LAW101DL, COMMERCIAL LAW, Secured Transactions, Professor Widen **[draft: 2/17/2020 8:23 AM]**

LECTURE NOTES: CHAPTER 10, TEXT P. 677 and ff.

OUR BUYER AND OTHERS SUE "UPSTREAM" WHEN DAMAGED BY DEFECTIVE GOODS (INCLUDING PRODUCTS LIABILITY)

Chapter 10 needs to be considered against the backdrop of three important cases: MacPherson v. Buick, 217 N.Y. 382 (1916); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358 (1960); and, Goddard v. General Motors Corp., 60 Ohio St. 2d 41 (1979). All three cases deal with attempts to limit liability of a manufacturer for defects in an automobile purchased by a customer from a dealer. The dealer purchased the auto from the manufacturer. The dealer sold the auto to the customer. [Note: the references in TEXT which refer to MacPherson and Henningsen, sometimes in bold face type.]

In its simple form: OUR SUPPLIER [manufacturer] -> [sells goods to] -> OUR STORE [dealer]. OUR STORE [dealer] -> [sells goods to] -> OUR BUYER [customer]. As a matter of strategy, OUR BUYER wants to sue OUR SUPPLIER (perhaps OUR SUPPLIER is a "deep pocket" and OUR STORE is not sound financially). The damages sought by OUR BUYER might be of two sorts: economic damages; or, damages for personal injury. Further, OUR BUYER might be a business entity or a consumer. In all cases, OUR BUYER is not in "privity" with OUR SUPPLIER. OUR BUYER is in privity with OUR STORE.

Historically, the common law did not allow OUR BUYER to sue OUR SUPPLIER for breach of warranty on these facts because of lack of privity between them. In brief, OUR BUYER did not have a contract with OUR SUPPLIER, it only had a contract with OUR STORE. This lack of a contract (i.e. resulting in lack of privity) meant that OUR BUYER could not sue OUR SUPPLIER for breach of a warranty. Conceptually, OUR BUYER might (in an appropriate case) seek to sue OUR SUPPLIER on the basis that OUR BUYER was an intended third-party beneficiary of a warranty made by OUR SUPPLIER to OUR STORE (but such an approach could be hit or miss--particularly in a case where the only damages claimed are economic damages).

Of course, a contract claim is not the only basis on which liability might be asserted. OUR BUYER might sue OUR SUPPLIER on a tort theory. The structure of the claim in tort is as follows: OUR SUPPLIER negligently manufactured the auto and placed the auto into the stream of commerce. OUR SUPPLIER owed a duty to potential purchasers in the stream of commerce to use reasonable care in the manufacture of its products. OUR SUPPLIER breached this duty of care when it made the defective auto. It was foreseeable that customers such as OUR BUYER would end up using the auto and that harm would result. Harm resulted--with the harm being proximately caused by the breach of the duty of care. "Proximate cause" existed at law (not on some deep metaphysical chain of being) simply because the harm was foreseeable. The tort theory is broad enough to allow suit not only by OUR BUYER but also by, at least some, third parties--such as passengers in the auto purchased by OUR BUYER.

At common law, the lack of privity in contract law functioned as a liability limiting device for sellers of goods. How did the above tort theory fare as an "end around" this contract law imposed liability limitation? Here lies the importance of MacPherson v. Buick. In MacPherson, Judge Cardozo held that because Buick had been found negligent in its manufacture of the auto, it was liable for MacPherson's injuries notwithstanding the fact that there was no contractual relationship between the customer and the manufacturer. (In this case, MacPherson sued only Buick and not its dealer, Close Brothers). The injury in MacPherson resulted from the collapse of a wheel which had been constructed with defective wood. Buick had purchased this wheel from a reputable supplier of wheels--but Buick was responsible for the finished product and had a duty of inspection. The fact that the defect arose from the negligence of its supplier did not absolve it from liability.

What did manufacturers, such as OUR SUPPLIER, do in response to the unwelcome legal development in MacPherson which created liability in the absence of privity? The conventional story is that, at least in the case of auto makers, manufacturers made an attempt to disclaim tort liability by use of express contract warranties which limited liability. How did this attempt to limit liability by contract fare? Here is the importance of Henningsen. (Recall that, as between two contracting parties in privity, the general rule is that warranties may be limited or disclaimed--e.g. with a limitation to "repair or replace" or with a blanket "as is" disclaimer of all warranties.) Professor Goldberg explained:

[start quote]

Ms. Henningsen was injured when the steering mechanism of hernew Plymouth failed. Plymouth had included language in its contract limiting its liability to repair or replacement. According to the court, Chrysler

(Plymouth's parent) argued that the language precluded it being held liable for her physical injuries. The disclaimer, Judge Francis suggested, was a deliberate industry ploy to avoid liability: "The judicial process has recognized a right to recover damages for personal injuries arising from a breach of that warranty. The disclaimer of the implied warranty and exclusion of all obligations except those specifically assumed by the express warranty signify a studied effort to frustrate that protection." After much anguished reasoning, he concluded that the damage limitation was against public policy and therefore void.

