

**Advanced Contracts (Sales and Leases)
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Sample Exam Questions Set #2 - Model Answers

1. K&T, Inc., (“K&T”) is the manufacturer of the MM-180, a computer-controlled machine tool capable of performing automatically a series of machining operations on metal parts. Master Engravers, Inc., (“Masters”) manufactures and engraves component parts for industrial application.

In response to a proposal from K&T, Master issued a purchase order for the MM-180. The order was promptly acknowledged and accepted by K&T. The purchase price was \$167,000. The agreement between the parties included the following provisions:

12. **WARRANTY, DISCLAIMER, LIMITATION OF LIABILITY AND REMEDY:** Seller warrants the products furnished hereunder to be free from defects in material and workmanship for the shorter of (i) twelve (12) months from the date of delivery * * * or (ii) four thousand (4,000) operating hours.

* * *

14. **THE WARRANTY EXPRESSED HEREIN IS IN LIEU OF ANY OTHER WARRANTIES EXPRESS OR IMPLIED INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE AND IS IN LIEU OF ANY AND ALL OTHER OBLIGATIONS OR LIABILITY ON SELLER’S PART. UNDER NO CIRCUMSTANCES WILL SELLER BE LIABLE FOR ANY INCIDENTAL OR CONSEQUENTIAL DAMAGES, OR FOR ANY OTHER LOSS, DAMAGE OR EXPENSE OF ANY KIND, INCLUDING LOSS OF PROFITS ARISING IN CONNECTION WITH THIS CONTRACT OR WITH THE USE OR INABILITY TO USE SELLER’S PRODUCTS FURNISHED UNDER THIS CONTRACT. SELLER’S MAXIMUM LIABILITY SHALL NOT EXCEED AND BUYER’S REMEDY IS LIMITED TO EITHER (i) REPAIR OR REPLACEMENT OF THE DEFECTIVE PART OF PRODUCT, OR AT SELLER’S OPTION, (ii) RETURN OF THE PRODUCT AND REFUND OF THE PURCHASE PRICE, AND SUCH REMEDY SHALL BE BUYER’S ENTIRE AND EXCLUSIVE REMEDY.**

Both of the foregoing provisions were located on the front page of the standard form contract executed by the parties.

K&T delivered the MM-180 on June 1, 2000. At the time of delivery, Master's engineers inspected the machine. It appeared to be satisfactory with the exception of components that did not appear to be properly sized or placed. The K&T representatives assured Master's engineers that the sizing and placement of these components would not negatively impact the MM-180's performance capabilities. On June 8, 2000, Master paid the full purchase price for the machine.

A week after Master paid the purchase price, the machine began to malfunction. In fact, over the next several weeks, the MM-180 malfunctioned frequently, and was inoperable from 40% to 50% of the time available for its use. This degree of "downtime" is substantially more than the industry average of five percent "downtime" for comparable machines.

In addition, between June 14, 2000 and December 1, 2000, K&T made 13 service calls in attempting to repair the machine. Certain of these calls related specifically to replacing improperly sized and placed components. These and other repair efforts were able to reduce the MM-180's "downtime" to between 25 and 40% of the time available for its use. While additional repairs may further reduce the "downtime," it is clear that repairs will not bring the machine close to the five percent industry average.

As a result of defects in the MM-180 and the resulting "downtime," K&T lost profits on unfilled customer orders.

Consequently, on December 1, 2000, Master's president called K&T's president and stated as follows: "the MM-180 is a disaster and we're getting out of this deal." K&T's president replied, "we are certain the problem can be cured. We just need a little more time." "No, you've had all the time we're going to give you" was the response from Master's president.

After the December 1 conversation, the parties did not communicate until February 3, 2001 when Master returned the MM-180 to K&T. Between the December communication and February 3, Master continued to use the MM-180 notwithstanding its problems. The evidence reveals that Master's use during this period was occasioned by its inability to obtain a replacement machine and its desire to minimize its rapidly increasing lost profits.

A. Assume the agreement does not contain paragraphs 12 and 14. Does the UCC give Master the right to return the MM-180 to K&T and seek damages?

