August, 2003

Uniform Commercial Code Survey, Sales

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Sales

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This Survey reviews recent significant judicial decisions involving Article 2 (Sales of Goods) of the Uniform Commercial Code (U.C.C.). The revision of Article 2 was approved by the National Conference of Commissioners of Uniform State Laws (NCCUSL) and the Council of the American Law Institute (ALI) during 2002. The ALI considered and approved the revisions at its 2003 Annual Meeting.[1] Because the revised text has yet to be enacted, all the decisions discussed in this Survey interpreted pre-revision Article 2.

Scope

Courts issued decisions on whether the U.C.C. applies to quite a variety of transactions. Four cases involved software. Courts have long recognized that there are analytical difficulties in characterizing a software sale as a sale of goods, either because the software does not seem tangible or because the purchaser really acquires only a license to use the software rather than title to the software.

The U.S. District Court for the District of Massachusetts decided *I. Lan Systems, Inc. v. Netscout Service Level Corp.*[2] Recognizing that the purchaser of software merely obtains a license to use the software, the court noted that prior Massachusetts decisions had nonetheless assumed that Article 2 governs software licenses.[3] The court suggested that because "software licenses exist in a legislative

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1. For a discussion of the actions of NCCUSL and ALI with respect to the revision of Article 2, see the Introduction to this Survey. Russell A. Hakes, Stephen L. Sepinuck & Robin L. Meadows, *The Uniform Commercial Code Survey: Introduction*, 58 BUS. LAW. 1541 (2003).

2. 183 F. Supp. 2d 328, 46 U.C.C. Rep. Serv. 2d (West) 287 (D. Mass. 2002).

3. *Id.* at 331, 46 U.C.C. Rep. Serv. 2d (West) at 290–91 (citing Novacore Techs., Inc. v. GST Communications Corp., 20 F. Supp. 2d 169, 183, 37 U.C.C. Rep. Serv. 2d (West) 638, 659 (D. Mass. 1998) *aff'd*, 229 F.3d 1133 (1st Cir. 1999)); VMark Software, Inc. v. EMC Corp., 642 N.E.2d 587, 590 n.1 (Mass. App. Ct. 1994); USM Corp. v. Arthur D. Little Sys., Inc., 546 N.E.2d 888, 894, 10 U.C.C. Rep. Serv. 2d (Callaghan) 327, 334 (Mass. App. Ct. 1989).

void," the U.C.C. best fulfilled the parties' expectations and should thus be the lens used to view the transaction, even though it technically does not apply.[4]

In *Multi-Tech Systems, Inc. v. Floreat, Inc.*,[5] Multi-Tech contracted with Floreat to have Floreat assist in designing several Multi-Tech software products. Seeking the application of Article 2,[6] Floreat argued that a sale of software is a sale of a good. The court agreed that a sale of software in a tangible medium is a good for purposes of the U.C.C. The court held, however, that the contract was primarily for software design work.[7] Thus, the court held that, under the predominant purpose test, the transaction was primarily the provision of services and not the sale of goods and therefore the U.C.C. did not apply.[8]

In *Richard A. Rosenblatt & Co. v. Davidge Data Systems Corp.*,[9] the appellate division of the Supreme Court of New York considered a transaction involving the sale and installation of a computerized securities trading system and the provision of maintenance services. The court applied the predominant purpose test and held that the contract was largely one for the sale of hardware and user rights to "extant, off-the-shelf software" and, thus, Article 2 applied.[10]

Similarly, in *EPresence, Inc. v. Evolve Software, Inc.*,[11] the U.S. District Court for the District of Massachusetts considered the application of Article 2 to a contract for a "professional service automation system."[12] The court began by assuming that the sale of software was a sale of goods, and that the obligation to provide support was a sale of services. It then applied the predominant purpose test and held that the agreement's price terms made plain that the software programs themselves were the "essence of the Agreement" and therefore Article 2 applied.[13]

Courts decided three cases concerning hybrid transactions that comprised the provision of both goods and services. In *Heart of Texas Dodge, Inc. v. Star Coach, LLC*,[14] the Court of Appeals of Georgia considered the application of Article 2 to a contract to convert a sport utility vehicle into a custom vehicle. The plaintiff supplied a vehicle to the defendant, and the defendant was to perform the conversion by installing parts furnished by a third party. Noting that the transaction

4. *I. Lan*, 183 F. Supp. 2d at 332, 46 U.C.C. Rep. Serv. 2d (West) at 291–92. It also indicated that it "certainly will not [govern] in the future," apparently anticipating the enactment of UCITA or at least looking to it instead of the U.C.C. for guidance. *Id.* at 332, 46 U.C.C. Rep. Serv. 2d (West) at 292.

5. No. CIV. 01-1320, 2002 WL 432016, 47 U.C.C. Rep. Serv. 2d (West) 924 (D. Minn. Mar. 18, 2002).

6. *Id.* at *3, 47 U.C.C. Rep. Serv. 2d (West) at 927. Specifically, it sought application of section 2-209(2), which allows parties to prohibit oral modifications and rescissions. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 927. This rule is contrary to traditional common-law principles. *See* RESTATEMENT (SECOND) OF CONTRACTS, § 148 cmt. b (1981).

7. *Multi-Tech*, 2002 WL 432016 at *3, 47 U.C.C. Rep. Serv. 2d (West) at 928.

8. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 928 (citing Architectronics, Inc. v. Control Sys., Inc., 935 F. Supp. 425, 432, 33 U.C.C. Rep. Serv. 2d (West) 714, 721–22 (S.D.N.Y. 1996)).

9. 743 N.Y.S.2d 471, 47 U.C.C. Rep. Serv. 2d (West) 1390 (N.Y. App. Div. 2002).

10. *Id.* at 472, 47 U.C.C. Rep. Serv. 2d (West) at 1391.

11. 190 F. Supp. 2d 159, 47 U.C.C. Rep. Serv. 2d (West) 132 (D. Mass. 2002).

12. *Id.* at 161, 47 U.C.C. Rep. Serv. 2d (West) at 133.

13. *Id.* at 163, 47 U.C.C. Rep. Serv. 2d (West) at 136.

14. 567 S.E.2d 61, 48 U.C.C. Rep. Serv. 2d (West) 48 (Ga. Ct. App. 2002).

involved both goods and services, the court applied the predominant purpose test and held that the contract was predominantly a sale of services.[15] The court relied on several factors in so holding, including that the plaintiff had complained about the defendant's "workmanship" and that the plaintiff stipulated that the contract was for "conversion work."[16] The court viewed the case as analogous to the repair cases, which hold the provision of parts incidental to the service of altering the condition of a vehicle.[17] As such, Article 2 did not apply.

In *Kietzer v. Land O'Lakes*,[18] the Court of Appeals of Minnesota dealt with a case involving the sale of chicken feed and consulting services. The plaintiff purchased chicken feed components from the defendant, and these components were mixed by a third party. Additionally, an agent of the defendant provided the plaintiff with consulting services. The court applied the predominant purpose test and determined that this was primarily a contract for the sale of feed, a good for purposes of the U.C.C.[19]

In *AAF-McQuay, Inc. v. MJC, Inc.*,[20] the U.S. District Court for the Western District of Virginia decided a case involving application of anti-corrosive coating. The plaintiff contracted with the defendant to have the defendant apply anti-corrosive coating to air conditioning condenser coils furnished by the plaintiff. Applying the predominant purpose test, the court held that the transaction was a sale of a good, namely the coating.[21] The court focused on the defendant's sales literature, which emphasized the coating itself rather than the service of applying the coating. Also, the court reasoned that words like "quantity," "product description," and "unit price" in the communications of the parties suggested that the transaction was a sale of goods.[22]

In *Lithuanian Commerce Corp., Ltd. v. Sara Lee Hosiery*,[23] the U.S. Court of Appeals for the Third Circuit addressed the issue of whether a letter agreement settling a dispute was a sale of goods. Sara Lee urged the court to apply the predominant purpose test and find that the predominant purpose of the agreement was to settle claims between Sara Lee and the plaintiff. The court rejected

15. *Id.* at 63, 48 U.C.C. Rep. Serv. 2d (West) at 50.

16. *Id.* at 64, 48 U.C.C. Rep. Serv. 2d (West) at 50.

17. *Id.* at 63, 48 U.C.C. Rep. Serv. 2d (West) at 49–50 (citing Alco Standard Corp. v. Westinghouse Elec. Corp., 426 S.E.2d 648, 21 U.C.C. Rep. Serv. 2d (CBC) 499 (Ga. Ct. App. 1992); American Warehouse Inc. v. Floyd's Diesel Svcs. Inc., 296 S.E.2d 64, 34 U.C.C. Rep. Serv. (Callaghan) 30 (Ga. Ct. App. 1982); Gee v. Chattahoochee Tractor Sales, 323 S.E.2d 176, 40 U.C.C. Rep. Serv. (Callaghan) 30 (Ga. Ct. App. 1984); Barry v. Stevens Equip. Co., 335 S.E.2d 129 (Ga. Ct. App. 1985)).

