August, 2000

Uniform Commercial Code Survey, Sales

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Sales

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This survey reviews recent case law under Article 2, Sales, of the Uniform Commercial Code (U.C.C.). Revised Article 2, which had been approved by the American Law Institute (A.L.I.), has been sent back to the drawing boards by the National Conference of Commissioners on Uniform State Laws (NCCUSL) as a result of opposition by certain industry groups. A new Reporter and Drafting Committee were appointed[1] and a new draft prepared.[2] The A.L.I. considered, but did not approve, this draft at its May 2000 meeting. At its July 2000 meeting, NCCUSL postponed consideration of the draft for another year. The plan is now to seek A.L.I. and then NCCUSL approval in 2001.

SCOPE OF ARTICLE 2

A patent infringement suit is settled by agreement. One of the terms of the settlement agreement requires the infringer to transfer its inventory of infringing medical devices to the patent holder. The medical devices are defective and, thus, cannot be resold. Is the settlement agreement a

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1. The new drafting committee will also recommend changes to Article 2A. The Reporter is Henry Deeb Gabriel, Jr., Professor of Law at Loyola University School of Law in New Orleans, Louisiana. Chair of the new drafting committee is William H. Henning, Professor of Law at University of Missouri-Columbia, School of Law in Columbia, Missouri. Committee members are: Boris Auerbach, Esq., Professor Marion W. Benfield, Jr., Professor Amelia H. Boss, Professor Neil B. Cohen, California State Senator Byron D. Sher, Esq., and Professor James J. White. The ABA Advisor is Thomas J. McCarthy, Esq. of Wilmington, Delaware.

2. The latest draft of Revised Article 2 is available on the Internet at <http://www.law.upenn.edu/bll/ulc/ulc_frame.htm> under "Drafts".

contract for the sale of goods governed by U.C.C. Article 2 so that the infringer made implied warranties of merchantability and fitness for a particular purpose? The Federal Circuit, in *Novamedix, Ltd. v. NCM Acquisition Corp.*,[3] held that the settlement agreement was not a contract for the sale of goods; hence the infringer made no implied warranties.[4] Fundamental to the court's holding was its decision to apply the predominant purpose test,[5] which is also called "the essential nature of the underlying contract" test.[6] This test typically is applied to contracts for a mixed sale of goods and services to determine whether or not U.C.C. Article 2 governs the entire contract. Its application in this context appears to be appropriate. The court found the primary purpose of the settlement agreement to be the settlement of patent infringement claims with the transfer of goods incidentally involved.[7] Hence, Article 2 did not apply in this instance.

CONTRACT FORMATION: SHRINKWRAP LICENSES

Courts continue to struggle with the enforceability of shrinkwrap licenses. This year, two federal courts declined to enforce a shrinkwrap license while two state courts enforced one. A shrinkwrap license is printed on the box or envelope containing the software.[8] Typically, the user does not see the license until after unwrapping the software, which usually occurs after purchase. In *Novell, Inc. v. Network Trade Center, Inc.*,[9] the United States District Court in Utah declined to enforce a shrinkwrap license. In that case Novel marketed its software program in two forms: an "Original" product (the Original) intended for a first time buyer, and an "upgrade" product (the Upgrade) restricted for use by either a registered user of an older version of the program or a user of a competitor's networking software.[10] The two forms of the program function identically, but the Upgrade is considerably less expensive than the Original. Network Trade Center (NTC) was in the business of distributing software programs. NTC would obtain copies of software that qualified for the Upgrade by buying the qualifying software in bulk at low prices. It would then obtain the Upgrade. NTC would then sell it as an Original at a price well below the price for an Original.

Novell sued NTC on a variety of theories including copyright infringement. Novell argued a theory of contributory infringement: it claimed that

3. 166 F.3d 1177, 37 U.C.C. Rep. Serv. 2d (West) 918 (Fed. Cir. 1999).
4. *Id.* at 1178, 37 U.C.C. Rep. Serv. 2d (West) at 918.
5. *Id.* at 1182, 37 U.C.C. Rep. Serv. 2d (West) at 925.
6. *Id.*
7. *Id.* at 1183, 37 U.C.C. Rep. Serv. 2d (West) at 925.
8. *See* Novell, Inc. v. Network Trade Center, Inc., 25 F. Supp. 2d 1218, 1230 n.16, 37 U.C.C. Rep. Serv. 2d (West) 528, 545 n.16 (D. Utah 1997).
9. 25 F. Supp. 2d 1218, 37 U.C.C. Rep. Serv. 2d (West) 528 (D. Utah 1997).
10. *Id.* at 1222, 37 U.C.C. Rep. Serv. 2d (West) at 540.

NTC's sales of the software violated Novell's licensing policy and caused the end users to infringe Novell's copyright. NTC argued that it was an owner of the software, and under the "first sale" doctrine,[11] it could sell its ownership rights to the end users. Novell countered that it retained ownership rights to the software, and that under the terms of the shrinkwrap license that accompanies each copy of the software, the purchaser is merely a licensee to use the software. The court declined to enforce the shrinkwrap license and found the transfers of software to be sales of goods governed by Article 2 and protected by the "first sale" doctrine.[12]

In refusing to enforce the shrinkwrap license the court noted that case law was split on the question of enforceability.[13] The court applied what it termed was the majority rule holding shrinkwrap licenses to be invalid.[14] The justification for this rule is that the contract for the software is generally considered to be complete by the end user when it pays the price and takes possession of the software. The shrinkwrap license is then characterized as a proposed modification of the contract which courts are reluctant to find the buyer has accepted merely by using the software.[15]

In *Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.*,[16] a United States district court in California declined to enforce a forum selection clause in a shrinkwrap license because the license was inconsistent with a previously negotiated licensing agreement between the parties that required amendments to be in a signed writing.[17] Morgan Labs sold to banks software that incorporated software modules produced by Micro Data Base Systems, Inc. (Micro Data). In 1991, the Morgan Labs and Micro Data negotiated and signed a licensing agreement covering Morgan Labs' right to use the Micro Data software modules. This agreement contained a clause requiring amendments to the agreement to be signed by both parties. In 1992, Micro Data began including a shrinkwrap license with the modules it sent to Morgan Labs. Morgan Labs employees read the shrinkwrap license. In 1996, Morgan Labs sued Micro Data in California. Subsequently, Micro Data sought to enforce a forum selection clause contained in the shrinkwrap license by a motion to transfer the case to Indiana.[18]

The court declined to enforce the shrinkwrap license and denied the motion.[19] The court concluded that the shrinkwrap license was a proposed

11. *Id.* at 1229-30 n.14, 37 U.C.C. Rep. Serv. 2d (West) at 545 n.14; *see also* 17 U.S.C. § 109(a).

12. *Id.* at 1230, 37 U.C.C. Rep. Serv. 2d (West) at 546.

13. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 546.

14. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 546 (citing Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 15 U.C.C. Rep. Serv. 2d (CBC) (3d Cir. 1991); Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th Cir. 1988)).

15. *Id.* at 1230 n.17, 37 U.C.C. Rep. Serv. 2d (West) at 546 n.17.

16. 39 U.C.C. Rep. Serv. 2d (West) 319 (N.D. Cal. 1997).

17. *Id.* at 319.

18. *Id.*

19. *Id.* at 323.

amendment of the previous licensing agreement. Although the court acknowledged that shrinkwrap licenses may be enforceable in some cases,[20] because Morgan Labs had not signed this particular shrinkwrap license as required by the parties' previous agreement, the court held this shrinkwrap license to be unenforceable under section 2-209(2).[21]

Micro Data argued that Morgan Labs had modified the original licensing agreement by its course of conduct in opening and using the software modules during the four years after Micro Data had included the shrinkwrap license with the modules. The court rejected this argument. It held that a course of performance required action of the parties with respect to the clause in question, here the forum selection clause.[22] Because the parties had not previously invoked the clause, there was no course of performance regarding the clause. The court also rejected Micro Data's argument that the shrinkwrap license constituted a supplemental agreement to, not an amendment of, the previous licensing agreement.[23]

In *Management Computer Controls, Inc. v. Charles Perry Construction, Inc.*,[24] a Florida District Court of Appeal enforced a forum selection clause in a shrinkwrap license.[25] In that case, the software user apparently signed order forms that incorporated the terms of the software maker's shrinkwrap license. The software arrived in sealed packages with the license terms printed on the outside of the package. The user opened the packages and installed the software. The court concluded that the license terms, including the forum selection clause, were part of the contract for two reasons: (i) the user had executed a contract that expressly incorporated those terms, and (ii) the user had assented to the terms of the license when it opened the packages marked with the terms.[26]

The Washington Court of Appeals enforced a shrinkwrap license in *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*[27] In that case, a programming bug in software designed to prepare construction bids produced an incorrect bid that caused the user a loss. The court denied recovery for the loss based on a limitation of liability clause in the shrinkwrap license accompanying the software.[28]

Mortenson (User) had used a prior version of Timberline's bid preparation software, and needed to upgrade to the most current version of the

20. *Id.* (citing *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1450-53 (7th Cir. 1996)).

