A Note On Damages And Disclaimers in Actions for Breach of a "Repair or Replacement" Warranty

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Introduction

Items "normally used for personal, family, or household purposes,"[1] which include automobiles and motor homes, fall within the definition of "consumer products" covered by the Magnuson-Moss Warranty Act—Federal Trade Commission Improvement Act of 1975 ("MMWA" or "Magnuson-Moss"), 15 U.S.C. § 2101, *et seq.*, and other consumer protection statutes. Consumer products are generally sold with a "limited warranty;" that is, a warranty that promises only to repair or replace defects in material and workmanship at no charge for a specified period. Ever more frequently, the MMWA is being invoked by customers who claim to have experienced problems with their vehicles, and related warranty repairs, especially in states without strong "Lemon Laws." This note examines the measure of damages applied and the treatment of disclaimers in such actions.

Typically, Magnuson-Moss plaintiffs request "difference in value" or benefit-of-the bargain damages, along with damages for aggravation and inconvenience, and loss of use. The courts routinely apply the Uniform Commercial Code's ("U.C.C." or "the Code") "standard" measure of damages found in § 2-714(2). On the other hand, many courts effectively ignore § 2-719(3) of the Code's express requirement that an incidental and consequential damages disclaimer be found unconscionable before being cast aside. As a result, damage awards seldom are in line with the actual economic loss sustained or the warranty terms.

The Code's damages provisions should not be mechanically applied in breach of limited warranty actions. Its standard measure of damages does not fit the promise made—or breached. But, a limited warranty is sufficiently analogous to a U.C.C.

[1] *See e.g.*, 15 U.S.C. § 2301 (1).

warranty that the Code's policies provide useful guidance for determining damages calculations. The best course is for the courts to fashion a measure of damages that produces a result that (1) is consistent with the U.C.C.'s aim of placing the aggrieved party in as good a position as he would have been in but for the breach, and (2) comports with the warranty promise. Because it is a promise to repair that has been breached, these aims are met by measuring damages in terms of repair cost. And consistent with the Code's policy of allowing the parties to shape their contractual relationship, the courts should enforce damages limitations and disclaimers unless unconscionable. Applying an appropriate measure of damages and enforcing proper damages disclaimers will promote fairness and efficiency. Damages awards will more accurately reflect the economic harm sustained, and will be more predictable. This in turn will facilitate prompt dispute resolution.

Discussion

The Role of State Sales Law

Most consumer product manufacturers offer a "limited warranty," as the term is defined under § 103(a)(2) of the MMWA.[2] The MMWA does not contain substantive remedy provisions applicable to a "limited warranty,"[3] so state sales law—generally the U.C.C.—has been held to control.[4] Section 2-714(2) of the Code provides the standard measure of damages for breach of warranty. But as Comment 3 to § 2-714 makes clear, "it is not intended as an exclusive measure." Because a repair or replacement warranty is

[2] 15 U.S.C. § 2303(a)(2).

[3] *Schimmer v. Jaguar Cars, Inc.*, 384 F.3d 402, 405 (7th Cir.2004).

[4] *MacKenzie v. Chrysler Corp.*, 607 F.2d 1162, 1166 & n. 7 (5th Cir.1979).

not a U.C.C. "express warranty," § 2-714(2) should not be mechanically applied in breach of limited warranty actions.

"Limited Warranty" vs. "Express Warranty"

A limited or repair-or-replacement warranty is fundamentally different than a U.C.C. "express" warranty. Under an express warranty the seller is required *to tender and deliver goods that conform to the terms of the agreement*.[5] For example, if a seller warrants that a truck-trailer has a 10-ton carrying capacity, but the buyer discovers that it is only capable of hauling eight tons, the trailer does not conform to the warranty and the agreement has been breached at the time of tender. On the other hand, a warranty to repair requires only that the warrantor *take action that conforms to the terms of the agreement*; it does not establish standards to which the goods must, or may be made to, conform.[6] Accordingly, a warranty to repair is not an express warranty, as defined by the Code, and goods accepted with such a warranty cannot be non-conforming.[7]

Moreover, a warranty to repair or replace is not—and cannot be—breached at tender, even if there are defects in the product's material or workmanship.[8] Breach occurs only when warrantor refuses or fails to make repairs after being given a reasonable opportunity to do so.[9] Strictly speaking, then, a warranty to repair or replace is not

[5] *Voelker v. Porsche Cars No. Amer.*, 353 F.3d 516, 526 (7th Cir.2003), *citing Cosman v. Ford Motor Co.*, 674 N.E.2d 61, 67-68 (Ill.App. 1996).

