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# Blending the Law of Sales with the Common Law of Third Party Beneficiaries

*Gary L. Monserud\**

## INTRODUCTION

The purpose of this article is to propose a blend between the law of sales governed by Article 2 of the Uniform Commercial Code and the common law of third party beneficiaries. A revised Article 2 will probably be agreed upon in 2001 and thereafter will be submitted to state legislatures for enactment.<sup>1</sup> Unless there are unexpected developments, the revised official text will have a section with alternatives similar to those offered by the current

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1. After a decade of effort, it appears that the revision process is nearly complete. The chairman of the drafting committee is Professor William Henning, University of Missouri-Columbia. He has advised the author that at the annual meeting of the National Conference of Commissioners on Uniform State Laws ("NCCUSL") held July 28 - August 4, 2000, approval of the 2000 annual meeting draft was deferred pending resolution of one main issue and several lesser issues. The main issue that needs resolution relates to the scope of Article 2, particularly whether its coverage extends to embedded computer programs. An example of a less difficult remaining issue is the wording of proposed section 2-313B which would govern sellers' obligations to remote purchasers created by communications to the public. Many persons have been involved in the drafting process. Currently, the Reporter is Professor Henry Gabriel, Jr., Loyola University School of Law, New Orleans. Members of the drafting committee are Boris Auerbach, Wyoming, Ohio; Marion Benfield Jr., New Braunfels, Texas; Amelia Boss, Temple University, Philadelphia, Pennsylvania; Byron Sher, Sacramento, California; James White, University of Michigan, Ann Arbor, Michigan; Linda Rusch, Hamline University School of Law, St. Paul, Minnesota; and Richard Speidel, Northwestern University, Chicago, Illinois. Professor Henning informed the author on August 8, 2000, that the revision is on track for approval by both sponsoring organizations, NCCUSL, and the American Law Institute, at their annual meetings in 2001. As this article was going to press, a November 2000 draft was circulated by Professors Henning and Gabriel. This latest draft does not contain any changes affecting any arguments made in this article because in relevant parts it follows the 2000 annual meeting draft.

section 2-318.<sup>2</sup> State legislators will choose among limited classes of third party beneficiaries and will grant rights to a selected class to sue for breach of warranty.<sup>3</sup> There will be ample room for supplementation by the common law of third party beneficiaries, as is the case under current Article 2. However, neither current Article 2 nor the most recent proposed revision provides meaningful guidance as to when and to what extent the common law of third party beneficiaries should be used to supplement Article 2. This article suggests a method that courts can use, and arguments that lawyers can make, for use of the common law of third party beneficiaries to supplement Article 2, or a revised Article 2, whenever enacted.<sup>4</sup>

This article focuses on the use of the common law of third party beneficiaries in situations where a claimant has suffered a direct or consequential economic loss apart from personal injury or property damage. This article is not intended to address questions about claimants who seek redress for personal injuries or property damage. However, it is necessary to discuss Code sections designed for personal injury and property damage cases in order to show where the need exists for the use of non-Code law in cases involving only economic loss.

The project of supplementing the third party provisions of Article 2 with the common law of third party beneficiaries has rarely received academic attention. A reading of the very substantial twentieth century commentary on third party beneficiary law reveals that scholarship usually falls into one of two categories: Either commentators have written extensively on the common law of third party beneficiaries while avoiding third party provisions in Article 2, or they have written about the rights of third parties

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2. All citations to current Article 2 in this article are citations to the Official Text - 2000, promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws unless otherwise specified. Uniform Commercial Code ("UCC") section 2-318 allows state legislators to choose among three possible rules for recognizing third party beneficiaries on UCC warranties. This section and related case law are discussed in Part II, *infra*. The 2000 annual meeting draft, the most recent draft, proposes a revised section 2-318 which would offer similar alternatives to the state legislatures. This proposed section is discussed in Part III, *infra*.

3. Section 2-318 of the 2000 annual meeting draft is discussed in Part III of this article. If history is a guide to the future, most state legislatures will adopt an official Alternative which gives a statutory right of suit for breach of warranty only when personal injury or property damage occurs.

4. There is no question that the common law and equity may be used to supplement the UCC, as provided by section 1-103, as long as the common law has not been displaced by UCC provisions.

under Article 2 with infrequent reference to the evolving common law of third party beneficiaries. Questions about who can sue whom under Article 2 have often been cast exclusively in terms of "privity" or the lack thereof.<sup>5</sup> However, since current Article 2 and the pertinent provisions of its likely successor do not address many questions about privity, it makes sense to resort to the common law as a supplement when the need arises.<sup>6</sup>

This article is divided into seven parts. Part I is a general history of third party beneficiary law from its English origins to the present. Part II is a description of third party rights under pre-revision (current) Article 2. Part III explores third party rights under recent revision drafts. Part IV suggests an appropriate blend of Article 2 and third party beneficiary law in common situations where horizontal privity is in issue.<sup>7</sup> Part V examines remedial questions raised by situations discussed in Part IV. Part VI suggests a blend of Article 2 and the common law of third party beneficiaries when vertical privity is problematic.<sup>8</sup> Part VII discusses particular remedial problems facing third party claimants making claims against non-privity manufacturers and distributors. Throughout the article, the blend suggested will be made with reference to section numbers under current article 2. The relevant

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5. BLACK'S LAW DICTIONARY (7th ed.) offers the following definition for privity of contract: "The relationship between the parties to a contract allowing them to sue each other but preventing a third party from doing so." Thus, privity of contract means an immediate contractual connection, e.g., between employer and employee or seller and buyer in a sale of goods transaction.

6. See section 1-103. As to the necessity of extensive borrowing from the common law of contracts to make Article 2 workable, there can be no doubt. See, e.g., sections 2-205 through 2-207 which would make no sense without assuming the common law definition of offer from Restatement (Second) of Contracts, section 24.

7. Horizontal privity raises the question: Who, aside from the final buyer in the distribution chain, can sue the merchant who sold the goods to the final buyer? Professors White and Summers use the following example:

The "horizontal" non-privity plaintiff is not a buyer within the distributive chain but one who consumes or uses or is affected by the goods. For example, a woman poisoned by a bottle of beer that her husband purchased from a local grocer is a horizontal non-privity plaintiff. So, too, is a son who is injured by a new lawnmower his father bought, and the employee hurt by equipment purchased by her employer and so on.

WHITE AND SUMMERS, 1 UNIFORM COMMERCIAL CODE § 11-2 (4th ed., Practitioner Treatise Series, 1995) ("White and Summers").

8. Vertical privity raises the question: Who, in the distributive chain, aside from the final seller, can be made a proper party defendant? White and Summers describe the vertical non-privity plaintiff as follows: "The 'vertical' non-privity plaintiff is a buyer within the distributive chain who did not buy directly from the defendant. For example, a man who buys a lathe from the local hardware store and then later sues the manufacturer is a 'vertical' non-privity plaintiff." *Id.*

section numbers will probably remain the same under the revision.<sup>9</sup>

## I. THE EVOLUTION OF THIRD PARTY BENEFICIARY LAW FROM 1677 TO THE PRESENT

### A. *English Origins*

Judicial recognition of third party rights in English law is usually traced to *Dutton v. Poole*,<sup>10</sup> though there are occasional citations to earlier cases.<sup>11</sup> *Dutton* arose from a family dispute. A father intended to cut and sell wood to raise a dowry for his daughter. The eldest son who expected to inherit the wood objected and promised his father that he would pay his sister a certain sum if his father would not sell the wood. The sister married, the father died, and the eldest son who inherited the wood refused payment. The question on appeal was whether the daughter should be allowed to recover on the judgment entered by the trial court when the promise on which she sued was made to her father (promisee) rather than to her. The court held that suit on a promise was not restricted to a promisee. The third party intended by the original parties to benefit from the promise could sue in her own name.<sup>12</sup> In twentieth century terminology, the daughter (sister) was recognized as a donee beneficiary. Simply stated, the principle was that an intended donee of an enforceable promise had a legally recognized right to enforce the promise. Of course, the case by its facts was limited to an intra-familial promise.

The principle was reaffirmed a century later in *Martyn v. Hind*<sup>13</sup> wherein Lord Mansfield expressed surprise that any doubt should have arisen about the correctness of *Dutton v. Poole*, the case having been fully argued and carefully decided. Yet, if we fast forward to the mid-nineteenth century, we see the principle of *Dutton v. Poole* breezily repudiated in the oft-cited case of *Tweddle v. Atkinson*.<sup>14</sup> *Tweddle v. Atkinson* involved a bride's father's promise to pay his prospective son-in-law a certain sum, the promise having been made to the prospective groom's father, in

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9. See Part III, *infra*. The drafting committee has decided to stay with the current numbering system.

10. 2 Lev. 210 (K.B. 1677).

11. L.P. Simpson, *Promises Without Consideration and Third Party Beneficiary Contracts in American and English Law*, 15 INT'L & COMP. L.Q. 835, 848-49 (1966).

12. It is commonly stated that women at this stage of history lost their legal capacity upon marriage and that the husband had all property and contract rights.

13. 98 Eng. Rep. 1174 (K.B. 1776).

14. 1 B. & S. 393 (Q.B. 1861).

return for his promise of a sum certain for the couple to be married. The Queen's Bench unanimously decided that the son-in-law had no cause of action on the promise made to his father by his father-in-law because, "the consideration must move from the party entitled to sue upon the contract."<sup>15</sup> As a result, the development of what is later called "classical contract law" erected a barrier to the further development of third party beneficiary contract law in England.<sup>16</sup> It was axiomatic: If a person furnished consideration, that person could sue on a promise given in return for the consideration; conversely, a person giving no consideration for a promise had no standing to sue. This view was deemed to have a solid moral underpinning. In the words of Judge Crompton from the *Tweddle* case, "It would be a monstrous proposition to say that a person was a party for the purpose of suing upon it for his own advantage, and not a party to it for the purpose of being sued."<sup>17</sup> Thus, the wisdom of the seventeenth century judiciary became the victim of classical contract theory and the altered moral perspective of the nineteenth century.

### *B. Third Party Beneficiary Law in the Commonwealth of Massachusetts*

The rise and sudden disappearance of third party rights in England was replayed in the Commonwealth of Massachusetts, albeit in an abbreviated time span. The first case of significance was *Felton v. Dickinson*,<sup>18</sup> decided in 1813. Felton, as a boy of fourteen, was put into the service of Dickinson who promised Felton's father that he would support the boy until age twenty-one, and at that time would either pay him \$200 or grant him a parcel of land in Vermont — whichever the young man elected. When Felton turned twenty-one, and Dickinson refused to pay him \$200 on his election as promised, Felton sued on the promise made to his father. He won a judgment at the trial court. The Supreme Judicial Court sustained this judgment on the basis of *Dutton v. Poole* and its progeny. Thus, by 1813 an intended third party beneficiary had a right to sue in the courts of Massachusetts. Case reports establish that third party rights were recognized for more than forty years.<sup>19</sup>

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15. *Tweddle*, 1 B. & S. at 398.

16. The rights of third parties on contracts went underground, becoming part of the law of trusts. Where one doctrine failed, another filled the void.

17. *Tweddle*, 1 B. & S. at 398.

18. 10 Mass. 287 (1813).

19. See, e.g., *Arnold v. Lyman*, 17 Tyng. 400 (1821); *Hall v. Marston*, 17 Tyng. 574 (1822);

Then, in *Mellen v. Whipple*,<sup>20</sup> decided in 1854, the development of third party rights on contracts stopped abruptly.

*Mellen v. Whipple* was a simple case arising from a mortgage assumption. Whipple purchased an interest in a lot and promised, as part of his consideration, to pay off an obligation secured by a mortgage to which his interest was subject. In a suit brought by the holder of the note and mortgage, Whipple argued that he could not be sued by a stranger to his assumption agreement. Of course, Whipple had made his promise of payment to his seller, not to the holder of the note or his predecessors. Whipple's argument prevailed at the trial court. The Supreme Judicial Court sustained the denial of recovery saying, "There must be privity of contract between the plaintiff and defendant, in order to render the defendant liable to an action, by the plaintiff on the contract."<sup>21</sup> In harmony with the judicial view expressed in England in *Tweddle v. Atkinson*, the court stated, "[the] general rule is and always has been, that a plaintiff, in an action on a simple contract, must be the person from whom the consideration of the contract actually moved, and that a stranger to the consideration cannot sue on the contract."<sup>22</sup> As on the Queen's Bench, the axioms of an emerging

*Carnegie v. Morrison*, 2 Met. 381 (1841); *Brewer v. Dyer*, 61 Mass. (7 Cush.) 337 (1851). In *Brewer v. Dyer*, the plaintiff, Brewer, leased a building to Parmelee. *Id.* Parmelee contracted with Dyer, allowing the latter use of the building in return for Dyer's promise to pay Brewer the rent Parmelee owed. *Id.* Under this arrangement, Brewer billed Parmelee, the latter billed Dyer, and Dyer paid Brewer until he abandoned the building. *Id.* In an opinion affirming Brewer's right to sue Dyer, the Supreme Judicial Court used language strongly affirming third party rights:

[W]hen one person, for a valuable consideration engages with another, by simple contract, to do some act for the benefit of a third, the latter, who would enjoy the benefit of the act, may maintain an action for breach of such engagement . . . [I]n the case at bar, the agreement made between Parmelee and Dyer, is in express terms to pay the rent to Brewer, the plaintiff, and he is the party to be benefited thereby. It is made upon a valuable consideration as between Parmelee and defendant; being the surrender of the shop by the former, and its occupation by the latter. To make the defendant liable, no consideration need move as between him and the present plaintiff. Nor is it any objection to plaintiff's right to recover, that Parmelee might also have a remedy on the contract, in case the plaintiff should not elect to adopt it. It does not operate to extinguish Parmelee's liability. The plaintiff, if he so elects, can seek his remedy on the agreement, or may rely on the original undertaking of his lessee; in which latter case, Parmelee could enforce the contract against the defendant. These principles are all well established in the adjudged cases, and it is unnecessary to enlarge upon them.

*Id.* at 340-41 (citations omitted).

20. 67 Mass. 317, 1 Gray 317 (1854).

21. *Id.* at 321.

22. Of course, *Mellen* preceded *Tweddle v. Atkinson* by seven years; consequently, if there was trans-Atlantic influence, it flowed from Massachusetts to England rather than the

classical contract law sharply curtailed the development of third party beneficiary law in Massachusetts.

*Mellen v. Whipple* notwithstanding, cases recognizing rights of third parties benefited by contracts did not wholly disappear in Massachusetts. Rather, the courts carved out and developed ever more complex exceptions over the 125 years following *Mellen*.<sup>23</sup> Finally, in 1979, recognizing that the exceptions were swallowing the rule, the Supreme Judicial Court reversed course and overruled *Mellen* in *Choate, Hall & Stewart v. SCA Services, Inc.*,<sup>24</sup> a case wherein the plaintiff law firm was allowed to recover fees from a corporate promisor who promised a director in a settlement agreement to pay his legal fees *directly*. This brought Massachusetts back into the mainstream. During the *Mellen* era, every other American jurisdiction had recognized third party rights on contracts either through case law or by statute.

### C. New York: Where the Modern Law of Third Party Beneficiaries Took Root and Matured — Sort of

Because the *Mellen* decision in 1854 caused the law favoring third party beneficiaries in Massachusetts to develop through exceptions to the general rule barring recovery, the mainstream of doctrinal evolution occurred elsewhere. It was New York's fate to be the state where the modern law of third party beneficiaries was given its firmest anchor. The leading case is *Lawrence v. Fox*<sup>25</sup> wherein Fox promised Holly (promisee) that he would repay Holly's debt to Lawrence.<sup>26</sup> A majority of the New York Court of Appeals (6-2 decision) agreed that Lawrence had a case against Fox.<sup>27</sup> The court thereby created what has subsequently been

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reverse.

23. The development of exceptions capable of swallowing the rule was carefully explained in two student authored law review articles. See *Contracts for the Benefit of Third Persons in Massachusetts*, 28 B.U. L. REV. 465 (1948); *The Third Party Beneficiary Rule in Massachusetts*, 8 SUFFOLK U. L. REV. 130 (1973). Each student author sought to explain the subtleties of the many exceptions to the *Mellen* rule against the recognition of third party rights on contracts. Both articles are a wealth of information on Massachusetts's history in this area of the law.

24. 378 Mass. 535 (1979).

25. 20 N.Y. 268 (1859).

26. In fact, the promisee was not Holly, but somebody named Hawley, probably Merwin Spencer Hawley, a well-to-do Buffalo businessman who lent money to Fox for gambling purposes. Anthony J. Waters, *The Property in the Promise: A Study of the Third Party Beneficiary Rule*, 98 HARV. L. REV. 1109-23 (1985) ("Waters"). The article is masterfully written and contains a rich and detailed history of the case.

27. Aside from the two dissenting opinions, it should be noted that two judges voting



known as the category of creditor beneficiaries. Allowing third party recovery on a contract was not wholly new in New York.<sup>28</sup> Neither was the opinion in *Lawrence v. Fox* especially enlightening, and its holding was soon restricted.<sup>29</sup> However, the opinion did greatly impress Samuel Williston and casebook editors who followed him. Consequently, it was adopted for casebooks and has appeared in Contracts casebooks up to the present, often featured as a leading case. *Lawrence v. Fox* gradually became, in the minds of legions of lawyers, the paradigmatic American case allowing third party recovery on a contract.<sup>30</sup>

The next high point in New York case law was *Ransom v. Seaver*,<sup>31</sup> decided in 1918. The promisor (Judge Beman) promised his dying wife that he would provide for a favored niece in his will. He died without having done so, and the niece sued the executors of Judge Beman's estate. The New York Court of Appeals upheld the niece's right of recovery. The court thereby recreated the category recognized in *Dutton v. Poole* and other cases in seventeenth century England, often referred to as donee beneficiaries. Therefore, in a span of about sixty years, the New York courts worked their way to a two-fold classification of recognized third party beneficiaries who were allowed direct actions against promisors for breach of promises not made to them nor in return for their consideration, but rather intended for their benefit.

#### D. *The Venerable Scholars: Williston and Corbin*

The development of twentieth century law pertaining to third party beneficiaries seems, in hindsight, very improbable had it not been for the labors of the two great scholars, Professors Samuel Williston and Arthur Corbin. Professor Williston's first article on the subject appeared in 1902 in the *Harvard Law Review*.<sup>32</sup> Today, this

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with the majority only did so because they believed Lawrence's recovery against Fox was justifiable on agency principles.

28. See, e.g., *Farley v. Cleveland*, 4 Cow. 432 (N.Y. Sup. Ct. 1825), *aff'd without opinion*, 9 Cow. 639, 640 (N.Y. 1827).