18. No. C1-01-1334, 2002 WL 233746, 47 U.C.C. Rep. Serv. 2d (West) 918 (Minn. Ct. App. Feb. 19, 2002).

19. *Id.* at *3, 47 U.C.C. Rep. Serv. 2d (West) at 921 (citing McCarthy Well Co., Inc. v. St. Peter Creamery, Inc., 410 N.W.2d 312, 4 U.C.C. Rep. Serv. 2d (Callaghan) 424 (Minn. 1987)). In so holding, the court noted that the plaintiff would not have received any consultations absent the sale of the feed. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 921.

20. No. CIV.A.5:00CV00039, 2002 WL 172442, 47 U.C.C. Rep. Serv. 2d (West) 48 (W.D. Va. Jan. 10, 2002).

21. *Id.* at *5, 48 U.C.C. Rep. Serv. 2d (West) at 53.

22. *Id.* at *4, 47 U.C.C. Rep. Serv. 2d (West) at 51. The court hastened to add, however, that the significance of this suggestion was undercut by the fact that the communications were conducted through the use of standardized forms. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 51–2.

23. 219 F. Supp. 2d 600, 48 U.C.C. Rep. Serv. 2d (West) 922 (D.N.J. 2002).

this contention, declining to view the contract as a hybrid transaction. Rather, the court viewed the agreement as more closely resembling "a contract in which LCC's right to sue Sara Lee [for an alleged breach of a franchise agreement] was 'exchanged' for Sara Lee's provision of pantyhose, store displays and marketing assistance."[24] Thus, the court opined that the situation was governed by section 2-304 of the U.C.C., which provides goods can be paid for "in money or otherwise."[25] The release of claims constituted payment for the pantyhose and therefore the transaction was a sale within the scope of Article 2.[26]

Courts decided two cases involving goods that were ultimately affixed to real property. The question in each was whether to apply Article 2 to the transaction. In *Loughridge v. Goodyear Tire & Rubber Co.*,[27] the U.S. District Court for the District of Colorado considered a case involving tubing used in radiant hydronic heating systems. Goodyear manufactured tubing used in such systems, a company called "Heatway" bought the hose and used it in hydronic systems that it sold, and the plaintiffs, in the instant case, were purchasers of hydronic heating systems from Heatway. Goodyear argued that the U.C.C. should not apply because the transactions involved the sale of fixtures of real property rather than goods. The court rejected Goodyear's contention, noting that the plaintiffs were suing as third-party beneficiaries of the contract between Goodyear and Heatway for sale of the hose.[28] The court observed that the fact that the tubing was eventually incorporated into real property did not change its character as a good at the time Goodyear sold it to Heatway.[29] This analysis suggests a possible route to circumvent the difficulties in applying Article 2 to fixtures.

The Supreme Court of Alabama took a more traditional approach in *Keck v. Dryvit Systems, Inc.*[30] The *Keck* court was called on to decide whether an exterior insulation system for homes was a good within the meaning of Article 2. The product in question was "a multilayered exterior wall system" that formed the walls of the structure once it was installed.[31] The product had already been installed when the plaintiffs bought their home. Reasoning that the wall system lost its characteristic as a "good" when it was installed, in part because it could not be removed from the realty without significant damage, the court held that the transaction was not a sale of goods.[32] The dissent took a view similar to that

24. *Id.* at 613, 48 U.C.C. Rep. Serv. 2d (West) at 929.

25. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 929 (citing N.J. STAT. ANN. § 12A:2-304 (2003) (providing, "[t]he price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the good which he is to transfer."). *Cf. Around the World Merchandisers, Inc. v. Rayovac Corp.*, 585 A.2d 437, 15 U.C.C. Rep. Serv. 2d (CBC) 49 (N.J. Super. Ct. Law Div. 1990).

26. *Sara Lee Hosiery*, 219 F. Supp. 2d at 614, 48 U.C.C. Rep. Serv. 2d (West) at 930.

27. 192 F. Supp. 2d 1175, 47 U.C.C. Rep. Serv. 2d (West) 962 (D. Colo. 2002).

28. *Id.* at 1182, 47 U.C.C. Rep. Serv. 2d (West) at 966.

29. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 966. The court noted that at the time of the Goodyear-Heatway contract for sale of the hose, the hose was clearly "an existing and identifiable thing, which was movable at the time of identification to the contract for sale, making it a 'good' for purposes of the UCC." *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 966 (citing COLO. REV. STAT. § 4-2-105(1)-(2) (2002)).

30. 830 So. 2d 1, 46 U.C.C. Rep. Serv. 2d (West) 635 (Ala. 2002).

31. *Id.* at 3, 46 U.C.C. Rep. Serv. 2d (West) at 635.

32. *Id.* at 8, 46 U.C.C. Rep. Serv. 2d (West) at 637 (citing Para. 1, Official Comment to ALA. CODE § 7-2-105 (2002)).

expressed in *Loughridge v. Goodyear Tire & Rubber Co.*, suggesting that the plaintiffs were trying to make claims based on breach of warranties made by the manufacturer of the wall system in connection with its sale to the builder of the home.[33]

The Supreme Court of South Dakota weighed in on the issue of whether water delivered by a city through its water works system is a good for purposes of Article 2 in *Dakota Pork Industries v. City of Huron*.[34] Recognizing that courts have adopted two differing views of this issue, the South Dakota court held without significant explanation that such a transaction is a sale of goods.[35]

In a case that clearly did not involve a sale of goods, the U.S. District Court for the Southern District of New York was asked to apply the U.C.C.'s unconscionability provision to a case involving a challenge to the actions of a labor union and its officials.[36] The question, therefore, was not whether to apply the U.C.C. directly, but whether U.C.C. principles should guide the court in shaping the federal common law governing disputes under labor agreements.[37] The court declined to "pass upon the validity of a union constitution by applying to it so broad a doctrine as contractual unconscionability."[38] In so holding, the court expressed its discomfort with the doctrine of unconscionability that has been expressed by so many other courts, namely that it puts the court in an unreasonably intrusive role.[39]

WARRANTIES

In two short but interesting cases, courts considered liability under U.C.C. section 2-314, the implied warranty of merchantability. In *Jaroslawicz v. Prestige Caterers*,[40] a guest on a hotel and meal tour package allegedly contracted food poisoning, which led to the development of Guillian-Barre Syndrome, a serious neurological disorder. The guest sued the tour operator, hotel, and caterer, alleging breach of the implied warranty of merchantability. The plaintiff purchased the package from the defendant tour operator, Leisure Time. Leisure Time contracted with the defendant hotel, Wyndham Hotel, for accommodations and the defendant

33. *Id.* at 15, 46 U.C.C. Rep. Serv. 2d (West) at 648 (Johnstone, J., dissenting). *See also* U.C.C. § 2-107(2) (2003) (providing that a contract for sale of goods "attached to realty and capable of severance without material harm thereto" is a contract for the sale of goods).

34. 638 N.W.2d 884, 46 U.C.C. Rep. Serv. 2d (West) 326 (S.D. 2002).

35. *Id.* at 886, 46 U.C.C. Rep. Serv. 2d (West) at 328–29 (citing RONALD A. ANDERSON, UNIFORM COMMERCIAL CODE, § 2-105:19, at 560 (3d ed. 1996) (suggesting that any substance that can be measured by a flow meter is movable for U.C.C. purposes)); *see also* Cincinnati Gas & Elec. Co. v. Goebel, 502 N.E.2d 713, 715, 2 U.C.C. Rep. Serv. 2d (Callaghan) 1187, 1190 (Ohio Mun. 1986) (holding that electricity is a "good" and Article 2 applies to sales of it). *Cf.* Kaplan v. Cablevision of PA, Inc., 671 A.2d 716, 724, 29 U.C.C. Rep. Serv. 2d (CBC) 425, 432 (Pa. Super. Ct. 1996) (holding that the provision of cable television services is not like a sale of gas, electricity, or water because no quantity can readily be determined, and thus it is not a sale of goods governed by Article 2).

36. Local Unions 20 v. United Brotherhood of Carpenters and Joiners of America, 223 F. Supp. 2d 491, 48 U.C.C. Rep. Serv. 2d (West) 519 (S.D.N.Y. 2002).

37. *Id.* at 499–500, 48 U.C.C. Rep. Serv. 2d (West) at 525 (citing Martinsville Nylon Employees Council Corp. v. NLRB, 969 F.2d 1263, 19 U.C.C. Rep. Serv. 2d (CBC) 438 (D.C. Cir. 1992)).

38. *Id.* at 500, 48 U.C.C. Rep. Serv. 2d (West) at 526.

39. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 526.