[6] *Cosman*, 674 N.E.2d at 67.

[7] *Id.*

[8] *Id.*

[9] *Id.* at 68.

covered by the U.C.C.[10] And it follows that the U.C.C.'s measure of damages provisions should not be mechanically applied in cases involving a limited warranty.[11] But, because such a warranty is analogous to an express warranty, the Code's policies and provisions should guide the court in setting a measure of damages.[12] So the court should endeavor to fashion a measure that is consistent with (1) the Code's policy of putting the aggrieved party in as good a position as if the breach had not occurred[13] and (2) the warranty promise.

To illustrate the point we return to our truck-trailer example. Let us assume: (1) that the buyer agreed to pay $100,000 for a trailer expressly warranted to have 10-ton carrying capacity; (2) that shortly after acceptance the buyer discovered that the trailer as accepted, although free of defects in materials or workmanship, has a maximum capacity of 8-tons; and (3) that an 8-ton capacity trailer has a market value of $80,000. The seller breached its express warranty by tendering non-conforming, although defect-free, goods. If the buyer elects to retain the non-conforming trailer and sue for damages, he would be put in as good a position as if the breach had not occurred by being awarded damages of $20,000, which equals the difference between the value of the goods as warranted (10-ton

[10] *Id.*

[11] The UCC's drafters recognized that even with respect to warranties covered under the Code, the terms agreed upon by the parties and the circumstances of the transaction may require that the court adjust the measure of damages, stating in Comment 3 to UCC § 2-714: "Subsection (2) describes the usual, standard, and reasonable method of ascertaining damages in the case of breach of warranty *but it is not intended as an exclusive measure.*" (Emphasis added.)

[12] *Cosman,* 674 N.E.2d at 68.

[13] U.C.C. § 1-106.

capacity/$100,000) and as accepted (8-ton capacity/$80,000) as provided under U.C.C. § 2-714(2).[14]

Now let us assume: (1) that the trailer was sold with only a one-year warranty to repair or replace defects in materials or workmanship; (2) that the buyer did not experience any difficulties with the trailer during the first 6 months after delivery and acceptance; (3) that the trailer's condition had changed substantially during the 6 months after delivery due to ordinary wear and tear prohibiting revocation of acceptance; (4) that at 6 months the rear axel breaks as a result of a defect in workmanship; (5) that the seller is unable to repair, and unwilling to replace, the axel in breach of the warranty; and (6) that the buyer then incurs costs of $5,000 to replace the axel. It would be unfair to the buyer, and inconsistent with the terms of the warranty provided, to calculate damages as the difference between the value of the trailer as warranted and as accepted. At the time of acceptance, the seller had not failed to perform in any way; the warranty had not been breached—there were no unrepaired defects that would bring about a reduction in the trailer's value. Measured at the time of acceptance, the buyer's damages would be $0.00. The warranty is breached, and the buyer sustains damages, only when the seller failed to repair or replace the axel, after being given a reasonable opportunity to do so, and the buyer incurred the $5,000 in repair costs. Measuring the buyer's damages at the time of the breach will result in a recovery of the $5,000 in repair costs. This in turn achieves the

[14] Alternatively, the buyer could elect to revoke acceptance (U.C.C. § 2-608) and effectuate cover (U.C.C. § 2-712). If promptly after discovery of the non-conformity the buyer were to choose this option, he would be required to return the trailer to the seller and, assuming no change in the trailer's condition, would be entitled to a refund of the $100,000 purchase price. If he were then required to expend $110,000 to purchase a 10-ton capacity trailer, he would be entitled to recover the $10,000 he was required to expend above the original contract price.

