Disputes in the Manufacturing Supply Chain

A Primer on Warranty and Disclaimer Law

By John R. Trentacosta and Vanessa L. Miller

Warranties, warranty disclaimers, limitations on remedies, and limitations on damages are contract provisions that are frequently at the heart of disputes in the manufacturing supply chain. What warranty did the buyer receive in the transaction? Is the buyer limited to a particular remedy in the event of a breach? Is there a cap or some other limitation on the type or the dollar amount of damages? These are all critical questions that play out in cases of this sort.

The starting point in most commercial cases involves analyzing the warranty given to the buyer by the seller. In general, warranties are obligations that a party undertakes by agreement or that are imposed by law. Warranties memorialize the commitments and expectations to which the seller and buyer will be held accountable. The expression of warranties is important to parties entering into a contract because warranties can and should provide an objective measurement for performance under the contract.

From a seller's perspective, the scope and duration of an express warranty will be driven by the competitive marketplace. Although the "safest" position for the seller is to make no express warranties (often referred to as an "as is" sale), the marketplace typically requires at least some warranty protection for the buyer. At the other end of the spectrum, the express warranty cannot be so broad and generous that the seller will be unable to satisfy the warranty. The seller must balance meeting the demands of the marketplace against over-promising and under-delivering (and being sued for breach of warranty).

This article provides an overview of express and implied warranties as well as warranty disclaimers, modifications, and other limitations. It also discusses important timing considerations related to warranties and their enforceability.

Types of warranties

Express warranties

Express warranties are promises a seller makes concerning the goods sold to a buyer, and are governed either by statute or common law. Article 2 of the Uniform Commercial Code (UCC), which has been adopted in all 50 states, applies to transactions involving the sale of goods.[1] Accordingly, the discussion in this article will focus on warranties under the UCC.[2]

Express warranties arise from affirmations of fact by the seller and may be created by oral statements, advertisements, specifications, drawings, samples, or models.[3] The seller does not need to use terms such as "warrant" or "guarantee" for a warranty to come into existence. In general, if the nature of the goods' performance is described and the description is part of the basis of the bargain, an express warranty that the goods "shall conform to the description" will be created.[4] For example, when a seller represents that the goods will be of a certain quality or perform to a certain standard, such representations have created express warranties.

It is important to distinguish between "puffing" and express warranties. Puffing, trade talk, and statements regarding the value of goods do not create express warranties.[5] To decide whether a statement is a warranty or mere puffing or trade talk, courts look at:

- the specificity and verifiability of the claim,
- the bargaining positions and relative knowledge of the parties to the transaction,
- the circumstances of the sale,

- the language used by the seller and the extent to which the seller equivocates a statement, and
- the nature of the defect.[6]

Bragging or opining about a product generally will not rise to the level of an express warranty under the UCC.[7] The more vague the statement, the less likely it is that a court will find the representation to be an express warranty. However, statements that specifically describe an aspect or performance criterion of the product will likely be found to be express warranties.[8]

Implied warranties

In addition to express warranties, there are implied warranties under the UCC and common law. The two most common implied warranties are the implied warranty of merchantability and the implied warranty of fitness for a particular purpose.

The implied warranty of merchantability

Unless disclaimed, a warranty that the goods sold are merchantable is implied "if the seller is a merchant with respect to goods of that kind."[9] Merchantable goods must:

- pass without objection in the trade under the contract description;
- be of fair or average quality within the description;
- be fit for the ordinary purposes for which such goods are used;
- run, within variations permitted by the agreement, of even kind, quality, and quantity within each unit;
- be adequately contained, packaged, and labeled as the agreement may require; and
- conform to any of the promises or affirmations of fact made on the container or label, if any.[10]

To recover under the implied warranty of merchantability, the buyer must show that the goods were defective when they left the possession of the manufacturer or seller.[11]

Under the implied warranty of merchantability, evidence concerning past course of conduct, trade practice, or custom may also be used to establish an implied warranty of merchantability. A buyer need not show reliance to establish a claim for breach of an implied warranty of merchantability.[12] However, it should be noted that the implied warranty of merchantability does not apply if the buyer uses the goods in a manner other than that intended under the contract.[13] In addition, for the implied warranty of merchantability to apply, the product must have reached the user without substantial change or modification.[14]