40. 739 N.Y.S.2d 670 (N.Y. App. Div. 2002).

caterer, Prestige Caterers, for the meals. Leisure Time moved for summary judgment on the grounds that it was not a merchant with respect to the implied warranty of merchantability.[41] Leisure Time argued that Prestige Caterers was an independent contractor that was not supervised or controlled by Leisure Time. The appellate court upheld the trial court's denial of the motion for summary judgment.[42] The court found evidence that Leisure Time sold the package including meals, assumed responsibility for preparing meals in its contract with the hotel, provided the dishes, utensils and cooking equipment for the kitchen, oversaw the kitchen, paid for the food and labor for meal preparation and provided suggestions and comments to the caterers in preparing the meals. In the court's view, these actions were more than those of general supervision, and, thus, there was sufficient evidence for the fact finder to conclude that Leisure Time was a merchant for purposes of the implied warranty of merchantability.[43]

In *Native American Arts, Inc. v. Bundy-Howard, Inc.*,[44] the U.S. District Court for the Northern District of Illinois considered whether alleged violations of a federal statute regulating the sale and marketing of Native American arts and crafts could be the basis of a claim for breach of the implied warranty of merchantability. The statute in question, the Indian Arts and Crafts Act as amended by the Indian Arts and Crafts Enforcement Act of 2000,[45] prohibits displaying for sale or the actual sale of a good "in a manner that falsely suggests it is Indian produced, an Indian product, or the product of a particular Indian or Indian tribe or Indian arts and crafts organization."[46] A crafts seller sought indemnity from its suppliers for breach of the implied warranty of merchantability alleging the goods violated this act. The court rejected the suppliers' argument that the warranty applied only to the condition of the good sold and not the manner in which it is marketed.[47] The court looked at U.C.C. section 2-314(f), which provides that to be merchantable, a good must "conform to the promise or affirmations of fact made on the container or label if any."[48] Noting that this section expressly includes the manner in which goods are represented on their packaging or label, the court ruled that the crafts seller had stated a claim for breach of the implied warranty of merchantability.[49] The court did note that mere allegations that the product used Indian motifs or designs was not sufficient to be a violation of the Indian Arts and Crafts Act and thus would not be a breach of the implied warranty of merchantability.[50] The

41. The implied warranty of merchantability only arises in contracts for the sale of goods, including the serving of food for value, where the seller is a merchant with respect to goods of the kind sold. U.C.C. § 2-314(1) (2003).

42. *Jaroslawicz*, 739 N.Y.S.2d at 670.

43. *Id.* at 671.

44. No. 01 C 1618, 2002 WL 1488861, 48 U.C.C. Rep. Serv. 2d (West) 123 (N.D. Ill. Jul. 11, 2002).

45. 25 U.S.C. § 305e (2002).

46. *Id.* § 305e(a).

47. *Native American Arts*, 2002 WL 1488861 at *2, 48 U.C.C. Rep. Serv. 2d (West) at 124.

48. U.C.C. § 2-314(f) (2003).

49. *Native American Arts*, 2002 WL 1488861 at *2, 48 U.C.C. Rep. Serv. 2d (West) at 125.

50. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 124.

warranty claim would be limited to situations where there were false representations on a label or tag that violated the federal statute.[51]

In addressing a frequently litigated issue, a Massachusetts court held that the reasonable expectations test was the proper test to determine whether food served to a customer breached the implied warranty of merchantability in *Carreiro v. 99 West, Inc.*[52] In this case, Carreiro was a regular patron of the defendant's restaurant, 99 West, and he frequently ordered the scrod dinner. On this particular occasion, when Carreiro took a bite of fish, he broke his tooth on a hard, irregular shaped bone fragment about the size of half a pea. In his deposition, Carreiro admitted he had found fish bones in previous scrod dinners but testified that they were "the very thin, flexible, wiry type . . . normally found in fish."[53] In its motion for summary judgment, the restaurant argued that bones were naturally found in fish and could be expected by consumers such as Carreiro. In denying the motion, the court held that there were genuine issues of material fact with respect to whether the bone's presence in the fish constituted a breach of the warranty of merchantability and whether Carreiro acted unreasonably in failing to find the bone in the fish before biting into it.[54]

The court considered a number of factors in rejecting the foreign/natural distinction and adopting the reasonable expectations test in determining the restaurant's liability for injuries caused by the food it served.[55] First, the court noted that the implied warranty of merchantability under Massachusetts law states "a harm-causing ingredient of the food product constitutes a defect if a reasonable consumer would not expect the food product to contain that ingredient."[56] Thus, the court initially questioned whether the foreign/natural distinction could even be applied in Massachusetts.

51. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 124.

52. No. 0154CV0015, 2002 WL 999475, 46 U.C.C. Rep. Serv. 2d (West) 583 (Mass. Dist. Ct. Jan. 16, 2002).

53. *Id.* at *8, 46 U.C.C. Rep. Serv. 2d (West) at 594.

54. *Id.*, 46 U.C.C. Rep. Serv. 2d (West) at 595. The court also noted that there was a genuine issue of material fact as to whether the restaurant had followed its own procedures in its inspection of the fish for bones. *Id.*, 46 U.C.C. Rep. Serv. 2d (West) at 595.

55. The foreign/natural distinction holds a seller of food liable for injuries only if the defect in the food is foreign to the product and not a naturally occurring substance in the food, such as a bone. *See id.* at *2, 46 U.C.C. Rep. Serv. 2d (West) at 584–85. The reasonable expectations test rejects the foreign/natural distinction and looks to whether the consumer could reasonably expect the injury-causing substance to be in the food. *Id.*, 46 U.C.C. Rep. Serv. 2d (West) at 585.

56. The court cited the Massachusetts version of U.C.C. section 2-314 for this statement. *Id.* at *3, 46 U.C.C. Rep. Serv. 2d (West) at 585 (citing MASS. GEN. LAWS ANN., Ch. 106, § 2-314(c) (West 2003)). Massachusetts, however, has enacted the uniform version of the U.C.C. section 2-314, which provides, in relevant part:

> (1) Unless excluded or modified by section 2-316, a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.
> (2) Goods to be merchantable must be at least such as . . .
> (c) are fit for the ordinary purposes for which such goods are used.

MASS. GEN. LAWS ANN., Ch. 106, § 2-314 (West 2003).

Moving to the purposes of the implied warranty, the court noted that the warranty was intended to place the risk and burden of loss caused by a good on a seller who is in a better position to spread that cost by allocating it among all goods sold.[57] Moreover, the entire purpose of the warranty under the U.C.C. is to hold the seller responsible for defective goods, whether or not the seller could or should have discovered the defect.[58] This purpose supports a broader application of the warranty in food cases. The court noted that the foreign/natural distinction was too narrow and failed to recognize that, in some instances, sellers should be held liable for unanticipated natural substances in food.[59]

The court then noted that the recent trend in cases in Massachusetts and other states was to use the reasonable expectations test and not the foreign/natural distinction. In fact, the court found that a majority of courts now use the reasonable expectations test for determining warranty liability for injuries caused by food.[60] This shift reflects a recognition, in the court's view, that the proper focus of the inquiry should be the nature of the warranty given, i.e. that the food be merchantable, that is, fit for human consumption and not the nature of the substance that caused the injury.[61] The court considered a 1964 Massachusetts case, *Webster v. Blue Ship Tea Room, Inc.*,[62] which has been relied on for both the foreign/natural distinction and the reasonable expectations test. The court agreed with previous Massachusetts courts that had found that the *Webster* case was one of the first cases to discuss the reasonable expectation test. That case concerned a customer who was seriously injured when she swallowed a fish bone in her fish chowder. Ruling that the presence of the bone did not render the chowder unmerchantable, the court in *Webster* held that the hazard of bones in fish chowder could be anticipated and thus no recovery for breach of warranty could be had.[63] The *Carreiro* court stated that this case set the test as whether a consumer could reasonably expect the injury-causing substance to be in the food.[64] Although *Webster* and other Massachusetts cases had both found that a customer should reasonably expect bones in dishes containing fish,[65] the court held that the test is a subjective one and required a determination as to whether Carreiro could reasonably expect a chunk of bone, given that he had only previously found thin,

57. *Carreiro*, 2002 WL 999475 at *3, 46 U.C.C. Rep. Serv. 2d (West) at 585.
58. *Id.*, 46 U.C.C. Rep. Serv. 2d (West) at 586.
59. *Id.* at *4, 46 U.C.C. Rep. Serv. 2d (West) at 587.
60. *Id.* at *4–*5, 46 U.C.C. Rep. Serv. 2d (West) at 588–89.
61. *Id.* at *5, 46 U.C.C. Rep. Serv. 2d (West) at 590.
62. 198 N.E.2d 309, 2 U.C.C. Rep. Serv. (Callaghan) 161 (Mass. 1964).
63. *Id.* at 312, 2 U.C.C. Rep. Serv. (Callaghan) at 165–66.
64. *Carriero*, 2002 WL 999475 at *5–*6, 46 U.C.C. Rep. Serv. 2d (West) at 590.
65. *See Webster*, 198 N.E.2d 309, 2 U.C.C. Rep. Serv. (Callaghan) 161 (holding fish bone in fish chowder should be anticipated and thus did not render chowder unfit for consumption); Phillips v. Town of West Springfield, 540 N.E.2d 1331, 9 U.C.C. Rep. Serv. 2d (Callaghan) 535 (1989) (holding although bone in fish may justify finding no liability for breach of warranty as a matter of law, bone in turkey chunk served by school cafeteria does not justify such a determination); Foss v. Carpenter Enters., Inc., 1985 Mass. App. Div. 82 (Mass. Dist. Ct. Apr. 23, 1985) (holding that "reasoned common experience" would lead one eating fish to expect bones, even if the fish was represented as filet).

wiry fish bones.[66] Finding sufficient evidence on this issue, the court denied the restaurant's motion for summary judgment.