U.C.C.'s aim of putting the buyer in as good position as if the seller had fully performed and is consistent with the warranty obligations undertaken by the seller.

The Wisconsin Supreme Court's recent decision in *Mayberry v. Volkswagen of America, Inc.*, is an excellent example of the unfairness resulting from mechanical application of § 2-714(2)'s standard measure of damages in a breach of limited warranty case.[15] There, the plaintiff purchased a new VW automobile, experienced numerous problems that were addressed under the warranty, made substantial use of the car, resold it for an amount concededly in excess of the car's fair market value, and then brought suit for damages. The trial court entered summary judgment for the defendant, finding that plaintiff failed to prove damages. The appellate court reversed, concluding that the trial erred by not applying § 2-714(2)'s standard measure of damages. In the supreme court the plaintiff claimed that as a result of defects discovered post-purchase, the car was not worth what she paid for it at the time of acceptance, thus entitling her to "difference in value," or benefit-of-the-bargain damages. The defendant countered that because the plaintiff's received greater than fair market value when she traded in the car, there existed "special circumstances" requiring a non-standard measure to be applied. It contended that the standard measure would result in a windfall to the plaintiff.

It appears that the court and the parties took it as a given that the VW limited warranty was a U.C.C. express warranty; accordingly the court found it necessary to apply § 2-714(2) as written. Although the court acknowledged Comment 3's admonition that the standard measure is not intended to be the exclusive measure, it rejected VW's contention that damages should be measured at the time of the alleged breach because the

[15] 692 N.W.2d 226 (2005).

case VW relied upon did not apply the "pertinent language of § 2-714(2)."[16] The court further held that plaintiff's opinion testimony that, at the time of acceptance, the car was not worth the amount she agreed to for it was sufficient to require submission of the damages issue to the jury.

The problem with the court's analysis is that plaintiff did not actually suffer economic injury or loss. Because VW offered a limited warranty, it had no obligation to provide a defect-free car. Accordingly, the presence of defects, manifest or latent, at the time of acceptance did not constitute a breach. VW merely promised to repair defects that arose during the warranty period, and it appears to have complied with this promise. So the court's application of the standard damages measure had the effect, no doubt unintended, of effectively rewriting VW's limited warranty. It was transformed from a promise to repair-or-replace into a promise to deliver a defect-free car. Defects existing at the time of acceptance merely presented the potential for breach and resulting damages in the event VW was provided with an opportunity to repair and failed to do so. Moreover, plaintiff did not resell the car and sustain a loss attributable to defects. Rather, she had the car repaired under warranty and made full use of the car for a substantial period of time. She then resold it for more than its fair market value. She made a profit at resale, and will reap a windfall if allowed to recover damages for what amounts to a theoretical injury (and one not attributable to defendant's breach of its promise to repair).

The correct damages analysis was applied in the case *Mayberry* refused to follow, *Valenti v. Mitsubishi Motor Sales of America, Inc.* There, the court found that because

[16] *Id.* 692 N.W.2d at 235.

the plaintiff received fair market value for the car in trade, she sustained no economic loss and affirmed summary judgment for the defendant.[17]

In the case of a repair or replacement warranty the U.C.C. standard measure of damages provisions do not fit. Instead, "repair cost" is the appropriate measure of damages because it equals the economic harm proximately resulting from the breach and thus places the aggrieved buyer in the position he would have been in had the defendant fully performed. Where a buyer resells or trades goods for fair market value, no economic harm is sustained, and there is no basis for a damages award.