29. See, e.g., *Garnsey v. Rodgers*, 47 N.Y. 233 (1872); *Vrooman v. Turner*, 69 N.Y. 280 (1877). These cases and others are discussed by Melvin A. Eisenberg in, *Third Party Beneficiaries*, 92 COLUM. L. REV. 1358 (1992) ("Eisenberg"). This article will be discussed in greater detail in Part I.G and again in Parts IV and VI.

30. See Hoeflich & Perelmutter, *The Anatomy of a Leading Case: Lawrence v. Fox in the Courts, the Casebooks, and the Commentaries*, 21 U. MICH. J.L. REFORM 721 (1988).

31. 120 N.E. 639 (N.Y. 1918).

32. Samuel Williston, *Contracts for the Benefit of a Third Person*, 15 HARV. L. REV. 101

article provides an excellent vantage point from which to assess the state of the law at the turn of the last century. In general, Williston was cautious of third party rights, at least initially, and thought that enforcement should be sparingly allowed *in equity* only when justice required. Professor Williston recognized that the great majority of states allowed third party suits.<sup>33</sup> His main criticism was that two recurring situations, those wherein the promisee sought indirectly to discharge an obligation, and those wherein the promisee simply wanted to make a gift, were usually lumped together indiscriminately in judicial opinions. He thought that, for analytical purposes, these two typical situations ought to be clearly distinguished, a point which he stressed in his treatise published in 1920.<sup>34</sup>

Arthur Corbin entered the fray with an article in the *Yale Law Journal* in 1918<sup>35</sup> and provided thereby a readable summary of the current state of the law as well as sharp criticism of the Massachusetts rule.<sup>36</sup> He strongly favored the recognition of third party rights and stridently opposed the view that privity between the claimant and promisor should be necessary for promissory liability. His disapproval of scholars who refused to recognize any third party contract rights for doctrinal reasons is evident in his introductory paragraphs, "To many students and practitioners of the common law privity of contract became a fetish. As such, it operated to deprive many a claimant of a remedy in cases where according to the mores of the time the claim was just."<sup>37</sup> As to the rationale for recognition, he stated, "The reasons for recognizing rights in the contract beneficiary are substantially the same as those underlying the rights of a cestui que trust. By so doing the intention of the parties is carried out and the beneficiary's just expectations are fulfilled."<sup>38</sup>

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(1902).

33. Exceptions at that time were Connecticut, Massachusetts, Michigan, Minnesota, New Hampshire, Vermont, Virginia, and possibly Pennsylvania. However, Connecticut, Michigan, Vermont, and Virginia allowed suits in equity. *Id.* at 780-81.

34. 1 SAMUEL WILLISTON, A TREATISE OF THE LAW OF CONTRACTS §§ 357-61 (1921). There were two subsequent editions and a fourth is in progress. Williston's insistence on separately viewing these two categories of beneficiaries later put him at odds with Corbin's insistence on a single principle for separating beneficiaries that should be judicially recognized, and those that should not be. *Id.*

35. Arthur L. Corbin, *Contracts for the Benefit of Third Persons*, 27 YALE L.J. 1008 (1918).

36. *Id.* at 1008.

37. *Id.*

38. *Id.* at 1009.

Professor Corbin clarified and expanded upon his views in five more law review articles.<sup>39</sup> His views were in part aimed at the forthcoming Restatement of the Law of Contracts by the American Law Institute, a project he strongly favored as a means of bringing more clarity and uniformity to the law, the lack of which he lamented.<sup>40</sup> Professor Williston served as Reporter for the work on the Restatement, and Professor Corbin worked as his associate.

### *E. The First Restatement of the Law of Contracts*

Recognition of third party rights on contracts was enshrined in the Restatement of Contracts (1932). Section 133 explicitly recognized three classifications of beneficiaries: The donee beneficiary, the creditor beneficiary, and the incidental beneficiary. The donee beneficiary category was so broad that it included not only true donees but a residual category subsequently referred to as "constructive donees."<sup>41</sup>

Subsection (a) of section 133 categorized a third party as a donee beneficiary if:

it appears from the terms of the promise in view of the accompanying circumstances that the purpose of the promisee in obtaining the promise of all or part of the performance thereof is to make a gift to the beneficiary or to confer upon him a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary.

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39. See Arthur L. Corbin, *Contracts for the Benefit of Third Persons in Connecticut*, 31 YALE L.J. 489 (1922); Corbin, *The Law of Third Party Beneficiaries in Pennsylvania*, 77 U. PA. L. REV. 1 (1928); Corbin, *Third Parties as Beneficiaries of Contractors' Surety Bonds*, 38 YALE L.J. 1 (1928); Corbin, *Contracts for the Benefit of Third Persons*, 46 LAW Q. REV. 12 (1930); Corbin, *Contracts for the Benefit of Third Persons in the Federal Courts*, 39 YALE L.J. 601 (1930).

40. Arthur L. Corbin, *Third Parties as Beneficiaries of Contractors' Surety Bonds*, 38 YALE L.J. 1, 1 (1928). Corbin stated that:

It may seem unfortunate that the law of a great industrial democracy must be built up by such a slow, uncertain, and costly process; but the limitations of the human mind and experience appear to make it inevitable. It will be a vitally serious reproach to the science of jurisprudence, however, if the law cannot now be so stated as to avoid another century of conflict over the same issues.

*Id.* Professor Corbin lived to make a unique contribution to the Second Restatement of Contracts in the 1960s. See Waters, *supra* note 26, at 1369-72.

41. See, e.g., Eisenberg, *supra* note 29. In my view, this is the best modern law review article on the subject. The latter four parts of this article are largely based upon my interpretation of the Eisenberg article.

Here is the long shadow of *Dutton v. Poole*, the early Massachusetts cases, and *Seaver v. Ransom*<sup>42</sup> broadened by the disjunctive: The promisee must have either the purpose of conferring a gift or simply the purpose of conferring upon the third party a right against the promisor to some performance not owing by the promisee to the third party. In either case, the focus was upon the promisee's purpose.

Subsection (b) of section 133 categorized a third party as a creditor beneficiary if:

no purpose to make a gift appears from the terms of the promise in view of the accompanying circumstances and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary against the promisee, or a right of the beneficiary against the promisee which has been barred by the statute of limitations or by a discharge in bankruptcy, or which is unenforceable because of the Statute of Frauds.

Here is the plurality decision of *Lawrence v. Fox*<sup>43</sup> broadened somewhat to include satisfaction of supposed or asserted obligations as well as obligations owed by the promisee to the beneficiary. Further, subsection (b) was self evidently a means by which a promisor could be bound to perform even if the beneficiary's case against the promisee were barred by positive law. Finally, subsection (c) of section 133 provided that a person who will benefit by the performance of a contract is "an incidental beneficiary if neither the facts stated in clause (a) nor those stated in clause (b) exist." Henceforth, in jurisdictions adopting the Restatement approach, a person claiming third party rights needed to fit the claim into either subsection (a) or (b); otherwise, the case would be lost as incidental beneficiaries had no enforceable rights.

The categories defined by section 133 were subsequently viewed by some critics as problematic, especially subsection (a) with its two-pronged definition of donee beneficiaries.<sup>44</sup> Already in 1938, a perceptive critic writing for the *California Law Review* contended that the Restatement categories were too narrow.<sup>45</sup> Criticism

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42. See *supra* note 31 and accompanying text.

43. See *supra* note 25 and accompanying text.

44. See Eisenberg, *supra* note 29, at 1377.

45. See Note, *Contracts: Third Party Beneficiaries: Cal. Civ. Code Section 1559*, 26 CAL. L. REV. 627 (1938). The note pointed out that, although section 1559 of the California Civil Code statutorily granted third party rights, the California courts were using the

continued through the 1940s and 1950s, with critics sometimes calling for a revision.<sup>46</sup> In the 1960s, the American Law Institute initiated the revision process with Professor Robert Braucher<sup>47</sup> as Reporter for the Restatement (Second) of Contracts. At this point, Professor Corbin, now in his eighties, pressed for his view that a single test dividing intended from incidental beneficiaries should be adopted.

In retrospect, whatever its deficiencies, section 133 of the Restatement First and its related sections performed an enormous service for contract law. The widespread hesitancy about allowing third party suits on contracts characteristic of the latter half of the nineteenth century disappeared, except in Massachusetts.<sup>48</sup> Allowing third parties to sue on contracts in some cases became a firmly rooted principle of American contract law. The stream that had risen and fallen in England and Massachusetts rose again with force and authenticity and eventually gained universal acceptance in the wake of the Restatement First. The recurring question was: In what type of case is allowing a third party beneficiary suit appropriate?

#### *F. The Restatement (Second) of the Law of Contracts*

The Restatement Second covers third party beneficiaries in sections 302 through 315. It is the First Restatement "Corbinized"<sup>49</sup>

Restatement categories to determine which claimants qualified; thus, the meaning of the Civil Code was fleshed out by section 133. The author of the note focused upon payment bonds and argued that claimants under payment bonds technically did not fit into either section 133(a) or (b).

46. See, e.g., Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406 (1957).

47. Later, Justice Braucher was appointed to the Supreme Judicial Court of Massachusetts. Justice Braucher was succeeded by Professor Allan Farnsworth who served as Reporter through the completion of the Restatement (Second) Contracts.

48. See Part I.B of this article and *Choate, Hall & Stewart v. SCA Services, Inc.*, 378 Mass. 535 (1979), where Massachusetts rejoined the mainstream, recognizing that exceptions were eviscerating the rule.

49. See Waters, *supra* note 26, commenting on the Restatement (Second) at 1171: The chapter on third party beneficiaries seems to be among the greatest of these innovations. With respect to this chapter, at least, the Second Restatement really is the First Restatement "Corbinized." What "Corbinization" entailed may be simply told: The relatively restrictive "donee beneficiary" and "creditor beneficiary" categories were abolished in favor of the broad "intended beneficiary" formulation. The stated reason for the change was that the "creditor" and "donee" categories were applied differently in different states, some recognizing an enforceable right in only one category, some in the other. Furthermore, courts in numerous cases had allowed recovery by third parties who were neither creditors nor donees, often purporting to apply the Restatement categories, and in so doing they had distended those

although the categorizations of former section 133 reappear with slight alterations in section 302(1)(a) and (b). Nominally, the categories are reduced to two: Intended beneficiaries and incidental beneficiaries. The stress on intent is great, arguably more so than in section 133 of Restatement First.

Section 302(1) declares:

Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intentions of the parties and either: (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

Subsection (a) is akin to section 133(b) of the First Restatement, but it is significantly narrower. To fit, the promisee must owe the beneficiary a binding obligation to pay money, meaning a supposed or asserted obligation will not do. A nonmonetary obligation will not suffice. Subsection (a) is *Lawrence v. Fox*<sup>50</sup> revived, assuming that Holly truly owed Lawrence a debt which Fox agreed to pay. Subsection (b) is akin to section 133(a) of the First Restatement with true donees submerged in a diluted general donative intent requirement. Thus, this subsection is broader than the holding in *Ransom v. Seaver* but arguably somewhat narrower than section 133(a). Section 302 was the culmination of a concerted attempt to capture a general principle for guidance in allowing third party suits on contracts. Section 302, with a single, overarching test for dividing incidental from intended (recognized) beneficiaries, was a posthumous victory for Professor Corbin.<sup>51</sup> Regrettably, section 302 has not always served as a very reliable guide. The meaning of its

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classifications to the point that the law required restating.

*Id.*

50. See *supra* note 25 and accompanying text.

51. Anthony Waters stated that:

Arthur Linton Corbin had more influence on the sustained development of this rule than anyone before him or since. It was at least an abiding interest, perhaps an obsession, through the latter half of his life. As we have seen, his scholarship in this area was meticulous, if not always accurate. Evidently, for him, the end justified the means, and that end was formally accomplished when the American Law Institute gave its blessing to the "intended beneficiary" formulation. When Corbin died in 1967, that ultimate victory was within sight, his extraordinary campaign at an end.

Waters, *supra* note 26.

"intent" requirement is often the main point disputed in litigation.<sup>52</sup>

The interpretive problems raised by section 302 derive from its use of "intention" as the fundamental principle for drawing a line between beneficiaries who have rights and those who do not. Subsection (1) requires that the factfinder divine the "intention of the parties." Subsection (1)(b) further requires the factfinder to determine whether the promisee "intends to give . . . the benefit of the promised performance" to the beneficiary. This double use of intent, coupled with the inherent ambiguity of the term "intent," has perplexed courts and stimulated commentators since the Restatement Second's adoption. Especially penetrating articles have been written by Harry Prince for the *Boston Law Review*,<sup>53</sup> Jean Powers for the *Utah Law Review*,<sup>54</sup> Melvin Eisenberg for the *Columbia Law Review*,<sup>55</sup> and by Orna Paglin for the *New England Law Review*.<sup>56</sup> While these scholars share many insights, there is no consensus about an analytical framework in which case law should develop in light of section 302. It is not surprising that the cases citing section 302 appear inconsistent.<sup>57</sup>

Sorting through the differing viewpoints in the secondary literature is a daunting task, not to mention consideration of the case law. In light of the complexity, any judgment about the best path for case law to take in light of section 302 is necessarily somewhat subjective. It is my view, however, that the best path for the evolution of the law of third party beneficiaries is that charted by Professor Eisenberg in his 1992 *Columbia Law Review* article where he sets forth and elucidates what he calls simply, "the third party beneficiary principle."<sup>58</sup> This principle is descriptive in the sense that it captures the results of the better reasoned cases. It is

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52. A recent example is *Grigerik v. Sharpe*, 721 A.2d 526 (Conn. 1998). The main issue on appeal was whether the factfinder should look only at the promisee's intent or look to both the intent of the promisor and the promisee for indications of intent to benefit the third party.

53. Harry G. Prince, *Perfecting the Third Party Beneficiary Standing Rule Under Section 302 of the Restatement (Second) Contracts*, 25 B.C. L. REV. 919 (1984).

54. Jean F. Powers, *Expanded Liability and Intent Requirement in Third Party Beneficiary Contracts*, UTAH L. REV. 67 (1993).

55. Eisenberg, *supra* note 29.

56. Orna S. Paglin, *Criteria for the Recognition of Third Party Beneficiaries' Rights*, 24 NEW ENG. L. REV. 63 (1989).

57. This unevenness in the case law is especially apparent in cases arising from construction sites. See the case law discussed in Part VI.D of this article and the discussion therein about owners having the rights of third party beneficiaries under prime-subcontractor contracts.

58. Eisenberg, *supra* note 29.

prescriptive in that it points to an analytical method capable of moving us beyond the ambiguities inherent in section 302 with its intense focus upon intent. I believe Professor Eisenberg's approach is theoretically sound as well as practical. Moreover, insights from other scholars can readily be blended with this approach.<sup>59</sup>

*G. Rethinking Section 302: A Plausible Future for Third Party Beneficiary Law*

Professor Eisenberg states the third party beneficiary principle as follows:

A third-party beneficiary should have the power to enforce a contract if, but only if: (I) allowing the beneficiary to enforce the contract is a necessary or important means of effectuating the parties' performance objectives, as manifested in the contract read in the light of surrounding circumstances; or (II) allowing the beneficiary to enforce the contract is supported by reasons of policy or morality independent of contract law and would not conflict with the contracting parties' performance objectives.<sup>60</sup>

The third party beneficiary principle is self evidently a principle with two branches. The first branch is predicated upon the propriety of effecting the contracting parties' performance objectives. The directive to ascertain performance objectives is reminiscent of the Restatement First with its stress upon purpose. In any event, the directive to ascertain performance objectives propels us away from attempts to peer into the minds of the contracting parties. Neither is the inquirer limited to the contract, itself, but is, in addition, directed to discern the objectives in light of the circumstances surrounding the contract. The second branch is predicated upon the desirability of effecting moral or policy objectives through third party enforcement so long as enforcement does not conflict with the contracting parties' objectives.

The first branch does not directly contradict Restatement Second section 302 but points beyond it to avoid getting bogged down in disputes about who intended to benefit whom.<sup>61</sup> With refreshing

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59. For example, the article authored by Professor Harry Prince contains an exhaustive analysis of case law that shows many pitfalls of which courts should be cognizant. Many of Professor Prince's conclusions can be used to support Professor Eisenberg's approach.

60. Eisenberg, *supra* note 29, at 1385.

61. See, e.g., Grigerik v. Sharpe, 721 A.2d 526 (Conn. 1998).



candor, Professor Eisenberg suggests that many, perhaps most, promisors do not really care about benefiting or actually intend to benefit either the promisee or a third party; rather, promisors usually intend to better their own positions and make contracts to do so. He states:

[I]n one sense, it is never an objective of a promisor to perform, but only to obtain what is promised to her if she agrees to and does perform. Such a characterization of the promisor's objectives, however, would be too narrow, because the promisor can attain what she has promised only by joining in the enterprise designed to fulfill various objectives, some shared, some dearer to the heart of the promisor, some dearer to the heart of the promisee. Accordingly, by the contracting parties' performance objectives, I mean those objectives of the enterprise embodied in the contract, read in the light of surrounding circumstances, that the promisor either knew or should have known at the time the contract was made.<sup>62</sup>

In light of this language, it may be helpful to think in terms of objectively discernible "enterprise objectives" in trying to apply the first branch of the third party beneficiary principle. A lawyer or judge ought to gain a little distance from the contract in question and as an objective, informed, third person, try to detect the enterprise objectives manifested in the contract and its context. The question following should *not* be whether the contract creates a right in a third person or class, but rather "whether empowering the third party to enforce the contract is a necessary or important means of effectuating the contracting parties' performance [enterprise] objectives."<sup>63</sup> The law of third party beneficiaries would be "largely conceived as remedial, rather than substantive."<sup>64</sup> Accordingly, this first branch would not necessarily be more or less expansive than case law currently resting upon section 302. Rather, the analytical pathway for deciding whether third parties should be empowered to sue would be different. Professor Eisenberg suggests that a lawyer or judge applying the first branch of the third party beneficiary principle can consider what the parties would have agreed upon if third party enforcement had been discussed. Consistent with this suggestion, Professor Eisenberg states:

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62. Eisenberg, *supra* note 29, at 1385.

63. *Id.* at 1386.