Economic Loss Doctrine

Several courts addressed the issue of whether the economic loss doctrine bars a fraud claim that arises in the context of a sales contract. In *Werwinski v. Ford Motor Co.*,[67] the U.S. Court of Appeals for the Third Circuit held that consumers' common-law and statutory claims of fraud against Ford for defective transmission parts were barred by the economic loss doctrine.[68] The plaintiffs, consumers who had each purchased or leased a Ford automobile, sued Ford Motor Company alleging the transmissions in their vehicles had two defective parts, which caused transmission failure resulting in substantial repair costs before the vehicles reached 80,000 miles. Plaintiffs alleged that Ford knew about one of the defects since at least 1990 and the other since 1991. Despite this knowledge, the plaintiffs alleged that Ford never warned the vehicle owners of the defects and continued to sell vehicles with defective transmissions. Additionally, Ford reduced its warranties from a six-year/sixty thousand mile powertrain warranty to a three-year/thirty-six thousand mile powertrain warranty with the 1992 models. Plaintiffs sought recovery for breach of implied and express warranties, fraudulent concealment, and violations of Pennsylvania's Unfair Trade Practices and Consumer Protection Law.

Ford moved for judgment on the pleadings on the fraud counts based on the economic loss doctrine. The plaintiffs argued that the economic loss doctrine did not apply for two reasons. First, they argued that it applies only to contracts between commercial entities and, second, that it does not bar claims for intentional fraud.

The court began its analysis of the plaintiffs' claims by noting that the Pennsylvania Supreme Court had not addressed the issue, thus this court had to predict how the Pennsylvania court would rule on the applicability of the economic loss doctrine to fraud claims in a consumer contract.[69] It then reviewed the history and development of the doctrine. The court considered the underpinnings of the doctrine as discussed in *East River S.S. Corp. v. Transamerica Delaval, Inc.*,[70] the case in which the U.S. Supreme Court adopted the doctrine in admiralty cases. The basis of the doctrine, the court noted, is that when the damage sustained by a buyer is solely to the purchased good, remedies under the contract and any attendant warranties appropriately reflect the allocation of risks between the parties.[71] In such a situation, where the buyer's complaint is failure of the product to meet expectations, tort remedies are unnecessary.[72] The court then noted that

66. *Carreiro*, 2002 WL 999475 at *8, 46 U.C.C. Rep. Serv. 2d at 594.
67. 286 F.3d 661 (3d Cir. 2002).
68. *Id.* at 681.
69. *Id.* at 670.
70. 476 U.S. 858, 1 U.C.C. Rep. Serv. 2d (Callaghan) 609 (1986).
71. *Werwinski*, 286 F.3d at 671 (citing *East River S.S. Corp.*, 476 U.S. 858, 1 U.C.C. Rep. Serv. 2d (Callaghan) 609).
72. *Id.* (citing *East River S.S. Corp.*, 476 U.S. at 872, 1 U.C.C. Rep. Serv. 2d (Callaghan) at 619).

the Pennsylvania Superior Court had adopted the rule set out in *East River* in actions between commercial entities in 1989, stating that, given the differing objectives of tort and contract law, contract claims, such as breach of warranty, were particularly suited to provide redress for economic losses.[73] Against this background, the court considered both arguments raised by the plaintiffs.

As to the applicability of the economic loss doctrine in situations involving consumers, the court noted that a Pennsylvania trial court had applied the economic loss doctrine in a case in which consumers sued an automobile manufacturer.[74] In that case, the Pennsylvania Superior Court had noted that a manufacturer's warranty is a "bargained for condition of the sale, the effect of which must not be undermined" regardless of whether the buyer was a consumer or commercial entity.[75]

The Third Circuit considered the reasoning of the Pennsylvania Superior Court well-founded and persuasive as to what the Pennsylvania Supreme Court would do if faced with the issue. The court rejected the arguments of the plaintiffs that consumers, unlike commercial entities, are powerless to bargain for the warranties and thus should not be limited to the breach of warranty claims. The court noted that a consumer is free to purchase a more expensive vehicle or a vehicle from a different manufacturer to obtain a better warranty.[76] Additionally, purchasers often have the opportunity to buy extended warranties if additional protection is desired. Moreover, the court noted that recognizing a distinction between commercial and non-commercial entities would be "entirely impracticable."[77] Such a line would require a case-by-case determination of the sophistication and relative bargaining power of the parties, with the potential for inconsistent results. Accordingly, the court held that the economic loss doctrine applies to consumer contracts.[78]

The court next looked to whether there was or should be an exception to the doctrine for allegations of intentional fraud. With no Pennsylvania law on this issue, the court considered cases from other jurisdictions which had distinguished between fraud that was extraneous to the contract and that which was interwoven with the contract.[79] Several of these courts held that although some fraud-in-the-inducement claims survived the economic loss doctrine,[80] if the fraudulent

73. *Id.* (citing and quoting REM Coal Co. v. Clark Equip. Co., 563 A.2d 128, 129, 9 U.C.C. Rep. Serv. 2d (Callaghan) 916, 918 (Pa. Super. Ct. 1989)).

74. *Id.* at 672 (relying on Jones v. General Motors Corp., 631 A.2d 665 (Pa. Super. Ct. 1993)).

75. *Jones*, 631 A.2d at 666.

76. *Werwinski*, 286 F.3d at 673.

77. *Id.* at 674.

78. *Id.*

79. *Id.* at 675–78. *Compare* Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc., 532 N.W.2d 541, 545 (Mich. Ct. App. 1995) (recognizing fraud-in-the-inducement exception to the economic loss doctrine but only where fraud extraneous to the contract), *with* Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147 (E.D. Wis. 1998) [Budgetel I] (arguing all fraud-in-the-inducement is extraneous to contract because it arises before contract formation).

80. Surviving fraud claims might include those relating to the decision about with whom to do business, rather than about the goods themselves. For example, intentional misrepresentations about a company's financing condition, non-profit status, or organizational form, could bypass the economic loss doctrine. *See* Rich Products Corp. v. Kemutec, Inc., 66 F. Supp. 2d 937, 979 (E.D. Wis. 1999).

misrepresentation went to the quality or character of the goods, warranty protection under the contract was the appropriate remedy, and therefore those claims were barred by the doctrine.[81]

The court went on to note that the narrowness of this fraud exception could be criticized on several bases. First, it could easily bar all fraud-in-the inducement claims because these types of claims almost always involve misrepresentations relating to the goods.[82] Second, all fraud-in the-inducement can be seen as separate and independent from the contract because it must necessarily occur before the contract is formed. Finally, this type of fraud impairs a party's ability to freely allocate risks in the contract because it impairs the negotiation process. The court noted, however, that these reasons had themselves been criticized as providing the opportunity to gut the economic loss doctrine completely by permitting parties to allege that fraudulent representations were made before the contract was formed.[83]

The court next considered the justifications advanced for either including or excluding intentional fraud claims from the purview of the economic loss doctrine. Ford argued that, if the misrepresentations relate to the goods as they did here, the harm caused by intentional and innocent misrepresentations is the same from the buyer's perspective, and, in either instance, the purchaser can adequately protect itself through contract warranties. The buyers countered that applying the economic loss doctrine to fraud claims does not serve the purpose of the doctrine, which is to preserve the allocation of risks in the contract freely agreed to by the contracting parties. The buyers also argued that a seller making an intentional misrepresentation was in a better position than an innocent buyer to determine the risk associated with the contract and therefore should bear those risks. Finally, the buyers argued that a party cannot and should not be required to anticipate misrepresentations, which could be made by the other, when negotiating the contract provisions.