21. *Id.*

22. *Id.*

23. *Id.* at 321-22.

24. 743 So.2d 627, 39 U.C.C. Rep. Serv. 2d (West) 1162 (Fla. Dist. Ct. App. 1999).

25. The court declined to apply the selection clause to a cause of action alleging a violation of the Florida Unfair and Deceptive Trade Practices Act, because requiring that claim to be litigated in a foreign jurisdiction would undermine the effectiveness of the Act. *Id.* at 632, 39 U.C.C. Rep. Serv. 2d (West) at 1168-69.

26. *Id.* at 631, 39 U.C.C. Rep. Serv. 2d (West) at 1166-67.

27. 970 P.2d 803, 37 U.C.C. Rep. Serv. 2d (West) 892 (Wash. Ct. App. 1999)

28. *Id.* at 812, 37 U.C.C. Rep. Serv. 2d (West) at 917.

program (referred to as Precision) when it upgraded its operating system. User negotiated the purchase of nine copies of the Precision software through Timberline's local authorized dealer, SDS. Both the dealer and User signed the User's purchase order. Timberline then shipped the software to the dealer, who then delivered it to User. Timberline shipped the software to the dealer in sealed envelopes, on which the shrinkwrap license was printed. The license was also printed in the software manual. There was a factual dispute as to whether the dealer or User opened the sealed envelopes and installed the software.

Some weeks before the sale, Timberline discovered a bug in the software. It did not consider the bug to be a significant problem, and so did not notify User. The bug caused the software to produce a bid for User that was two million dollars below what the bid should have been. User did not notice the error and submitted the bid. When User later learned that the bug had caused the incorrect bid, it sued Timberline for breach of express and implied warranties and sought consequential damages.[29] Timberline asserted a limitation of liability clause contained in its shrinkwrap license.[30] Nevertheless, the trial court granted Timberline's motion for summary judgment, concluding that the shrinkwrap license agreement controlled and that it was not unconscionable.[31]

The Washington Court of Appeals accepted without deciding the parties' position that Article 2 applied to the transaction and affirmed.[32] It concluded that the User's purchase order, which had been signed by User and Timberline's dealer, was not an integrated contract, thus permitting the shrinkwrap license to be part of the agreement between the parties.[33] The court noted that integration is normally a question of fact, but that reasonable minds could not differ on the resolution of that question here, so it was appropriate to resolve the question on summary judgment.[34] The court reasoned that because User had licensed other software with similar shrinkwrap licenses, it would have understood that its use of Timberline's software would be governed by the shrinkwrap license.[35]

The court then proceeded to find that the shrinkwrap license was part of the agreement between the parties.[36] The court cited two Seventh Circuit cases enforcing terms sent with the product purchased,[37] and noted the commercial usefulness of a contract formation procedure that per-

29. *Id.* at 807, 812, 37 U.C.C. Rep. Serv. 2d (West) at 909, 917.
30. *See id.* at 806, 37 U.C.C. Rep. Serv. 2d (West) at 907-08.
31. *See id.* at 807, 37 U.C.C. Rep. Serv. 2d (West) at 909.
32. *Id.* at 813, 37 U.C.C. Rep. Serv. 2d (West) at 917.
33. *Id.* at 808, 37 U.C.C. Rep. Serv. 2d (West) at 911.
34. *Id.* at 807-08, 37 U.C.C. Rep. Serv. 2d (West) at 910-11.
35. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 910-11.
36. *Id.* at 809, 37 U.C.C. Rep. Serv. 2d (West) at 913.
37. ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 29 U.C.C. Rep Serv. 2d (CBC) 1109 (7th Cir. 1996); Hill v. Gateway 2000, Inc., 105 F.3d 1147, 31 U.C.C. Rep. Serv. 2d (CBC) 303 (7th Cir. 1997).

mitted sending detailed terms with the product that would bind the recipient if it did not return the product.[38] It rejected User's effort to distinguish those cases based on the prior negotiation that occurred in this case. User argued that under U.C.C. section 2-207 questions of fact existed as to whether its conduct constituted assent to the license. The court distinguished a case cited by User that applied section 2-207 to shrinkwrap licenses,[39] and held User's installation and use of the software to be sufficient assent to make the additional terms in the license part of the agreement.[40]

The court next concluded that the limitation of remedy clause was not unconscionable.[41] The court noted that no factual hearing was necessary when, as here, there was no possible basis for finding unconscionability.[42] The court then proceeded to find the limitation clause to be neither procedurally nor substantively unconscionable.[43] The limitation clause was not procedurally unconscionable, reasoned the court, because the introductory screen included a notice that use of the software was governed by the license; User had a reasonable opportunity to read and understand the terms of the license; and such limitation clauses are widely used in the software industry.[44] The court dismissed User's argument that failure to warn of the bug or offer a new bug-free version of the software made the limitation unconscionable.[45] The court cited language in Timberline's internal memo that the bug was "obscure" and "not a major problem" to support its conclusion.[46] The court also indicated there was no proof that Timberline was aware that the bug could cause an inaccurate bid.[47] The court held the limitation to be substantively conscionable because such clauses are standard in the software industry, do not shock the conscience, and make software affordable.[48]

The Uniform Computer Information Transaction Act (UCITA), promulgated in 1999 by the National Conference of Commissioners on Uniform State Laws (NCCUSL), contains provisions designed to validate

38. 970 P.2d 803, 809, 37 U.C.C. Rep. Serv. 2d (West) 892, 912.

39. *Id.* at 810, 37 U.C.C. Rep. Serv. 2d (West) at 913-14 (making reference to Step-Saver Data Sys., Inc. v. Wyse Tech., 939 F.2d 91, 15 U.C.C. Rep. Serv. 2d (CBC) 1 (3d Cir. 1991)).

40. *Id.* at 808, 37 U.C.C. Rep. Serv. 2d (West) at 913.

41. *Id.* at 811, 37 U.C.C. Rep. Serv. 2d (West) at 916.

42. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 915.

43. *Id.* at 812, 37 U.C.C. Rep. Serv. 2d (West) at 917.

44. *Id.* at 811-12, 37 U.C.C. Rep. Serv. 2d (West) at 916.

45. The court also affirmed the trial court's denial of User's motion to amend its complaint to add claims of fraud and misrepresentation based on Timberline's failure to disclose the bug. The court concluded that User's lawyer had delayed too long in moving to amend its complaint after learning that Timberline knew of the bug. *Id.* at 813, 37 U.C.C. Rep. Serv. 2d (West) at 916.

46. *Id.* at 812, 37 U.C.C. Rep. Serv. 2d (West) at 917.

47. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 917.

48. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 917.

shrinkwrap licenses.[49] UCITA refers to Shrinkwrap licenses as "Mass-Market Licenses,"[50] and their enforceability is governed by sections 208 and 209. The UCITA provisions on enforceability of terms sent with the product are substantially different than those in U.C.C. Article 2.[51]

STATUTE OF FRAUDS

In *Webcor Packaging Corp. v. Autozone, Inc.*,[52] the Court of Appeals for the Sixth Circuit decided a case requiring an interpretation of the "specially manufactured goods" exception to the statute of frauds requirement under subsection (3) of section 2-201. Webcor Packaging (Seller) manufactured and sold cartons to be used by Autozone's (Buyer) auto parts supplier (Vendors) in packaging the parts to be sold by Buyer to its retail customers. Although the cartons were made according to Buyer's specifications, they were primarily sold to the Vendors who supplied Buyer with parts it sold under the "Duralast" brand name. It was rare that Buyer purchased the cartons from Seller directly, but Buyer did refer its suppliers to Seller to purchase the cartons for packaging.