64. *Id.*

To put the matter simply, the question is whether it is likely that the promisee would have made the contract on the price terms he accepted if the contract had explicitly stated that the third party would be allowed to bring suit, and whether the promisor would have made the contract on the price terms she accepted if the contract had explicitly stated that the third party would not be allowed to bring suit.<sup>65</sup>

The second branch of the third party beneficiary principle would in some cases be more expansive than the text of section 302 because its boundaries would ultimately depend upon judicial determinations of morality and policy. However, Professor Eisenberg identifies substantial support for the second branch in comment d to section 302 wherein it is provided that:

[C]onsiderations of procedural convenience and other factors not strictly dependent on the manifested intention of the parties may affect the question whether . . . recognition of a right in the beneficiary is appropriate. In some cases, an overriding policy, which may be embodied in a statute, requires recognition of such a right without regard to the intentions of the parties.<sup>66</sup>

The original parties' discernible enterprise objectives would not act as a brake upon allowing third party beneficiary standing for reasons of policy unless that standing conflicted with discernible performance objectives. The second branch overtly vests in the judges considerable power to implement moral and policy judgments through third party beneficiary law so long as they do not trample upon private parties' discernible objectives. Professor Eisenberg set forth the two branches as disjunctives. Either branch could support third party beneficiary standing. However, in my view, the second branch might often serve in conjunction with the first when discernible objectives tend to overlap with public policies or commonly accepted moral principles.

My purpose in trying to summarize the Eisenberg approach is this: Later in this article, I will attempt to apply Professor Eisenberg's "third party beneficiary principle" to cases involving contracts for sales of goods. I will thereby suggest a method for blending the common law (and what the common law could become) with Article 2, current or revised, to reach paradigmatic

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65. *Id.* at 1387.

66. *Id.* at 1389, quoting RESTATEMENT (SECOND) OF CONTRACTS § 302, cmt. d. (1977).

situations not adequately covered under Article 2. A preliminary task is to explain how current Article 2 and the 2000 annual meeting draft fail to cover the subject thereby leaving space available for importation of the common law.

## II. THIRD PARTY BENEFICIARIES AND OTHER NON-PRIVITY CLAIMANTS UNDER ARTICLE 2

### *A. An Introduction to Warranties and Beneficiaries Under Article 2*

In fashioning Article 2, the drafters confronted questions about third party rights, mainly in connection with warranties. Consequently, Article 2's treatment of third party beneficiaries must be investigated in the context of Code-based warranties because, except in connection with warranties, Article 2 has no third party beneficiary provisions.<sup>67</sup> Section 2-313 covers express warranties made by representations of fact, promises, descriptions, samples, or models, which relate to the goods and go to the basis of the bargain.<sup>68</sup> Section 2-314 imposes an implied warranty of merchantability upon sales by merchants engaged in selling goods of the kind. This is an exceedingly flexible warranty that most importantly means goods must be "fit for the ordinary purposes for which such goods are used."<sup>69</sup> Section 2-315 provides for an implied warranty of fitness for a particular purpose when a buyer reasonably relies upon the seller's skill or knowledge to furnish or select suitable goods for a particular purpose of which the seller knew or had reason to know.<sup>70</sup> These sections pertain to buyers and sellers in privity. Third party rights are not explicitly recognized. Indeed, the texts of each of these three sections can be strained a little to bear extensions of these warranties beyond immediate buyers,<sup>71</sup> but nothing in these sections requires extension to third parties.

The extension of warranties to third parties under Article 2 is governed by section 2-318's Alternatives, A through C, which are

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67. Section 2-210 has rules on delegations and assignments, and delegations tend to create third party beneficiaries, but nothing in section 2-210 recognizes third party beneficiary rights. Other third party rights are touched upon in Article 2, e.g., section 2-403 with its rules on entrustment and voidable title. However, under Article 2, third party beneficiaries are only explicitly recognized as such in connection with warranties.

68. See U.C.C. § 2-313 (1995).

69. See § 2-314 (1995).

70. See § 2-315 (1995).

71. See the case law discussed in Part II.C.

progressively more expansive in coverage of persons and allowable claims. Whenever any legislature adopts an alternative from official section 2-318, it makes a partial codification of third party beneficiary law. Despite the simplicity of the text offered for each alternative, the case law under these alternatives is not uniform from state to state. This non-uniformity, as well as policy concerns, has generated a rich secondary literature bearing upon the meaning of section 2-318's alternatives.<sup>72</sup> Relying upon the secondary literature and citations to key cases, I will briefly summarize the coverage of each alternative under section 2-318 with a single objective: To demonstrate that in all jurisdictions there is some room for supplementation from the common law of third party beneficiaries, although some jurisdictions require supplementation more than others.

### *B. Third Party Beneficiaries Under Section 2-318's Alternatives*

Alternative A under section 2-318 provides:

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 A, albeit with slight variations, is the law in a majority of jurisdictions, thirty by a recent count, if we include the District of Columbia and the Virgin Islands.<sup>73</sup> The requirement that a

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72. See William L. Stallworth, *An Analysis of Claims Instituted by Non-Privy Plaintiffs in Jurisdictions That Have Adopted Uniform Commercial Code Section 2-318 (Alternative A)*, 20 PEPP. L. REV. 1215 (1993) ("Stallworth I"); William L. Stallworth, *An Analysis of Warranty Claims Instituted by Non-Privy Plaintiffs in Jurisdictions That Have Adopted Uniform Commercial Code Section 2-318 (Alternatives B & C)*, 27 AKRON L. REV. 197 (1993) ("Stallworth II"); Alex Devience, Jr., *The Developing Line Between Warranty and Tort Liability Under the Uniform Commercial Code: Does 2-318 Make a Difference?*, 2 DEPAUL BUS. L.J. 295 (1990); David B. Gaebler, *Negligence, Economic Loss, and the U.C.C.*, 61 IND. L.J. 593 (1986); William K. Jones, *Products Defects Causing Commercial Loss: The Ascendancy of Contract over Tort*, 44 U. MIAMI L. REV. 731 (1990); and Richard E. Speidel, *Warranty Theory, Economic Loss, and the Privy Requirement: Once More into the Void*, 67 B.U. L. REV. 9 (1987). I have relied especially upon Professor Stallworth's articles for my analysis of section 2-318's Alternatives. See also White and Summers, *supra* note 7, § 11-2-7; RONALD A. ANDERSON, 3A-UNIFORM COMMERCIAL CODE § 2-318:1-82 (3rd ed. 1995).

73. UNIFORM COMMERCIAL CODE § 2-318, 1A U.L.A. 558 (1989) & Supp. 2000, at 163. An adoption of Alternative A, however, can be deceptive. For example, Mississippi has Alternative A in Miss. Code Ann. section 75-2-318, but Miss. Code Ann. section 11-7-20

claimant be "injured in person" makes it apparent that Alternative A is a product liability statute allowing actions by natural persons beyond the final buyer based upon a breach of warranty, most commonly breach of the warranty of merchantability. Using the word "nonpurchaser" to denote someone beyond the final buyer in the distribution chain, Professor William Stallworth has listed four factors that determine the reach of Alternative A, "First, the nonpurchaser must be a natural person. Second, the nonpurchaser must be in the purchaser's family or household or a houseguest of the purchaser. Third, the nonpurchaser must have sustained personal injury. Fourth, the defendant must be a direct seller."<sup>74</sup>

What the drafters did, therefore, was to give the states a standard provision that would allow Code-based personal injury actions to a narrow class of persons beyond the final buyer in the distributive chain. The issue addressed is commonly described as an issue of horizontal privity.<sup>75</sup> By and large, the courts have implemented the statute as it stands, ruling that a lack of privity defense fails when the foregoing four factors are present.<sup>76</sup> A minority of courts in Alternative A jurisdictions have allowed claims for personal injuries by natural persons not within the scope of this alternative on the grounds that the statute defines a minimum class of rightful claimants leaving the courts free to expand the class to buyer's employees or even bystanders.<sup>77</sup> A minority of courts in Alternative A jurisdictions have also reached beyond the text and have allowed suits for personal injury without

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provides that: "In all causes of action for personal injuries or property damage or economic loss brought on account of negligence, strict liability, or breach of warranty, including actions brought under the provisions of the Uniform Commercial Code, privity shall not be a requirement to maintain said action." MISS. CODE ANN. § 11-7-20 (1999). Therefore a lawyer working with section 2-318's alternatives must always consider the case law and related statutory law in the jurisdiction in question.

74. Stallworth I, *supra* note 72, at 1242.

75. See *supra* note 5.

76. Stallworth I, *supra* note 72, at 1243.

77. Stallworth I, *supra* note 72, at 1256-61. Some courts have made an inference about their powers to extend the claimant class on the basis of official comment 3 to section 2-318 which states:

The first Alternative expressly includes as beneficiaries within its provisions the family, household, and guests of the purchaser. Beyond this, the section in this form 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.

In my view, this comment is clearly aimed at issues of vertical privity; hence, judicial extension of the class of allowable horizontal claimants in personal injury cases in jurisdictions adopting Alternative A is questionable.

vertical privity on the grounds that Alternative A does not address this question, leaving the courts free to create law bearing upon vertical privity.<sup>78</sup> However, it is nearly universally true that courts in states adopting Alternative A will not allow third party claims — claims made by persons beyond the final buyer — when the claims are based upon economic loss in the absence of personal injury.<sup>79</sup> Therefore, in Alternative A jurisdictions, there is a vacuum concerning cases of economic loss suffered by persons beyond the final buyer. At this point, the common law of third party beneficiaries can sometimes rightly enter. For example, persons who take goods from the final buyer in the distributive chain either by gift or bargain (e.g., sale from consumer to consumer) may suffer an economic loss due to defective goods and may be proper claimants under third party beneficiary law.

Alternative B provides, “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 in person by breach of the warranty. A seller may not exclude or limit the operation of this section.” In principle, Alternative B extends Alternative A to a broader class. By a recent count, ten jurisdictions have adopted Alternative B, occasionally with a slight variation from the official text.<sup>80</sup> Claimants must be natural persons who suffer personal injuries attributable to a breach of warranty to qualify for protection. Instead of a tightly drawn limitation aimed at protecting persons in the buyer’s home, the scope turns upon the foreseeability of use, consumption, or simply effect. Professor Stallworth lists three key factors for judging whether or not claimants are within the scope of Alternative B, “First, the plaintiff must be a natural person. Second, the plaintiff must have sustained personal injury as a result of the breach of warranty. Third, the individual must be someone ‘who may reasonably be expected to use, consume, or be affected by the goods.’ ”<sup>81</sup>

Since being a natural person and suffering a personal injury are not mysterious qualifications, the relevant scope question becomes: Who, in the judgment of a reasonable person, would use, consume,

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78. Stallworth I, *supra* note 72, at 1264-65. This is legitimate on the basis of Comment 3 to section 2-318. See *supra* note 73.

79. Stallworth I, *supra* note 72, at 1261-63. However, the case law is not necessarily reflective of what courts would do with a well presented case based upon the common law of third party beneficiaries.

80. UNIFORM COMMERCIAL CODE § 2-318, 1A U.L.A. 558-59 & Supp. 2000, at 163.

81. Stallworth II, *supra* note 72, at 204.

or be affected by these goods? This alternative is susceptible to a very broad interpretation that will allow many suits for personal injury. The class of persons which could foreseeably be affected by most goods is exceedingly broad. According to Professor Stallworth, "[I]n Alternative B jurisdictions, the foreseeability requirement rarely if ever precludes the right to sue for breach of warranty because the courts are willing to 'stretch' to find that the plaintiff is foreseeable."<sup>82</sup> Only in a rare case will the foreseeability requirement result in a claim being lost.<sup>83</sup> Alternative B differs from A in that Alternative B's sweeping language arguably abolishes the requirement of vertical privity. Some cases so hold.<sup>84</sup> Under this interpretation, bystanders and pedestrians injured, for example, by a defective vehicle, may rightly recover against a manufacturer (not only a dealer), assuming the defect amounts to a breach of warranty. Therefore, as to persons who can make claims, the scope is broad. However, as to *kinds* of claims, the scope is narrow. Alternative B leaves the same vacuum in the economic loss area as does Alternative A.

Alternative C provides in pertinent part:

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.

By a recent count, five jurisdictions have enacted Alternative C as officially promulgated, but approximately a dozen jurisdictions have statutory provisions which capture its breadth.<sup>85</sup> The main

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82. Stallworth II, *supra* note 77, at 211 (citing *Townsend v. Ed Fine Oldsmobile*, 536 A.2d 615 (Del. 1987)); *Nacci v. Volkswagen of America*, 325 A.2d 617 (Del. Super. Ct. 1974).

83. For an example, see *Cohen v. McDonnell Douglas Corp.*, 450 N.E.2d 581 (Mass. 1983).

84. See the cases cited in Stallworth II, *supra* note 72, at 201.

85. UNIFORM COMMERCIAL CODE § 2-318 (c), 1A U.L.A. 559-60 & 2000 Supp., at 163. The Massachusetts's variation is an example of a non-uniform statute which is similar to Alternative C of section 2-318. It states in relevant part:

Lack of privity between plaintiff and defendant shall be no defense in any action brought against the manufacturer, seller or supplier of goods for breach of warranty, express or implied, or for negligence, although the plaintiff did not purchase the goods from the defendant, if the plaintiff was a person whom the manufacturer, seller or supplier might reasonably have expected to use, consume, or be affected by the goods.

MASS. GEN. LAWS ANN. ch. 106, § 318 (West 1999).

difference from Alternatives A and B is the absence of the words "in person" after "injury" meaning that compensable injuries need not be personal injuries nor need the claimants be natural persons. In terms of foreseeability, the class of potential claimants is the same as in Alternative B. Thus, Alternative C eliminates privity as a defense so long as the loss complained of was foreseeable. Courts in jurisdictions that have enacted Alternative C have generally construed it so that any privity defense fails if the plaintiff was a natural or legal person who foreseeably could be affected by the goods. Most important, property damage and economic loss are encompassed by the language of Alternative C, as the courts have construed it. Professor Stallworth, in the course of his study, concluded, "Alternative C is more generous than either of the other versions of section 2-318 because Alternative C does not require personal injury. Thus, nonprivity plaintiffs who have sustained only property damage or economic loss have standing to sue under Alternative C."<sup>86</sup>

There is reason to suspect that the judicial construction noted by Professor Stallworth may have outrun the drafters' intent.<sup>87</sup> Nonetheless, as a practical matter, Alternative C's only limitations are foreseeability and a judicially imposed limitation to direct as opposed to consequential economic losses.<sup>88</sup> This common preclusion of consequential economic losses where Alternative C is enacted leaves a small space for the importation of the common law of third party beneficiaries. Moreover, as the text plainly states, sellers can exclude or limit the operation of Alternative C except as to personal injuries to an individual to whom the warranty extends. As will be evident in Part III, the probable replacement for section 2-318's Alternative C would also allow sellers to avoid contractually any liability for economic loss.

From a historical perspective, there has been a tendency for

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86. Stallworth I, *supra* note 72, at 203. Professor Stallworth later cites *Hydra-Mac, Inc. v. Onan Corp.*, 430 N.W.2d 846 (Minn. Ct. App. 1988), *aff'd in part, rev'd in part*, 450 N.W.2d 913 (Minn. 1990); *Cumdy v. Int'l Trencher Serv., Inc.*, 358 N.W.2d 233 (S.D. 1984); and *Milbank Mut. Ins. Co. v. Proksch*, 244 N.W.2d 105 (Minn. 1976) as illustrations of losses recoverable under Alternative C. The *Milbank* cases involved property damages but the others only economic losses.

87. Alternative C does not expressly authorize recovery for direct or consequential economic loss apart from property damage or personal injury. Indeed, the notes of the Permanent Editorial Board suggest that the Code drafters may have intended Alternative C merely to extend as far as section 402A of the Restatement of Torts, which abolished the privity requirement only in cases of personal injury and property damage. See White and Summers, *supra* note 7, § 11-5 (citing Perm. Ed. Bd. UCC Report No. 3 at 14 (1966)).

88. White and Summers, *supra* note 7, § 11-6.



roughly forty years to expand third party coverage under section 2-318. The draft of Article 2 promulgated in 1952 had only the text now appearing as Alternative A. In response to a fear of nonuniform variations, Alternatives B and C were promulgated a decade later. Given the proliferation of nonuniform alternatives, and the lack of uniformity where an official alternative has been adopted, the choice made in 1962 must, at best, be regarded as a marginal success. Needless to say, any lawyer with a case that might fit into section 2-318 must research the particular jurisdiction's statutory law and case law. An overview of the whole may be misleading for any one jurisdiction. One thing, however, is clear: In a majority of jurisdictions, section 2-318 offers no basis for judicial relief to nonprivity plaintiffs who seek to recover for economic losses apart from personal injury. This justifies careful consideration of non-Code law as a supplemental basis for relief in appropriate cases, especially because the 2000 annual meeting draft, if promulgated, will perpetuate similar limitations.

*C. Abolishing Lack of Vertical Privity as a Defense Without Resort to Section 2-318: Judicial Extension of Express Warranties*

As indicated earlier, nothing in section 2-318 or its comments expressly precludes courts from abolishing lack of vertical privity as a defense.<sup>89</sup> Since the Code's widespread adoption in the 1960s, courts in the vast majority of jurisdictions have extended seller's liabilities for express statements beyond immediate buyers, particularly in cases arising from advertisements and product representations shipped to the ultimate buyers with, or affixed to, the goods sold through a normal distributive chain, even where Alternative A has been adopted. Judicial action has followed commonly held expectations. Every reader of this article knows first hand that manufacturers, distributors, and retailers make many representations about goods in an attempt to induce members of the general public to buy them. Some representations are mere commendations or puffery; others qualify as factual statements about or descriptions of the goods or promises about how the goods will perform.<sup>90</sup> Millions of such representations are made through the media. Millions more are written on containers or in

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89. In fact, given the broadly worded language of Alternatives B and C, it is arguable that they do abolish vertical privity as a defense.

90. These are requisites for express warranties. *See* U.C.C. § 2-313.

manuals or brochures packaged with goods and delivered to buyers. Every middle class American participating in the mainstream economy is a recipient of representations about goods. Whether to meet public expectations or for deeper policy reasons, courts have frequently allowed claims on express warranties for economic loss by so called remote buyers, without resort to section 2-318 and without any secure statutory footing in Article 2, although official comment 2 to section 2-313 has given the courts a textual toe-hold for liberality.<sup>91</sup>

As summarized by White and Summers:

When the non-privity plaintiff's suit is [based] upon the defendant's express representations made to the particular plaintiff in advertising or otherwise, courts generally hold that the plaintiff need not be in privity with the defendant. Usually courts characterize these cases as express warranty cases though in some jurisdictions they are classed as misrepresentation cases. The misrepresentation may come through the defendant's advertising, through labels attached to the product, or through brochures and literature about the product. The plaintiff must be a party whom the defendant could expect to act upon the representation and must rely on it. Of course, any plaintiff must also state other elements of its cause of action.<sup>92</sup>

Other scholars agree with this characterization of the trend of the case law and lend their support. For example, Professor William Hawkland's treatise states:

[I]t should be noted that the privity rules have been applied less restrictively to express as opposed to implied warranties. For example, the advertising of a remote manufacturer designed to induce a customer to buy certain goods has been held to create an express warranty that the goods are as advertised, even though the consumer did not buy the goods directly from the manufacturer but from a dealer who, himself, may have been several steps removed from the manufacturer in the distribution chain. Such cases, independent of Section

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91. Comment 2 to section 2-313 states in relevant part: 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.