The court noted that the justifications advanced by both the buyers and Ford had merit.[84] It also recognized that providing tort remedies to victims of fraud could deter fraudulent behavior.[85] The court concluded, however, that the buyers had provided no reason why the particular mental state of the seller leading to the breach of contract caused a harm different from that which could be remedied by resort to warranty liability and contract damages.[86] Buyers of defective products were entitled to damages for breach of express and implied warranties regardless

81. *Huron*, 532 N.W.2d at 545–46; *see also* AKA Distrib. Co. v. Whirlpool Corp., 137 F.3d 1083, 1086 (8th Cir. 1998) (holding only claims of fraud that were outside of or collateral to the contract and thus independent from contract actionable for economic loss); HTP, Ltd. v. Lineas Aereas Costarricenses, 685 So. 2d 1238, 1239–40 (Fla. 1996) (same).

82. *Werwinski*, 286 F.3d at 677 (citing reasons discussed in *Budgetel I*, 8 F. Supp.2d at 1146–48).

83. *Id.* at 677–78 (citing *Rich*, 66 F. Supp.2d at 977–80).

84. *Id.* at 679.

85. *Id.*

86. *Id.* at 679–80.

of whether a seller's misrepresentation regarding the quality of the goods was innocent, negligent or intentional.[87]

Finally, the court observed that Pennsylvania law is generally hostile to tort actions for purely economic loss.[88] The court agreed with the district court's assessment that Pennsylvania courts have shown a "penchant for dismissing fraud claims that simply restate breach of contract claims."[89] On this basis, finding that the proper role of the federal court was to choose the interpretation that restricts liability and not expands it, the court held that the district court properly dismissed the buyers' common-law and statutory fraud claims based on the economic loss doctrine.[90]

Just three months after the Third Circuit's decision in *Werwinski*, the U.S. District Court for the District of New Jersey declined to use the economic loss doctrine to bar a fraud-in-the-inducement claim, even though the fraud related to the quality of the goods.[91] The case, *Lithuanian Commerce Corp. v. Sara Lee Hosiery*, involved a dispute between a Lithuanian distributor and the American manufacturer of L'eggs pantyhose. The manufacturer, Sara Lee, granted the distributor, Lithuanian Commerce Corporation (LCC), the exclusive right to sell L'eggs in Lithuania, Latvia, Estonia and the Russian district of Kalingrad.[92] LCC obtained government approval, advertised and marketed the product. About six months after LCC began selling L'eggs in Lithuania, Sara Lee donated L'eggs pantyhose to a charitable relief organization for distribution in Belarus, which borders Lithuania and Latvia. Some of the donated pantyhose reached the Lithuanian black market, adversely affecting LCC's sales. LCC demanded that Sara Lee take some action to remedy the situation. To settle the dispute in 1995, Sara Lee and LCC entered into an agreement in which Sara Lee agreed to provide LCC with 34,835 dozen pantyhose manufactured in Mexico at no cost except shipping. The pantyhose, manufactured in Mexico and delivered under this agreement, were poor quality and LCC was ultimately forced to remove them from the Lithuanian market. In fact, Sara Lee ceased manufacturing these pantyhose in Mexico and removed all L'eggs from the Mexican market because of consumer complaints in 1995, the same year as the settlement agreement with LCC. LCC sued Sara Lee claiming violations of New Jersey Franchise Practices Act, breach of express and implied warranties under the U.C.C., and fraud arising from the settlement agreement and the delivery of the defective Mexican pantyhose. LCC alleged that Sara Lee's fraudulent conduct induced LCC to enter into the settlement agreement in exchange for the Mexican-made pantyhose.

87. *Id.* at 680.

88. *Id.* (quoting Aloe Coal Co. v. Clark Equip. Co., 816 F.2d 110, 119 (3d Cir. 1987)).

89. *Werwinski*, 286 F.3d at 680.

90. *Id.* at 680–81. The court was persuaded by an earlier case treating statutory and common-law fraud actions alike, *Weather Shield Mfg., Inc. v. PPG Indus., Inc.*, No. 97-C-707-S, 1998 WL 469913 (W.D. Wis. June 11, 1998), and noted that the same policy considerations apply to both. *Id.* at 681.

91. Lithuanian Commerce Corp. v. Sara Lee Hosiery, 219 F. Supp. 2d 600, 608, 48 U.C.C. Rep. Serv. 2d (West), 922, 927-28 (D.N.J. 2002) [Lithuanian III].

92. Lithuanian Commerce Corp. v. Sara Lee Hosiery, 47 F. Supp. 2d 52, 529 (D.N.J. 1999) [Lithuanian I], *rev'd in part*, 248 F.3d 1130 (3d Cir. 2000) [Lithuanian II].

The court began its analysis with two principles enunciated by the New Jersey Supreme Court. First, if a tort cause of action duplicates a claim made under the U.C.C., the tort action is "superfluous and counterproductive" and therefore barred under the economic loss doctrine.[93] Second, the U.C.C. does not completely supplant common-law fraud and state and federal statutes in protecting victims of fraud or unconscionable conduct.[94] It then noted prior decisions which had distinguished between fraud allegations with respect to performance of the contract and fraud-in-the-inducement claims.[95] Finding that LCC presented sufficient evidence from which a jury could find Sara Lee fraudulently induced LCC to enter into the settlement agreement, the court denied Sara Lee's motion for judgment as a matter of law.[96] The district court considered the Third Circuit's decision in *Werwinski*, based on Pennsylvania law, but determined that it was not dispositive because the New Jersey legislature had specifically provided a remedy of treble and punitive damages against persons who commit fraudulent commercial practices in the sale of merchandise.[97] To foreclose fraud-in-the-inducement claims would, in the court's opinion, prevent plaintiffs from seeking these special remedies specifically provided by the New Jersey legislature.[98]

Two additional cases considered the applicability of the economic loss doctrine to fraud claims and held, under California and Michigan law, that fraud claims for product defects that arise from performance of the contract were barred by the economic loss doctrine.[99] In these cases, buyers had each alleged the seller committed a fraud in its performance of the contract. In the Michigan case, the buyers alleged the sellers fraudulently provided refurbished computers instead of new computers as purportedly required under the contract.[100] In the California case, the buyers alleged that the sellers had fraudulently provided clutches for use in helicopters at a different level of hardness than required by the contract. Both courts held that the economic loss doctrine bars such fraud actions for purely economic loss.[101] The California court noted that, unless the alleged fraud causes some harm distinct from the breach of contract or results in additional undertakings on the part of the defrauded party, contract remedies adequately protect the

93. *Lithuanian III*, 219 F. Supp. 2d at 607, 48 U.C.C. Rep. Serv. 2d (West) at 926 (citing Alloway v. Gen. Marine Indus., 695 A.2d 264, 275 (N.J. 1997)).

94. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 926. *See also* U.C.C. § 1-103 (2001) (providing that the common law and equity, including fraud, supplement provisions of the U.C.C. unless displaced).

95. *Lithuanian III*, 219 F. Supp. 2d at 607, 48 U.C.C. Rep. Serv. 2d (West) at 926 (citing Florian Greenhouse, Inc. v. Cardinal IG Corp., 11 F. Supp. 2d 521, 528 (D.N.J. 1998)).

96. *Id.* at 608, 48 U.C.C. Rep. Serv. 2d (West) at 927.

97. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 927–28.

98. *Id.*, 48 U.C.C. Rep. Serv. 2d (West) at 928.

99. *See* Robinson Helicopter Co. v. Dana Corp., 129 Cal. Rptr. 2d 682, 699, 49 U.C.C. Rep. Serv. 2d (West) 759, 779 (Cal. Ct. App. 2003) (holding under California law that the economic loss doctrine bars a claim of fraud grounded in the performance of contract); Cyberco Holdings, Inc. v. Am. Express Travel Related Servs. Corp., 48 U.C.C. Rep. Serv. 2d (West) 1324, 1329 (S.D.N.Y. 2002) (finding a similar result under Michigan law).

100. *Cyberco*, 48 U.C.C. Rep. Serv. 2d (West) at 1324.

101. *Cyberco*, 48 U.C.C. Rep. Serv. 2d (West) at 1329.

expectations of the buyer.[102] Both courts recognized, however, that a claim of fraud extraneous to the contract, such as fraud which induced the buyer to enter into the contract, would not be barred by the economic loss doctrine.[103]

On the whole, the courts rightly considered the balancing of interests involved in determining the extent to which the economic loss doctrine bars tort claims, particularly fraud. The *Werwinski* court's decision to prohibit claims under consumer fraud statutes, however, is troubling. These types of statutes are enacted to protect consumer buyers from the fraudulent acts and representations of sellers and to deter sellers from committing consumer fraud. By denying consumers access to these protections and thus, protecting sellers from the penalties imposed by the statutes, the court may be undermining the legislative purpose of these acts.