The implied warranty of fitness for a particular purpose

Goods need to be fit for the purpose for which they were intended. When the seller "has reason to know any particular purpose for which the goods are required" and the buyer is relying on the seller's skill or judgment, a warranty "that the goods shall be fit for such purpose" is implied under the UCC.[15]

In order for an implied warranty of fitness for a particular purpose to arise, the seller must know or have reason to know at the time of the sale the particular purpose for which the goods are intended.[16] Actual knowledge is not required. Instead, a court will examine whether, under the circumstances, the seller had reason to realize the purpose for which the goods were intended.[17] Unlike the implied warranty of merchantability, an implied warranty of fitness for a particular purpose requires reliance by the buyer.[18] In Michigan, caselaw is clear that no warranty of fitness will be implied if the product is manufactured in accordance with specifications provided or drafted by the buyer.[19]

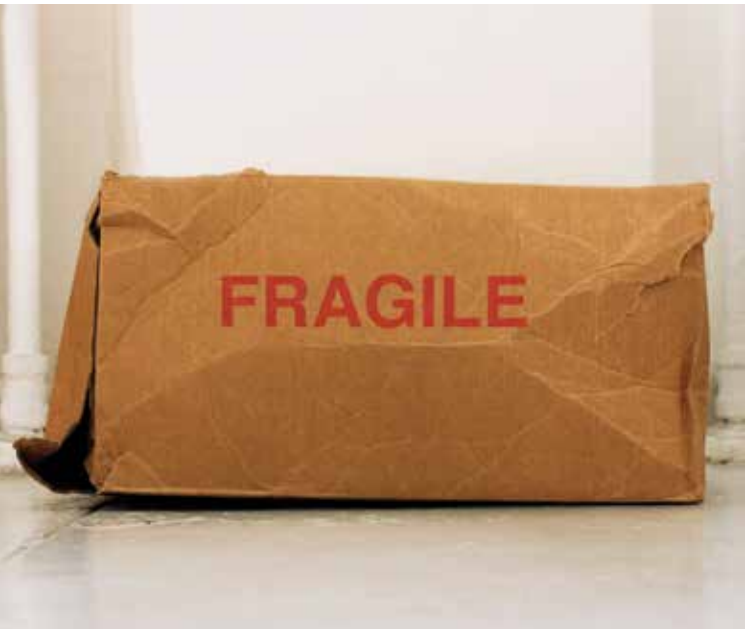
FAST FACTS

Disputes in the manufacturing supply chain often involve questions concerning warranties and damage disclaimers. Understanding the basics of warranty and disclaimer law is critical to managing and litigating these disputes.

Disclaimers

Once an express warranty is made, it cannot be disclaimed.[20] However, some protection for a seller can be achieved through the use of integration clauses that limit the warranties to those contained within the written contract. Conversely, sellers can and often do disclaim implied warranties. A disclaimer may contain the term "as is" or similar language to disclaim any implied warranty.[21]

Disclaimers of implied warranties generally are enforceable as long as the requirements set forth in the UCC have been met. To disclaim the implied warranty of merchantability through express language in the contract, the disclaimer must specifically mention merchantability and must be conspicuous.[22] Similarly, to disclaim the implied warranty of fitness, the exclusion must be in writing and



must be conspicuous.[23] Although a court will view the disclaimer in the context of all the sales documentation, often a disclaimer that is in a bold-faced and all-capitalized typeface will be sufficient to meet the conspicuousness requirement.[24]

Limitations on remedies and damages

The parties to a contract may agree to fix or limit remedies or damages. This is accomplished by using one of two methods. First, the parties at the time of contracting may agree to fix the damages owed in the event of a breach by either party. Second, the parties may agree to limit remedies that would otherwise be available.[25]

There are several important and interrelated reasons to include such limitations in a contract for the sale of goods. The seller may include limitations to reduce risk. For example, by including a damages cap or excluding certain categories of damages, the seller may reduce or, in some cases, eliminate its liability for certain damages in the event of breach. The seller also may want to enhance predictability. By including a liquidated damages provision, an uncertain and indefinite exposure for breach of contract can be turned into a known quantity. Finally, limitations of both kinds are important for business planning purposes. A seller may rely on these provisions in pricing its goods, performing financial forecasting, and even obtaining insurance coverage.