92. See White and Summers, *supra* note 7, § 11-7.

2-318, are supported by Section 2-313, because Comment 2 states that this section is not to be regarded as disturbing case law which recognizes that warranties need not be confined to the direct parties to the contract.<sup>93</sup>

Therefore, in most jurisdictions, a judicial gloss on section 2-313 eliminates lack of vertical privity as a defense in cases arising from sellers' representations, which run to downstream, remote buyers thereby grafting avenues for buyers' relief against remote sellers (manufacturers and distributors) onto the text of Article 2 without reference to section 2-318. At least one eminent scholar has argued that these warranties are not covered by section 2-313; first, because the basis of the bargain requirement is seldom met; and second, because there is no sale, i.e., transfer of title from the warrantor to the plaintiff buyer.<sup>94</sup> Nonetheless, many courts have treated such warranties as if they were governed by section 2-313. I subscribe to the view set forth by Professor Donald Clifford, "Many courts simply [have] had the good sense to deal with remote-seller express warranties as if Article 2 applied . . . ."<sup>95</sup> Courts have not developed any consistent theory as an underpinning for these warranties.<sup>96</sup> Rather, courts have allowed suits by remote buyers based upon express representations about goods because it has seemed reasonable and just — what is generally expected — without articulating any specific theory of contract. Generally, the obligations recognized are not conceived of as third party obligations, but rather as direct obligations running from the warranting seller to the complainant downstream. In these cases, common law third party beneficiary theory has played no role extending the coverage of section 2-313.

Courts have appealed to reason and justice, making policy-based extensions of sellers' liabilities. An interesting example is the seminal case of *Randy Knitwear, Inc. v. American Cyanamid Co.*,

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93. See 1 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-313:9 at 578. ("Hawkland"); accord WILLIAM H. HENNING & GEORGE I. WALLACH, THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE 1193-94 (Rev. ed. 1992).

94. See, e.g., Curtis R. Reitz, *Manufacturers' Warranties of Consumer Goods*, 75 WASH. U. L.Q. 357 (1997).

95. Donald F. Clifford, *Express Warranty Liability of Remote Sellers: One Purchase, Two Relationships*, 75 WASH. U. L.Q. 413, 421 (1997).

96. *Id.* at 426-27. Professor Clifford suggests, *inter alia*, that the cases could be analyzed as unilateral contracts with the ultimate buyers' acts of purchase and payment from retailers constituting acceptances of offers contained in upstream sellers' representations. However, courts generally impose the warranty obligations once privity is removed as a barrier without specific consideration of contractual issues.

decided in 1962.<sup>97</sup> The defendant's product did not prevent fabric shrinkage as promised in advertisements and labels. The remote business buyer won a case for economic loss based upon breach of an express warranty. Justifying its decision in light of long-held privity requirements, the Court of Appeals of New York observed:

Manufacturers make extensive use of newspapers, periodicals and other media to call attention, in glowing terms, to the qualities and virtues of their products, and this advertising is directed at the ultimate consumer or at some manufacturer or supplier who is not in privity with them. Equally sanguine representations on packages and labels frequently accompany the article throughout its journey to the ultimate consumer and, as intended, are relied upon by remote purchasers. Under these circumstances, it is highly unrealistic to limit a purchaser's protection to warranties made directly to him by his immediate seller. The protection he really needs is against the manufacturer whose published representations caused him to make the purchase.

The policy of protecting the public from injury, physical or pecuniary, resulting from misrepresentations outweighs allegiance to an old and outmoded technical rule of law which, if observed, might be productive of great injustice. The manufacturer places his product upon the market and, by advertising and labeling it, represents its quality to the public in such a way as to induce reliance upon his representations . . . . Having invited and solicited the use, the manufacturer should not be permitted to avoid responsibility, when the expected use leads to injury and loss, by claiming that he made no contract directly with the user.<sup>98</sup>

Unquestionably, the judicial extension of section 3-313 for policy reasons reduces the need for the importation of third party beneficiary law.<sup>99</sup> But consider: There are many recurring situations where representations made only to an immediate buyer are made for the benefit of a downstream buyer. These fact patterns will not fit within the most liberal judicial extensions of section 2-313. At this point, there is space for the importation of third party beneficiary law.

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97. 181 N.E.2d 399 (N.Y. 1962).

98. *Id.* at 402-03.

99. Of course, tort law (misrepresentation) can do much the same job to the extent jurisdictions allow it to supplement the Code.

D. *Abolishing Lack of Vertical Privity as a Defense Apart from Section 2-318: Judicial Extension of the Implied Warranty of Merchantability*

Courts have been less generous in extending the implied warranty of merchantability than they have been in extending the reach of express representations.<sup>100</sup> However, in a minority of jurisdictions, the courts have allowed suits for direct economic loss (apart from personal injury or property damage) on the basis of the implied warranty of merchantability codified in section 2-314.<sup>101</sup> An oft-cited and interesting example is *Morrow v. New Moon Homes, Inc.*<sup>102</sup> wherein the Supreme Court of Alaska allowed the buyers to bypass the insolvent dealer and to recover direct economic loss against the manufacturer of a defective mobile home on the basis of implied warranties.<sup>103</sup> Alaska had adopted Alternative A of section 2-318, the most limiting Alternative.<sup>104</sup> The court stated explicitly that section 2-318, Alternative A, had nothing to say about vertical privity, hence, the court was free to fashion its own privity rule when a suit was brought by the buyer at the end of the distributive chain against a remote manufacturer.<sup>105</sup> Then, for policy reasons, the court cut a new path explained in the following language:

The fear that if the implied warranty action is extended to direct economic loss, manufacturers will be subjected to liability for damages of unknown or unlimited scope would seem unfounded. The manufacturer may possibly delimit the scope of his potential liability by use of a disclaimer in compliance with AS 45.05.100 [2-316] or by resort to the

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100. White and Summers, *supra* note 7, at 592-97; Henning & Wallach, *supra* note 93, ¶ 11.11[1][a]. Both commentators recognize that courts are split on allowing either direct or consequential economic damages in the absence of vertical privity when the claim made is based upon an implied warranty instead of an express warranty. *Id.* There seems to be a shared assumption that none of section 2-318's Alternatives necessarily resolve this issue. This implies doubt that Alternative C is really intended to allow suits for direct or consequential economic loss alone.

101. *Id.*

102. 548 P.2d 279 (Alaska 1976).

103. *Id.* at 295-96. The plaintiffs sought to recover under sections 2-314 (merchantability) and 2-315 (fitness for a particular purpose). The Supreme Court of Alaska acknowledged that recovery under section 2-315 would be improbable because to create the warranty, the seller must know of the particular purpose. *Id.* at 291. The value of the opinion arises from its breaking down of the privity defense for suits based upon section 2-314.

104. *Id.* at 287.

105. *Id.* In this case, Alternative A had nothing to add about horizontal privity, either, because the claim was based upon economic loss alone.

limitations authorized in AS 45.05.230 [2-719]. These statutory rights not only preclude extending the theory of strict liability in tort . . . but also make highly appropriate this extension of the theory of implied warranties . . . . We therefore hold that a manufacturer can be held liable for direct economic loss attributable to a breach of his implied warranties, without regard to privity of contract between the manufacturer and the ultimate purchaser.<sup>106</sup>

A more recent example is *Jacobs v. Yamaha Motor Corp.*,<sup>107</sup> wherein the Supreme Judicial Court of Massachusetts allowed recovery of direct economic loss by a motorcycle buyer against the manufacturer, again bypassing an insolvent dealer.<sup>108</sup> The court relied in part upon the policy implicit in Massachusetts's non-uniform disclaimer section that renders ineffective any purported disclaimers in consumer sales.<sup>109</sup> The court also placed some reliance upon Massachusetts's non-uniform version of section 2-318 which resembles, but expands upon, Alternative C.<sup>110</sup> Both *Morrow* and *Jacobs* were consumer cases that reflected a minority view. The majority of states will not allow the buyer, whether a consumer or business buyer, to sue upstream against a remote seller for breach of the implied warranty of merchantability when the buyer has suffered economic loss alone, whether direct or consequential. Where such suits are permitted, consequential economic losses are generally precluded.<sup>111</sup> Therefore, with respect to implied warranty claims, there is a space where the law of third party beneficiaries can rightly be imported if the requisites for third party beneficiary standing are proved because the subject matter is not expressly covered by Article 2 and case law has left the law uneven from jurisdiction to jurisdiction.

### E. Summary

The law bearing upon who can sue whom for economic loss

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106. *Morrow*, 548 P.2d at 291-92.

107. 649 N.E.2d 758 (Mass. 1995).

108. *Id.* The court also allowed treble damages and attorney's fees on the basis of a state consumer protection statute. *Id.*

109. *Id.* at 762. See MASS. GEN. LAWS ANN. ch. 106, § 2-316A (West 1999).

110. *Jacobs*, 649 N.E.2d at 762. Massachusetts's version of section 2-318, in relevant part, tracks Alternative C of the Official Code but is limited to tort-type warranty cases, i.e., cases arising from personal injury or wrongful death or property damage. *Id.* See *Bay State Spray & Provincetown Steamship, Inc. v. Caterpillar Tractor Co.*, 533 N.E.2d 1350 (1989).

111. White and Summers, *supra* note 7, at 595-97.

based upon breach of express or implied warranties under Article 2 is complex and uneven from jurisdiction to jurisdiction. Statutory Alternatives in section 2-318 of the official code have made the law diverse rather than uniform. Approximately a dozen jurisdictions have not been content with these Alternatives and have fashioned non-uniform statutory language. Case law arising under each of the three official Alternatives is less than consistent. Quite apart from section 2-318, courts in a great majority of jurisdictions have developed rules extending express warranties made by manufacturers and distributors to non-privity buyers, thereby eroding the defense of vertical privity. In a minority of jurisdictions, courts have allowed buyers to claim against vertical non-privity sellers for recovery of economic loss when the suit is based upon the implied warranty of merchantability. The case law under sections 2-313, 2-314, and 2-318 has been largely driven by policy concerns. It has not developed with any consistent reference to the common law of third party beneficiaries.<sup>112</sup>

This is the messy context in which the drafting committee has long sought to fashion an acceptable revision of Article 2's treatment of third parties. Nobody familiar with the statutes, the cases, and the commentaries would surmise that making an acceptable revision of third party rights is an easy task. Apparently the task has proved terribly difficult, as the next section will demonstrate. Perhaps solutions to problems bearing upon third party rights lie outside the charged process of making a tightly drawn uniform state statute.

### III. THE ARTICLE 2 REVISION PROCESS AND THE RECENT DRAFTS

#### A. *July 1999: Derailing Meaningful Revision*

Professor Linda Rusch has written an informative law review article bearing upon the pressures involved in the drafting process, including the events of July 1999.<sup>113</sup> This article is a helpful

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112. This does not mean that the relevancy of the common law of third party beneficiaries is never recognized in the sales context. On the contrary, scholars from time to time allude to the possible use of third party beneficiary law as a supplement to Article 2. See, e.g., MARION W. BENFIELD, JR. AND WILLIAM D. HAWKLAND, *CASES AND MATERIALS ON SALES* 297 (3rd ed. 1992). In a note the editors state, "If a particular buyer has not relied upon the representation, it may not be proper to impose liability unless the intent of the original contracting parties was clearly to make the remote buyer a third party beneficiary of the contract between the seller making the representation and his immediate buyer." *Id.*

113. Linda J. Rusch, *A History and Perspective of Revised Article 2: The Never Ending Saga of a Search for Balance*, 52 *SMU L. REV.* 1683 (1999).

resource for understanding the revision process. Suffice it to say that the culmination of a decade of work was approved by the American Law Institute in May 1999, and submitted for consideration at the July meeting of the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in Denver, Colorado. Before any vote was taken, the NCCUSL leadership withdrew the draft, due to vocal opposition from business advocates coupled with an apprehension about poor prospects for uniform enactment. The Reporter, Professor Richard Speidel, and the Associate Reporter, Professor Linda Rusch, resigned from their respective positions. Professor Henry Gabriel was thereafter appointed as Reporter.<sup>114</sup> Professor William Henning was appointed chairperson of the drafting committee.<sup>115</sup>

The committee has subsequently considered three drafts: A December 1999 draft, a March 2000 draft, and a draft for the July/August 2000 NCCUSL meeting — the 2000 annual meeting draft. I will examine these drafts to ferret out the provisions bearing upon third party rights, concentrating mainly on the 2000 annual meeting draft. However, to put these drafts into an historical context, it is important to understand selected parts of the July 1999 draft. Although it is now an historical artifact, it was a high water mark for those who wished to make a serious effort to tackle problems involving third party rights under Article 2 contracts for sale. It embodied several proposals bearing upon third party claims and can rightly be consulted as a source for reflective work in the future. In fact, it appears that the drafters did not wholly repudiate the substance of the July 1999 draft, but made a careful, tactical retreat on sensitive points.<sup>116</sup>

### *B. Third Party Rights Under the July 1999 Draft*

In the July 1999 draft, warranties of quality were placed into

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114. *Id.* at 1686. Professor Henry Gabriel is a law professor at Loyola University School of Law in New Orleans, Louisiana. *See supra* note 1.

115. Professor William Henning is a law professor at the University of Missouri-Columbia School of Law. *See supra* note 1.

116. William C. Smith, *Selling Contracts Revisions, Again*, 85 A.B.A. J. 26. Professor Henning, drafting committee chairman, clarified his position in the December 1999 issue of the American Bar Journal. His views were summarized as follows: "To deal with fears that new text will prompt new lawsuits, Henning plans to retain Article 2's current numbering system, and return, whenever appropriate, to the original language. However, the drafting committee will not be 'starting from scratch,' he claims. 'We will be capturing most of the changes and clarifications of the prior revision.'" *Id.*



three sections of a new Part 4.<sup>117</sup> Part 4 was, for the most part, a straight-forward recodification of the warranty sections from current Article 2 with slight changes of a clarifying rather than an innovating nature. The changes of consequence were in new sections 2-408 and 2-409, each of which extended warranties beyond immediate buyers. Subsection 2-408(b) sought to codify case law relating to the pass-through warranties, i.e., an express warranty packaged with the goods.<sup>118</sup> The proposal would have foisted fresh legal obligations upon nobody, but would have given statutory legal force to express pass-through representations that reasonable remote purchasers would believe and probably rely upon.<sup>119</sup> Subsection 2-408(c) sought to codify the case law on representations made through the media to the buying public.<sup>120</sup>

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117. Rusch, *supra* note 113, at 1698-99.

118. *Id.* at 1702. Subsection 2-408(b) stated in pertinent part:

If a seller makes a representation or remedial promise in a record packaged with or accompanying the goods and the seller reasonably expects the record to be, and the record is, furnished to the remote buyer . . . the following rules apply: (1) The seller has an obligation to the remote buyer . . . that the goods will conform to the representation or that it will perform any remedial promise unless: (A) a reasonable person in the position of the remote buyer . . . would not believe that the representation created an obligation; or . . . the representation is merely of the value of the goods or is an affirmation purporting to be merely the seller's opinion or commendation of the goods.

*Id.* at 1699 n.40.

119. *Id.* at 1701. It is true that proposed section 2-408(b)(2) extended rights beyond the final buyer in the following language:

The seller's obligation to the remote buyer or remote lessee created under paragraph (1) also extends to: (A) any member of the family or household unit or any invitee of the remote consumer buyer or remote consumer lessee; and . . . a transferee from the remote consumer buyer or remote consumer lessee and any subsequent transferee, but, for purposes of this paragraph, the seller may limit its obligation to the remote consumer buyer or remote consumer lessee or may limit extension to a particular person or transferee or a class of transferees, if the limitation is furnished to the remote consumer buyer or remote consumer lessee at the time of the sale or with the record which makes the representation, whichever is later.

*Id.* This does not seem to have been a very dangerous or even necessary section. First, it overlaps with proposed section 2-409(a). Second, the seller had enormous limiting power.

120. *Id.* Proposed section 2-408(c) provided:

If a seller makes a representation in a medium for communication to the public, such as advertising, the seller has an obligation to the remote buyer or remote lessee that the goods will conform to the representation and that the seller will perform any accompanying remedial promise if: (1) the remote buyer purchased or the remote lessee leased the goods from a person in the normal chain of distribution with knowledge of the representation and with the expectation that the goods will conform to the representation; . . . a reasonable person in the position of the remote buyer or the remote lessee with knowledge of the representation would expect the goods to conform to the representation; and . . . the representation is not merely of the value of the goods or is not an affirmation purporting to be merely the seller's opinion or

This subsection would have made representations through the media legally enforceable obligations if the representations were such that a reasonable person would rely upon them as importing a legal obligation.<sup>121</sup> Thus, proposed subsections 2-408(b) and (c) were attempts to make Article 2 consistent with case law that had moved in the direction anticipated by official comment 2 to section 2-313 of current Article 2.<sup>122</sup>

Proposed section 2-409 of the July 1999 draft (a substitute for section 2-318) was innovative. In a sense, section 2-409 would have turned current section 2-318 on its head, using subsection (a) for economic loss claims on consumer contracts. Section 2-409(a) provided:

In a consumer contract, a seller's express or implied warranty or a remedial promise made to an immediate consumer buyer extends to any member of the family or household of the immediate consumer buyer or an invitee to the household of the immediate consumer buyer or a transferee from the immediate consumer buyer who may reasonably be expected to use, consume, or be affected by the goods and *who suffers damage other than injury to the person* resulting from a breach of warranty or a remedial promise. The seller may not disclaim, modify, or limit damages arising under this section unless the seller has a substantial interest in having a warranty or remedial promise extend only to the immediate consumer buyer.<sup>123</sup>

If this proposal had been adopted, rights under warranties, express and implied, would have extended to members of the buyer's household and invitees to the buyer's home and to other foreseeable transferees *for injuries other than injuries to the person*. It would have had special applicability to gifts given to children, family members, guests, and more distant recipients. For example, if a consumer buyer gave away a bicycle as a holiday gift to a member of the household or to a guest or to a grandchild living at a distance, the recipient could have made a claim against the retail merchant if the bicycle was defective. This subsection

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commendation of the goods.

*Id.* at 1699.

121. *Id.* at 1699 n.40.