As a result of a growth in demand for the Duralast products, Seller advised Buyer that it would need to produce a sixty-day supply of cartons instead of the thirty-day supply it had previously maintained. Seller claimed that Buyer assured it of coverage for any losses Seller might incur should the cartons become obsolete. When Buyer changed its logo, the cartons did in fact become obsolete. Seller demanded Buyer cover its losses and ultimately sued Buyer on an oral agreement. The district court applied the specially manufactured goods exception to the statute of frauds requirement to determine if Buyer would be liable absent a written agreement.[53] It held that because Buyer was not a "single buyer" of the cartons, the specially manufactured goods exception was not applicable to make Buyer liable under contract.[54]

The circuit court reviewed the district court's ruling *de novo*. It noted that most courts use a traditional four-part test in applying the specifically manufactured goods exception. That test requires that:

(1) the goods must be specially made for the buyer;
(2) the goods must be unsuitable for sale to others in the ordinary course of the seller's business;

49. The latest draft of the UCITA is available at the following URL: <http://www.law.upenn.edu/library/ULC/ULC.htm#UCITA>. For a brief description of the drafting history of UCITA, see Jane Kaufman Winn and Michael Rhoades Pullen, *Dispatches from the Front: Recent Skirmishes Along the Frontiers of Electronic Contracting Law*, 55 BUS. LAW. 455, 457-59 (1999).

50. UCITA p. 36, § 209, <http://www.law.upenn.edu/library/ULC/ULC.htm#UCITA>.

51. *Compare* UCITA §§ 204, 205, 208, 209, and 210 *with* U.C.C. § 2-207.

52. 158 F.3d 354, 37 U.C.C. Rep. Serv. 2d (West) 554 (6th Cir. 1998).

53. *Id.* at 356, 37 U.C.C. Rep. Serv. 2d (West) at 556.

54. *Id.*

(3) the seller must have substantially begun to have manufactured the goods or to have a commitment for their procurement; and
(4) the manufacture or commitment must have been commenced under circumstances reasonably indicating that the good are for the buyer and prior to the seller's receipt of notification of contractual repudiation.[55]

While the circuit court agreed with the district court's finding that Buyer was not a single buyer, it held that the courts need to look beyond the identity of the buyer in applying the exception, particularly in a case involving multi-layer transactions and multi-buyers.[56] It found the first two prongs of the traditional test to have shortcomings in that these two requirements often resulted in a "circular meaning."[57] It noted that courts should also consider whether the goods are unsalable to others in the ordinary course of business without some major modifications, as the Court of Appeals for the Fifth Circuit Court did in *Impossible Electronic Techniques, Inc. v. Wackenhut Protective Systems, Inc.*[58]

Thus, the circuit court held that the identity of the buyer should not be the sole issue in determining the applicability of the exception and it should look to other factors, including:

(1) the course of dealings between the parties;
(2) the flow of the allegedly specially manufactured goods;
(3) the essence of the goods to be received by the alleged buyer; and
(4) the duty to compensate the manufacturer undertaken by or the existence of any right of repudiation of the alleged buyer.[59]

In applying these factors to this case, the court concluded that this was not a case involving specially manufactured goods because (i) Seller dealt with many vendor/buyers and rarely sold cartons to Buyer, and its contact with Buyer only supplemented the agreement with the vendor/buyers; (ii) the cartons were manufactured for sale to the vendor/buyers and then sold to Buyer as a part of the "packaging" of the auto parts Buyer purchased; (iii) the essence of the goods being purchased by Buyer were the auto parts and not the cartons; and (iv) Buyer owed no duty to compensate Seller for the cartons and had no contractual right to order production stoppage of the cartons.[60]

55. *Id.* at 356, 37 U.C.C. Rep. Serv. 2d (West) at 557 (citing Colorado Carpet Installation, Inc. v. Palermo, 668 P.2d 1384, 1389; 36 U.C.C. Rep. Serv. (Callaghan) 1516 (Colo. 1983)).
56. *Id.* at 357, 37 U.C.C. Rep. Serv. 2d (West) at 558.
57. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 558.
58. 669 F.2d 1026; 33 U.C.C. Rep. Serv. (Callaghan) 806 (5th Cir. 1982).
59. 158 F.3d at 360, 37 U.C.C. Rep. Serv. 2d (West) at 563.
60. *Id.* at 360, 37 U.C.C. Rep. Serv. 2d (West) at 563-64.

CONTRACT MODIFICATION

Since the last survey, two circuit courts of appeals have rendered decisions that address section 2-209 of Article 2 concerning contract modification. In *BMC Industries, Inc. v. Barth Industries, Inc.*[61], the Court of Appeals for the Eleventh Circuit addressed the question of whether a waiver of a contract performance deadline can occur without reliance or consideration. This case involved a contract for the design, manufacture, and installation of equipment for the automated manufacture of eyeglass lenses. Under the contract as originally agreed between BMC (Buyer) and Barth (Seller), the equipment was to be delivered to Buyer by June of 1987. Because of difficulties in designing the equipment, the parties executed two written extensions of the due date. Although no other extensions were put in writing, the parties engaged in conduct that "demonstrated a willingness to continue performance under the [c]ontract."[62]

Such conduct included Buyer obtaining assurances from the parent company of Seller that it would complete performance under the contract and that the parent company's resources were committed to completion of the contract.[63] The facts also indicated that Buyer and Seller collaborated to work out design problems encountered under the contract and that Buyer made partial payment to cover some of Seller's cost overruns.[64] In May of 1989, Seller completed the design and manufacture of the equipment and was ready to tender delivery. However, Buyer refused delivery and sued Seller for breach of contract in its failure to deliver the equipment by the last formally amended due date of October 1987. Seller counterclaimed, alleging Buyer breached the contract by refusing to accept the tendered goods after the delivery date had become indefinite. The district court ruled that the contract was outside the scope of Article 2 as one primarily for services.[65] The jury returned a verdict in favor of Buyer based on the court's instruction that there could be no waiver of the contractual delivery date without consideration or reliance.

On appeal, the Eleventh Circuit held that the contract was predominately for the sale of goods and was therefore subject to the U.C.C.[66] The question for the court was whether Buyer had waived the delivery date through conduct under section 2-209 and, if so, was the tender of the goods made "within a reasonable time under the circumstances."[67]

Accordingly, the court reviewed its prior interpretation of the waiver provisions under subsections (4) and (5) of section 2-209 in which it held

61. 160 F.3d 1322, 37 U.C.C. Rep. Serv. 2d (West) 63 (11th Cir. 1998).
62. *Id.* at 1325, 37 U.C.C. Rep. Serv. 2d (West) at 66.
63. *Id.* at 1326, 37 U.C.C. Rep. Serv. 2d (West) at 66.
64. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 67.
65. *Id.* at 1328, 37 U.C.C. Rep. Serv. 2d (West) at 70.
66. *Id.* at 1329-32, 37 U.C.C. Rep. Serv. 2d (West) at 72-76.
67. *Id.* at 1329, 37 U.C.C. Rep. Serv. 2d (West) at 71.

that a "waiver requires '(1) the existence at the time of the waiver a right, privilege, advantage, or benefit which may be waived; (2) the actual constructive knowledge thereof; and (3) an intention to relinquish such right, privilege, advantage, or benefit."[68] It noted further that conduct of the parties may result in a waiver but such an implied waiver must be proven with "clear evidence."[69] Moreover, the waiver can be implied through conduct by the parties inconsistent with continuation of the original right alleged to be waived.[70]

The court also held that a waiver under section 2-209 does not require that there be detrimental reliance by the party asserting waiver or that there be consideration given for the waiver as required under Florida common law,[71] or as held by the majority in *Wisconsin Knife Works v. National Metal Crafters*.[72] Instead of following the majority in *Wisconsin Knife Works*, the Eleventh Circuit adopted Judge Easterbrook's dissenting position, which rejected a detrimental reliance requirement for a waiver under section 2-209:

> While subsection (4) states that an attempted modification that fails may still constitute a waiver, subsection (5) provides that the waiver may be retracted *unless* the non-waiving party relies on the waiver. Consequently, the statute recognizes that waivers may exist in the absence of detrimental reliance–these are the retractable waivers referred to in subsection (5). Only this interpretation renders meaning to subsection (5), because reading subjection (4) to require detrimental reliance for all waivers means that waivers would *never* be retractable.[73]

In its review of the facts of the case, the court concluded that based on the conduct of the parties, Buyer had "impliedly demonstrated an intent to relinquish that right" to the contract delivery date of October 1987.[74] The remaining question to address on remand was whether the tender of the equipment was done within a reasonable time period under section 2-309(1).[75]

68. *Id.* at 1332-33, 37 U.C.C. Rep. Serv. 2d (West) at 77 (quoting Dooley v. Weil (In re Garfinkle) 672 F.2d 1340, 1347 (11th Cir. 1982)).