Liquidated damages clauses

A liquidated damages provision sets a fixed damages amount in the event of a breach by the seller. There is no magic language required other than clear and unambiguous language showing that the parties intended to set a specific damages amount in the event of a breach. Liquidated damages provisions may be enforced as long as the amount is reasonable in light of the circumstances.[26] However, the seller should be careful that the damages amount is not so small that it will be voided as unconscionable.

Courts rely on three reasonableness factors, which are viewed under the particular circumstances of each case. First, courts look at the anticipated or actual harm caused by the breach.[27] The harm that the liquidated damages clause seeks to remedy must have been harm that was contemplated at the time the parties entered into the bargain. Damages that were not contemplated at the time the parties entered into the contract likely will fall outside of the liquidated damages provision. Second, courts consider the difficulty of estimating and proving the damages sustained.[28] When damages caused by an anticipated breach are readily measurable, the parties may not disregard the actual damages and stipulate to an alternative amount. Third, some courts weigh the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.[29] However, many courts treat this factor as redundant of or related to the second factor.

To ensure that a liquidated damages provision will be enforceable, it is best to make a record describing each of the reasonableness factors during the contractual negotiations. The record should show that the liquidated damages provision was the product of negotiations between the parties to fix damages in advance for a sum certain in the event of a breach.

Limitation of remedies

Under the UCC, parties may limit or alter remedies.[30] When a contract seeks to limit remedies, it is important to explicitly state that such remedies are exclusive. Otherwise, there may be a presumption that the remedies are cumulative to other remedies available under the UCC.[31] There are two common types of limited remedy provisions. First, a seller may restrict the buyer's remedies to repair or replacement of the nonconforming goods. Second, a seller may limit the remedy to the buyer to credit for the goods returned.

If an exclusive limited remedy fails of its essential purpose, it is unenforceable and a buyer is then entitled to all available remedies under the UCC.[32] A remedy will be deemed to fail of its essential purposes if, for example, there is an exclusive repair remedy but repeated attempts to repair do not fix the issues.[33] As long as minimum adequate remedies are left for the aggrieved party, the limitation of remedies will not be deemed to fail of its essential purpose.

Important timing considerations

To bring a claim for breach of warranty, there are two separate timing hurdles to consider: (1) warranty eligibility, meaning the claim falls within the applicable warranty period; and (2) timeliness under the UCC's four-year statute of limitations period. The expiration of either the warranty period or the four-year statute of limitations period is an absolute bar to a breach of warranty claim.

Under the UCC, a party has four years after the cause of action accrues to bring its breach of warranty claims.[34] The general rule is that a cause of action accrues (and the statute of limitations begins to run) when the breach occurs, regardless of the

aggrieved party's lack of knowledge of the breach.[35] For warranties extending to future performance, a cause of action for breach does not accrue until the breach is or should have been discovered.[36] Even if a buyer does not know the extent of its damages for the allegedly defective product or the number of products that will fail, these factors do not influence the critical question of when the breach of warranty claim accrued in a statute of limitations analysis.

Strategy takeaways

Whether representing the seller or the buyer, the following checklist should be consulted:

(1) Draft clear and concise express warranties concerning the goods being sold. Rather than relying solely on vague phrases ("free from defect"), include precise, objective performance criteria for the goods ("machine will cycle at 85 rpms").

(2) As a seller, disclaim the implied warranties and all other express warranties not specifically given in the contract. As a buyer, focus on negotiating the proper express warranties rather than relying on implied warranties.

(3) Sellers will want to limit the buyer's remedies, such as to repair or replace. Buyers should resist. If the seller has the leverage and a limitation on remedy is accepted, the buyer should negotiate for tight deadlines and specific activity relative to compliance by the seller with the limited remedy ("machine shall be rendered fully operational within 24 hours of notice").

(4) Buyers should fight against damage limitations. If, once again, the leverage is such that a seller wins on this point, the buyer should look to add carve-outs for certain circumstances (intentional acts, gross negligence, etc.). Additionally, argue for excluding certain types of claims from the disclaimer (IP infringement, indemnity claims, etc.).