Yes. This case is similar to *North American Lighting*, where the buyer accepted the nonconforming machine, knowing of the nonconformity, based on the seller's assurances that the machine could be modified to resolve the buyer's concerns and where the court permitted the buyer to revoke several months after its initial acceptance because during the intervening time

repeated attempts were made by both the buyer and the seller to resolve the defects in the machine. As in *NAL*, Buyer's acceptance of the MM-180 knowing that it was nonconforming did not destroy Buyer's right to revoke its acceptance where the Buyer's accepted "on the reasonable assumption that the non-conformity would be ... cured." § 2-607(2). As in *NAL*, the defects in this case "substantially impair" the MM-180's value to the Buyer. And, as in *NAL*, Buyer's failure to revoke sooner was based on the Seller's continuing assurances that the machine's problems could be resolved.

B. Assume the agreement does contain paragraphs 12 and 14. What remedial options, if any, are available to Master?

Paragraph 12 would not change the outcome of this case. It merely limits whatever warranties apply to the first 12 months after delivery or the first 4,000 hours of operation. We are not told how many hours the machine operated, but Master revoked its acceptance well within the first 12 months after K&T delivered the MM-180 to Master.

Paragraph 14 is more problematic for Master. Clearly, the UCC permits K&T to disclaim the implied warranties of merchantability and of fitness for a particular purpose as long as the disclaimer is in writing and conspicuous. § 2-316(2). Paragraph 14 satisfies both requirements. Likewise, the UCC permits K&T to limit the remedies available to Master, *see* §§ 2-316(4) & 2-719(1), and in particular to exclude consequential damages as long as the exclusion is not unconscionable, *see* § 2-719(3).

Paragraph 14 limits Master's remedies to repair or replacement of the defective MM-180 or return and refund of the purchase price, and gives K&T the choice between the two.

2. In *Cereo v. Takigawa Kogyo Co.*, 676 N.Y.S.2d 364 (N.Y. App. Div. 1998), the Plaintiff (Cereo) was injured while repairing a machine with a leaky air line. When someone turned off the power at an operating panel, a pneumatically controlled roller returned to an "up" position and crushed plaintiff's foot. The machine that injured the Plaintiff had been modified by defendant Reliance prior to the Plaintiff's injury. Plaintiff sued Reliance, among others, claiming Reliance had negligently redesigned the machine's operating panels, by failing to install lock-out devices that would have prevented the power from being shut off while the Plaintiff was working on the machine. Reliance moved for summary judgment alleging that it performed the modification pursuant to a subcontract with its co-defendant Fordees, who had sold the machine to Cereo's employer; and, therefore, that it was not in privity with Plaintiff, and that Plaintiff could not sue it for breach of warranty. Applying New York's version of the Uniform Commercial Code, the court of appeals denied Reliance's motion for summary judgment, holding that "[p]rivacy is not required in a personal injury action for breach of express or implied warranty."

A. Assuming that the quoted passage accurately describes the full extent to which privity was not required under New York's UCC at the time the case was decided, what version of § 2-318 did New York law most closely resemble at the time the case was decided?

Alternative “B.” The court’s statement about N.Y.’s view of § 2-318 privity is too broad to fall under Alternative “A,” because it does not limit recovery to member’s of the purchaser’s family or household and guests in the purchaser’s home. It is also too narrow to encompass Alternative “C,” which does not limit itself to claims by natural persons nor to claims for personal injury; but, rather, extends recovery to any person (whether a natural or artificial person) who might foreseeably use, consume, or be affected by the good, for both personal injury and property damage.

B. Same facts as “A,” except that the machine belonged to Cereo’s brother, and Cereo was working on the machine in his brother’s garage when he was injured.

1. Would Reliance be entitled to summary judgment applying the same provision of the New York UCC? If so, why? If not, why not?

No. Cereo would certainly qualify as “a[] natural person who may be reasonably expected to use, consume or be affected by the goods and who is injured in person” Therefore, Reliance would not be entitled to summary judgment against Cereo’s claims.

2. Would Reliance be entitled to summary judgment applying the most restrictive (*i.e.*, least “plaintiff-friendly”) version of the same UCC provision?

Probably not. Even under Alternative “A,” Cereo clearly seems to be “a[] natural person who is in the family or household of the buyer or who is a guest in [the buyer’s] home.”

C. Same facts as “A,” except that Reliance’s contract with Fordees expressly disclaimed “any and all warranties not expressly set forth herein.” If the contract included no express warranties about the machine’s safety, should the inclusion of this disclaimer change the court’s ruling on Reliance’s motion for summary judgment? If so, why? If not, why not?

