

1991

## Exclusive Warranties Failing in Essential Purpose Do Not Prevent Consequential Damage Recovery

Richard E. Nawracaj

Follow this and additional works at: <http://lawcommons.luc.edu/lclr>

 Part of the [Consumer Protection Law Commons](#)

---

### Recommended Citation

Richard E. Nawracaj *Exclusive Warranties Failing in Essential Purpose Do Not Prevent Consequential Damage Recovery*, 3 Loy. Consumer L. Rev. 67 (1991).

Available at: <http://lawcommons.luc.edu/lclr/vol3/iss2/9>

This Recent Case is brought to you for free and open access by LAW eCommons. It has been accepted for inclusion in Loyola Consumer Law Review by an authorized administrator of LAW eCommons. For more information, please contact [law-library@luc.edu](mailto:law-library@luc.edu).

The court also reversed the trial court's award of statutory penalties under La. Rev. Stat. Ann. § 22:658(B) (West Supp. 1985).

Aida M. Alaka

## Exclusive Warranties Failing In Essential Purpose Do Not Prevent Consequential Damage Recovery

In *Ragen Corp. v. Kearney & Trecker Corp.*, 912 F.2d 619 (3d Cir. 1990), the United States Court of Appeals for the Third Circuit held that warranties containing exclusive remedies, which fail in their essential purpose, do not preclude recovery for consequential damages under Wisconsin law.

### Background

Ragen Corporation ("Ragen") was a New Jersey manufacturer of component parts for computers and nuclear reactors. Since 1955, Ragen conducted business with Kearney & Trecker Corporation ("K & T"), a Wisconsin corporation that manufactured high-speed machining equipment.

In 1976, K & T began manufacturing the MM800, a fully automated machine designed to drill metal castings. For approximately two years, K & T discussed the MM800 with Ragen and submitted a proposal to Ragen for the sale of MM800 units in April 1978. The proposal described the MM800 in detail and specified the conditions of the proposed sale.

K & T's proposal stated that the entire and exclusive warranty for the MM800 was either (1) repair or replacement of the defective part or product; or, at K & T's option, (2) return of the product and refund of the purchase price. Furthermore, the proposal stipulated that under no circumstances would K & T be liable for any consequential damages arising in connection with the MM800. The proposal also provided that Wisconsin law would govern any resulting contracts between K & T and Ragen.

Ragen sent purchase orders to K

& T for eight MM800 machines. In January, 1979, K & T installed the first two MM800 units at Ragen's plant. Soon thereafter, the MM800s began to malfunction. In late 1979, after the installation of the next two units, Ragen discovered defects in the MM800s.

Pursuant to its warranty, K & T repaired and serviced the MM800 units at Ragen's plant over the next five years. However, these efforts provided only a temporary solution to the problem. Prior to and after repair, the machines could not operate at, or near, their capacity.

Along with the MM800 problems, Ragen also experienced difficulties with four Eb/1624 machines. Ragen had previously purchased these units from K & T, which retrofitted them to operate like the MM800. In November 1980, and March 1982, Ragen cancelled orders to purchase other machines from K & T.

In August 1981, in response to Ragen's threat to cancel orders for the remaining MM800 units, K & T offered to aid Ragen in maintaining an 85% operating capacity for the MM800s, if Ragen also agreed to perform preventive maintenance on the machines. Ragen accepted K & T's proposal and did not revoke the orders for the remaining MM800 units. However, by 1982, Ragen realized that K & T could not sustain the 85% operating capacity for the MM800 units; Ragen also had not been maintaining the machines as agreed. Subsequent negotiations between the parties failed. Ragen discontinued business with K & T.

In July 1983, Ragen filed suit against K & T in the United States District Court for the District of New Jersey. Ragen claimed breach of warranty, design defect, and fraud against K & T for the MM800 and retrofitted Eb/1624 units. K & T counterclaimed, contending that Ragen breached the purchase contracts for machines other than the MM800s. In its decision, the district court awarded Ragen compensation only for direct damages resulting from K & T's breach of warranty. Additionally, the court rejected K & T's counterclaim. Both parties ap-

pealed the court's verdict to the United States Court of Appeals for the Third Circuit.

### The District Court's Opinion

The district court first determined the parties' contractual rights and liabilities. Using the terms contained in K & T's proposal, the district court concluded that Ragen's contractual remedy was limited to repair or replacement of the defective machines; the contract explicitly excluded recovery for any consequential damages. The court held that this explicit exclusion was not unconscionable.

Next, the district court addressed Ragen's breach of warranty claim. The court agreed with Ragen's claim that the MM800s suffered from design defects which constituted a breach of warranty. Therefore, the contract entitled Ragen to seek the repair or replacement of the MM800s. However, since K & T was unable to repair adequately or replace the defective MM800 units, the court found that the limited remedy failed in its essential purpose. Consequently, in order to provide an appropriate remedy, the district court decided to apply section 2-719 of the Uniform Commercial Code ("UCC").