Finally, the most important focus of any commercial contract should be to capture all aspects of the parties' commercial relationship in the written agreement. Uncertainty breeds disputes and litigation. Conversely, a well-drafted, comprehensive agreement will serve as a road map for the parties' commercial dealings. ■

ENDNOTES

1. Trentacosta, Michigan Contract Law (2d ed), § 6.2.
2. In transactions for the sale of goods that involve services, the UCC applies if the contract primarily concerns the sale of goods and the rendering of services is incidental to the sale of goods. *Citizens Ins Co v Osmose Wood Preserving, Inc*, 231 Mich App 40; 585 NW2d 314 (1998).
3. The terms "sample" and "model" are not synonymous. A sample is drawn from the bulk of the goods to be sold. Unlike a sample, a model is not part of the goods to be sold. Instead, a model typically is a tangible representation that the seller offers to the buyer to view or inspect. If the buyer requests a modification to the goods that were shown as represented by the model, the buyer's ability to rely on the model as an express warranty is weakened.
4. UCC 2-313(1)(b).
5. *Carpenter v Alberto Culver Co*, 28 Mich App 399; 184 NW2d 547 (1970).
6. Lewis, *Toward a theory of strict "claim" liability: Warranty relief for advertising representations*, 47 Ohio St L J 671, 679–680 (1986).
7. *Beyette v Ortho Pharm Corp*, 823 F2d 990, 993 (CA 6, 1987).
8. See *Scott v Illinois Tool Works*, 217 Mich App 35; 550 NW2d 809 (1996).
9. UCC 2-314(1).
10. UCC 2-314(2).
11. *Jodway v Kennametal, Inc*, 207 Mich App 622; 525 NW2d 883 (1994).
12. *US Fibres, Inc v Proctor & Schwartz, Inc*, 509 F2d 1043 (CA 6, 1975).
13. *Guaranteed Constr Co v Gold Bond Products*, 153 Mich App 385; 395 NW2d 332 (1986).
14. *Wittkamp v United States*, 343 F Supp 1075 (ED Mich, 1972).
15. UCC 2-315.
16. *United Trade Assoc v Dickens and Matson (USA)*, 848 F Supp 751 (ED Mich, 1994).
17. *Computer Network, Inc v AM Gen Corp*, 265 Mich App 309, 316; 696 NW2d 49 (2005) (citations omitted).
18. *Leavitt v Monaco Coach Corp*, 241 Mich App 288, 293; 616 NW2d 175 (2000) (citations omitted).
19. See, e.g., *Hartford Fire Ins Co v Walter Kiddle & Co*, 120 Mich App 283, 293; 328 NW2d 29 (1982) (where a restaurant owner had ordered a specific, defined automatic fire extinguishing system, the appellate court found that the trial court had properly granted a directed verdict on the buyer's claim of implied warranty of fitness for a particular purpose).
20. However, if the express warranty was oral and there is a later written contract containing a disclaimer, the parol evidence rule may apply to prevent the admissibility of an oral express warranty.
21. *Lumber Mut Ins Co v Clarklift*, 244 Mich App 737; 569 NW2d 681 (1997).
22. See UCC 2-316(2).
23. *Fargo Mach & Tool Co v Kearney & Trecker Corp*, 428 F Supp 364 (ED Mich, 1977).
24. *Fish v Home Depot USA, Inc*, 455 Fed Appx 575 (CA 6, 2012).
25. Although less common, the parties may also agree to expand remedies that would otherwise be available.
26. UCC 2-718(1), Comment 1; see also Aiello, *Use of liquidated damage and limitation of remedies clauses in contracts*, 16(1) Mich Bus L J 11 (1994).
27. See UCC 2-302.
28. See UCC 2-718(1).
29. *Skyline Steel Corp v AJ Dupuis Co*, 648 F Supp 360, 375 n 17 (ED Mich, 1986).
30. UCC 2-719.
31. UCC 2-719(1)(b), Comment 2.
32. *North American Steel Corp v Siderius, Inc*, 75 Mich App 391; 254 NW2d 899 (1977).
33. *Stone Transp Inc v Volvo Trucks N Am Inc*, 129 Fed Appx 205 (CA 6, 2005).
34. UCC 2-725(1).
35. UCC 2-725(2).
36. UCC 2-725(2).

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