Reliance should prevail, barring a finding of unconscionability. Section 2-316 permits a seller (in this case, Reliance) to limit or exclude the implied warranties of merchantability and fitness and to substitute in their place, at the seller’s option, one or more express warranty(-ies). Section 2-316(2) specifically provides that a seller may disclaim all implied warranties of fitness with language that states, for example, “There are no warranties which extend beyond the description on the face hereof.” The disclaimer described above would seem to be the equivalent of the statutorily-approved waiver.

D. Same facts as “A,” except that Reliance’s contract with Fordees stated that “any and all warranties expressed herein or implied hereby extend only to the purchaser of this machine.” Should the inclusion of this disclaimer change the court’s ruling on Reliance’s motion for summary judgment? If so, why? If not, why not?

Reliance should lose here, because Alternatives A, B, and C all prohibit “exclud[ing] or limit[ing] the operation of this section.” The comments to § 2-318 make it clear that this language does not prohibit a seller from limiting or disclaiming any warranty as to the purchaser.

Instead, the point of this language is that the seller may not allow warranty claims by purchasers but disallow them by others who fall within the scope of § 2-318's coverage. See § 2-318 cmt. 1.

3. Seller, whose place of business is Boston, contracted to sell 80 boxes of clothing to Buyer, whose place of business is Las Vegas. The price term in the contract was "\$1,800 FOB Las Vegas." Seller contracted with Interstate Freight to ship the boxes to Buyer. Interstate picked the boxes up from Seller's factory and transported them to Interstate's terminal, where they would be loaded on a truck carrying shipments for several buyers in Nevada. Before the boxes could be loaded on the truck, they were destroyed when a fire broke out at the terminal.

A. Is Buyer obligated to pay the \$1,800?

No. In the first place, this is a destination contract, as opposed to a shipment contract, therefore the Seller bears the risk of loss until the goods are tendered or delivered to Buyer at the designated destination. § 2-319(1)(b). Second, even if this were a shipment contract, Seller did not notify Buyer that the goods had been delivered to the carrier for shipment; therefore, risk of loss would not have shifted from Seller to Buyer. § 2-504(c).

B. How would your answer to Part "A" differ if the delivery term in the contract was "FOB Boston"?

In this case, this would be a shipment contract. § 2-319(1)(b). However, because Seller did not notify Buyer that the goods had been delivered to the carrier for shipment, risk of loss would not have shifted from Seller to Buyer. § 2-504(c).

C. What if the fire that broke out at Interstate's terminal was intentionally set by an employee of Interstate?

Interstate was not a party to the contract between Buyer and Seller; therefore, while the fact that the fire was set by an Interstate employee might require Interstate's insurer to reimburse Seller for its loss, Seller would still bear the risk of loss as between it and Buyer, as explained in both "A" and "B" above.

D. What if the fire that broke out at Interstate's terminal was intentionally set by an employee of Seller?

If the damage or destruction to the goods subject to the contract is caused by one of the parties, then that party is responsible for the loss, notwithstanding the default risk allocation rules. Thus, if Seller caused the loss, Seller would have to bear its expense. In this case, that is no great revelation, because Seller bore the risk of loss in any event.

4. On July 1, 2002, Monica, a fruit merchant, mailed Chandler, a fruitstand operator, a written offer to sell up to 500 crates of mangoes (30 per crate) for \$6.00 per crate. By the terms of Monica's offer, Chandler had the exclusive right to accept or decline the offer until July 10, 2002 at 5:00 p.m. Chandler received Monica's written offer on July 3rd.

On July 5, Monica wrote Chandler revoking the offer. Monica promptly placed the letter in the mail, properly addressed and with adequate postage. Later that same day, Monica sold all 500 crates of mangoes to Phoebe, a mango-loving vegetarian (or, should it be "fruititarian"?), at a price of \$6.50 per crate.

On July 6, Chandler wrote Monica that Chandler would purchase 100 crates of mangoes from Monica for \$6.00 per crate, provided that Monica deliver the mangoes no later than August 1, 2002 and that Monica pay any delivery costs.

Monica received Chandler's July 6th letter on July 8th. Monica immediately sent a fax to Chandler informing Chandler that Monica had revoked the offer and sold the mangoes to Phoebe. Chandler received Monica's July 5th letter later on July 8th.