122. See *supra* Part II.C of this article.

123. U.C.C. § 2-409 (a) (July 1999 Draft) (emphasis added). See also Rusch, *supra* note 113, at 1701 n.48.

would have corresponded to a liberal reading of Alternative C and non-uniform variations thereof in descriptions of loss suffered, but the class of claimants probably would have been smaller. The comments to proposed section 2-409 were explicit on a related point: The implied warranty of merchantability would not have extended to third parties apart from section 2-409(a).<sup>124</sup> Thus, this proposal addressed a narrow problem about horizontal privity in economic loss cases arising from consumer contracts. Section 2-409(a) had nothing to do with eliminating lack of vertical privity as a defense. Neither remote consumers nor commercial buyers would have had claims against a manufacturer or non-privity distributor based upon section 2-409(a). Their claims could only have been predicated upon the express pass-through warranties or media-communicated warranties from the non-privity warrantors. It is difficult to understand why business interests would have opposed the third party provisions of section 2-409(a). Consumers would have had greater basis to complain since the text did not address issues of vertical privity for implied warranties at all.<sup>125</sup> It would have been of no assistance to commercial buyers.

Section 2-409(b) contained Alternatives A and B: Alternative A followed current section 2-318 (Alternative A) allowing actions for personal injury to the buyer, members of the buyer's household, or guests in the buyer's home;<sup>126</sup> and Alternative B followed current section 2-318 (Alternative B) allowing actions for personal injuries to any natural person who might reasonably be expected to use, consume, or be affected by the goods.<sup>127</sup> Viewed as a whole, the

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124. U.C.C. § 2-409 (Proposed Official Draft, July 1999). According to proposed comment 2 to section 2-409:

There is no extension of warranties under this subsection when the immediate buyer is not a consumer. Express warranties, however, may be made to remote buyers and others under Section 2-408 or one of the Alternatives in subsection (b). The implied warranty of merchantability is not extended by Article 2 in commercial cases but may be extended under other state law.

*Id.*

125. I am assuming that proposed sections 2-313A and 2-313B count as sections addressing the issue of vertical privity for express warranties even though the relevant word is now representation.

126. *Id.* at § 2-409 (b). Proposed section 2-409 (b), July 1999, Alternative A stated: A seller's warranty, whether express or implied extends to any individual who is injured in person by breach of the warranty in the family or household of the immediate buyer or who is a guest in the immediate buyer's home if it is reasonable for the seller to expect that the individual may use, consume, or be affected by the goods. A seller may not disclaim or limit the operation of this section.

*Id.*

127. *Id.* at § 2-409 (b). Proposed section 2-409(b), July 1999, Alternative B stated, "A

proposed extensions of warranties under section 2-409 were more restrictive than the Alternatives put to the states in the early 1960s when Alternatives B and C to section 2-318 were developed, assuming Alternative C is rightly construed as pertaining to some economic losses for both consumer and commercial buyers apart from property damage or personal injury. The big difference that approval of section 2-409 would have wrought was this: Proposed section 2-409(a), with its breakdown of horizontal privity in limited cases of economic loss, was not an alternative but rather an integral part of the warranty scheme intended for universal enactment. In a sense, this would have been an improvement on current section 2-318 because it would have achieved greater uniformity and a consequent reduction in confusion about who can sue whom for breach of warranty resulting in only economic loss to consumers. Yet, it avoided the related questions about vertical privity in relation to consumer and commercial buyers.

In my view, a better part of proposed section 2-409 was included in subsection (c) with its explicit link to non-Code law. Proposed section 2-409(c) stated:

*This article does not diminish the rights and remedies of any third party beneficiary or assignee under the law of contracts or of persons to which goods are transferred by operation of law and does not displace any other law that extends a warranty or remedial promise to or for the benefit of any third person.*

This dovetailed with a comment to proposed section 2-503(b) on the subject of delegation.<sup>128</sup> The comment provided in relevant part: “[I]f the third person accepts the delegation, an enforceable promise is made to both the delegator and the person entitled

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seller's warranty whether express or implied extends to any individual 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 disclaim or limit the operation of this section.”

128. *Id.* at 2-503 (b). Proposed section 2-503(b) recaptured the law of current section 2-210 in the following language:

(1) A party may delegate to another person its duty to perform a contract for sale unless the other party to the original contract has a substantial interest in having the original promisor perform or control the performance required by the contract. A delegation of performance does not relieve the delegating party of any duty to perform or any liability for breach of contract. (2) Acceptance of a delegation of duties by an assignee constitutes a promise by the assignee to perform those duties. The promise is enforceable by either the assignor or the other party to the original contract.

*Id.*

under the contract to perform [sic] those duties . . . in short, as to the person entitled under the contract a third party beneficiary contract is created."<sup>129</sup>

It is doubtful that the textual reference to third party beneficiary law and the reference in the proposed comment to section 503(b) were intended to change the law. Rather, these references were probably intended to make explicit what is available through section 1-103, the open door to the common law. These linkages, however, captured in a few short phrases one main point of this article: That Article 2 is incomplete without selective importation of the common law of third party beneficiaries. It is unfortunate that textual cross-references were deleted in later drafts.<sup>130</sup> In summary, the July 1999 draft was a very tame document as far as third party rights are concerned. It did do at least two things of particular benefit for non-privity claimants: (i) it gave rights to a specific class of horizontal non-privity claimants for economic losses, and (ii) it recognized in its text and proposed comments the continuing viability of the common law of third party beneficiaries.

### C. *The Drafts of December 1999 and March 2000*<sup>131</sup>

The December 1999 draft was circulated with a memorandum from Professor Henning wherein he invited interested observers to submit written critiques for the drafting committee's consideration. The December draft's provisions concerning third party rights contained a significant carry-over from the July draft on the extension of express warranties. To blend pass-through warranties and warranties created through the media into the current numbering system, sections 2-313A and 2-313B were created.

Section 2-313A would have codified pass-through warranties renamed as merely "obligations." Section 2-313B would have codified the law on "obligations" undertaken by representations through the media. These sections replaced section 2-408 of the

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129. U.C.C. § 2-503, cmt. 3 (Proposed Official Draft, July 1999).

130. *See supra* Part III.D. A meaningful reference has reappeared in the 2000 annual meeting draft.

131. There was also a November 1999 draft. Professor Henry Gabriel called it an interim draft and circulated it with this caveat: "This draft has not been considered by the drafting committee. It is the Reporters Interim Draft, circulated for comment prior to the consideration of the Drafting Committee. The Reporters Notes appended to the various sections are just that — notes." *See* UNIFORM COMMERCIAL CODE, Article 2-Sales, Preliminary Note (Proposed Official Draft, November 1999). This draft requires no comment except to note that it reverted to the current Article 2 numbering system.

July 1999 draft. Because provisions in the March 2000 draft and the 2000 annual meeting draft are substantively very similar, I will neither set forth nor comment upon these new sections here except to say that these sections did not create third party beneficiary rights. Instead, they were designed to recognize rights running *directly* from the representing sellers to the recipients of the representations. As to explicit third party beneficiary provisions, nothing remained of the proposed section 2-409 which would have replaced section 2-318. Rather, there was a new section 2-318 with Alternatives A through C, quite similar to the current Alternatives, adjusted to recognize the obligations created by new sections 2-313A and 2-313B.

The December draft did contain a group of significant deletions from the July 1999 draft. The linkages to the common law of third party beneficiaries were missing. Section 2-409(c) with its textual recognition of the availability of the common law of third party beneficiaries was gone. Section 2-503, on delegation, was replaced by a new section 2-210, but the reference to third party beneficiary law in the proposed comments was gone. This was probably not intended as a change in the law for, unless displaced, the common law is available through section 1-103. However, a negative inference could have been drawn; namely, that third party beneficiary law would be displaced.

The March 2000 draft was, in the main, a continuation and refinement of the December draft. As in the December draft, section 2-313A codified the best of the case law on pass-through "obligations" and section 2-313B again captured the law on obligations to remote buyers created through sellers' media representations. Again, explicit references to the law of third party beneficiaries were missing. On this foundation, the draft for the 2000 annual meeting of the NCCUSL was put forward for debate. Its key provisions are important for third party claimants.

#### *D. The 2000 Annual Meeting Draft*

Let us start with section 2-313A that is captioned, "Obligation to Remote Purchaser Created by Record Packaged with or Accompanying Goods." Subsection (a) has three definitions. "Goods" are defined for this section as "new goods and goods sold or leased as new goods unless the transaction or purchase does not

occur in the normal chain of distribution.”<sup>132</sup> “Immediate buyer” is defined as, “a buyer that enters into contract with the seller.”<sup>133</sup> “Remote purchaser” means, “a person that buys or leases goods from an immediate buyer or other person in the normal chain of distribution.”<sup>134</sup> According to the introductory words, these definitions are only for the construction of this new section.

The statutory substantive rules follow in subsection (b) that states:

If a seller makes an affirmation of fact or promise that relates to the goods, or provides a description that relates to the goods, or makes a remedial promise, in a record packaged with or accompanying the goods, and the seller reasonably expects the record to be, and the record is, furnished to the remote purchaser, the seller has an obligation to the remote purchaser that: (1) the goods will conform to the affirmation of fact, promise, or description unless a reasonable person in the position of the remote purchaser would not believe that the affirmation of fact, promise, or description created an obligation, and (2) the seller will perform the remedial promise.

Preliminary Comment 1 states in pertinent part, “No direct contract exists between the seller and remote purchaser, and thus the seller’s obligation under this section is not referred to as an ‘express warranty.’ ” True, there is no contract for sale, but if the obligation does not arise from a promise or representation, what is its source? Perhaps we should consider it a statutorily imposed obligation analogous to the obligations of issuers of negotiable instruments under Article 3.<sup>135</sup> However conceived, the obligations imposed correspond to earlier case law. The policy underlying section 2-313A should not be controversial among fair-minded observers. Because section 2-313A creates or recognizes direct seller — remote purchaser obligations, third party beneficiary analysis plays no role.<sup>136</sup>

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132. *Id.* at § 2-313A (a)(1).

133. *Id.* at § 2-313A (a)(2).

134. *Id.* at § 2-313A (a)(3).

135. *See, e.g.*, U.C.C. §§ 3-412-15 (2000). All citations to current Article 3 in this article are citations to the Official Text — 2000, promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws unless otherwise specified.

136. However, situations will remain where third party beneficiary law should flow in; namely, whenever a record which counts under section 2-313A passes only part way down the distributive chain but manifests an intent of the seller and the immediate party that a

The case law respecting communications to the buying public through the media is codified in proposed section 2-313B. After reiterating the definitions of section 2-313A(a) with one slight alteration,<sup>137</sup> subsection (b) sets forth the following:

If a seller makes an affirmation of fact or promise that relates to the goods, or provides a description that relates to the goods, or makes a remedial promise in advertising or a similar communication to the public and the remote purchaser enters into a transaction of purchase with knowledge of and with the expectation that the goods will conform to the affirmation of fact, promise, or description, or that the seller will perform the remedial promise, the seller has an obligation to the remote purchaser that: (1) the goods will conform to the affirmation of fact, promise, or description unless a reasonable person in the position of the remote purchaser would not believe that the affirmation of fact, promise, or description created an obligation; and (2) an obligation to the remote purchaser that the seller will perform the remedial promise.

As with proposed section 2-313A, the language speaks of “obligations,” not warranties. According to the Preliminary Comment, cmt. 1: “In the paradigm situation, a manufacturer will engage in an advertising campaign directed towards all or part of the market for its product and will make statements that if made to an immediate buyer would amount to an express warranty or remedial promise under Section 2-313.” To be a proper claimant under this section, a person would need to hear or read or otherwise have knowledge of the statement at the time of purchase and, “must also have an expectation that the goods will conform or that the seller will comply.”<sup>138</sup> As with proposed section 2-313A, 2-313B is a clear codification of accepted rules fashioned through case law.<sup>139</sup> There is no obvious contractual basis for enforcement, apart from the assumption that legislative action will make these

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downstream buyer should have the benefit thereof or creates a situation where the objectives of the original buyer and seller require third party enforcement.

137. U.C.C. § 2-313 B (Proposed Official Draft, March 2000). Section 2-313B(a)(1) defines “Goods” as follows: “‘Goods’ means new goods and goods sold or leased as new goods in a transaction of purchase that occurs in the normal chain of distribution.” *Id.* Why there is a difference from the definition in section 2-313A(a)(1) is not apparent from the comments.

138. *Id.* at § 2-313B, cmt. 3.

139. *See* Part II.C.



obligations enforceable.<sup>140</sup> There is no reference to the law of third party beneficiaries and rightly so, for the paradigm does not involve a promise made to a promisee for the benefit of a third person. The law would simply impose direct obligations where communications through the media reasonably create expectations of one sort or another at the bottom of the distribution chain thereby extinguishing want of vertical privity as a viable defense.

In sum, sections 2-313A and 2-313B recognize sets of direct obligations running from sellers to remote purchasers, long recognized by case law. For purposes of this article, these sections operate to do one important thing for buyers' cases: They extinguish want of vertical privity as a defense in some cases thereby diminishing to a limited extent the area where third party beneficiary law might otherwise flow in.<sup>141</sup> These sections do the job intended for proposed section 2-408 of the July 1999 draft.

As in current Article 2, third party beneficiary principles appear in proposed section 2-318 of the 2000 annual meeting draft. Subsection (a) has two definitions. "Immediate buyer means a buyer that enters into a contract with the seller."<sup>142</sup> "Remote purchaser means a person that buys or leases goods from an immediate buyer or other person in the normal chain of distribution."<sup>143</sup> These definitions are identical to those contained in proposed sections 2-313A and 2-313B, and simply set the stage for the rules to follow.

Subsection (b) presents Alternatives A through C which in principle would constitute only slight modifications of current law. Each Alternative is hereinafter quoted and commented upon.

#### ALTERNATIVE A

A seller's warranty whether express or implied to an immediate buyer, a seller's remedial promise to an immediate buyer, or a seller's obligation to a remote purchaser under Section 2-313A or 2-313B extends to any natural person who is in the family or household of such immediate buyer or such remote purchaser or who is a guest in the home of either if it is reasonable to expect that such person may use, consume or

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140. Commentators have proposed contract models. *See, e.g.*, Clifford, *supra* note 95, at 421.

141. Naturally, the requisites for third party suits would need to be established. The mere recognition of a vacuum does not imply that third party beneficiary law would fill it.

142. U.C.C. § 2-318 (a)(1) (Proposed Official Draft, 2000 Annual Meeting Draft).

143. *Id.* at § 2-318 (a)(2).

be affected by the goods and who is injured in person by breach of the warranty, remedial promise or obligation. A seller may not exclude or limit the obligation of this section.

With adjustments for proposed sections 2-313A and 2-313B and the recognition of remedial promises, this statutory proposal corresponds to current Alternative A. The preliminary comments are enlightening. Preliminary comment 3 states:

As applied to warranties and remedial promises arising under Sections 2-313, 2-314, and 2-315, the purpose of this section is to give certain beneficiaries the benefit of the warranties and remedial promises which the immediate buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accomplish this purpose without any derogation of any right or remedy arising under the law of torts. Implicit in this section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him. Obligations and remedial promises under Sections 2-313A and 2-313B arise initially in a non-privity context but are extended under this section to the same extent as warranties and remedial promises running to a buyer in privity.

Alternative A creates a fairly narrow class of third party beneficiaries for personal injury suits. It thus addresses a question of horizontal privity. Personal injury lawyers could combine warranty law with strict liability and negligence in suits against the last seller in the distribution chain as well as against non-privity sellers who undertake the extended obligations described above. Comment 3<sup>144</sup> makes it clear that Alternative A does not address the issue of vertical privity. It states:

The first Alternative expressly includes as beneficiaries within its provisions the family, household, and guests of the immediate buyer or remote purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to an immediate buyer who resells, extend to other persons in the distributive chain.

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144. U.C.C. § 2-318 cmt. 4 [3] (2000 Annual Meeting Draft). It appears that Preliminary Comment 4 for section 2-318 was mistakenly mislabeled as a second Comment 3. The reference in the text is to the second Proposed Comment 3. I will nonetheless refer to it as Comment 4.

For the states which elect Alternative A, as a majority have under current Article 2, there will be a significant area for the importation of third party beneficiary law for economic loss cases, because except for the connections to sections 2-313A and 2-313B, the law will remain unchanged in Alternative A states. After the tactful retreat from the July 1999 draft, the recurring questions about vertical and horizontal privity in economic loss cases rest once again with the courts.<sup>145</sup>

### ALTERNATIVE B

A seller's warranty whether express or implied to an immediate buyer, a seller's remedial promise to an immediate buyer, or a seller's obligation to a remote purchaser under Section 2-313A or Section 2-313B 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 the breach of warranty, remedial promise or obligation. A seller may not exclude or limit the operation of this section.

As under current law, proposed Alternative B is a personal injury statute with a larger class of potential claimants than under Alternative A. The language has been adjusted to take account of the obligations to remote buyers created under sections 2-313A and 2-313B. The test for inclusion is foreseeability: Who may be expected to use, consume, or be affected by these particular goods? Preliminary Comment 3 *implies* that vertical privity will fail as a defense in those jurisdictions that adopt Alternative B.<sup>146</sup> This comment states in relevant part, "The second alternative is designed for States where case law has already developed further and for those that desire to expand the class of beneficiaries." By itself, this sentence means only that the class of persons beyond the final buyer allowed to make claims has been expanded; however, the absence of neutrality language about the liability of upstream sellers, used in explicating the meaning of Alternative A, implies a breakdown of vertical privity as a defense.<sup>147</sup> By virtue of

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145. Vertical privity, even more than horizontal privity, will continue to be the business of the courts. See U.C.C. § 2-318 cmt. 1 (2000 Annual Meeting Draft).

146. See *supra* note 144.

147. In explaining the meaning of Alternative A, the second Proposed Comment 3 states, "[T]he section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to an immediate buyer who resells, extend to other persons in the distributive chain." Thus, under Alternative A, the matter of vertical privity is left exclusively to the courts. By implication, under Alternative B,

its limitation to personal injury cases, Alternative B leaves plenty of room for third party beneficiary law in economic loss and property damage cases.

### ALTERNATIVE C

A seller's warranty whether express or implied to an immediate buyer, a seller's remedial promise to an immediate buyer, or a seller's obligation to a remote purchaser under Section 2-313A or Section 2-313B extends to any person that may reasonably be expected to use, consume or be affected by the goods and that is injured by breach of the warranty, remedial promise or obligation. 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, remedial promise or obligation extends.

