175] Recently, for example, in *Dinsmore Instrument Co. v. Bombardier, Inc.*,[176] the Sixth Circuit, applying Michigan law, distinguished between fraud which is extraneous to the contract dispute and fraud which arises out of the contractual arrangement. The former can give rise to recovery for economic loss, the latter cannot.

In that case, Dinsmore Instrument Company, a manufacturer of compasses, contracted to sell 20,000 compasses to Bombardier, a maker of jet-ski recreational vehicles. The compasses were to be installed in the jet skis by Digico, Bombardier's subcontractor.

Although what went on between the parties is unclear from the decision, ultimately Dinsmore was paid the sums due under the contract and no contract claims were before the court. According to the court, "Dinsmore's tort claims [were] based on two theories: (1) Bomardier was really attempting to obtain Dinsmore's trade secrets and drive it out of business; and (2) Digico was interfering with the two companies' contractual relationship in an attempt to improve its own business relationship with Bombardier."[177] Apparently, plaintiff alleged fraud as to Bombardier and intentional interference with contract and interference with prospective economic advantage as to Digico.

Regarding the fraud claim, the court held that unless extraneous to the contractual dispute, fraud was not actionable because of the economic loss rule.[178] Given that allegations in a complaint are treated as admissions of the party making the allegations and because the plaintiff's complaint alleged that the representations were made in connection with the making of the contract, the court concluded the fraud was not extraneous and therefore barred.[179] Similarly, because the tort claims against Digico "arise

173. Wladis et al., *Sales*, 54 BUS. LAW. 1831, 1851 (1999).

174. U.C.C. § 1-103 (2000). *See also* Wladis, *supra* note 173, at n.169; Steven W. Sanford, *Fraud and the Economic Loss Doctrine*, COMM. L. NEWSLETTER 3 (Dec. 2000).

175. Sanford, *supra* note 174, at 4 (collecting and discussing cases).

176. 199 F.3d 318, 40 U.C.C. Rep. Serv. 2d (West) 118 (6th Cir. 1999).

177. *Id.* at 319, 40 U.C.C. Rep. Serv. 2d (West) at 119.

178. *Id.* at 320, 40 U.C.C. Rep. Serv. 2d (West) at 121.

179. *Id.*, 40 U.C.C. Rep. Serv. 2d (West) at 121.

out of the contractual arrangement between them, those claims must also fail as a matter of law."[180]

This is the broadest imaginable interpretation of the economic loss rule. The effect is to preclude all tort suits if the torts are committed in the course of entering into or performing in a contractual relationship. Perhaps such a result might be defensible on some basis, however, there is nothing in the economic loss rule cases cited by the court which mandates or even justifies the decision reached.

180. *Id.*, 40 U.C.C. Rep. Serv. 2d (West) at 121.