Incidental and Consequential Damages

U.C.C. § 2-719 governs incidental and consequential damages exclusions[18] and provides:

> Contractual Modification or Limitation of Remedy. (1) Subject to the provisions of subsections (2) and (3) … and of the preceding section on liquidation and limitation of damages,
>
> (a) the agreement of the parties 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 …, as by limiting the buyer's remedies . . . to repair and replacement of non-conforming good or parts; and

[17] In *Valenti v. Mitusbishi Motor Sales of America, Inc.*, 773 N.E.2d 1199, 1202 (Ill.App.2002), the plaintiff purchased a Mitsubishi Galant in April 1997. She owned the car for 32 months, drove it 17,290 miles, and had it serviced under warranty on several occasions for a variety of alleged defects. Claiming that warranty repairs were ineffective, the plaintiff filed a Magnuson-Moss action alleging breach of written limited warranty and the implied warranty of merchantability. *Id.* at 1200. While suit was pending, the plaintiff traded-in the car and received a credit of $11,000 towards the purchase of a new car. *Id.* at 1201. After learning of the trade-in, Mitsubishi moved for summary judgment and submitted an affidavit from the used-car sales manager at the trade-in dealership attesting that the Galant's wholesale fair market value was $11,000. *Id.* at 1202. The trial court granted the motion and plaintiff appealed. The appellate court affirmed, holding that because plaintiff received fair market value for the car in trade she could not, as a matter of law, prove damages. *Id. See also* U.C.C. § 2-314, Comment 13 ("In an action for breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that *the breach of warranty was the proximate cause of the loss sustained."* (emphasis added)).

[18] *Intrastate Piping & Controls v. Robert-James Sales, Inc.*, 315 Ill.App.3d 248, 733 N.E.2d 718 (2000); *Sorce v. Naperville Jeep Eagle*, 309 Ill.App.3d 313, 722 N.E.2d 227 (2nd Dist.1999).

(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 this Act...

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable . . .[19]

Relying on § 2-719(2), warranty plaintiffs generally contend that, if a limited warranty fails of its essential purpose, they are entitled to recover incidental and consequential damages. The courts are split on the issue of the proper interplay between subsections (2) and (3) of § 2-719. The majority trend is to construe § 2-719 in a manner consistent with its express terms and underlying policies and purposes.[20] Under § 2-719(3), a damages exclusion is enforceable so long as it is not unconscionable.

In *Rheem Mfg. v. Phelps Heating & Air Conditioning*, the Indiana Supreme Court recognized that two lines of interpretation had developed under § 2-719.[21] One line holds that the enforceability of a consequential damages exclusion is "dependent on whether a limited remedy fails of its essential purpose." The second line takes "an 'independent' view and reason[s] that because § 2-719(2) and (3) are separate subsections with separate language and separate standards, the failure of a limited remedy has no effect on an

[19] U.C.C. § 2-719.

[20] *Rheem Mfg. Co. v. Phelps Heating & Air Conditioning*, 746 N.E.2d 941 (Ind.2001) (§ 2-719(2) and (3) operate independently); *Pierce v. Catalina Yachts, Inc.*, 2 P.3d 618, 622 (Alaska 2000) (noting and adopting the majority view which holds that subsections (2) and (3) of § 2-719 operate independently).

[21] *Rheem Mfg*. 746 N.E.2d. at 946-47. In a footnote, the court stated that same analysis applies whether the exclusion applies only to consequential damages or includes both incidental and consequential damages.

exclusion of consequential damages."[22] *Rheem Mfg.* holds that the "independent" view is the correct one.[23]

The *Rheem Mfg*. court based its holding on several factors. First, it noted that the U.C.C.'s drafters inserted different legal standards into §§ 2-719(2) and (3). While a limited remedy clause is unenforceable when the remedy fails of its essential purpose, an incidental and consequential damages exclusion is enforceable so long as it is not unconscionable.[24] Second, it observed that while the jury determines whether a limited remedy has failed of its essential purpose, the court determines, as a matter of law, whether a damage exclusion is unconscionable.[25] Theses differences, the court concluded, demonstrate "a legislative intent that the provisions should function independently of one another."[26]

Third, the court applied the well-established principle of statutory contraction that a court must interpret a statute such that every word is given meaning, and no part is rendered meaningless. It found that "[t]he 'dependent' view renders § 2-719(3)

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[22] *Id.* (Citation omitted.)