69. *Id.* at 1333, 37 U.C.C. Rep. Serv. 2d (West) at 77 (citing American Somax Ventures v. Touma, 547 So. 2d 1266, 1268 (Fla. Dist. Ct. App. 1989)).

70. *Id.* at 1333, 37 U.C.C. Rep. Serv. 2d (West) at 77 (citing First Pa. Bank, N.A. v. Oreck, 357 So. 2d 743, 744 (Fla. Dist. Ct. App. 1978)).

71. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 77-78.

72. 781 F.2d 1280, 42 U.C.C. Rep. Serv. (Callaghan) 830 (7th Cir. 1986).

73. 160 F.3d at 1333, 37 U.C.C. Rep. Serv. 2d (West) at 77. The court noted that one state court in Florida had agreed with this interpretation in *Linear Corp. v. Standard Hardware Co.*, 423 So. 2d 966; 35 U.C.C. Rep. Serv. (Callaghan) 1141 (Fla. Dist. Ct. App. 1982).

74. 160 F.3d at 1334, 37 U.C.C. Rep. Serv. 2d (West) at 80.

75. *Id.* at 1336, 37 U.C.C. Rep. Serv. 2d (West) at 82.

In *Zemco MFG., Inc. v. Navistar International Transp. Corp.*,[76] the Court of Appeals for the Seventh Circuit Court addressed the question of whether, under the Indiana version of section 2-209(3), all modifications of contract terms must be in writing or only modifications of contract terms that are required to be in writing under section 2-201. In this case, Zemco (Seller) supplied Navistar (Buyer) with machine parts over a period of time from 1968 to 1995. The two sole shareholders of Seller fell in dispute and split, with one shareholder forming a new company. After this occurred, Buyer phased out the purchase contract with Buyer and entered into a purchase agreement with the newly formed company. Seller then brought suit for breach of its contract against Buyer, alleging that it was an exclusive requirements contract. The district court held that it was not an exclusive requirements contract and that the annual oral extensions of the contract between Buyer and Seller did not satisfy the statute of frauds requirement of subsection (3) of section 2-209, and thus, did not constitute a valid modification of the one-year contract duration term to a non-definite duration term.[77]

On appeal, the circuit court held that the contract was too ambiguous to conclude that it was not a requirements contract and that this question would have to be determined by the course of dealings and usage of trade, thus, it reversed the district court's grant of summary judgment in favor of Buyer.[78] On the question of whether the oral renewals of the purchase contract violated the statute of frauds requirement for contract modification under section 2-209(3), the court held that Indiana would most likely follow the majority interpretation of the statute of frauds requirement under subsection (3), which provides that all contract modifications be in writing (if the contract, as modified, falls under the statute of frauds) and is not limited to modifications of those contract terms required to be in writing under section 2-201 (*i.e.*, language evidencing a contract for sale; the requirement that the contract be signed; and the quantity requirement).[79] Although no Indiana court had interpreted section 2-209(3), the court assumed they would follow the majority rule because Indiana courts had a record of following the majority in prior decisions interpreting the U.C.C., and the "Indiana Legislature has affirmatively directed that, in construing the Code, the goal of uniformity ought to be a guidepost of decision."[80]

Having found that Indiana would follow the majority interpretation of the statute of frauds requirement of section 2-209(3), mandating that all terms of the contract be in writing for a valid modification, it reviewed

76. 186 F.3d 815, 39 U.C.C. Rep. Serv. 2d (West) 25 (7th Cir. 1999).

77. *Id.* at 816-17, 39 U.C.C. Rep. Serv. 2d (West) at 27.

78. *Id.* at 818, 39 U.C.C. Rep. Serv. 2d (West) at 29-30.

79. *Id.* at 820, 39 U.C.C. Rep. Serv. 2d (West) at 32-33.

80. *Id.*, 39 U.C.C. Rep. Serv. 2d (West) at 32-33 (citing the Indiana Legislature's verbatim adoption of U.C.C. § 1-102, Ind. Code § 26-1-1-102)).

printouts generated by Buyer that recorded updated purchase orders between Buyer and Seller. Buyer argued the printouts were insufficient to meet a "writing" under the statute of frauds because under Official Comment 3 to section 2-209, an "authenticated memo modifying an original contract is 'limited in its effect to the quantity of goods set forth in it.'"[81] It argued that all parts listed in the printouts had been paid for and it could not be held liable for parts beyond those listed in the printouts. The court rejected this argument noting that Comment 3 to section 2-209 did not apply to requirements contracts under section 2-309; thus, the quantities listed on the printout would not be applicable if the contract were found to be a requirements contract on remand.[82]

WARRANTIES

In *Yates v. Pitman Manufacturing Co.*,[83] the Virginia Supreme Court interpreted U.C.C. section 2-607(3)(a), which states: "Where a tender has been accepted . . . the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy."[84] In *Yates*, plaintiff was injured when an outrigger on a crane manufactured and sold by defendant, suddenly and without warning dropped onto his foot. At issue was whether the trial court erred in ruling that plaintiff was required to give defendant notice of breach of warranty as a prerequisite to recovery. The court noted that the statute clearly and unambiguously states that "the *buyer* must . . . notify the seller of [the] breach."[85] Because plaintiff was not the buyer of the crane, the court held that he was not required to give notice as a prerequisite to recovery.[86] Although the issue was one of first impression in Virginia, the court noted that its conclusion was "consistent with the decisions of the vast majority of other courts that have ruled on the issue."[87]

A second issue in *Yates* was whether defendant had created and breached an express warranty under section 2-313. At the time of the sale, defendant

81. *Id.* at 821, 39 U.C.C. Rep. Serv. 2d (West) at 33-34 (quoting Official Comment 3 to the Indiana Code § 26-2-209(3)).

82. *Id.*, 39 U.C.C. Rep. Serv. 2d (West) at 34. An additional issue raised regarding whether the printouts satisfied the statute of frauds requirement was whether they were signed by Navistar with the intent to authenticate as required under §§ 2-201 and 1-201(39). The court noted that some of the printouts were stamped or typed with the name "Navistar" and an issue of fact remained as to whether these represented intentions to authenticate and qualify as a signature. *Id.* at 821-22, 39 U.C.C. Rep. Serv. 2d (West) at 34-35.

83. 514 S.E.2d 605, 38 U.C.C . Rep. Serv. 2d (West) 386 (Va. 1999).

84. U.C.C. § 2-607(3)(a).

85. 514 S.E.2d at 607, 38 U.C.C. Rep. Serv. 2d (West) at 388. Note that U.C.C. § 2-103(1)(a) defines "buyer" as "a person who buys or contracts to buy goods."

86. *Id.*, 38 U.C.C. Rep. Serv. 2d (West) at 388.