Assuming that Monica's sale to Phoebe constituted a breach of her contract with Chandler and that

1. Monica can acquire another 100 crates of mangoes in time to deliver them to Chandler by August 8th,
2. Chandler can purchase replacement mangoes for delivery on or before August 1st from another seller, Ross, for \$7.00 per crate (including delivery),
3. the market price of mangoes on July 6th was \$6.50 per crate,
4. the market price of mangoes on August 1st will be \$7.00 per crate, and
5. Chandler sells 50 crates of mangoes per week to his customers at a price of 3 for \$1,

what remedy or remedies do/does Article 2 afford Chandler against Monica? Please explain.

Because Monica failed to deliver the goods under the contract, § 2-711 governs. Chandler may:

- (1) cancel the contract – so what?;
- (2) recover any money already paid to Monica – none;
- (3) "cover" by purchasing replacement mangoes from another supplier, per § 2-712, and recover the difference between the cover price and the contract price, plus any incidental and

consequential damages (none, here, since Chandler could cover by the contract deadline), less any expenses saved by Monica's breach (none): $\$700 - \$600 + \$0 + \$0 - \$0 = \100 ;

(4) recover the difference between the market price at the time Chandler learned of the breach and the contract price, per § 2-713, plus any incidental and consequential damages (none, here, since Chandler could cover by the contract deadline), less any expenses saved by Monica's breach (none): $\$650 - \$600 + \$0 + \$0 - \$0 = \50 ;

(5) seek specific performance, per § 2-716 – probably not a likely outcome here, since there is no evidence that Monica's mangoes are unique, and there are obviously other suppliers out there; or

(6) agree to modify the contract and allow Monica to deliver the contract quantity at the contract price on or before August 8th.

5. Sugarbakers is a small but successful interior design business. Wanting to expand into graphic design and advertising, Sugarbakers' principal, Suzanne Sugarbaker, contracted with an upstart computer engineering firm, Dilbert & Co., to design customized graphics software. Dilbert & Co.'s chief engineer, Dilbert – who Suzanne met on a flight from Atlanta to San Jose, California (where Dilbert & Co. is headquartered) – promptly designed and tested the software. Claiming that he was unsatisfied with the software's performance on Sugarbakers' existing computers, Dilbert suggested that Sugarbakers buy a new computer specially designed for graphics software, the Dogbert Y2K Special ("DY2KS"), to run the new software. The DY2KS is manufactured by Dilbert & Co. Delighted with Dilbert's demonstration of the custom software using the DY2KS, Suzanne willingly agreed to buy the DY2KS to run the software. The parties amended their contract to include Sugarbakers' purchase and Dilbert & Co.'s delivery of the DY2KS.

Less than two weeks after taking delivery of the software and the DY2KS, Suzanne began to notice a recurrent glitch that caused a small, bespectacled dog to appear randomly in the graphical layouts she designed using the DY2KS. Acting on a hunch, Suzanne discovered the same glitch while running other software that had been installed on the DY2KS. When she called Dilbert & Co. to complain, her call was directed to their customer service specialist, Dinosaur Bob, who threatened to give Suzanne a wedgie if she didn't stop complaining. The problem persisted, causing Sugarbakers to lose a lucrative advertising contract for the Greater Atlanta Garfield Fan Club. Finally fed up with it all, and wanting to prevent any further loss of business, Sugarbakers purchased a MicroSpaz 3000GT computer for \$3,000, new graphics software for \$2,000, and filed suit against Dilbert & Co., alleging breach of any and all applicable express and/or implied warranties.

The parties' pleadings and discovery reveal, in addition to the foregoing, that: (1) Sugarbakers paid Dilbert & Co. \$25,000 to design the custom software; (2) Sugarbakers paid Dilbert & Co. \$2,500 for the DY2KS computer; (3) Sugarbakers paid Dilbert & Co. the entire \$27,500 prior to taking delivery of the software and the DY2KS; (4) the parties agree that any glitch is a "hardware" problem with the DY2KS, not a "software" problem; (5) Sugarbakers' expert witness has opined that the software designed by Dilbert & Co.

would have performed as well or better on any number of other commercially-available computers as it did on the DY2KS before the glitch appeared; (6) Suzanne's assistant, Theo, loaded the software onto another computer and ran it for several weeks without ever encountering the glitch; (7) the warranty card that accompanied the DY2KS computer did not disclaim any implied warranties and expressly warranted that the computer would operate free of any errors other than those caused by third-party software, for a period of no less than one year from the date of purchase; (8) the contract Sugarbakers lost with the Greater Atlanta Garfield Fan Club would have netted Sugarbakers a profit of at least \$25,000; and (9) the MicroSpaz 3000GT and the new graphics software have been glitch-free.