Here is the most expansive Alternative, seldom enacted under current Article 2, with appropriate adjustments for sections 2-313A and 2-313B. Wherever adopted, this Alternative could have an impact upon the main question addressed in this article: When do third parties (non-privity claimants) have a claim for economic loss against warrantors (obligors) in a contract for sale? As acknowledged in Part II of this article, most courts considering the issue have construed current Alternative C to allow claims for economic loss apart from property damage.<sup>148</sup> Consequently, in light of case law, Alternative C, if enacted, will probably be construed in most jurisdictions to allow at least claims for direct economic loss by persons not in privity with the defendant when the limiting power impliedly allowed to sellers in the last sentence is not exercised. However, the power vested in sellers is important. The preliminary comment on this sentence could not be clearer. It states:

The last sentence of Alternative C permits a seller to reduce its obligations to third-party beneficiaries to a level

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the statute takes away vertical privity as a defense. This is precisely what Professor Stallworth discovered in examining the case law under current Alternative B. *See* Stallworth II, *supra* note 72.

148. *See* White and Summers, *supra* note 7, § 11-5, where the authors express doubt that this was the drafters' intent in the early 1960s. Alternative C may well have been intended for personal injury and property damage cases. Because of the proposed comments to section 2-318 of the 2000 annual meeting draft, the same question may hover over the law for years to come.

commensurate with that imposed on the seller under Alternative B — that is, to eliminate liability to persons that are not individuals and to eliminate liability for damages other than personal injury.<sup>149</sup>

Common sense suggests that many sellers will exercise this limiting power reserved to them in jurisdictions where Alternative C is adopted — making it the functional equivalent of Alternative B. Therefore, where Alternative C, or a variation thereof, is enacted and liberally construed, the need for importing third party beneficiary law could shrink, but especially in light of the power reserved for sellers, there will remain fact patterns where resort to the common law of third party beneficiaries will be necessary and appropriate, provided that Alternative C is not interpreted as a complete displacement of the common law of third party beneficiaries.

In contrast to the December 1999 and March 2000 drafts, the 2000 annual meeting draft explicitly recognizes the continuing viability of the common law of third party beneficiaries for some sales-of-goods cases. The reference is not in the proposed statutory text, as in the July 1999 draft,<sup>150</sup> but only in a preliminary comment to proposed section 2-313A. Preliminary Comment 2 provides:

The party to which an obligation runs under this section may either buy or lease the goods, and thus the term “remote purchaser” is used. The term is more limited than “purchaser” in Article 1, however, and does not include a donee or any voluntary transferee who is not a buyer or lessee. Moreover, the remote purchaser must be part of the normal chain of distribution for the particular product. That chain will by definition include at least three parties and may well include more — for example, the manufacturer might first sell to a wholesaler, that would then resell the goods to a retailer for sale or lease to the public. A buyer or lessee from the retailer would qualify as a remote purchaser and could invoke this section against either the manufacturer or the wholesaler (if the wholesaler provided a record to the retailer to be furnished to the ultimate party), but no subsequent transferee, such as a used-goods buyer or sublessee, could qualify. *The*

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149. U.C.C. § 2-318 cmt. 1 (2000 Annual Meeting Draft).

150. See the discussion of proposed subsection 2-409(c) and related comments at notes 120-24, *supra*, and the accompanying text.

*law governing assignment and third party beneficiary [sic], including Section 2-318, must be consulted to determine whether a party other than the remote purchaser can enforce an obligation created under this section. (emphasis added).*

While rather slender, this reference to the common law of third party beneficiaries corrects a deficiency in the December 1999 and March 2000 drafts and partially recaptures a strength of the July 1999 draft on an important point: The continuing viability of non-Code third party beneficiary law. Curiously, there is no parallel comment following proposed sections 2-313 or 2-313B. This is partly rectified by Preliminary Comment 2 to section 2-313B, which notes the parallelism to section 2-313A and advises that, “the Official Comments to that section should be consulted.” Furthermore, Comment 2 to section 2-313 reiterates the openness to outside law contained in Comment 2 of current Article 2 albeit with an altered phraseology.<sup>151</sup> Therefore, quite apart from section 1-103, there are toe-holds in the 2000 annual meeting draft for the creative importation of the common law of third party beneficiaries.

### *E. Summary*

After a long and tortured process, the drafting committee presented a 2000 annual meeting draft for revised Article 2 which would leave the recognition of third party rights generally where the law was in the early 1960s, except in regard to pass-through warranties and media-communicated warranties that would become statutory “obligations” running directly to distant, downstream parties. As to third party claims for economic losses for breach of warranties, express or implied, proposed section 2-318 would probably perpetuate current variations among jurisdictions. Wherever Alternative C is adopted, if it is adopted, some third party claims for economic losses would be recognized, but the outer limits of Alternative C liability would remain uncertain, especially in light of the cryptic comments proposed to date. Preliminary Comment 3 states, after addressing Alternatives A and B: “The third alternative goes further, following the trend of modern decisions as indicated by Restatement of Torts 2d, section

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151. Comment 2 to proposed section 2-313 in the 2000 annual meeting draft states in pertinent part: “It is not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined to contracts within the scope of this Article.” Compare Official Comment 2 to current Article 2.

402A.”<sup>152</sup> Taken at face value, this would limit Alternative C to personal injury and property damage cases and would not cover economic losses apart from personal injury or property damage. In any event, sellers would retain the power to turn Alternative C into merely a tort-type products liability statute. In this context, the explicit reference to the law of third party beneficiaries in Preliminary Comment 2 to section 2-313A is enlightening and encouraging. The 2000 annual meeting draft points toward the necessity of blending the law of sales and the common law of third party beneficiaries. The question is: In what situations should a blend be made?

#### IV. PARADIGMS THAT RAISE ISSUES OF HORIZONTAL PRIVACY: WHEN A PERSON BEYOND THE FINAL BUYER HAS A CLAIM FOR ECONOMIC LOSSES ATTRIBUTABLE TO A SELLER'S BREACH

##### A. *Introduction*

There are at least three recurring fact patterns involving sales of goods and economic loss in which the common law of third party beneficiaries can be employed to resolve issues of horizontal privity. The three situations are: (1) promotions where a seller promises a prize to a sponsor (promisee) in return for advertising or similar rights, the prize to be awarded to a third party according to terms established by the sponsor; (2) sales of goods where the buyer requests and intends delivery and passage of title to a third person in order to make a gift; (3) sales of goods where the buyer for business reasons requests and intends delivery and passage of title to a third party. No doubt some of these patterns recur more often than the others. The second pattern probably occurs more frequently than the other two. With respect to each, there is a paucity of case law recognizing the relevancy of third party beneficiary law. Nevertheless, each pattern displays a life situation in which third party beneficiary law can play a useful role. There are a few cases worth considering.

With respect to each paradigm, I will proceed as follows: First, I will set up with reasonable detail a hypothetical case wherein a third party claim could arise. Second, taking a backward look, I will make an argument for third party beneficiary recognition on the basis of precedent, most of which can be read in harmony with section 302 of the Restatement (Second). Third, taking a forward

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152. The reference is to the second Preliminary Comment numbered 3.

look, I will try to justify allowing third party beneficiary rights in the hypothetical situation by testing it against the two-branch third party beneficiary principle put forth by Professor Eisenberg.<sup>153</sup> I have drawn the hypothetical situations with an eye on precedent and on Professor Eisenberg's third party beneficiary principle with the objective of arguing that in every case, recognizing third party rights to sue on Article 2 obligations would be appropriate.

Throughout, there are four underlying assumptions: (i) that the 2000 annual meeting draft with its Alternatives for section 2-318 will eventually be promulgated and adopted in most jurisdictions; (ii) that in jurisdictions adopting Alternatives A or B of section 2-318, a right to sue would not be allowed for the third party in the hypothetical situation without resort to non-Code law; (iii) that in jurisdictions which do adopt Alternative C as proposed in the 2000 annual meeting draft, standing to sue as a third party for direct or consequential economic loss alone will remain controversial;<sup>154</sup> and (iv) that the most liberal interpretations of Alternative C would provide no basis for a third party suit apart from breach of warranty. For example, Alternative C would give a third party no rights on account of non-delivery or anticipatory repudiation by the seller. On these assumptions, no matter which official Alternative any jurisdiction adopts, there will be room for the selective importation of the common law of third party beneficiaries in situations analogous to the following hypothetical situations. Naturally, importation will require that courts accept the argument that none of the Alternatives offered by official section 2-318 totally displaces the common law of third party beneficiaries.

## *B. Promotions and Prizes*

### *1. The Hypothetical Situation*

Assume that an association of environmentally concerned citizens ("Association") decides to promote alternatives to the internal combustion engine. To that end, the Association sponsors a Bikers' Weekend during which many roads are reserved for cyclists. The focal point of the weekend is bike races for which prizes are awarded. SuperBikes, Inc. contracts with the Association for advertising purposes on the following terms: SuperBikes promises

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153. See *supra* Part I.G.

154. If Alternative C of the 2000 annual meeting draft is not widely enacted, as is the case with current Alternative C, there will be a nearly universal need for borrowing from the common law of third party beneficiaries.



to give twenty new trail bikes valued at \$1000 each to bikers selected by the Association as winners in the bike races in return for the Association's inclusion of SuperBike's advertisements in its promotional material and the privilege of setting up advertising booths at rallying points. Accordingly, the Association represents to all registrants at the Bikers' Weekend that SuperBikes will give new trail bikes to the twenty bikers with the best time on the designated routes. All goes according to plan except that SuperBikes reneges when a vigilant comptroller decides that the promotional benefits were far less than \$20,000, the value of the bikes. Quare: Do the winning bikers have a claim against SuperBikes, Inc. for non-delivery? Or suppose the bikes are delivered, but prove to be damaged and, consequently, unmerchantable. Would the winners have warranty claims against SuperBikes, Inc. in the absence of any representations passed on to the bikers by the Association? I contend that the bikers should have rights to sue as third parties in either the case of non-delivery or upon receipt of unmerchantable bikes.

## 2. *Case Law Supporting Intended Third Party Beneficiary Rights*

Case law relevant to the foregoing hypothetical situation is exceedingly scarce. I have found no reported third party beneficiary case arising from a promotional game where the promise sued upon was a promise for the delivery of goods to the sponsor. Indeed, cases arising from promises of new cars to winners in promotional games are very common,<sup>155</sup> however, the promise sued upon in reported cases seems always to have been a promise made by the sponsor to the participants in the game, i.e., the Association in the foregoing hypothetical. The sponsor generally procures the prizes and promises delivery to the winners according to the rules of the game.<sup>156</sup> Even though sponsors commonly enter into one or more contracts for procurement of the prizes, cases (with exceptions, *infra*) do not show third party suits on those contracts. Perhaps suppliers who sell goods to sponsors of promotional games seldom breach. Or perhaps the lack of case law is attributable to a widespread perception that such claims would not be viable. The following two cases would give the

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155. See Mark B. Wessman, *Is Contract the Name of the Game? Promotional Games as Test Theory for Contract Theory*, 34 ARIZ. L. REV. 635 (1992) ("Wessman").

156. *Id.* at 645-54.

plaintiff's lawyer a toe-hold in a suit by a contest winner against a non-privity supplier to a game sponsor.

*Whitehead v. Burgess*, 38 A. 802 (N.J. 1897)

Burgess owned a stallion through which he offered breeding services for payment of \$100. Purcell paid \$100 to have his mare bred with Burgess's stallion. In connection with this transaction, Burgess promised Purcell that he would pay \$750 to the owner of a foal of Purcell's mare, "if such foal should prove to be the first one of the get of said stallion that should trot a mile in 2 minutes and 30 seconds."<sup>157</sup> Whitehead alleged that he purchased the foal of Purcell's mare having knowledge of Burgess's promise to Purcell, and that this foal, "trotted a mile in less than 2 minutes and 30 seconds, and was the first one of the get of said stallion to make the said time."<sup>158</sup> When Burgess refused to pay the \$750 as promised, Whitehead sued him. Burgess demurred on three grounds, one of which was lack of privity.<sup>159</sup> The Supreme Court of New Jersey decided that the case was not subject to dismissal for want of privity.<sup>160</sup>

The court's acknowledgment of Whitehead's third party beneficiary status and his entitlement to sue thereon could not be clearer:

The law in this state is that an action may be maintained on a promise made by the defendant to a third person for the benefit of the plaintiff without any consideration moving from the plaintiff to the defendant . . . . The fact that the person to whose benefit the promise may inure is uncertain at the time it is made, and that it cannot be known until the happening of a contingency, cannot deprive the person who thereafter establishes his claim to be the beneficiary of the promise of the right to recover upon it.<sup>161</sup>

This language would have made Professor Williston delighted at the turn of the last century. It embodies a clear recognition of third party beneficiary rights, contrary to the views of many courts in the

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157. *White v. Burgess*, 38 A. 802 (N.J. 1897). This is taken from the court's summary of the plaintiff's allegations.

158. *Id.* at 802.

159. *Id.* at 802-03. The other two grounds for demurring were the statute of frauds and public policy, neither of which were successful. *Id.*

160. *Id.* at 803. The procedural reason for this case coming before four judges of the Supreme Court of New Jersey on the demurrer is not clear from the opinion.

161. *Id.* at 802 (citation omitted).

decades immediately preceding.<sup>162</sup> Now, consider the hypothetical situation about SuperBikes, Inc. in light of *Whitehead v. Burgess*. Suppose Burgess had promised a saddle, a riding cart, or another foal from the get of his stallion (any kind of goods) in lieu of the \$750 promise made to Purcell. Are we to infer that the court, which overruled a demurrer to the claim for \$750 predicated upon third party beneficiary standing, would have sustained a demurrer if the promise sued upon had been for the delivery of goods? The answer is self-evident; the court which allowed a suit for money as promised surely would have allowed a suit on a promise for the delivery of goods. Unless the goods were unique, damages instead of specific performance would have been the appropriate remedy. The hypothetical case is analogous. SuperBikes made a promise knowing that the Association would advertise it. The bikers, who entered races with the promise of new trail bikes as a reward for winning, should be allowed to sue SuperBikes, Inc. either for non-delivery or for breach of warranty.

*Finch v. Rhode Island Grocers Assoc.*, 175 A.2d 177 (R.I. 1961)<sup>163</sup>

The case arose from the following events: The Rhode Island Grocers Association ("Association") was holding a convention to mark its 50th anniversary and decided to invite the public. To enhance public interest, the Association made arrangements, "for a drawing in the nature of a door prize"<sup>164</sup> consisting of two round-trip tickets to Hawaii. TransOcean Air Lines ("Air Lines") promised the Association that it would provide the tickets in exchange for a booth at the convention and specified advertising rights. The Association performed its part of the bargain and accordingly awarded two tickets to Finch, the winner of the drawing.<sup>165</sup> Before the tickets were used, the Air Line suspended operations. Finch sued the Association.

The trial court allowed recovery on a third party beneficiary theory.<sup>166</sup> The Supreme Court of Rhode Island reversed, whimsically discarding Finch's asserted third party beneficiary standing for her

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162. See *supra* Part II.D.

163. See Michael P. Sullivan, Annotation, *Private Contests and Lotteries: Entrants' Rights and Remedies*, 64 A.L.R. 4TH 1021, 1081 (1988).

164. *Finch v. Rhode Island Grocers Assoc.*, 175 A.2d 177, 179 (R.I. 1961).

165. *Id.* According to the opinion: "No consideration was required to participate in the drawing other than to attend as a spectator and fill out a card which presumably called for the name and address of the individual participating." *Id.* at 179.

166. *Id.* at 180. The trial court thought that Finch should recover against the Association as a third party beneficiary on the basis of Rhode Island case law. *Id.* at 181.

claim against the Association. More importantly, the court explicitly acknowledged a probable third party claim against the Air Lines. The court stated:

The plaintiff contends . . . that she is a donee beneficiary falling within the definition of that term as defined in 2 Williston, Contracts (3d ed.) . . . . We do not disagree with this definition but we think it immaterial that plaintiff may be a donee beneficiary. We hold that such beneficiary may recover if at all only from that party to the contract whose promise if enforced inures to her benefit . . . . The plaintiff further argues, however, that if she is a donee beneficiary it has been held to be immaterial whether the consideration flows from the promisee or the promisor. She takes this to mean that she can bring suit against either party. It is sufficient to answer this contention to point out that consideration flows from both parties, thus giving rise to the following question: On the consideration of which party must the beneficiary rely? We think that the beneficiary must look to the party that promised the benefit.<sup>167</sup>

It is difficult to quarrel with the result or with the court's *dicta* about Finch's claim against the Air Lines. It seems apparent that Finch could have sued the Air Lines on a third party beneficiary theory. If the Air Lines were defunct, the suit might not have been economically worthwhile, but the plaintiff would have had the satisfaction of naming the proper party defendant. Applying the *dicta* from *Finch* to the hypothetical situation posed earlier, the bike winners' argument for standing to sue SuperBikes, Inc. for non-delivery is strong. The case is equally strong if SuperBikes delivered unmerchantable bikes or bikes which did not conform to any actionable warranties given to the Association. There was, after all, a bargain between the Association and SuperBikes wherein<sup>168</sup> both parties objectively manifested a purpose, namely, conferring the benefit of new trail bikes on twenty self-selected hard riding bikers.<sup>169</sup>

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167. *Id* at 181.

168. The bikers might make out a claim against the Association on a tort theory if some species of fraud were involved or possibly on a contract theory, but this is beyond the scope of my inquiry.

169. Given the manifestations of intent evident in the bargain, I contend that the bikers fit quite easily into Restatement (Second) section 302(1)(b); at least, there is a good argument for recognizing them as intended beneficiaries on the basis of the text alone.

### 3. *The Third Party Beneficiary Principle and the Hypothetical Situation*

If we apply Professor Eisenberg's third party beneficiary principle to the hypothetical situation involving SuperBikes, assuming either non-delivery or the delivery of defective, non-conforming bikes, third party suits should be allowed the winning bikers. Take the first branch of the third party beneficiary principle and ask: Is allowing the winners to enforce the contract between SuperBikes and the Association a necessary or important means of effectuating the original parties' enterprise objectives? Allowing the bikers to sue SuperBikes is important and probably necessary. Recognizing third party rights may be important because the Association may not have the resources necessary, nor an interest in pursuing litigation for the bikers. Even if the Association's decisionmakers have the interest and the resources, there is little economic incentive for a suit against SuperBikes. Litigation would poison relations with SuperBikes and would yield little for the Association, except that future participation in its contests might be increased by good publicity about its good faith efforts to help the prize winners. Assuming inaction by the Association, recognition of third party rights is necessary to effectuate the original parties' performance objectives.