Remedies

In *Ellis v. Precision Engine Rebuilders, Inc.*,[104] the majority and dissent sparred over how to determine the damages due buyers. The actual case was simple enough. Ellis bought a rebuilt engine for his automobile from Precision. The engine did not work. Precision tried repairing it three times over more than a year, succeeding only on the third try. Ellis sued for, *inter alia,* both breach of contract and breach of implied warranty. The trial court granted summary judgment on both counts, though it did not state the grounds for its decision. Ellis appealed as to the contract claim. The appellate court affirmed.[105] It held that because Ellis received and accepted defective goods, he would be limited to a breach of warranty action with damages under section 2-714, rather than a breach of contract action with damages under 2-711.[106] Because the claim was pleaded as breach of contract, summary judgment was fitting.[107] A dissenting judge attacked the bright-line distinction between breach of contract and breach of warranty.[108] Chief Judge Schneider pointed out that acceptance does not necessarily mean that one is relegated to damages under section 2-714, as a buyer can revoke its acceptance and become entitled to other measures of damages, and that equating delivery and acceptance ignores the fact that a buyer may reject delivered goods during its time to inspect.[109] He added that with proper notice of breach a

102. *Robinson*, 129 Cal. Rptr. 2d at 698–99; *see also Cyberco*, 48 U.C.C. Rep. Serv. 2d (West) at 1328 (stating that where fraud "interwoven with the breach of contract" no separate action for fraud may be maintained for purely economic loss).

103. *Robinson*, 129 Cal. Rptr. 2d at 698 (noting that fraudulent inducement to enter contract could prevent buyer from negotiating fair terms and freely agreeing and therefore, a separate tort action could lie); *accord Cyberco*, 48 U.C.C. Rep. Serv. 2d (West) at 1327–28.

104. 68 S.W.3d 894, 47 U.C.C. Rep. Serv. 2d (West) 993 (Tex. Ct. App. 2002).

105. *Id.* at 897, 47 U.C.C. Rep. Serv. 2d (West) at 996.

106. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 996.

107. *Id.*, 47 U.C.C. Rep. Serv. 2d (West) at 996.

108. *Id.* at 899, 47 U.C.C. Rep. Serv. 2d (West) at 998 (Schneider, C.J., dissenting).

109. *Id.* at 899–900, 47 U.C.C. Rep. Serv. 2d (West) at 998–99 (Schneider, C.J., dissenting).

buyer who has accepted goods may still pursue contract damages, referring to comment two of section 2-714 as going beyond breach of warranty.[110]

Whatever one may say of the majority's formalistic approach to pleading, the result seems to reflect the right measure of damages, given the facts and circumstances of the case. The action for breach was not initiated until over a year after delivery and acceptance, and the goods ultimately were repaired. Ellis may well have had a right to revoke acceptance, but it is at least plausible that too much time passed for revocation to be an option.[111] If so, then section 2-714 would govern, for it provides the measure of damages for non-conforming and accepted goods where the acceptance was not revoked. The main problem comes with the court's overbroad statement that "breach of contract damages are available for failure to perform, but not for delivery of nonconforming goods."[112] The dissent properly points out that this dictum ignores revocation and post-delivery rejection.[113] Moreover, section 2-714 does not require that the usual difference in value measure be used for breach of warranty actions. As section 2-714(2) states, that measure applies "unless special circumstances show proximate damages of a different amount."[114] Most breach of warranty cases use the standard measure but a handful use something else.[115] One hopes the court's dangerous dictum will be ignored.

Damages for lost volume sellers yielded an interesting opinion. In *New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc.*,[116] the plaintiff, a milk and dairy products manufacturer and distributor, contracted with the defendant, the owner of a chain of convenience stores, to supply its stores with dairy products. They made a requirements contract for needs up to a specified level, which it anticipated would be reached in about five years. New England Dairies paid Dairy Mart Convenience Stores ("Dairy Mart") for these exclusive rights. In addition, the agreement contained an assignment clause which provided that the requirements obligation would apply to any buyer or transferee of the stores. Just under two years later, Dairy Mart entered into a purchase and sale agreement for the stores covered by the contract with New England Dairies and did not require that the agreement with New England Dairies be assigned. The buyer did not deal with New England Dairies, and this suit began.

110. *Ellis*, 68 S.W.3d at 900 n.2, 47 U.C.C. Rep. Serv. 2d (West) at 999 n.2 (Schneider, C.J., dissenting).

111. Nor does the admittedly sparse opinion say whether he even sought to revoke his acceptance.

112. *Ellis*, 68 S.W.3d at 897, 47 U.C.C. Rep. Serv. 2d (West) at 995.

113. *Id.* at 899–900, 47 U.C.C. Rep. Serv. 2d (West) at 998–99 (Schneider, C.J., dissenting).

114. U.C.C. § 2-714(2) (2001); *see also id.* cmt. 3 ("Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure.").

115. *See, e.g.*, R.W. Murray Co. v. Shatterproof Glass Corp., 758 F.2d 266, 271, 40 U.C.C. Rep. Serv. (Callaghan) 1283, 1289 (8th Cir. 1985) (using the value at the time the buyer discovered the non-conformity); City of New York v. Pullman Inc., 662 F.2d 910, 917–18, 31 U.C.C. Rep. Serv. (Callaghan) 1375, 1383 (2d Cir. 1981) (using the replacement cost); Vista St. Clair, Inc. v. Landry's Com. Furnishings, Inc., 643 P.2d 1378, 1380, 33 U.C.C. Rep. Serv. (Callaghan) 1332, 1335 (Or. Ct. App. 1982) (same).

116. 47 U.C.C. Rep. Serv. 2d (West) 480 (D. Conn. 2002).

After the court concluded that the assignment clause was breached, it dealt with the remedy.[117] The court concluded that New England Dairies was a lost volume seller and thus was entitled to lost profits under section 2-708(2).[118] It began by finding that New England Dairies had the capacity to perform both the contract at issue and other contracts.[119] After the breach, New England Dairies operated at about sixty-six to sixty-seven percent capacity, and the lost Dairy Mart business totaled just under nineteen percent of New England Dairies' capacity, so New England Dairies could take on more business and indeed did. The court then limited the period for lost volume damages to seventeen months, because by then New England Dairies had replaced the lost business and was running at full capacity.[120] The court added that New England Dairies could have recovered damages under section 2-708(1) for the balance of the contract, but it did not introduce evidence of contract-market damages and thus would recover none.[121]

Turning to the actual lost profit figure, the court used the gross profit (sales price less standard cost of production) under the only full year in which the parties carried out their obligations. It then determined the variable costs by looking at all production and distribution expenses and multiplying by the percentage of New England Dairy's business that was attributable to Dairy Mart. The court subtracted these costs from the gross profit and, after deducting certain discounts Dairy Mart was entitled to under the contract and the annual incentive payments Dairy Mart would have received, arrived at an annual lost profit figure to be multiplied by the number of years for breach.[122]

The court's decision is generally sound but leaves a couple of points for closer analysis. First, it is not clear that the court picked the right point for cutting off damages. The appropriate point is not when the seller is at full capacity; as the court observed, it is when the seller cannot serve both the original customer and the substitutes. Under a requirements contract, this would fall when the sum of the buyer's requirements and the seller's other contracts first exceeds the seller's capacity. Certainly this happened when New England Dairies was at full capacity but presumably it came before that as well—indeed, when New England Dairies was at around eighty-one percent capacity, beyond which it could not also handle the nineteen percent hitherto taken by Dairy Mart. From eighty-one percent capacity on up, it would seem that New England Dairies lost only some of its volume. It would have been beyond full capacity, and lost volume sellers by definition must have capacity to spare.[123] From that point on, New England Dairies

117. 47 U.C.C. Rep. Serv. 2d (West) at 491.

118. 47 U.C.C. Rep. Serv. 2d (West) at 495–96.

119. 47 U.C.C. Rep. Serv. 2d (West) at 495–96.

120. 47 U.C.C. Rep. Serv. 2d (West) at 496–97.

121. The court could have added that section 2-706 damages would have been available as well, for the goods were resold. If the profit on resale equaled the profit on the original contract, though, presumably the resale price did as well, so this path probably would have gained the plaintiff nothing.

122. *New England*, 47 U.C.C. Rep. Serv. 2d (West) at 491–94.