Victor P. Goldberg, The MacPherson-Henningsen Puzzle, Columbia Law and Economics Working Paper No. 570 (2017).

Note that in MacPherson, the basic theory of liability sounded in tort. Though Judge Cardozo had pioneered manufacturer liability to customers based on tort principles, in Henningsen, the court's language sounds in contract: "The judicial process has recognized a right to recover damages for personal injuries arising from a breach of that warranty." The contract basis for liability comes directly from the court's holding:

"Accordingly, we hold that under modern marketing conditions, when a manufacturer puts a new automobile in the stream of trade and promotes its purchase by the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of the ultimate purchaser. Absence of agency between the manufacturer and the dealer who makes the ultimate sale is immaterial."

Both MacPherson and Henningsen preceded enactment of UCC Article 2. Following enactment of Article 2, three types of questions commonly arise. As background, recall that Article 2 specifically allows a seller to limit

the warranties available to a buyer. There are three important restrictions on this ability to contractually limit liability.

(1) In the case of a consumer transaction, a limitation on consequential damages for personal injury is presumptively unconscionable. This presumption of unconscionability for a limitation on consequential damages for personal injury basically codifies the core idea behind Henningsen.

(2) The limitation of remedies cannot be such as to cause remedies to fail of their essential purpose. Here is where Goddard v. General Motors Corp. comes into play. It describes a case in which repeated attempts to repair a vehicle failed. The court allowed a suit to overturn the sale because the contractual limitation to repair had caused the remedy to fail of its essential purpose. Plaintiffs often try to overcome a contractual limitation of a remedy on the idea that "enough is enough"--not unlike the idea behind revocation of an acceptance based upon the expectation of a cure which is not provided seasonably.

(3) Article 2 supplements the common law with s.2-318 which creates a form of third party beneficiary protection in a limited set of circumstances (with three different options for states to enact [TEXT P. 681]). One might have thought that codification allowing a non-privity plaintiff to sue for breach of an express or implied warranty would simply be a codification of MacPherson. As we will see, the UCC enactment is NOT a substitute for the core idea of MacPherson (particularly in its more restrictive versions suggested for enactment by the states). Consider the different versions.

[begin statute insert]

§ 2-318. Third Party Beneficiaries of Warranties Express or Implied.[Note: If this Act is introduced in the Congress of the United States this section should be omitted. (States to select one alternative.)]

Alternative A

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Alternative B

A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Alternative C

A seller's warranty whether express or implied extends to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends. [end statute insert]

Alternatives A and B to s.2-318 protect natural persons against personal injury (with A being narrower than B in its scope of coverage). Only alternative C arguably covers businesses for economic damages (and even this coverage is uncertain [TEXT P. 681]). Unfortunately, it is not clear on the drafting of s.2-318 whether and to what extent it covers situations like MacPherson and Henningsen. To see the drafting problem, add two other parties to our basic fact pattern: FAMILY MEMBER and BYSTANDER.

Under Alternative A, if FAMILY MEMBER is injured while driving an auto which OUR BUYER purchased from OUR STORE, it is pretty clear that FAMILY MEMBER could sue OUR STORE for breach of any warranty given in the sale of the auto from OUR STORE to OUR BUYER. This is because the "seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer." The key word here is "his" as in "his buyer." The warranty described in s.2-318, version A, is the warranty made by OUR STORE when it sold the auto to OUR BUYER. FAMILY MEMBER can pretty clearly sue OUR STORE for a breach of this warranty.

Note that OUR STORE should not be able to disclaim liability for personal injury in such a case. Per s.2-319(3), "[l]imitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not." The auto in this case is a consumer good, so any attempt to limit liability for personal injury is highly problematic (and of most doubtful enforceability). However, a close reading of Alternative A reveals that it may not provide for FAMILY MEMBER to claim as a third-party beneficiary against OUR SUPPLIER because OUR SUPPLIER is not the party who

made the "seller's warranty" referred to in this section. [This is the concern expressed at TEXT P. 680-681 when it states that it "may be limited to the problem of lack of privity when a plaintiff [] sues Our Store because of injury resulting from goods Our Store sold Our Buyer"].