Section 2-719 allows a court to apply any remedy available under the UCC for a contract breach, such as Ragen's, whose limited warranty failed in its essential purpose. Using this rule, the court concluded that the only remedy Ragen could pursue was section 2-714(2), UCC § 2-714(2) (1989), which allowed Ragen to recover direct damages amounting to the difference in value between the MM800 units as received and the MM800 units as warranted. Although Ragen failed to submit evidence showing the difference in value between the MM800s as received and the MM800s as warranted, the district court awarded Ragen damages based on its own estimate of direct damages.

The district court did not address Ragen's fraud claims against K & T. Also, due to apparent confusion concerning machine identities, it is unclear whether the court decided the claims concern-

(continued on page 68)

## Exclusive Warranties

(continued from page 67)

ing the Eb/1624 machines. Finally, the court rejected K & T's breach of contract counterclaim against Ragen.

### The Third Circuit's Opinion

The Third Circuit reversed the lower court's holding that Wisconsin state law denied Ragen consequential damages. The court concluded that the exclusive limited warranties which failed in their essential purpose, allowed recovery for consequential damages, even if the contract excluded such consequential damages. Because K & T, after extensive effort, could not repair or replace the machines to make them perform as warranted, K & T's exclusive warranty failed in its essential purpose. Therefore, the court reversed the district court's decision that Ragen was not entitled to recover consequential damages, despite explicit exclusion of such damages in the warranty. The court remanded the issue of consequential damages for retrial.

The Third Circuit then reviewed the district court's decision to award Ragen direct damages. The court stated that in order for Ragen to recover direct damages, Ragen must present evidence of losses, on which a reasonable assessment of damages may be based. The court reasoned that this required Ragen to produce evidence showing the actual value of the MM800 units it received and the value of the units as warranted. Ragen, however, only submitted evidence on (1) the purchase price of the MM800, (2) the average up-time of the machines, and (3) the average up-time of similar machines in the industry. The court decided that this evidence was insufficient to prove adequately the actual value of the MM800. Therefore, the court held that Ragen was not entitled to direct damages and accordingly reversed the district court's decision.

Next, the Third Circuit examined the lower court's rejection of K & T's counterclaim against Ragen for damages allegedly arising

from Ragen's cancellation of orders for new machines. The court decided that the issue required application of section 2-708(2), UCC § 2-708(2) (1989), commonly referred to as the "lost volume seller" provision. Section 2-708(2) provides that a seller may recover lost profits in the event the standard measure of damages is inadequate. The court defined a lost volume seller as one who could have sold an item to both the breaching buyer and a subsequent buyer; the seller, having made essentially only one rather than two sales, suffered damage which could only be remedied by an award for the amount of lost profits.

The Third Circuit noted that the fundamental question in applying the lost volume seller provision was whether the seller had the ability to provide the item to the breaching buyer as well as to the resale buyer. The court found that, based on testimony of the case, K & T, at the time Ragen cancelled the orders, had more orders for machines than it could fill. Thus, the court concluded that K & T could not have simultaneously supplied both Ragen and another buyer; K & T was not a "lost volume seller." Thus, the court held that K & T was not entitled to damages and affirmed the district court's decision.

Finally, the Third Circuit reviewed the district court's decision on the Eb/1624 retrofitted machines. The court found that the district court did not refer to the Eb/1624s. Instead, the district court had discussed a retrofitted MM200, a machine not involved in the case. Although the court suspected the district court simply misnamed the Eb/1624s, it remanded this issue for clarification. Additionally, since the district court did not rule on Ragen's fraud claims, the Third Circuit remanded this issue as well.

Richard E. Nawracaj

## Bankruptcy Court Holds Debtor Responsible For Obsessive-Compulsive Use of Credit Card

In *In re Borste*, 117 Bankr. 995 (Bankr. W.D. Wash. 1990), the United States Bankruptcy Court for the Western District of Washington held that a debtor's credit card debts were not dischargeable in bankruptcy even though the debtor had incurred the obligations while suffering from an obsessive-compulsive disorder which affected her ability to control her credit card spending.

### Background

Cathy Borste ("Borste"), the debtor, was a machinist at the University of Washington. She earned approximately \$26,000 annually. Borste used a combination of seven credit cards to make at least ninety-two charges from May through August 1989, the majority of which were for luxury items. Prior to this period, Borste had difficulty controlling her spending and meeting her resulting financial obligations. In May 1989, Borste owed about \$24,000 in secured and unsecured debt. In June 1989, Borste sought credit counseling but was refused assistance. During credit counseling, however, Borste had learned that she could declare personal bankruptcy.

Borste shopped extensively in the following months. She also travelled to Europe in early September and returned in mid-October. Upon her return, she consulted an attorney and filed a Chapter 7 petition on November 7, 1989. Borste owed over \$43,000 to her creditors at the time she filed for bankruptcy.

Nordstrom, Inc. ("Nordstrom"), a creditor, filed a complaint alleging that thirty-six of the charges made to Borste's Nordstrom account were not dischargeable. Nordstrom argued that these charges fell within the Bankruptcy Code, 11 U.S.C. § 523 (a)(2)(A) (1979), because Borste made them with no intention of paying them. Thus, the charges had been incurred through fraud, making them not dischargeable.