123. *See, e.g.*, Bill's Coal Co. v. Bd. of Pub. Utils. of Springfield, 887 F.2d 242, 245, 9 U.C.C. Rep. Serv. 2d (Callaghan) 1238, 1242 (10th Cir. 1989); Lake Erie Boat Sales, Inc. v. Johnson, 463 N.E.2d 70, 72, 38 U.C.C. Rep. Serv. (Callaghan) 845, 847 (Ohio Ct. App. 1983).

would therefore get lost volume seller damages only to the extent of its unfilled capacity.[124] It is not clear from the opinion whether Dairy Mart raised this issue, though, so perhaps the court was using the best evidence available to it. Also a little troubling is the use of average profit data to show damages. In principle, the relevant information is not the average profit over all transactions but rather the marginal profit on the lost sale. Under conventional economics, the marginal profit is probably lower than the mean profit, given diminishing marginal returns. As a result, New England Dairies may have recovered more than it should.[125]

Turning from *in personam* to *in rem* rights, a recent bankruptcy decision provided a thorough treatment of the law of stoppage in transit. *Cargill Inc. v. Trico Steel Co.* (In re *Trico Steel Co.*)[126] concerned a contract in which Trico bought pig iron from Cargill. Cargill arranged for carriers to ship the iron from its supplier in Brazil to Trico in New Orleans. Trico then contracted with Celtic Marine to ship the iron from New Orleans to Trico's facility in Alabama, and Celtic, in turn, subcontracted with Volunteer Barge & Transportation ("Volunteer") to do the actual transportation. Under the Celtic/Trico contract, Trico was to load the goods in New Orleans and unload the goods in Alabama, and Volunteer bore the risk of loss in transit. After the iron arrived in New Orleans, Trico sold about a third and had the remainder loaded onto barges for shipment to Alabama under two non-negotiable bills of lading. While the iron was in transit to Alabama, Cargill learned that Trico was insolvent and sent Celtic a letter asserting Cargill's right to stop the goods in transit. Trico then filed a voluntary petition in bankruptcy. The next day, Cargill offered to indemnify Celtic for any losses incurred in stoppage. The parties agreed to allow the iron to be sold by a third party, with the funds to be placed in escrow pending resolution of their dispute.

There was no apparent dispute whether Trico was insolvent, so Cargill had the right to stop the iron until one of the events listed in section 2-705(2) occurred:

124. This is not a question of mitigation. New sales procured by lost volume sellers are not in mitigation; indeed, the point of the lost volume measure is that a resale does not substitute for the initial sale. Rather, once New England Dairies would have reached capacity with the Dairy Mart sales, any additional sales it got would remove that much lost volume.

125. Indeed, one could go further. Some critics of the lost volume remedy point out that the breaching buyer could have entered the market, which lowers the expected value of the sale. Though the seller incurs some resale costs in addition to any loss on the resale, these would not equal the lost profit. For a sample of critiques, see Robert Cooter & Melvin Aron Eisenberg, *Damages for Breach of Contract*, 73 CAL. L. REV. 1432, 1455–59 (1985); Victor P. Goldberg, *An Economic Analysis of the Lost-Volume Retail Seller*, 57 S. CAL. L. REV. 283 (1984); Robert E. Scott, *The Case for Market Damages: Revisiting the Lost Profits Puzzle*, 57 U. CHI. L. REV. 1155, 1165–69, 1179–86 (1990).

Additionally, under some formulations of the lost volume seller test, the seller must prove not just that it could have produced both the breached units and what it actually sold, but also that it would have been profitable for the seller to produce and sell both. *See, e.g.*, R.E. Davis Chem. Corp. v. Diasonics, Inc., 826 F.2d 678, 684, 4 U.C.C. Rep. Serv. 2d (Callaghan) 369, 376 (7th Cir. 1987) [Davis I]. This too looks at marginal profit rather than average profit. In *Davis II*, the appellate court on remand accepted average profit data. R.E. Davis Chem. Corp. v. Diasonics, Inc., 924 F.2d 709, 712, 13 U.C.C. Rep. Serv. 2d (Callaghan) 1094, 1098–99 (7th Cir. 1991) [Davis II].

126. 282 B.R. 318, 48 U.C.C. Rep. Serv. 2d (West) 1004 (Bankr. D. Del. 2002). Eight days earlier the same judge issued another opinion in a different case turning in part on stoppage in transit and using substantially similar analysis. *In re* Kellstrom Indus., Inc., 282 B.R. 787, 48 U.C.C. Rep. Serv. 2d (West) 613 (Bankr. D. Del. 2002).

the buyer's receipt of the goods, a non-carrier bailee's acknowledgment to the buyer that the bailee holds the goods for the buyer, a similar acknowledgment by a carrier by reshipment or warehouseman, or negotiation to the buyer of any negotiable document of title covering the goods.[127] The court held that Trico did not receive the goods—in the code's definition, take physical possession of them—notwithstanding Trico's responsibility for unloading the pig iron in New Orleans.[128] The stevedores who unloaded the pig iron were merely intermediaries in the transport of the goods, as were Celtic and Volunteer; nor was New Orleans the final destination for the goods, despite a shipping term providing for "Destination New Orleans CIFFO."[129] The shipping term merely allocated the risk of loss and related responsibilities. Even if title had passed to Trico, the iron remained in the hands of carriers.[130] Second, Trico never received acknowledgment from a bailee other than a carrier that the bailee held the goods for Trico. Both Volunteer and Celtic were carriers. The Celtic-Volunteer contract, the Trico-Celtic contract, and the non-negotiable bills of lading all stated that Volunteer was a carrier nor was Celtic a bailee, as it never had exclusive possession of the pig iron; rather, it simply provided services to Trico.[131] Third, neither Celtic nor Volunteer held the goods by reshipment—there was no new shipment contract—or as warehousemen.[132] Finally, the last cutoff did not apply because the second shipment was under non-negotiable bills of lading.[133] As a result, Cargill had the right to stop the pig iron in transit.

The court's decision is, on balance, reasonable. Delivery and possession are not the same; one can take constructive possession before delivery, and one can make delivery without the buyer ever taking possession of the goods.[134] Neither is title relevant to possession, as one can hold title to goods in the hands of others.[135] The issue is clouded because Trico arranged for so much of the transportation, which makes plausible the statement that Trico had possession from the time the carriers it hired took charge of the goods. Still, the goods had not arrived at Trico's place of business, and the code ends the right of stoppage at "the place of *final* delivery," not some intermediate point.[136] This is consistent with commercial logic. Who arranges for delivery may be an artifact of convenience and cost, so the right of stoppage should not rest on it.

127. U.C.C. § 2-705(2) (2003).
128. *Trico*, 282 B.R. at 325, 48 U.C.C. Rep. Serv. 2d (West) at 1010.
129. *Id.* at 323, 48 U.C.C. Rep. Serv. 2d (West) at 1010.
130. *Id.* at 322–25, 48 U.C.C. Rep. Serv. 2d (West) at 1009–12.
131. *Id.* at 325–26, 48 U.C.C. Rep. Serv. 2d (West) at 1012–14.
132. *Id.* at 326–27, 48 U.C.C. Rep. Serv. 2d (West) at 1014.
133. *Id.* at 327, 48 U.C.C. Rep. Serv. 2d (West) at 1014–15.
134. *See, e.g.*, U.C.C. § 2-103 cmt. 2 (2001); Kunkel v. Sprague Nat'l Bank, 128 F.3d 636, 643, 33 U.C.C. Rep. Serv. 2d (West) 943, 951 (8th Cir. 1997); Abilene Nat'l Bank v. Fina Supply, Inc. (*In re* Brio Petroleum, Inc.), 800 F.2d 469, 472, 2 U.C.C. Rep. Serv. 2d (Callaghan) 159, 163 (5th Cir. 1986).
135. *See, e.g.*, Chemsource, Inc. v. Hub Group, Inc., 106 F.3d 1358, 1362, 31 U.C.C. Rep. Serv. 2d (CBC) 769, 771–72 (7th Cir. 1997); Ramco Steel, Inc. v. Kesler (*In re* Murdock Mach. & Eng'g Co.), 620 F.2d 767, 773, 28 U.C.C. Rep. Serv. (Callaghan) 1351, 1358–59 (10th Cir. 1980).
136. U.C.C. § 2-705 cmt. 2 (2001) (emphasis added).

STATUTE OF LIMITATIONS

The last year brought two cases on how promises to repair affect the Article 2 statute of limitations.[137] In *Poli v. DaimlerChrysler Corp.*,[138] the plaintiff bought an automobile with a seven-year, seventy-thousand mile powertrain warranty that provided for repair for any defective part. The auto's timing belt needed replacing several times over five years, the last failure destroying the short block of the engine. Fed up, the owner sued for breach of warranty under Article 2 as well as under, among other things, Magnuson-Moss. The trial court dismissed the Magnuson-Moss and Article 2 claims as untimely, because they had not been brought within four years after delivery of the car.[139] The appellate court reversed. It gave two reasons. First, it held that the seven-year warranty was a promise of future performance.[140] As a result, it fell under the discovery exception in section 2-725(2), and so the warranty was breached only when the seller failed to repair the timing belt properly, well within the four year period.[141] Alternatively, it held that the warranty was not a warranty at all but a promise to repair.[142] This promise was breached when the seller failed to repair, just as under the first alternative, therefore suit was again timely.[143] A concurring judge agreed with the second characterization but not the first.[144]

137. And some other cases of less importance as well. *See, e.g.*,Webco Indus., Inc. v. Thermatool Corp., 278 F.3d 1120, 1127, 46 U.C.C. Rep. Serv. 2d (West) 698, 704 (10th Cir. 2002) (stating that the limitations period begins on delivery, not after installation); Sherman v. Sea Ray Boats, Inc., 649 N.W.2d 783, 791, 47 U.C.C. Rep. Serv. 2d (West) 1012, 1022 (Mich. Ct. App. 2002) (finding that statements in owner's manual that boat would provide "years of trouble free boating" and "family fun for years to come" did not explicitly extend to future performance); Imperia v. Marvin Windows of N.Y., Inc., 747 N.Y.S.2d 35, 37, 49 U.C.C. Rep. Serv. 2d (West) 185, 187 (N.Y. App. Div. 2002) (finding that statements in brochures claiming that finish "lasts four to five times as long as paint" explicitly extend to future performance); Richard A. Rosenblatt & Co. v. Davidge Data Sys. Corp., 743 N.Y.S.2d 471, 472, 47 U.C.C. Rep. Serv. 2d (West) 1390, 1391 (N.Y. App. Div. 2002) (finding that the limitations period for installation of computerized trading system started on delivery, not after installation, but for the service component started only on the failure to service the system); Int'l Periodical Distribs. v. Bizmart, Inc., 768 N.E.2d 1167, 1170, 47 U.C.C. Rep. Serv. 2d (West) 1227, 1231 (Ohio 2002) (using section 2-725(3) savings provision rather than general savings provision).