87. *Id.*, 38 U.C.C. Rep. Serv. 2d (West) at 388 (citing Cole v. Keller Industries, Inc., 132 F.3d 1044, 1047 (4th Cir. 1998) and decisions cited therein).

certified that the crane met ANSI standard B30.5-1968, which required that outriggers be visible from the actuating position. Plaintiff presented evidence that the crane operator could see neither the outrigger nor a person who might come in contact with it. The trial court struck plaintiff's express warranty claim on the basis the ANSI certification was not part of the basis of the bargain. The court disagreed, holding that (i) an affirmation of fact, once made, is presumed to be part of the agreement and any fact that would remove it from the agreement requires clear affirmative proof, and (ii) the plaintiff need not show reliance on the affirmation to recover on an express warranty claim.[88] Accordingly, because defendant presented no evidence to remove its affirmation from the agreement, it was part of the basis of the bargain.[89]

Reliance also was an issue in *Lennar Homes, Inc. v. Masonite Corp.*[90] In this case, homeowners sued Masonite for breach of express warranty resulting from premature failure of defendant's siding. At issue was whether the plaintiff's admitted nonreliance on defendant's express written warranties barred recovery. The court noted that although reliance may be an issue in determining the *creation* of the warranty, it has no role in cases involving express written warranties. The court cited Official Comment 3 to section 2-313 for the point that reliance is not required to weave an express warranty "into the fabric of the agreement," and noted that, like other contract terms, liability for damages "depends on nothing more than the breach of the warranty."[91] The court concluded that

> [I]nterposing a reliance requirement, no doubt, would render consumer warranties illusory. The Court imagines that few consumers rely, in the strict sense, on warranties when making purchases. Rather, consumers' reliance materializes only at the moment of disappointed expectations. When an appliance breaks, for instance, one might peruse the owner's manual to discover a little-known warranty buried in the fine print. What matters most is the fact that the buyer has purchased the seller's promises as part of the bargain, . . . , and now seeks to invoke the promised terms when things have gone awry. Thus, Masonite cannot escape plain contractual terms by arguing that unsophisticated home buyers did not rely on their written promises.[92]

88. *Id.*, 38 U.C.C. Rep. Serv. 2d (West) at 389 (citing Daughtrey v. Ashe, 413 S.E.2d 336, 16 U.C.C. Rep. Serv. 2d (CBC) 294 (Va. 1992)).

89. *Id.*, 38 U.C.C. Rep. Serv. 2d (West) at 388.

90. 32 F. Supp. 2d 396, 38 U.C.C. Rep. Serv. 2d (West) 56 (E.D. La. 1998).

91. *Id.* at 399, 38 U.C.C. Rep. Serv. 2d (West) at 59-60 (quoting *Glacier General Assurance Co. v. Casualty Indem. Exchange*, 435 F. Supp. 855, 860 (D. Mont. 1977)).

92. *Id.* at 400, 38 U.C.C. Rep. Serv. 2d (West) at 60-61.

At issue in *In re Breast Implant Product Liability Litigation*[93], was whether health care providers should be liable either under strict products liability or for breach of warranty under U.C.C. Article 2 for injuries allegedly caused by breast implants. After surveying the strict liability cases, the Supreme Court of South Carolina concluded that health care providers who use products, such as breast implants, while treating patients are providing services, not goods.[94] Accordingly, they are not "sellers" to whom strict liability applies under the South Carolina statutory version of *Restatement (Second) of Torts* section 402A. As noted by the court:

> We hold that health care providers who perform breast implant procedures are, in essence, providing a service. Although the breast implant procedure requires the use of a product, the implant, the health care provider is fundamentally and predominantly offering a service. The provider must have medical knowledge and skill to conduct the procedure. He must advise the patient of the medical consequences and must recommend to the patient the preferable type of procedure. The product may not be purchased independently of the service. One does not "buy" a breast implant procedure in the same way as one would buy a product, such as a lawn-mower. At its heart, the breast implant procedure is a service and not a product.[95]

For the same reason, the court rejected plaintiff's express and implied warranty claims, holding that Article 2 warranties apply to transactions in goods, not to the services offered by the health care providers in this case.[96]

LIMITATION OF REMEDIES

This year has seen a flurry of cases focusing on contractually limited remedies. There is no doubt, of course, that the parties to an agreement may limit the remedies available on breach.[97] But when is the contractual remedy exclusive? What's more, when does a limited remedy "fail of its essential purpose,"[98] thus giving rise to the default remedies? Do these default remedies include full consequential damages? How can we tell?

The first of these problems appears—albeit framed unusually—in *Figgie International, Inc. v. Destileria Serralles, Inc.*[99] There Figgie supplied Serralles, a rum distributor, with bottle-labeling equipment. The equipment never worked properly, despite several months of failed attempts at repair. Eventually Serralles returned the equipment and Figgie refunded the purchase

93. 503 S.E.2d 445, 38 U.C.C. Rep. Serv. 2d (West) 49 (S.C. 1998).
94. *Id.* at 448, 38 U.C.C. Rep. Serv. 2d (West) at 53.
95. *Id.* at 448-49, 38 U.C.C. Rep. Serv. 2d (West) at __.
96. *Id.* at 452, 38 U.C.C. Rep. Serv. 2d (West) at 52-53.
97. U.C.C. § 2-719(1).
98. U.C.C. § 2-719(2).
99. 190 F.3d 252, 39 U.C.C. Rep. Serv. 2d (West) 275 (4th Cir. 1999).

price. Serralles then sued for the losses caused by the delay in obtaining replacement equipment and the equipment's failure to perform as promised.[100] Before the court could decide whether the contractual remedy failed of its essential purpose, it had to find a contractual limitation. Here proof problems abounded. Figgie had lost the original sales agreement, though it did introduce a copy of its usual agreement, which provided for repair, replacement, or refund as the exclusive remedies. Serralles provided a document lacking remedy limitations–but the document referred to terms on the reverse, and the reverse was blank. A copying error, said Figgie; the whole agreement, said Serralles.[101]

Not to worry, said the court. It found that the agreement, as defined in Article 1, included usage of trade.[102] Because Figgie provided uncontroverted evidence that its usual remedy limitation was common in the trade, the limitation was held part of the agreement.[103] Serralles objected that an *implied* term cannot possibly be the *express* statement of exclusivity required under Article 2.[104] Pointing once again to the Code provisions that make usage of trade part of an agreement, the court found that trade usage could create an exclusive remedy.[105] Because trade usage allowed for a refund, and as that was given, the court concluded that the exclusive remedy had not failed of its essential purpose and thus was enforceable.[106]

Once one determines that the exclusive remedy allows for refund, the court's conclusion seems unexceptionable. The problem is getting to the exclusive remedy via trade usage. After all, the language of section 2-719(1)(b) is plain, and the comment drives home that this subsection "creates a presumption that clauses prescribing remedies are cumulative rather than exclusive."[107] As Professor Anderson has observed, "one would suppose that the quite specific requirement in subsection (1)(b) that exclusivity of remedies be 'expressly agreed' would take priority over the Code's general concept of 'agreement'."[108] Courts have been picky about language that makes a damages limitation exclusive when it is spelled out in a writing; it seems incongruous, then, to allow sometimes nebulous trade

100. *Id.* at 254, 39 U.C.C. Rep. Serv. 2d (West) at 276.

101. *Id.* at 254-55, 39 U.C.C. Rep. Serv. 2d (West) at 276-77.

102. *Id.* at 257, 39 U.C.C. Rep. Serv. 2d (West) at 281; *see* U.C.C. §§ 1-201(3), 1-205(2-3).

103. 190 F.3d at 256, 39 U.C.C. Rep. Serv. 2d (West) at 279.

104. *Id.*, 39 U.C.C. Rep. Serv. 2d (West) at 279; *see also* U.C.C. § 2-719(1)(b) ("resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.").

105. 190 F.3d at 257, 39 U.C.C. Rep. Serv. 2d (West) at 280.

106. *Id.* at 258, 39 U.C.C. Rep. Serv. 2d (West) at 281-82.