On the eve of trial, Dilbert & Co. moved for summary judgment on Sugarbakers' warranty claims on the grounds that (1) that Article 2 does not govern its dispute with Sugarbakers and, therefore, it did not owe Sugarbakers any implied warranty(-ies); and, (2) even if it did owe Sugarbakers one or more express and/or implied warranty(-ies), Dilbert & Co. did not, as a matter of law, breach any express and/or implied warranty(-ies). Sugarbakers responded that the dispute is governed by Article 2 and that Dilbert & Co. did, in fact, breach both express and implied warranties covering the software and the DY2KS computer.

You are the law clerk for the trial judge considering Dilbert & Co.'s motion and preparing, if she decides to deny the motion, for a mandatory settlement conference and possibly a trial on the merits. Your judge wants you to answer the following questions:

A. Assuming that Article 2 governs this transaction and that Dilbert & Co. breached one or more implied or express warranty(-ies), what damages might Sugarbakers be entitled to recover and why?

Because Sugarbakers did not discover Dilbert & Co.'s breach(-es) of warranty until after Sugarbakers had accepted both the software and the DY2KS computer, Sugarbakers' options upon discovering the nonconformity were to (1) revoke acceptance, per § 2-608, or (2) keep the nonconforming good(s) and sue Dilbert & Co. for breach under § 2-714. However, because so much time has passed since Sugarbakers first noticed the glitch, and because Sugarbakers' failure to revoke sooner was not caused by Dilbert & Co.'s assurances that they would cure the problem, Sugarbakers' best option seems to be to sue under § 2-714, which permits Sugarbakers to recover its "expectation" damages – that is, the difference at the time and place of acceptance between the value of the (nonconforming) good accepted and the value the good would have had if it had performed as warranted – plus any incidental and consequential damages recoverable under § 2-715 that can be attributed to the nonconformity, provided it gave Dilbert & Co. proper notice of the non-conformity, as required by § 2-607(3)(a).

Here, Sugarbakers should be able to recover the difference between the \$2,500 paid for the DY2KS and its fair value in light of the nonconformity. What about the \$25,000 profits lost on the Garfield Fan Club account as consequential damages? According to § 2-715, that will depend on whether Sugarbakers could have prevented the lost profits "by cover or otherwise." If the custom software ran without a glitch on other computers – a fact of which Sugarbakers

should have been aware, because Suzanne's assistant, Theo, "loaded the software onto another computer and ran it for several weeks without ever encountering the glitch" – Sugarbakers may be barred from recovering the lost profits. It probably boils down to a timing question. At the time they lost the account, did Sugarbakers know that they could run the software on another computer; and, if so, for how long?

B. Assume, instead, that this transaction is governed by the CISG, and that Dilbert & Co. breached one or more warranty(-ies) recognized by the CISG, what remedy or remedies would the CISG afford Sugarbakers against Dilbert & Co.? Please explain.

Under the CISG, a buyer may "avoid" its contract if, as here, the seller has committed a fundamental breach, Art. 49(1)(a); but only if the buyer declares the contract avoided within a reasonable time, Art. 49(2)(b). A buyer who successfully avoids the contract may sue to recover either "cover" damages, Art. 75, or contract-market price differential damages, Art. 76(1), plus incidental and consequential damages, Art. 74. For the same reasons that Sugarbakers does not appear to be eligible to revoke its acceptance, Sugarbakers would also not appear eligible to avoid its contract with Dilbert & Co. Therefore, it may choose between (1) specific performance, Art. 46(2), but only to the extent that forum law would permit specific performance, Art. 28, and (2) "expectation" damages, plus incidental and consequential damages, Art. 74. If Sugarbakers elected to pursue "expectation" damages, it must have taken reasonable steps to mitigate its damages, Art. 77.