Under the second branch of the third party principle we can ask: Is allowing enforcement by the winners supported by reasons of policy or morality independent of contract law? The answer depends mainly on whether it is in the public interest to employ the judiciary to promote honesty in games open to the public. In this light, I believe that the argument for third party rights is strong. If prize winners in the contest sponsored by an environmentally concerned group cannot gain the help of the courts to enforce the obligations undertaken by SuperBikes, cynicism and a reluctance to participate in future contests will ensue. Confidence in future contests and confidence in the courts will be enhanced if the winners are accorded rights as third party beneficiaries. Furthermore, this game would qualify in some jurisdictions as a lottery, subject to state regulation.<sup>170</sup> The state's interest in preventing fraudulent contests will be advanced by third party enforcement with no costs to the state apart from the usual

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170. See Sullivan, *supra* note 163. The annotation discusses, among other subjects, the universal state tendency to regulate lotteries. In the hypothetical, allowing bikers standing to sue enables them to assist in policing the lottery.

expense of running the judicial branch.

### *C. Gifts for Friends and Relatives*

#### *1. The Hypothetical Situation*

Suppose Lillian decides to give her granddaughter, Jenny, an expensive painting upon graduation from law school. Deciding against surprise and in favor of allowing her granddaughter a choice in the selection, Lillian and Jenny visit galleries together until they come upon an early American painting that Jenny loves passionately. A representative of the gallery states that it is guaranteed to be authentic and further states that this justifies the high price, \$300,000. Lillian arranges for payment. The painting is timely delivered to Jenny on graduation day. She thereafter proudly displays it in her office, insures it, and describes it to visitors according to assurances given in the gallery. Lillian suffers a stroke within a few months, and goes into a deep coma. About this time, Jenny decides to have the painting appraised and discovers that it is a fake whereupon she indignantly demands a refund from the gallery. The gallery wrongfully defends the authenticity of the painting and refuses to discuss any refund. Does Jenny have a cause of action against the gallery as a third party beneficiary? Or must a guardian be appointed for Lillian to commence litigation? Or should Jenny be denied any legal or equitable relief on a contract theory? Precedent points toward allowing Jenny to sue as a third party beneficiary.

#### *2. Case Law Supporting Jenny's Right to Sue*

Warren v. Monahan Beaches Jewelry, Inc., 548 So.2d 870 (Fl. Dist. App. Ct. 1989)

According to the allegations, Warren, the plaintiff, was Jay Andresen's girlfriend. Andresen purchased what was represented to him as a diamond ring from Monahan Beaches Jewelry ("Monahan"), paying more than \$3000. Monahan knew from conversations with Andresen that the ring was intended for Warren to whom Andresen gave the ring as a Christmas present. Warren later had the ring appraised and discovered that it was cut glass or zirconia, much less valuable than a diamond. She sued Monahan on several theories, including breach of the implied warranty of merchantability under section 2-314. The trial court dismissed her

suit for failure to state a claim.<sup>171</sup> However, the Florida appellate court decided that Warren's complaint was "sufficient to withstand [a] motion to dismiss as to all counts."<sup>172</sup> The reason was that the pre-contract dealings between Andresen and Monahan clearly established Warren's standing as an intended third party beneficiary.

The appellate court stated:

As to breach of contract, the law is that a person not [a] party to a contract may sue for breach of contract where the parties' dealings clearly express the parties' intent to create a right primarily and directly benefiting a third party. In the present case, the precontract dealings between Andresen and appellee, and the subsequent dealings between appellant and appellee, clearly establish appellant [Warren] as an intended third party beneficiary of the contract at issue. The complaint properly alleges that appellee breached the contract when he failed to deliver a diamond ring to Andresen. The alleged breach of contract by appellee deprived appellant of the benefit of owning a diamond ring, which was the purpose of the sale. Appellant has a valid cause of action for breach of contract as an intended third party beneficiary.<sup>173</sup>

If the *Warren* case makes sense, the answer to the hypothetical situation where Lillian makes a gift of a painting is obvious: Jenny should be empowered to sue the gallery for a refund or damages. She would need to prove purchase, payment by her grandmother Lillian, and breach of warranty to recover. Denying Jenny any rights as a third party beneficiary would make no sense if *Warren* was decided correctly.

*Rosen v. Spanierman*, 894 F.2d 28 (2nd Cir. 1990), applying New York Law

According to the allegations, Frances Lipman decided to buy a painting for her daughter and son-in-law, Norma and Hobart Rosen, as an anniversary gift in 1968. Knowing of Lipman's intent, Hobart Rosen entered into discussions with Ira Spanierman, owner of Spanierman's Gallery, for the acquisition of a portrait entitled, "The Misses Wertheimer," which Spanierman represented as the work of John Singer Sargent. They reached agreement on a price of \$15,000.

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171. *Warren v. Monahan Beaches Jewelry, Inc.*, 548 So.2d 870 (Fla. App. 1 Dist. 1989).

172. *Id.*

173. *Id.* at 872 (citing RESTATEMENT (SECOND) OF CONTRACTS, § 302 and *Goodell v. K.T. Enterprises, Ltd.*, 394 So.2d 1087 (Fla. App. 1 Dist. 1981)).

Spanierman prepared an invoice addressed to Lipman C/O Rosens and shipped the painting directly to the Rosens. Hobart Rosen instructed Lipman to send a check to Spanierman for \$15,000, which she did. The invoice contained express warranties of authenticity and origin.<sup>174</sup> In 1987, nearly twenty years after the acquisition from Spanierman, the Rosens decided to sell the painting, having received appraisals ranging from \$175,000 to \$250,000. However, upon placing the painting with Christie's in New York for auction, the Rosens were informed for the first time that it was a fake.

The Rosens sued Spanierman on four theories, including breach of warranty and common law fraud.<sup>175</sup> Spanierman raised the Rosens' alleged lack of standing. The Rosens amended to add Lipman as a party plaintiff. The trial judge nonetheless granted Spanierman's motion for summary judgment. The trial judge decided that the warranty claim was barred by the four year statute of limitations in UCC section 2-725, and that the common law fraud claim was not viable without a showing of reliance upon the false representations by Lipman, the purchaser. The Rosens and Lipman appealed arguing only that the claims above-mentioned, namely, breach of warranty and common law fraud should not have been dismissed by summary judgment. Applying New York law, the second circuit held that the warranty of authenticity did not explicitly extend to future performance; hence, the four year statute of limitations in section 2-725(1) had commenced to run on tender in 1968. Therefore, any claim based upon breach of warranty was time-barred. The court also held that Lipman had no standing to sue for fraud, having never relied upon any representation by Spanierman. However, the court reversed the summary judgment for Spanierman on the Rosens' fraud claim, finding evidence in the record sustaining the Rosens' reliance on the false representations of authenticity.<sup>176</sup>

For the present article, the relevant inquiry is: Were the Rosens recognized as parties having rights under the *contract for sale*

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174. *Rosen v. Spanierman*, 894 F.2d 28 (2d Cir. 1990). According to the court's opinion, the invoice contained the following warranties: "This picture is fully guaranteed by the undersigned to be an original work by John Singer Sargent." The invoice further stated that the painting had been "[a]cquired from a member of the Wertheimer family." *Id.* at 30.

175. *Id.* The suit was also based upon allegations of negligent misrepresentation and professional negligence, neither of which needs consideration in this article. *Id.*

176. *Id.* at 34. Assumed false for purposes of argument only. Spanierman had contested the conclusion that the painting was a fake. *Id.*



between Spanierman and Lipman. The answer is in the affirmative. An assumption throughout the opinion is that the sale was within the scope of Article 2. During the court's extended discussion of section 2-725 — that wrestling with the question of whether or not a warranty of authenticity extends explicitly to future performance — the court never expressed any reservations about the applicability of Article 2 or the Rosens being proper plaintiffs on the warranty claim. Moreover, finding that the Rosens were entitled to sue on the fraud claim, though they were not buyers under Article 2, the court stated:

We understand the district court's reluctance to find detrimental reliance by the Rosens when the invoice lists Mrs. Lipman as the purchaser. But to hold that Lipman may not recover because no representations were made to her and that the Rosens may not maintain their claim because they technically were not parties to the sale would unrealistically isolate the different parts of this transaction . . . . The weakness of a mechanistic approach to this case becomes even more apparent when one imagines the different forms that this transaction might have taken. Lipman might have given the funds for the purchase directly to the Rosens, and the Rosens could then have written their own check to Spanierman. Or the Rosens might have gone ahead with their plan to purchase the painting and parted with their own money, and Lipman could then have reimbursed them. In either of these scenarios Spanierman would have no basis for asserting that the Rosens did not rely to their detriment on his purported misrepresentations. To deny the Rosens recovery simply because they chose to instruct Mrs. Lipman to write a check directly to Spanierman would be to treat this common law fraud claim as if it were controlled by the law of commercial paper.<sup>177</sup>

Despite the court's unfortunate, gratuitous remark disparaging the law of negotiable instruments, it is a justifiable inference that the Rosens would have been allowed to bring their warranty claims if the applicable statute of limitations had not run.<sup>178</sup> The court

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177. *Id.*

178. Under section 2-313 an express representation of fact or promise must be part of the "basis of the bargain" to have any legal effect. U.C.C. § 2-313 (1995). Despite differing opinions on the meaning of "basis of the bargain" most courts construe this to mean a reliance requirement of some sort. It is fair to say that the representation of authenticity

never used the term “third party beneficiaries” in the opinion. Nothing indicates that the parties argued the applicability of third party beneficiary law. The point of the case for this article is simply this: Without using the language of third party beneficiary law, the court discussed the warranty claim assuming the Rosens were proper third party claimants on the sale. Consequently, *Rosen* by analogy would justify allowing Jenny, in the hypothetical situation, a cause of action for breach of warranty.<sup>179</sup> Recognition of Jenny’s rights as a third party would best be explained by resort to the common law of third party beneficiaries.<sup>180</sup>

### 3. *The Third Party Beneficiary Principle and the Hypothetical*

Consider again Professor Eisenberg’s explication of the third party beneficiary principle against the facts of the hypothetical situation wherein Lillian purchased and paid for the painting delivered to Jenny. First, we must inquire: Is allowing the third party to enforce the contract a necessary or important means of effectuating the original parties’ enterprise objectives? Certainly an objective was the delivery of a painting matching the gallery’s description to Jenny. In this situation, allowing Jenny to enforce warranty rights is not only important; it is necessary because Lillian lies in a coma from a stroke. Perhaps a guardian could be appointed for Lillian to pursue the gallery for Jenny’s benefit, but what sane person would require such a convoluted approach to enforce express obligations undertaken by the gallery for a price? Moreover, it is doubtful that any concerned friend or relative would want Lillian’s means reduced to pursue a lawsuit about a painting in view of the gravity of her situation. Neither would any heir want

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went to the basis of the bargain in which the Rosens were the intended recipients of the goods because the Rosens relied upon it. In a sense this cuts new ground because normally a court is looking for a buyer’s reliance, e.g., Lipman’s in this case.

179. Of course, a suit for fraud should also lie. Article 2 explicitly recognizes suits for fraud. See U.C.C. § 2-721 (1995). As on other points, the 2000 Annual Meeting Draft is consistent with section 2-721.

180. The question naturally arises whether in the hypothetical situation resort to the common law of third party beneficiaries will be required if the 2000 annual meeting draft is adopted in any jurisdiction. The answer is in the affirmative. Jenny could not make a claim under section 2-313 because she is not an immediate buyer as a proper claimant must be under subsections 2-313(a) and (b). She is not an immediate buyer because she cannot qualify under the Code as a buyer, a person that buys or contracts to buy goods. See U.C.C. § 2-102(3) (2000 Annual Meeting Draft). Jenny did not buy or contract to buy the painting; her grandmother did because she paid the price. For the same reason, Jenny could not qualify as a remote purchaser under section 2-313A. Jenny’s only Code-based route to recovery would be her jurisdiction’s choice under section 2-318, which in most cases would not allow her suit.

Lillian's estate diminished. Yet, the painting was a part of Lillian's legacy to Jenny. It takes no fertile imagination to suggest that Lillian *would have wanted* Jenny to have enforcement rights.

We can further inquire: Is allowing third party enforcement of the warranty supported by reasons of policy or morality independent of contract law which do not conflict with the contracting parties' performance objectives? Again, an affirmative answer can be given. There is no point in allowing a public seller of fine art to be unaccountable for misrepresentations simply because the purchase was made for immediate and direct delivery as a gift to a third party rather than the buyer. Representations of authenticity become express warranties by virtue of statutory law embodying legislatively agreed upon policies.<sup>181</sup> Furthermore, the seller's risk is not increased by recognizing rights in Jenny.

While the first branch of the third party beneficiary principle fits more exactly than the second branch, either branch, or both together, justify a recognition of a right to sue in Jenny. Standing to sue as a third party beneficiary should probably be allowed even if all of the representations bearing upon authenticity were made to Lillian, the buyer under Article 2. In *Warren v. Monahan*, the warranties were made to the purchaser, Andresen. Third party rights were recognized in *Warren* because Monahan knew that Andresen was buying the ring for her; hence, a performance objective was the sale of a diamond ring for Warren. In the hypothetical situation, the same moral and policy reasons would pertain if the representations had been made only to Lillian and relayed to Jenny in connection with the gift. In short, the third party beneficiary principle, as set forth by Professor Eisenberg, is consistent with *Warren v. Monahan*, and could appropriately be applied to the facts of *Rosen v. Spanierman*. In addition, it can serve as a workable guide for establishing third party beneficiary standing in this paradigm: Whenever goods are purchased with an understanding between the seller and the buyer, or an appropriate disclosure by the buyer to the seller in the context of the sale, that the goods are being purchased as a gift for a third person, and the goods are accordingly delivered, directly or indirectly, to the third person.

Arguably, the principle should be extended to yet a wider class, namely, recipients of gifts by family or friends even without

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181. See U.C.C. § 2-313 (1995).

disclosure of the buyer's purpose at the time of purchase.<sup>182</sup> This was precisely the class sought to be included as claimants for breach of express and implied warranties by section 2-409(a) of the July 1999 draft.<sup>183</sup> If the warrantor's risk is not increased by this extension, the extension should probably be made in order to do justice to the recipients of gifts, especially big-ticket items such as cars, expensive appliances, furniture and the like. Such an extension could also have particular applicability to gift certificates. Without specifying exactly the class to be encompassed, it is plain that the common law of third party beneficiaries can be employed to fill a gap left by the rejection of the July 1999 draft when gift recipients have claims for economic loss.<sup>184</sup> Even in jurisdictions which adopt Alternative C of proposed section 2-318, non-Code third party beneficiary law will be essential to empower a claimant, such as Jenny, in a case of non-delivery because section 2-318 would only apply if delivery were made and a warranty were breached.

#### *D. Delivery of Goods to a Third Party in a Business Context*

##### *1. The Hypothetical Situation*

Suppose A and B form Woodworkers, Inc., each contributing \$10,000 in return for 100 shares of corporate stock. The business plan is for Woodworkers, Inc. to make replicas of early American furniture. After a year in business and with bright prospects for growth, A and B recognize that their corporation needs more capital. Each agrees to contribute another \$10,000 in return for another 100 shares of stock. At this time, A and B meet C who agrees to give up his own shop and join them as a stockholder in, and an employee of, Woodworkers, Inc. In return for 200 shares of stock, C agrees to contribute a specially built power saw on order directly from the manufacturer for his own business for the price of \$20,000. C, who has paid the manufacturer in advance, negotiates for modifications to make the saw suitable for Woodworkers, Inc. and arranges for delivery and installation at its shop. The saw is timely delivered and accepted in accordance with

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182. The case for third party rights becomes weaker as the seller has less reason to understand the purpose of the purchase. However, if the seller's risk is not increased, allowing direct suits is a good policy because it reduces inefficiency in the enforcement of contracts.

183. See *supra* Part III.C.

184. This will be especially important in the future in those jurisdictions not adopting Alternative C.

section 2-606 by the absence of any timely rejection. Within three months, the saw malfunctions, reducing production significantly. The manufacturer cannot make it work properly. We can assume that a case for breach of the implied warranty of merchantability (section 2-314) and the implied warranty of fitness for a particular purpose (section 2-315) is strong. Moreover, since the saw's non-conformity substantially impairs its value to Woodworkers, and a replacement is sorely needed, revocation of acceptance under section 2-608 and cover under section 2-712 seem appropriate. Cover will cost \$25,000. Can Woodworkers revoke acceptance under section 2-608, sue for a refund under section 2-711, seek cover costs under section 2-712, and demand consequential damages under section 2-715(2)? Or must C sue for these remedies, promising to remit anything he recovers to the Woodworkers? Case law points toward allowing these remedies for Woodworkers, Inc. even in the absence of an assignment of the contract for sale.

## 2. *Precedent Supporting an Intended Beneficiary Claim*

Goodell v. K.T. Enterprises, Ltd., 394 So.2d 1087 (Fla. Dist. Ct. App. 1981)<sup>185</sup>

John Goodell ("Buyer") entered into a contract with K.T. Enterprises ("K.T.") for the purchase of a belt conveyor system. The agreement provided that K.T. would deliver this unit to Better Baked Foods, Inc. ("Better Baked") and install it according to the latter's direction. K.T.'s president knew that the conveyor was intended for Better Baked's pizza freezing business. Design details were negotiated between Better Baked and K.T. The conveyor was delivered directly to Better Baked and installed. The contract was never assigned to Better Baked. Goodell remained the buyer, took title to the conveyor system, and paid a deposit. Goodell was corporate counsel, a stockholder, and a member of the Board of Directors; he probably kept title to the belt conveyor system as security for a loan he had made to Better Baked.<sup>186</sup>

The conveyor system was defective, and K.T.'s remedial efforts were ineffective. Goodell notified K.T. that if his deposit were not returned by a stated date, he would sue for a refund, cover costs,

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185. 394 So. 2d 1087 (Fla. App. 1 Dist. 1981). Only one reported case in the business context has been found that supports a third party beneficiary claim. However, the gift cases in Part IV.C should be useful by analogy.

186. *Id.* at 1088 n.2. The opinion stated that: "Goodell owns some of Better Baked's stock, is on the Board of Directors, and is the company attorney. Apparently, he took title to the unit as security for a loan to Better Baked for expansion." *Id.*

and enumerated losses in the nature of consequential damages. K.T. made no refund. Goodell purchased a substitute conveyor system paying in excess of \$12,000 above the original contract price. Better Baked lost profits. Goodell and Better Baked jointly commenced suit. The trial judge found that K.T. was in breach and that Goodell had timely "rescinded." Consequently, the trial judge ordered the return of Goodell's deposit with interest. The trial judge, however, denied Goodell's claim for cover costs and rejected Better Baked's claim for consequential damages incurred as an alleged third party beneficiary of the Goodell-K.T. contract.

Plaintiffs appealed. The Florida appellate court first held that Goodell was entitled to cover costs, predicating this damage upon a timely rejection or revocation of acceptance and cancellation.<sup>187</sup> More importantly for our purposes, the court held that Better Baked had a claim for its losses (consequential damages) as an intended third party beneficiary.