107. U.C.C. § 2-719 cmt. 2.

108. 2 ROY RYDEN ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 12:05 (1992); *see also, e.g.*, Mark S. Kloster, Comment, *Trade Usage, Exclusive Remedies, and U.C.C. Section 2-719(1)(b)*, 25 HOUS. L. REV. 363 (1988) (criticizing courts that employ usage of trade to create exclusive remedies).

usage to create exclusivity.[109] Still, *Figgie* is in at least plentiful, if not good, company.[110]

Another knotty problem that has exercised courts this year comes when a limited remedy fails of its essential purpose. If the agreement also contains a bar on consequential damages, is the bar enforceable? On the one hand, section 2-719(2) expressly states that "remedy may be had as provided in this Act" and the accompanying comment states that if a remedy limitation fails of its essential purpose, "it must give way to the general remedy provisions of this Article."[111] On the other hand, section 2-719(3) lays out a distinct test for the enforceability of consequential damages disclaimers, one turning on unconscionability rather than on failure of essential purpose.[112] Comment 3 suggests that these disclaimers "are merely an allocation of unknown or undeterminable risks" and should, if not unconscionable, be valid.[113] This textual confusion has given rise to much commentary and a good many judicial tests, some of which appear in this year's crop of decisions.[114]

One example of treating the limited remedy and consequential damages disclaimer independently is *Rheem Manufacturing Co. v. Phelps Heating and Air Conditioning, Inc.*[115] Rheem, a manufacturer of furnaces, supplied a limited warranty with a remedy confined to providing replacement parts and, if no replacements were available, a credit toward the purchase of a new furnace. The contract disclaimed all consequential damages. Phelps, a heating contractor, found that its customers had problems with the Rheem furnaces. It obtained some service labor credits from Federated, the Rheem distributor from which Phelps purchased its furnaces, but eventually Rheem announced that it would grant no more service credits. Faced with a great deal of uncompensated time, Phelps sued Rheem and Fed-

109. *See, e.g.*, Northern States Power Co. v. ITT Meyer Indus., 777 F.2d 405, 42 U.C.C. Rep. Serv. (Callaghan) 1 (8th Cir. 1985); Upjohn Co. v. Rachelle Labs., Inc., 661 F.2d 1105, 32 U.C.C. Rep. Serv. (Callaghan) 747 (6th Cir. 1981); Parsons v. Motor Homes of Am., Inc., 465 So. 2d 1285, 40 U.C.C. Rep. Serv. (Callaghan) 1264 (Fla. Dist. Ct. App. 1985).

110. *See, e.g.*, Western Indus., Inc. v. Newcor Canada Ltd., 739 F.2d 1198, 38 U.C.C. Rep. Serv. (Callaghan) 1458 (7th Cir. 1984); Transamerica Oil Corp. v. Lynes, Inc., 723 F.2d 758, 766, 37 U.C.C. Rep. Serv. (Callaghan) 1076 (10th Cir. 1983); Posttape Assoc. v. Eastman Kodak Co., 537 F.2d 751, 756-57, 19 U.C.C. Rep. Serv. (Callaghan) 832 (3d Cir. 1976).

111. U.C.C. § 2-719(2) & cmt. 1.

112. U.C.C. § 2-719(3).

113. U.C.C. § 2-719 cmt. 3.

114. *See, e.g.*, Howard Foss, *When to Apply the Doctrine of Failure of Essential Purpose to an Exclusion of Consequential Damages: An Objective Approach*, 551 DUQ. L. REV. 551 (1987); Henry Mather, *Consequential Damages When Exclusive Repair Remedies Fail: Uniform Commercial Code Section 2-719*, 38 S.C. L. REV. 673 (1988); Kathryn I. Murtagh, Note, *UCC Section 2-719: Limited Remedies and Consequential Damages Exclusions*, 74 CORNELL L. REV. 359 (1989).

115. 714 N.E.2d 1218, 39 U.C.C. Rep. Serv. 2d (West) 436 (Ind. Ct. App. 1999); *see also, e.g.*, Northeastern Power Co. v. Balcke-Durr, Inc., 39 U.C.C. Rep. Serv. 2d (West) 713 (E.D. Pa. 1999); Laidlaw Transp., Inc. v. Helena Chem. Co., 680 N.Y.S.2d 365, 39 U.C.C. Rep. Serv. 2d (West) 98 (N.Y. App. Div. 1998).

erated. Rheem sought summary judgment, which was denied on the consequential damages claims; accordingly, Rheem sought interlocutory review, which was allowed.[116] The appellate court, after canvassing the pertinent authority, relied particularly on the two different standards contained in section 2-719 and on the general idea of freedom of contract, along with a related skepticism about judicial remaking of contracts. It thus concluded that the "independent" approach, adopted by most courts and advocated by Professors White and Summers, was the best.[117]

Just across the border, the Court of Appeals for the Seventh Circuit Court took rather a different view. In *Sunny Industries, Inc. v. Rockwell International Corp.*,[118] the court was faced with a contract for the sale of a high-volume printing press capable of running five rolls of paper at once. The press never worked properly, at most producing less than a quarter of the promised output. After many attempts to repair the printing press, Sunny, the buyer, declined to make further payments and Rockwell declined to make further attempts to repair. The contract contained a clause limiting Rockwell's liability to repair or replacement of nonconforming parts or machinery. Rockwell also had the right to rescind the contract and refund the amounts paid by Sunny. Because Rockwell failed to repair or replace the press, and because Rockwell did not elect to rescind the contract, the court held that Rockwell's limited remedy failed of its essential purpose under section 2-719(2).[119] The contract also contained a clause barring Sunny from consequential damages. As before, the court had to decide whether the consequential damages exclusion would be given effect after the failure of the limited remedy clause. The court acknowledged that some courts automatically invalidate consequential damages disclaimers when a contractually limited remedy fails of its essential purpose.[120] It pointed as well to the line of cases that find limited damages and the bar on consequentials independent.[121] In the end, it adhered to its earlier authority that rejected both absolute views in favor of case-by-case analysis.[122] This approach requires courts to ascertain the parties' intent to allocate risk; while it is possible that the parties meant to bar consequential

116. 714 N.E.2d at 1221-22, 39 U.C.C. Rep. Serv. 2d (West) at 440-42.

117. *Id.* at 1223-27, 39 U.C.C. Rep. Serv. 2d (West) at 444-50; *see also* 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 12.10c (4th ed. 1995).

118. 38 U.C.C. Rep. Serv. 2d (West) 827 (7th Cir. 1999) (per curiam) (unpublished decision).

119. *Id.* at 839-41.

120. *Id.*; *see also, e.g.*, R.W. Murray Co. v. Shatterproof Glass Corp., 758 F.2d 266, 40 U.C.C. Rep. Serv. (Callaghan) 1283 (8th Cir. 1985); Koehring Co. v. A.P.I., Inc., 369 F. Supp. 882, 14 U.C.C. Rep. Serv. (Callaghan) 368 (E.D. Mich. 1977); Page v. Dobbs Mobile Bay, Inc., 599 So. 2d 38, 18 U.C.C. Rep. Serv. 2d (CBC) 720 (Ala. Ct. App. 1992).

121. 38 U.C.C. Rep. Serv. 2d (West) at 842-43.

122. *Id.* at 843; *see also, e.g.*, Smith v. Navistar Int'l Transp. Corp., 957 F.2d 1439, 17 U.C.C. Rep. Serv. 2d (CBC) 84 (7th Cir. 1992); AES Tech. Sys., Inc. v. Coherent Radiation, 583 F.2d 933, 24 U.C.C. Rep. Serv. (Callaghan) 861 (7th Cir. 1978).

damages, whatever the state of the rest of the agreed-upon remedies, it is also possible that the parties meant to allow full remedies if the main agreed-upon remedy failed. Accordingly, the court looks to such things as the relative bargaining power, the nature of the goods, and the exact language to determine whether the risk allocation provisions are entwined or independent.[123] Given the fact-dependence of this inquiry, the court remanded the matter to the trial court for further proceedings.[124]

The courts treating the failure of essential purpose inquiry independently from the consequential damages inquiry probably are, as the *Rheem* court observed, in the majority. One may ask, however, whether they should be. Invocations of freedom of contract rather beg the question, for they assume that the parties intended to give independent effect to the consequential damages disclaimer. On the other hand, automatically striking consequential damages disclaimers may have the effect of inefficiently forcing contracting parties wanting limited consequential damages to subsidize those who want more.[125] The *Rheem* approach is one of nuanced contract interpretation, equally free from reflexive rules of independence or dependence. If the parties know best how they wish to allocate risk, then modern, fully contextual analysis should be used to give effect to the parties' intent.[126]

Turning briefly to seller's remedies, we find an inventive use of incidental damages to get around the Fair Debt Collection Practices Act (FDCPA). In *Tuttle v. Equifax Check*,[127] Tuttle, a customer at a hardware store, wrote a check in payment for his merchandise. The store had contracted for Equifax to determine whether checks should be accepted. If Equifax authorized a check that was later dishonored, Equifax would purchase the check from the merchant at face value and then attempt to collect from the customer on its own behalf. That is exactly what happened here. Equifax sought to collect not just the face value of the check from Mr. Tuttle but also a twenty dollar service fee. Tuttle paid both the value of

123. *Id.* at 844; *see also, e.g.*, Waters v. Massey-Ferguson, Inc., 775 F.2d 587, 591-92, 41 U.C.C. Rep. Serv. (Callaghan) 1553, 1557-61 (4th Cir. 1985); Fiorito Bros., Inc. v. Fruehauf Corp., 747 F.2d 1309, 1315, 39 U.C.C. Rep. Serv. (Callaghan) 1298, 1305-06 (9th Cir. 1984); AES Tech. Sys., Inc. v. Coherent Radiation, 583 F.2d 933, 941, 24 U.C.C. Rep. Serv. (Callaghan) 861, 871-72 (7th Cir. 1978).