138. 793 A.2d 104, 47 U.C.C. Rep. Serv. 2d (West) 260 (N.J. Super. Ct. App. Div. 2002).

139. The usual limitations period in Article 2 is four years from the time of tender of delivery. U.C.C. § 2-725(1)-(2) (2001).

140. *Poli*, 793 A.2d at 108, 47 U.C.C. Rep. Serv. 2d (West) at 265–66.

141. *Id.* at 108–09, 47 U.C.C. Rep. Serv. 2d (West) at 266–67; *see also, e.g.*, Prousi v. Cruisers Div. of KCS Int'l, Inc., 975 F. Supp. 768, 773 (E.D. Pa. 1997); Ouellette Mach. Sys., Inc. v. Clinton Lindberg Cadillac Co., 60 S.W.3d 618, 622, 45 U.C.C. Rep. Serv. 2d (West) 163, 166 (Mo. Ct. App. 2001).

142. *Poli*, 793 A.2d at 110, 47 U.C.C. Rep. Serv. 2d (West) at 268.

143. *Id.* at 109–10, 47 U.C.C. Rep. Serv. 2d (West) at 267–68; *see also, 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); Cosman v. Ford Motor Co., 674 N.E.2d 61, 68, 33 U.C.C. Rep. Serv. 2d (West) 1118, 1125 (Ill. App. Ct. 1996). The court reversed the dismissal of the Magnuson-Moss claim on the grounds that Magnuson-Moss borrows the Article 2 statute of limitations, and the broad Magnuson-Moss definition of warranty clearly encompasses promises to repair. *Poli*, 793 A.2d at 111, 47 U.C.C. Rep. Serv. 2d (West) at 269–70; *see also, e.g.*, *Cosman*, 674 N.E.2d at 67, 33 U.C.C. Rep. Serv. 2d (West) at 1125.

144. *Poli*, 793 A.2d at 112, 47 U.C.C. Rep. Serv. 2d (West) at 271 (Wells, J., concurring).

The concurring justice is on stronger ground. The "warranty" in this case did not promise that the goods would work or make any other assertion as to the nature or quality of the goods. It said only that if the goods failed, the seller would repair them. Such a promise is not really a warranty, therefore the discovery exception in Article 2 should not apply. Article 2 treats warranties differently from remedial promises, most notably regarding disclaimers.[145] In contrast, if the promise to repair is an ordinary contractual obligation, the buyer has four years from breach, which, as the court held, does not occur until the failure to repair. This method honors the difference between warranty and remedial promises.[146]

The other repair case dealt with tolling while the seller repairs the goods. In *Curragh Queensland Mining Ltd. v. Dresser Industries, Inc.*,[147] the plaintiff bought a machine for coal reclamation in 1990. The machine carried a repair or replace promise covering defects that arose in the first year after delivery. The machine's mechanical defects required repairs over the next seven years. After attempts to fix it once and for all failed, the buyer brought suit in 1998 for, among other things, breach of warranty. At trial, the seller unsuccessfully sought to assert a limitations defense, a point it raised on appeal. The court agreed that more than three years[148] had passed between discovery of the defect and suit but nevertheless did not reverse. It held that the cause of action for the final promise to repair did not accrue until 1997, as the seller had promised the buyer a certain level of performance for successive three-month periods until then.[149] The buyer's claims for past repair damages normally would be barred if they occurred more than three years before suit. The court chose to toll the statute of limitations during the repairs, though, reasoning that to do otherwise would force a buyer to begin suit while informal attempts to repair were still going on. This would chill informal dispute resolution and hurt business relationships.[150]

145. *Compare* U.C.C. § 2-316 (2001) (providing disclaimers of warranties), *with* U.C.C. § 2-719 (2001) (providing disclaimers of remedies).

146. For a fuller discussion of these issues, see Larry T. Garvin, *Uncertainty and Error in the Law of Sales: The Article Two Statute of Limitations*, 83 B.U. L. REV. 345, 377–81 (2003).

The court chose not to follow the other major strand of cases arising from promises to repair or replace–those holding that these promises are warranties, but not warranties as to future performance, meaning that the limitations period runs for four years from tender. *See, e.g.*, Nebraska Popcorn, Inc. v. Wing, 602 N.W.2d 18, 23–24, 40 U.C.C. Rep. Serv. 2d (West) 227, 232–33 (Neb. 1999); Gianakakos v. Commodore Home Sys., Inc., 727 N.Y.S.2d 806, 808, 45 U.C.C. Rep. Serv. 2d (West) 815, 816 (N.Y. App. Div. 2001). This line, like the line holding these promises warranties explicitly extending to future performance, muddles warranty and remedy. Even worse, though, under this line the time for suit would pass four years from tender, even for a seven-year warranty–surely an absurd result, as the *Poli* court observed. *Poli*, 793 A.2d at 108–09, 47 U.C.C. Rep. Serv. 2d (West) at 266; *see also, e.g.*, Jacqueline Kanovitz, *Warranties with Exclusive Repair-and-Replacement Remedies: When Does the Buyer's Cause of Action Accrue?*, 3 ARIZ. ST. L.J. 431, 445–46 (1984).

147. 55 P.3d 235, 47 U.C.C. Rep. Serv. 2d (West) 1065 (Colo. Ct. App. 2002).

148. Colorado has a non-uniform version of Article 2, making the limitations period three years but using a discovery rule for breach of warranty actions. COLO. REV. STAT. ANN. §§ 4-2-725(1) (providing the limitations period), 13-80-108(6) (setting forth the discovery rule) (2002).

149. *Curragh*, 55 P.3d at 239–40, 47 U.C.C. Rep. Serv. 2d (West) at 1068.

150. *Id.* at 240, 47 U.C.C. Rep. Serv. 2d (West) at 1069.

Most courts do not recognize repair tolling,[151] although a handful do.[152] Under facts such as these, one can see why tolling has much appeal. The court properly pointed out the practical absurdity of the alternative. Short of bringing suit while repairs still went on, what could the buyer have done to protect its rights? Possibly a lay buyer could secure a waiver of the limitations defense, but that seems improbable at best. Nor do we want sellers to drag out repair attempts in hopes that the limitations period will pass before the buyer realizes it.[153] *Curragh* seems to have reached a sound result for sound reasons.

151. *See, e.g.*, Ludwig v. Ford Motor Co., 510 N.E.2d 691, 699, 5 U.C.C. Rep. Serv. 2d (Callaghan) 361, 371 (Ind. Ct. App. 1987); Gus' Catering, Inc. v. Menusoft Sys., 762 A.2d 804, 807, 43 U.C.C. Rep. Serv. 2d (West) 1163, 1166 (Vt. 2000); Holbrook, Inc. v. Link-Belt Constr. Equip. Co., 12 P.3d 638, 643–45, 42 U.C.C. Rep. Serv. 2d (West) 1022, 1029–32 (Wash. Ct. App. 2000).

152. *See, e.g.*, Little Rock Sch. Dist. v. Celotex Corp., 574 S.W.2d 669, 674, 25 U.C.C. Rep. Serv. (Callaghan) 666, 673 (Ark. 1978); Biocraft Labs., Inc. v. USM Corp., 395 A.2d 521, 522, 25 U.C.C. Rep. Serv. (Callaghan) 484, 485–86 (N.J. Super. Ct. App. Div. 1978); Keller v. Volkswagen of Am., Inc., 733 A.2d 642, 646, 39 U.C.C. Rep. Serv. 2d (West) 118, 122 (Pa. Super. Ct. 1999). These courts follow a wide range of formulations, ranging from simple tolling during repair to added requirements of a promise that the repair will work, that the buyer relied upon a promise, or that the seller have committed fraud. For more on these lines of cases, see Garvin, *supra* note 146, at 377–81.

153. Normally this would not rise to the level of fraudulent concealment, unless the seller had no intention of repairing the goods.