[23] Under the independent view, "the court must make three inquiries: (1) whether the contract limited the remedy to repair or replacement; (2) whether, if the remedy were so limited, it failed of its essential purpose; and (3) whether, *if the limited remedy failed of its essential purpose, consequential damages may be recovered because their exclusion is unconscionable*." *Intrastate Piping*, 733 N.E.2d at 724 (emphasis added; internal punctuation omitted), *quoting Myrtle Beach Pipeline Corp. v. Everson Electric Co.*, 843 F.Supp. 1027, 1041 (D.S.C.1993), and *citing J.D. Pavlak, Ltd. v. William Davies Co.*, 40 Ill.App.3d 1, 3-5, 351 N.E.2d 243 (1st Dist.1976).

[24] *See also Sorce v. Naperville Jeep Eagle*, 722 N.E.2d at 236 ("the only requirement for enforcement of a damage exclusion under § 2-719(3) is that the exclusion be conscionable"). In *Sorce*, a Magnuson-Moss breach of warranty action, the court upheld a damage disclaimer. Conversely, in *Lara v. Hyundai Motor America*, 770 N.E.2d 721 (2002), a different panel of the same appellate court analyzed a damage exclusion under § 2-719(2), rather than of § 2-719(3), despite recognizing that § 2-719(3) governs the exclusion of incidental and consequential damages. *Lara's* construction of § 2-719 cannot be reconciled with *Sorce* and *Intrastate Piping*.

[25] *Id.*; *see also* U.C.C § 2-302.

[26] *Id*. 746 N.E.2d at 948.

inoperative by deleting an exclusion of consequential damages without any analysis of unconscionability," while "the 'independent' view allows both provisions to operate …"[27] The court explained that the "independent" construction:

> … harmonizes the language in § 2-719(2) that "remedy may be had as provided in [the U.C.C.]" with the unconscionability test imposed by § 2-719(3)." The "remedy" clause in § 2-719(2), which is crucial to the dependent argument, must be taken in its fullest sense. [Citation omitted.] On its face, the phrase refers to all of the UCC, not merely its remedy provisions. [Footnote omitted.] Therefore, "remedy may be had" under subsection (2) only to the extent that it is not limited by subsection (3), which is part of [the Code].[28]

Fourth, the court considered § 2-719 in light of the Code's underlying purposes to simplify, clarify, and modernize the law governing commercial transactions; to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and, to encourage uniformity.[29] The "independent" view, the court held, serves the Code's purposes because it: "supplies simplicity and clarity by allowing a clearly expressed agreement to control a transaction;" "aids sound *commercial practice* by allowing the parties to anticipate clearly the results of their transaction, while the dependent view retains the specter of unknown damages for the seller despite the parties' explicit understanding;" and, as the majority view and modern trend, promotes uniformity.[30] An additional factor relied upon by the Court was that one of the U.C.C.'s "paramount concerns is enabling contracting parties to control their own relationships."[31]

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[27] *Id.* at 949-50.

[28] *Rheem Mfg.*, 746 N.E.2d at 949.

[29] *Id.*

[30] *Id.* (emphasis in original).

[31] *Id.* at 950.

Conclusion

The Code's policies, not a mechanical application of its damages provisions, should be utilized in actions claiming breach of a warranty to repair or replace. The courts should fashion a measure of damages that produces a result that (1) is consistent with the U.C.C.'s aim of placing the aggrieved party in as good a position as he would have been in but for the breach, and (2) comports with the warranty promise. Because it is a promise to repair that has been breached, these aims are met by measuring damages in terms of repair cost. And consistent with the Code's policy of allowing the parties to shape their contractual relationship, the courts should enforce damages limitations and disclaimers unless unconscionable. Applying an appropriate measure of damages and enforcing proper damages disclaimers will promote fairness and efficiency. Damages awards will more accurately reflect the economic harm sustained, and will be more predictable. This in turn will facilitate prompt dispute resolution.

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