124. *Id.* at 843-44.

125. *See* Daniel Scott Schecter, Note, *Consequential Damage Limitations and Cross-Subsidization: An Independent Approach to Uniform Commercial Code Section 2-719*, 66 S. CAL. L. REV. 1273 (1993). Schecter actually opposes both the dependent approach and the hybrid approach, but his rejection of the latter is based on the question-begging assumption that the parties intended the clauses to act independently. *See id.* at 1283-86.

126. An observation made by many. *See, e.g.*, 1 ANDERSON, *supra* note 108, § 12:14; Foss, *supra* note 114; Mather, *supra* note 114; Murtagh, Note, *supra* note 114. *But see* 2 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-719:3, at 2-629 to 2-630 (supporting independent approach); 1 WHITE & SUMMERS, *supra* note 117, § 12-10c (same).

127. 190 F.3d 9, 39 U.C.C. Rep. Serv. 2d (West) 410 (2d Cir. 1999).

the check and the services fee, but then sued, alleging a violation of the FDCPA. At trial, the jury found for Equifax; Tuttle appealed.

Why is this case in the U.C.C. survey? The FDCPA provides that a debt collector may not recover service charges unless the charges are either allowed expressly by the agreement creating the debt or permitted by law.[128] One ground for the decision, and an independent ground for affirmance, was express agreement; there were facts to support Tuttle's knowledge at the time of purchase of the bad check fee.[129] The alternative ground is the pertinent one for us. The Court of Appeals for the Second Circuit, after looking briefly at a Connecticut statute on dishonored checks with which Equifax did not comply, fastened on section 2-710, the provision detailing the seller's incidental damages. It reasoned that a person in the position of a seller may, as provided in section 2-707, recover incidental damages. In turn, the comment to 2-707 sweeps in "a financing agency which has acquired documents . . . by discounting a draft for the seller . . . ."[130] Equifax did so under its agreement with the hardware store and, therefore, could recover "commercially reasonable charges, expenses or commissions . . . resulting from the breach."[131] Equifax provided evidence that its collection costs were slightly over twenty dollars; accordingly, the twenty dollar fee fell within the scope of incidental damages and could be recovered under the FDCPA.[132]

This decision breaks no new ground on incidental damages, as other courts have held that collection costs are recoverable under section 2-710.[133] The decision is more interesting—and apparently novel—because of its FDCPA ramifications. The effect seems to be that check collection agencies can add their reasonable costs of collection to the face value of the check written as part of an Article 2 transaction even if the check's writer did not know that a fee would be charged if the check was dishonored. The result flows logically from the statute. Whether this will prove to be a large loophole is doubtful. Because the fees must be reasonable, the agency or factor cannot profit directly from the fee.

ECONOMIC LOSS DOCTRINE

Courts continue to struggle with defining the line between tort and contract law in cases where losses arise from defects in goods sold. To

128. 15 U.S.C. § 1692f(1).

129. 190 F.3d at 15, 39 U.C.C. Rep. Serv. 2d (West) at 416.

130. U.C.C. § 2-707 cmt. "Financing agency" is defined as one "who in the ordinary course of business . . . by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft. . . ." U.C.C. § 2-104(2).

131. U.C.C. § 2-710.

132. 190 F.3d at 14-15, 39 U.C.C. Rep. Serv. 2d (West) at 416-17.

133. *See, e.g.*, Charles Adams Importers, Ltd. v. Dana, 503 N.Y.S.2d 53 (App. Div. 1986); Mace Indus., Inc. v. Paddock Pool Equip. Co., 339 S.E.2d 527, 42 U.C.C. Rep. Serv. (Callaghan) 825 (S.C. Ct. App. 1986).

make the distinction, most courts have adopted the economic loss doctrine. This judicially created doctrine provides that a purchaser of goods is limited to its remedies under the U.C.C. and the contract if the damages sustained as a result of a defect in the product are solely economic in nature.[134] Economic loss includes damage to the product itself and damages for loss of use of the product but do not include personal injury or damage to other property.[135] The rule is based on the premise that these types of economic losses are foreseeable and should be allocated by the parties in the contract.[136]

This rule is well accepted in commercial cases, however courts have not agreed as to its application to a consumer transaction.[137] Two courts, the Wisconsin and North Dakota Supreme Courts, aligned their states with those jurisdictions that have applied the economic loss doctrine to consumer transactions.[138] In both cases, a defective ignition switch in a Ford vehicle caused a fire, destroying the vehicle. Both consumers were paid for their losses by their insurance companies, who then filed subrogation actions seeking damages for the loss of the truck from Ford Motor Co., the manufacturer. The courts agreed that the policies behind the economic loss doctrine, as applied in commercial transactions, applied equally to consumer transactions.[139] In particular, the distinct functions of tort and contract law are equally important when the goods are sold to a consumer. In the courts' view, contract law is concerned with fulfilling the economic expectations of the parties,[140] while tort law protects a societal interest in shifting the risk of unexpected harm caused by a dangerous product to the seller or manufacturer.[141] Where there is no harm to persons or property other than the product that was involved, the societal interest is min-

134. State Farm Mutual Automobile Ins. Co. v. Ford Motor Co., 592 N.W.2d 201, 205, 38 U.C.C. Rep. Serv. 2d (West) 751, 754 (Wis. 1999).

135. *See, e.g.*, Hapka v. Paquin Farms, 458 N.W.2d 683, 688, 12 U.C.C. Rep. Serv. 2d (Callaghan) 60, 66 (Minn. 1990); Biese v. Parker Coatings, Inc., 588 N.W.2d 312, 315, 39 U.C.C. Rep. Serv. 2d (West) 64, 66 (Wis. Ct. App. 1998).

136. *See* Henry D. Gabriel, Thomas J. McCarthy, Linda Rusch, *General Provisions and Sales*, 51 BUS. LAW 1361, 1366 (1996) (explaining assumptions underlying economic loss doctrine); *see also* Diamond Surface, Inc. v. State Cement Plant Comm'n, 583 N.W.2d 155, 161, 38 U.C.C. Rep. Serv. 2d (West) 391, 399 (S.D. 1998).

137. *See* Thomas J. McCarthy, Patricia A. Tauchert, John D. Wladis, Mark E. Roszkowski, *Sales*, 53 BUS. LAW. 1461, 1475 (1998) (noting courts split in deciding whether economic loss rule should apply in a consumer transaction).

138. Clarys v. Ford Motor Co., 592 N.W.2d 573, 39 U.C.C. Rep. Serv. 2d (West) 72 (N.D. 1999): State Farm Mutual Automobile Ins. Co. v. Ford Motor Co., 592 N.W.2d 201, 205, 38 U.C.C. Rep. Serv. 2d (West) 751, 754 (Wis. 1999).

139. *Clarys*, 592 N.W.2d at 573, 39 U.C.C. Rep. Serv. 2d (West) at 72; *State Farm*, 592 N.W.2d at 205, 38 U.C.C. Rep. Serv. 2d (West) at 753.

140. *Clarys*, 592 N.W.2d at 575, 39 U.C.C. Rep. Serv. 2d (West) at 75; *State Farm*, 592 N.W.2d at 206, 38 U.C.C. Rep. Serv. 2d (West) at 755.