When FAMILY MEMBER sues OUR STORE the situation is considered a case of a "horizontal" non-privity plaintiff. When FAMILY MEMBER wants to sue OUR SUPPLIER up the supply chain, FAMILY MEMBER is considered a "vertical" non-privity plaintiff. A number of cases, including Bellman v. NXP Semiconductors USA, Inc., 248 F. Supp. 3d 1081, 1151 (D.N.M. 2017) [TEXT P. 681], hold that s.2-318, version A, creates an exception to the privity requirement for the "horizontal" case when FAMILY MEMBER wants to sue OUR STORE (i.e. it can sue as a statutory third-party beneficiary relying on s.2-318, version A), but not when FAMILY MEMBER wants to sue "vertically" upstream against OUR SUPPLIER (or another person in the chain of supply).

It is not claimed that such a "vertical" suit is not possible. Rather, the ability to pursue such a suit is left to case law development by the courts, and is not solved by reference to s.2-318. Comment 3 to s. 2-318 states that "the section ... is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain."

Under Alternative B, the scope of protection for a non-privity horizontal plaintiff is expanded to persons beyond family, household or guests to any person who may reasonably be expected to use, consume or be affected by the goods. Thus, BYSTANDER might sue OUR STORE if BYSTANDER suffered a personal injury from a defective product purchased by OUR BUYER. Again, it must be a personal injury, rather than an economic

injury, suffered by a natural person. Note, however, the absence of the limiting language "his buyer" in Alternative B.

[begin statute insert]

Alternative B

A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

[end statute insert]

The absence of the "his buyer" language leaves open the possibility that either FAMILY MEMBER or BYSTANDER might be a vertical non-privity plaintiff against OUR SUPPLIER, and not simply a horizontal non-privity plaintiff against OUR STORE. One way to look at the difference is to think of Alternative A as requiring that the plaintiff must piggy-back or claim through OUR BUYER. It can piggy-back on the warranty made to OUR BUYER, but only if there is a family or similar relationship between the plaintiff and OUR BUYER.

Alternative C is, in form, the broadest third-party beneficiary protection for a non-privity plaintiff. It is not limited to plaintiffs who are natural persons. It is not limited to injuries to the person. It appears available to a business plaintiff who alleges economic injuries. In contrast, alternative A seems practically limited to

consumers because of the family, household or guest limitation. Alternative B does not state that it is limited to consumers, though limiting claims to natural persons tends to narrow the scope primarily to consumers.

[begin statute insert]

Alternative C

A seller's warranty whether express or implied extends to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends.

[end statute insert]

CASE DISCUSSION

Crews v. W.A. Brown & Son, Inc., 416 S.E.2d 924 (N.C. App. 1992)

The structure of the relevant facts appear as follows:

BROWN

[sold good to]

↓

FOODCRAFT [sold good to] ⟶ CHURCH. CHURCH [allowed use of good by] ⟶ CREWS

In a products liability action: CREWS sued FOODCRAFT for breach of express and implied warranties (among other claims). CREWS is a horizontal non-privity plaintiff with respect to FOODCRAFT. These claims are against CHURCH's seller. The applicable version of UCC s.2-318 is version A, as enacted by the State of North Carolina. The court said:

“The statute does not extend warranty coverage to persons beyond those specifically enumerated. This construction is consistent with the legislative intent behind N.C.G.S. § 25–2–318 which was to eliminate the doctrine of privity as to the buyer’s family, household, and guests, but not to abolish the doctrine as it relates to strangers to the contract.” [TEXT P. 685]

HELD: CREWS does not qualify as a covered third-party beneficiary under North Carolina's version of s.2-318 because CREWS is not a member of CHURCH's family or household, and CHURCH is not a home. Thus, it was proper to dismiss claims asserted for express and implied warranties. IMPORTANT: the court notes that CREWS did not separately allege that she was a third-party beneficiary of CHURCH'S contract with FOODCRAFT. Thus, the court was not able to consider whether or not it should "imply" privity between CREWS and FOODCRAFT sufficient to support breach of warranty claim outside of s.2-318.

Additional questions for class discussion based on Foodcraft case:

One might stay alert for other troubling scenarios under alternative A. Suppose that I invite a guest to a hotel room I have rented to watch a televised parade before attending a college football bowl game. I brought a popcorn popper with me. While popping popcorn, the device catches fire due to a defect and burns my guest. Can my guest sue the retailer who sold me the device under s.2-318, version A? The guest was not in my "home". Should it matter? What if I had rented a vacation cabin for a week? A month? A semester while I taught as a visitor at another law school?

What argument would CREWS need to make to bring a claim against BROWN?

CASE DISCUSSIONS

Kinlaw v. Long Mfg. N.C., Inc., 259 S.E.2d 552 (N.C. 1979); Randy Knitwear, Inc. v. Am. Cyanamid Co. 181 N.E.2d 399 (N.Y. 1962)

Background: Sometimes a manufacturer provides an express warranty to the end users of its product. The ability of the end user to make a claim for breach of warranty in such a case does not depend on s.2-318 (or at least it should not depend on it). Suppose that OUR SUPPLIER provided such an express warranty for its widgets--perhaps on the outside of its packaging, in a manual included in the box with the product, or in an advertisement in a newspaper, magazine or radio spot. Could OUR BUYER make a claim on such a warranty? Note that OUR BUYER did not contract directly with OUR SUPPLIER. OUR BUYER contracted with OUR STORE.

The Kinlaw and Randy Knitwear cases demonstrate that, in some jurisdictions, a court will allow OUR BUYER to make a direct claim against OUR SUPPLIER despite the lack of conventional privity. If a manufacturer addresses express assurances to ultimate purchasers, the ultimate purchaser can sue for breach of warranty. Lack of privity will provide no defense. The theoretical basis for the liability is somewhat cloudy: it is either "quasi ex contractu" or a declaration of tort for false warranty.

Alberti v. Manufactured Homes, Inc. 407 S.E.2d 819 (N.C. 1991)

The basic point of Alberti is that, while a damage remedy for breach of warranty by a manufacturer may be made by an ultimate customer, the remedy of revocation of acceptance against the manufacturer is not available. The lack of privity between OUR SUPPLIER and OUR BUYER means that there is no contract between the two and, as a result, acceptance of goods may not be revoked. OBSERVATION: This makes theoretical sense if the basis for liability is theorized as grounded in tort. If, however, liability is based on some sort of implied privity, the rationale for denying a remedy of revocation of acceptance is less clear--however, in either case, it probably is the practical result. OUR SUPPLIER did not receive a purchase price from OUR BUYER which it might return. Indeed, if OUR SUPPLIER sold to OUR STORE at wholesale, and OUR STORE sold to OUR BUYER at retail, the price to be returned would not match. Thus, as a general matter, the remedy of revocation of acceptance is available only when there is traditional privity--and the UCC definitions of "buyer" and "seller" support this result. However, the case notes that the NC legislature made an exception for self-propelled motor vehicles, allowing the manufacturer who makes an express warranty targeted to ultimate customers to be considered a "seller." In that limited case, but not others, revocation of acceptance would be available. The use of the terms "buyer" and "seller" in s.2-313 are not, however, to be used so restrictively for purposes of s.2-313 as for s.2-608. It goes against best practices for statutory interpretation to construe the same defined term differently in different parts of the statute. However, here the court attempts to justify the disparate treatment with reference to the UCC Official Comments, particularly Comment 2 to s.2-313, which reads in full:

[begin comment quote]

OFFICIAL COMMENTS

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of section 2-318 on third-party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of the Uniform Commercial Code may offer useful guidance in dealing with further cases as they arise.

[end comment quote]

PRODUCTS LIABILITY STATUTES

Under Article 2, injury to person or property is a type of consequential damage. A buyer may recover a consequential damage under s.2-715. Recall that, to be eligible for this recovery, s.2-715 has a somewhat convoluted "mitigation" requirement. To be a consequential damage, it must not have been avoidable (i.e. "which could not reasonably be prevented by cover or otherwise"). In effect, the mitigation requirement is built into the definition of consequential damage--if it could have been avoided, by definition it is not a consequential damage.

Though an award for consequential damages for injury to person or property is available under Article 2, as a practical matter, a damage award of this type may, and often is, effectively blocked by the seller of the goods. Sellers routinely take advantage of s.2-719 to limit remedies, including the exclusion of consequential damages for injury to the person.

[begin statute quote]

2-719.

Contractual modification or limitation of remedy.

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and

(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.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in the Uniform Commercial Code.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not. [end statute quote]

Thus, a plaintiff buyer often uses other theories to impose liability on a seller of a defective product that causes harm. One example of this is the implied warranty theory used in the Henningsen case discussed earlier. Another is to assert a common law strict liability in tort for an inherently dangerous product. However, in many cases, state legislatures have stepped in to provide an additional basis for recovery in the form of a products liability statute. One such example from North Carolina appears in the TEXT P. 706 and following. In form, products liability statutes supplement, rather than replace, ordinary claims for breach of warranty. The practical effect of such a statute is to create a form of strict liability for a manufacturer of a defective good which may not be disclaimed. Persons entitled to claim under such a statute may, by definition, include persons in addition to those specified in s.2-318, alternative A; note, for example, the inclusion of an "employee of the buyer" in N.C.G.S. s. 99B-2(b) [TEXT P. 707].

Typical defenses to manufacturer liability include: alteration or modification of the product; misuse of the product; knowledge of the defect by the user; and, failure to exercise reasonable care in using the product.

At the same time that liability is created for manufacturers, liability is excluded for non-manufacturers in the supply chain, typically using a device known as the "sealed container" defense (which applies to sealed containers, as well as cases in which there is no opportunity for the middleman or dealer to inspect the defective good.