141. *Clarys*, 592 N.W.2d at 575, 39 U.C.C. Rep. Serv. 2d (West) at 75-76; *State Farm*, 592 N.W.2d at 205-06, 38 U.C.C. Rep. Serv. 2d (West) at 754.

imal.[142] In those situations, the parties are free to—and should—allocate the risk of economic losses caused by the good failing to perform as expected in their contract.[143] The buyer should not be permitted to use tort law to circumvent the allocation of risk agreed to by the parties.[144] The economic loss rule preserves a balance struck by tort and contract law between the risks assumed by a manufacturer and seller and the purchaser by recognizing the distinction between contract and tort remedies.[145]

Several courts did address potential exceptions to the economic loss doctrine. In two additional defective ignition cases between insurance companies as subrogees and Ford Motor Co., the Wisconsin Supreme Court and the Iowa Supreme Court disagreed as to whether there was an exception for sudden and calamitous losses. In *American Fire & Casualty Co. v. Ford Motor Co.*,[146] the Iowa Supreme Court held that the economic loss doctrine did not prevent recovery in tort of economic losses for the damage to the vehicle sold and its contents where the loss was caused by a "sudden or dangerous occurrence."[147] This court rejected a bright-line test focusing solely on whether the loss was economic loss or physical harm.[148] Instead, the court considered several factors, including nature of the defect, the type of risk and manner of injury, to determine where the line between contract and tort should be drawn.[149] Where the loss related to a buyer's disappointed expectations, recovery would be limited to that provided by contract law.[150] However, tort law provides a remedy where a sudden or dangerous occurrence created by a "genuine hazard in the nature of a product defect" causes the harm.[151] The court found that in prior economic loss cases where tort recovery was prohibited, there was no danger caused by the product.[152] Finding that a truck which started itself on fire was more of a danger than a disappointment, the court held that recovery in tort was appropriate.[153]

142. *Clarys*, 592 N.W.2d at 575, 39 U.C.C. Rep. Serv. 2d (West) at 75; *State Farm*, 592 N.W.2d at 207, 38 U.C.C. Rep. Serv. 2d (West) at 756.

143. *Clarys*, 592 N.W.2d at 573, 39 U.C.C. Rep. Serv. 2d (West) at 72; *State Farm*, 592 N.W.2d at 208, 38 U.C.C. Rep. Serv. 2d (West) at 758, 762.

144. *See Clarys*, 592 N.W.2d at 576, 39 U.C.C. Rep. Serv. 2d (West) at 77-78; *State Farm*, 592 N.W.2d at 210-11, 38 U.C.C. Rep. Serv. 2d (West) at 762-63.

145. *Clarys*, 592 N.W.2d at 576, 39 U.C.C. Rep. Serv. 2d (West) at 77 (quoting Casa Clara Condominium Ass'n, v. Charley Toppino & Sons, Inc., 620 So.2d 1244, 1246 (Fla. 1993)); *State Farm*, 592 N.W.2d at 209, 38 U.C.C. Rep. Serv. 2d (West) at 760.

146. 588 N.W.2d 437, 37 U.C.C. Rep. Serv. 2d (West) 601 (Iowa 1999).

147. *Id.* at 439, 37 U.C.C. Rep. Serv. 2d (West) at 603.

148. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 602.

149. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 602.

150. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 602-03.

151. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 603 (emphasis omitted).

152. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 603.

153. *Id.* at 440, 37 U.C.C. Rep. Serv. 2d (West) at 603.

The Wisconsin Supreme Court rejected this exception in *General Casualty Co. of Wisconsin v. Ford Motor Co.*[154], aligning itself with the majority of courts which have addressed the issue. The court, relying on the reasoning of the United States Supreme Court in *East River S.S. Corp. v. Transamerica Delaval,*[155] held that where the loss is to the product itself, without physical injury to persons or other property, the loss is purely economic and therefore a concern of contract, not tort law.[156] The court noted that the proposed exception was routed in safety concerns for an endangered user, but found that these concerns were adequately protected by holding manufacturers liable in tort for personal injury and property damage to other property when that does occur.[157] The court, consistent with its opinion on the applicability of the doctrine to consumer transactions that was decided the same day,[158] found that applying the "sudden and calamitous" exception and permitting recovery in tort for purely economic loss would destroy the risk allocation established by the parties' contract and the U.C.C.[159] Finding this result contrary to the policies behind the distinction between tort and contract law and inconsistent with the majority rule, the court refused to recognize the "sudden and calamitous" exception to the economic loss doctrine.[160]

In considering another exception to the economic loss doctrine, Judge Adelman of the Eastern District of Wisconsin, in *Budgetel Inns, Inc. v. Micros Systems, Inc.,(Budgetel II)*[161] rejected the position of other judges in the district and held that the economic loss doctrine, under Wisconsin law, would not bar a claim for fraud in the inducement.[162] In *Budgetel II,* the purchaser of software alleged it entered into the contract to purchase computer software because of promises, made by the seller to service and upgrade the software, which the seller had no intention of performing.[163] The seller moved to dismiss the claim based on the economic loss doctrine. Finding the Wisconsin courts would not apply the economic loss doctrine for claims of fraud in the inducement, Judge Adelman denied the motion to dis-

154. 592 N.W.2d 198, 38 U.C.C. Rep. Serv. 2d (West) 779 (Wis. 1999).

155. 476 U.S. 858, 1 U.C.C. Rep. Serv. 2d (Callaghan) 609 (1986).

156. *General Casualty Co.*, 592 N.W.2d at 200, 38 U.C.C. Rep. Serv. 2d (West) at 782.

157. *Id.* at 200-01, 38 U.C.C. Rep. Serv. 2d (West) at 783.

158. *See* State Farm Mutual Automobile Ins. Co. v. Ford Motor Co., 592 N.W.2d 201, 38 U.C.C. Rep. Serv. 2d (West) 751 (Wis. 1999).

159. *General Casualty Co.*, 592 N.W.2d at 201, 38 U.C.C. Rep. Serv. 2d (West) at 783.

160. *Id.*, 38 U.C.C. Rep. Serv. 2d (West) at 783.

161. 34 F. Supp. 2d 720, 37 U.C.C. Rep. Serv. 2d (West) 993 (E.D. Wis. 1999).

162. *Id.* at 724, 37 U.C.C. Rep. Serv. 2d (West) at 997.

163. Budgetel Inns, Inc. v. Micro Systems, Inc. (*Budgetel I*), 8 F. Supp. 2d 1137, 1140, 35 U.C.C. Rep. Serv. 2d (West) 1073. Shortly after entering into the contract, Micros Systems, the seller, acquired Fidelio Software Company and began promoting its software systems and reduced support for the system Micros sold the Budgetel. Budgetel alleged Micros knew of this acquisition prior to the sale. *Id.*, 35 U.C.C. Rep. Serv. 2d (West) at 1074.

miss[164] and defendants' motion for reconsideration.[165] In this court's view, permitting fraud in the inducement claims only for matters extraneous to the contract, as the seller urged, would have the practical effect of eliminating the exception altogether because any allegation that the buyer was fraudulently induced into entering the contract would require reference to the contract itself.[166] Moreover, the court recognized that fraud in the inducement claims arise independent of the contract because they necessarily occur before the contract is entered into and involve the common law duty of honesty, as opposed to a duty to perform under the contract.[167] Finally, the policy supporting the economic loss doctrine of freedom of contracting parties to allocate risk would not be undermined by permitting tort recovery for fraud claims where one party is lying.[168] The court noted that negotiations in which one party is lying are not the free and open bargaining the economic loss doctrine seeks to encourage.[169] The court, therefore, refused to extend the protections of the economic loss doctrine to sellers defending claims of fraud in the inducement.

Several months after *Budgetel II*, however, another judge in the Eastern District of Wisconsin refused to extend the fraud exception as far as Judge Adelman, holding that intentional misrepresentation claims were barred by the economic loss doctrine unless the misrepresentation was extraneous to the contract and did not concern the quality or characteristics of the good sold or otherwise relate to performance of the contract.[170] This court noted that misrepresentations as to contract performance or quality of the goods should be settled as a matter of warranty law under the U.C.C.[171]

164. *Id.* at 1139, 35 U.C.C. Rep. Serv.2d (West) at 1073.

165. *Budgetel II*, 34 F. Supp. 2d at 725, 37 U.C.C. Rep. Serv. 2d (West) at 1000.

166. *Id.* at 723, 37 U.C.C. Rep. Serv. 2d (West) at 995.

167. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 996. Pursuant to § 1-103, the law of fraud is supposed to supplement the provisions of the U.C.C.

168. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 996.

169. *Id.*, 37 U.C.C. Rep. Serv. 2d (West) at 996.

170. Rich Products Corp v. Kemutec, Inc., 66 F. Supp. 2d 937, 977-79 (E.D. Wis. 1999)

171. *Id.* at 979-80.