In the court's language:

We also find that appellee is liable to Better Baked as a third party beneficiary. As shown in the facts above, the precontract dealings of the parties, the contract itself, and the subsequent dealings between the parties show that the clear intent and purpose of the contract was to directly and substantially benefit Better Baked . . . .

Although we hold that the unrefuted evidence shows Better Baked is entitled to sue appellee for damages as a third party beneficiary, we decline to rule as to the amount of damages, if any, which should be awarded. The evidence in this respect is infused with factual determinations which should properly be made by the trial court.<sup>188</sup>

Viewing the hypothetical situation in light of *Goodell v. K.T. Enterprises Ltd.*, it is reasonable to conclude that Woodworkers, Inc. should have the rights of a third party beneficiary. The hypothetical situation is distinguishable from *Goodell* in that C in the hypothetical did not retain any interest in the saw but, rather, took 200 shares of stock in return for granting his interest to Woodworkers. This should strengthen a third party claim. On the

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187. *Id.* at 1089. The court did not decide whether Goodell's actions were a rejection under section 2-602 or a revocation of acceptance under section 2-608. Either section could have been employed on the facts. Either action would have entitled Goodell to refund and cover damages under section 2-711(1).

188. *Id.* at 1089 (citations omitted).

other hand, the manufacturer knew nothing of Woodworkers, Inc. until modifications were made at C's request. This tends to weaken the third party claim. On balance, however, *Goodell* suggests that Woodworkers, Inc., rather than C, should reject or revoke acceptance, demand a refund, and claim cover damages as well as incidental and consequential damages. The rights of a buyer under Article 2 should vest in Woodworkers, Inc. as a third party beneficiary if we reason analogically from *Goodell v. K.T. Enterprises*.

### 3. *The Third Party Beneficiary Principle and the Hypothetical*

First, we should ask in accord with the first branch of the third party beneficiary principle: Is allowing Woodworkers to enforce the contract a necessary or important means of effectuating the contracting parties' objectives as manifested in the contract and surrounding circumstances? A third party suit could be important, or necessary, to effect the parties' modified enterprise objectives. The original parties' objectives were modified to require delivery of a conforming saw to Woodworkers, Inc., not to C, even though C did not assign his contract rights to Woodworkers, Inc.<sup>189</sup> Much as if C had gifted the saw to Woodworkers, Inc. the latter took title on delivery. Woodworkers, Inc. now has a direct economic interest in enforcing warranty and related rights against the manufacturer. As with donors in gift cases, C, as the promisee, has only an indirect interest in enforcing promises made by the manufacturer. As a stockholder, C is economically interested and might rightly represent the interests of Woodworkers, Inc., but the corporation would likely need to advance costs. Even if C were high-minded and advanced costs for the suit, it makes no sense to require C to launch a suit and then be reimbursed by Woodworkers, Inc. for expenses and costs, with an award, if any, going to the corporation. Moreover, C might die or sell his stock to another. Should C's successor be expected to sue for Woodworkers, Inc.? What if the successor refused? It is important as a practical matter for Woodworkers, Inc., the corporate owner, to be given third party beneficiary rights; and depending on what C decides to do, recognizing such rights may be essential for a resolution of issues

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189. Obviously, the transaction could have taken the form of an assignment. See section 2-210 of current Article 2 and proposed section 2-210 of the 2000 annual meeting draft. However, as in *Goodell v. K.T. Enterprises, Ltd.*, there was no assignment or delegation, just delivery to a third party designated by the promisee (buyer).

arising from the manufacturing defects.<sup>190</sup>

### *E. Summary*

I have examined three hypothetical situations in which someone other than a buyer took delivery of goods.<sup>191</sup> In each situation, the original contracting parties knew before the time of delivery that the goods were intended for the third person, not the buyer, i.e., the person who paid the price. The recipients of the goods were beyond the final buyer in the distribution chain. None of the recipients of the goods would have legal rights under either section 2-313A or section 2-313B of the 2000 annual meeting draft or case law underlying those sections. What the situations have in common is a problem of horizontal privity. If the 2000 annual meeting draft is enacted, and a jurisdiction adopts either Alternative A or B to section 2-318, the third party claimants in the three hypothetical situations must resort to non-Code law or have their claims denied. If any jurisdiction adopts Alternative C to proposed section 2-318(b), these situations might be covered, in which case lack of privity should not bar relief, assuming a reasonably liberal interpretation that allows suits for economic loss apart from personal injury or property damage. However, under the 2000 annual meeting draft, sellers will be empowered to exclude the operation of Alternative C except in cases of personal injury. If history is a guide, few jurisdictions will adopt Alternative C.

Yet, in each hypothetical situation set forth above, some precedent as well as cutting edge third party beneficiary theory represented by the work of Professor Eisenberg, point toward allowing a third party claim. To avoid injustice and to enhance Code jurisprudence, the courts should carefully blend revised Article 2's law of sales, especially its law of warranties, with the common law of third party beneficiaries in like situations. This view is in accord with Preliminary Comment 2 to section 2-313A of the 2000 annual meeting draft wherein it states in relevant part, "The law governing assignment and third-party beneficiary [sic],

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190. I have not discussed the second prong of Professor Eisenberg's third party beneficiary principle because no obvious public policy undergirds Woodworkers claim, except perhaps a policy favoring efficient resolution of disputes without unnecessary parties.

191. Buyer is defined as a person that buys or contracts to buy goods. U.C.C. § 2-102 (3) (2000 Annual Meeting Draft). Sale is defined as the passing of title to goods from the seller to the buyer for a price. U.C.C. § 2-102 (36) (2000 Annual Meeting Draft). The definitions used in the 2000 Annual Meeting Draft are identical to those utilized in the current code.



including section 2-318, must be consulted to determine whether a party other than the remote purchaser can enforce an obligation created *under this section*.” The reference to the law of *third party beneficiaries, including section 2-318*, implies a role for the common law of third party beneficiaries. Situations calling for the blend may come up rarely. A good blend in many jurisdictions may take decades to accomplish, but along the way, in certain fringe cases, blending will be important for the parties and for the wholeness and integrity of sales law.

V. REFLECTIONS ON REMEDIES FOR THIRD PARTY CLAIMANTS IN THE  
HYPOTHETICAL SITUATIONS IN PART IV (WHERE THE CLAIMANTS ARE  
BEYOND THE FINAL BUYERS IN THE DISTRIBUTION CHAIN)

During the discussion of possible third party claims in Part IV, I alluded frequently to remedies which might be available. Here I want to reflect more specifically on remedies and try to answer the following questions: If the winners are allowed to sue SuperBikes, and Jenny is allowed to sue the gallery, and Woodworkers, Inc. is allowed to sue the manufacturer, what remedies, if any, should they be afforded under Article 2? Assuming their rights to sue are based upon standing as common law third party beneficiaries, should all of Article 2's remedies be available? In my view, each claimant recognized as a third party beneficiary under the common law should have the benefit of the full panoply of Article 2 buyers' remedies, including rejection and revocation of acceptance. Otherwise, such claimants cannot fully enforce the original parties' objectives, nor can considerations of policy be rightly implemented because the third party claimants will fall short of gaining recoupment of their lost expectancies.

Consider non-delivery, varying the original hypothetical situations as necessary. In the event of non-delivery, available remedies should include specific performance under section 2-716(1) if the goods are unique or other circumstances strongly favor delivery of specific goods.<sup>192</sup> The bikers would probably not have very strong claims for specific enforcement because trail bikes can be purchased on the market without undue difficulty. On the other hand, if the gallery failed to deliver a painting to Jenny (instead of delivering a fake), her claim for specific performance would be strong because one painting would not normally be an adequate

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192. U.C.C. § 2-716 (1) (1995). Specific performance may be decreed when the goods are unique or in other proper circumstances. *Id.*

substitute for another. Woodworkers, Inc.'s claim for the specially built saw would lie within the boundaries set by the other cases; if a substitute were difficult or inordinately expensive to obtain, specific performance should be allowed. In every instance, the propriety of specific performance assumes payment was made by the buyer.

If non-conforming goods were delivered, and accepted, the third parties in each case should be entitled to damages. The guiding star for computing damages should be the expectancy objective stated in section 1-106(1) of current Article 2. The expectancy objective can ordinarily be met by applying the specific directives of section 2-714 which have not been modified by the 2000 annual meeting draft. Thus, for breach of any warranty, express or implied, the third party claimant should be entitled to the difference between the value the goods would have had as warranted and the actual value of the non-conforming goods which amounts to loss of bargain damages.<sup>193</sup> This would be helpful to the bikers if they received defective but repairable bikes, and to Woodworkers, Inc. if the saw were repairable. If Jenny received a virtually worthless painting, the formula would be a roundabout way of gaining a refund.

Finally, the third party beneficiaries should have the rights of rejection under section 2-601<sup>194</sup> and revocation of acceptance under section 2-608<sup>195</sup> with the accompanying right of refund under section 2-711.<sup>196</sup> Of course, in the case of either rejection or revocation of acceptance, title to the defective goods would revert to the seller under section 2-401(4).<sup>197</sup> As is discussed in Part VII, applying rejection and revocation of acceptance against non-privity

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193. Section 2-714 (2) states: "The measure of damage for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show damages of a different amount."

194. U.C.C. § 2-601 (1995). Section 2-601 states, in relevant part, "[I]f the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may (a) reject the whole . . . ."

195. U.C.C. § 2-608 (1) (1995). Section 2-608 (1) states: "The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it (a) on the reasonable assumption that its non-conformity would be cured; or (b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances."

196. U.C.C. § 2-711 (1) (1995). See section 2-711(1), which allows recovery (refund) of so much of the price as has been paid.

197. U.C.C. § 2-401 (4) (1995). Section 2-401(4) states: "A rejection or other refusal by the buyer to receive or retain goods, whether or not justified, or a justified revocation of acceptance revests title to goods in the seller." *Id.*

sellers has been controversial. But, the controversy has surrounded cases where vertical privity is lacking. In each of the hypothetical situations explored in Part IV, rejection and revocation of acceptance should work without complication. In each situation, while three parties were involved, there was only one bargain, one sale for one price. That simple fact should negate arguments commonly made against using rejection and revocation of acceptance; namely, that the rejecting or revoking buyer has paid a price greater than that received by the non-privity seller.

The successful rejecting or revoking third party beneficiary should likewise be entitled to the additional costs of cover pursuant to section 2-712<sup>198</sup> or, alternatively, contract-market damages computed under section 2-713.<sup>199</sup> Obligations of notice and care of the rejected goods, e.g., sections 2-602 through 2-607, should properly fall upon the third party who rejects or revokes acceptance. If the 2000 Annual Meeting Draft is adopted, third party beneficiaries should be entitled to the same array of remedies discussed above.

The remedies afforded the third party beneficiaries in the foregoing situations should parallel the remedies available to any aggrieved buyer similarly situated. If this is not allowed, the standing or rights or empowerment conferred upon third parties will be hollow. The cases do not show any particular procedural or administrative problems that would in any way preclude the use of the full range of Code remedies. Therefore, blending the law of sales and the common law of third party beneficiaries requires a blend of Article 2 remedies with the rights established under third party beneficiary law.

## VI. CONTRACTS IN WHICH GOODS ARE PROCURED THROUGH AN INTERMEDIARY: ISSUES OF VERTICAL PRIVACY

### A. *Introduction*

Part VI of this article is about three kinds of contracts: (1)

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198. U.C.C. § 2-712 (2) (1995). Section 2-712(2) states: "The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach." *Id.*

199. U.C.C. § 2-713 (1) (1995). Section 2-713(1) states in relevant part: "[T] measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715) less expenses saved in consequence of the seller's breach." *Id.*

contracts which require that a seller procure goods from a remote (non-privity) supplier to meet the special needs of a buyer; (2) contracts for the procurement of component parts for incorporation into goods then sold to a downstream buyer; and (3) contracts whereby a prime contractor procures goods under a contract of sale for incorporation into a construction project in accord with the owner's plans and specifications.<sup>200</sup> These situations all raise issues of vertical privity. Case law arising from the three paradigmatic situations is very uneven. Any doctrinal summary accurately reflecting reality must of necessity be disjointed. As in situations involving horizontal privity, there is case law showing a role for the common law of third party beneficiaries. I have constructed the hypothetical situations and selected the following cases to support my viewpoint; namely, that the law of sales should be blended with the law of third party beneficiaries.

*B. Contracts Whereby Goods Are Procured from a Remote Seller Through a Dealer When the Remote Seller Knows About and Purports to Satisfy the Final Buyer's Needs*

*1. The Hypothetical Situation*

Suppose Earl, a farmer plagued by drought, finds that he has riparian rights which allow pumping water sufficient to irrigate his tillable land. Earl contacts a local dealer for Great Western Irrigation, Inc., ("Great Western"), a manufacturer of irrigation equipment. Due to the size of Earl's operation, Great Western sends a field representative to assist in assessing his requirements. Together, the dealer and Great Western's representative evaluate Earl's soil and the expected rainfall in order to assess Earl's irrigation needs for the crops he intends to grow. Stating that Great Western can design a system appropriate for Earl's fields, the dealer writes up an offer for sale and installation of a pivot system for \$400,000. Earl accepts, promising to pay the price to the dealer according to an agreed-upon schedule. The dealer will earn a five per cent commission (\$20,000) on the sale plus a fee for installation under Great Western's direction. The dealer makes no express warranties, unless the statement above about Great Western's capability qualifies.<sup>201</sup> Great Western's written, express warranties

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200. Essentially the same issues can arise when a subcontractor procures goods from a supplier, designating them for incorporation into a construction project.

201. Under section 2-313 the dealer's representation that Great Western would design an appropriate system available for \$400,000 *might* qualify as an actionable warranty.

passed on to Earl concern only the dimensions and qualities of component parts. Assume the dealer conspicuously disclaims all implied warranties under section 2-316, and that Great Western makes no disclaimers of implied warranties.<sup>202</sup>

The components are all shipped directly to Earl in early May. The dealer receives an invoice for \$380,000. Under the supervision of a Great Western representative, the dealer completes installation in a timely manner. Because the system functions well in June and July, Earl makes his final payment to the dealer who in turn makes final payment to Great Western in July. In August, a mere seventy days after installation, as heat becomes especially intense, the system fails. The system simply lacks the capacity to deliver the quantity of water required for Earl's crops. Worse yet, pipes begin to leak, and numerous minor malfunctions occur, decreasing the already insufficient water supply. With field help from a Great Western technician, Earl keeps the pivots operating day and night as best he can, but his crops are severely stressed due to insufficient moisture, eventually yielding far less than would have been the case if water had been plentiful. It is clear that major parts of the system will need to be replaced, many minor repairs are needed on other parts, and an upgrade of the intake system will be required to enhance the system's capacity.

Great Western and the dealer are suddenly unavailable when Earl phones. Earl consults with another irrigation company only to discover that for a mere \$100,000 he can replace defective components, make minor repairs to others, and upgrade the intake to meet his requirements. He will need to borrow the money. Sorely pressed financially, Earl contacts a lawyer who recommends suit against the dealer for breach of the implied warranty of merchantability (section 2-314) and the implied warranty of fitness for a particular purpose (section 2-315). The lawyer hopes to invalidate the dealer's disclaimer under section 2-302. However, Earl is reluctant to sue the dealer. They are members of the same church, and Earl knows that the dealer has insufficient assets to respond to a large judgment. In any event, the dealer is popular locally and is likely to garner considerable sympathy from a local jury. Earl's lawyer admits that the disclaimer would probably survive judicial scrutiny. The question then becomes: Does Earl

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202. On disclaiming implied warranties, section 2-316 (2) states in relevant part: "[T]o exclude the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous."

have an action against Great Western for direct and consequential economic losses predicated upon breach of implied warranties? Or is Earl stuck with a claim against the dealer, his immediate seller, that at best would yield an uncollectible judgment? There is case law favorable to Earl.<sup>203</sup>

*2. Precedents Showing the Final Buyer as an Intended Beneficiary of an Upstream Supply Contract*

Kadiak Fisheries Co. v. Murphy Diesel Co., 422 P.2d 496 (Wash. 1967)

Kadiak Fisheries Company ("Kadiak") decided to re-power a salmon fishing boat to adapt it for crab fishing. Kadiak's representative discussed this project with Alaska Pacific Supply Company ("Alaska Pacific") that communicated Kadiak's needs to Murphy Diesel Company ("Murphy Diesel"), an out-of-state supplier. Two sales contracts were thereafter made. By the terms of these contracts, Murphy Diesel sold a diesel engine to Alaska Pacific, and Alaska Pacific sold the engine to Kadiak. Representatives of all three parties assisted in installing the engine in Kadiak's fishing boat. Numerous problems followed relating to excessive exhaust and lubricating oil temperatures. Eventually a fire broke out and destroyed part of the boat and some cargo. Kadiak also suffered lost profits while the boat was out of service.

Kadiak sued both Alaska Pacific and Murphy Diesel for breach of implied warranties. A jury exonerated Alaska Pacific, but allowed recovery against Murphy Diesel. The trial judge dismissed Alaska Pacific, leaving the non-privity antagonists, Murphy Diesel and Kadiak, the only parties remaining in the suit on appeal. One of Murphy Diesel's main arguments against the judgment for Kadiak was lack of privity. Kadiak in response argued that either Alaska Pacific had acted as its agent for purchasing the engine, or as Murphy Diesel's agent for selling it, or that Kadiak had rights against Murphy Diesel as a third party beneficiary. For purposes of argument, the Supreme Court of Washington assumed that Alaska Pacific was neither Murphy Diesel's agent nor Kadiak's agent; hence, the court assumed no contractual privity on the basis of

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203. The hypothetical situation was not created as a construction project. The assumption underlying the hypothetical is that the irrigation equipment remains goods and does not become incorporated into the real estate. If this were a construction project, the cases and arguments in Part VI.D would be pertinent. For an analogous case where Article 2 was applied, see *Sheesley Plumbing & Heating Co.*, 324 N.W.2d 266 (S.D. 1982).

agency law. Therefore, the issue was squarely presented: Did the non-privity buyer have a direct action against the remote supplier for breach of implied warranties? The Supreme Court of Washington upheld the judgment in favor of Kadiak stating that, "the evidence conclusively established Kadiak as the third party beneficiary of the sale of the motor in question by Murphy Diesel."<sup>204</sup>

The court's explanatory language is instructive:

Murphy Diesel knew the identity, the purpose, and requirements of Alaska Pacific's customer — Kadiak. It engineered and constructed the motor to meet certain specifications . . . . Although it invoiced the motor through Alaska Pacific, it shipped the motor direct to Kadiak. Some communications were carried on directly between Kadiak and the factory before and after shipment. An official of the company, the regional sales representative, and a factory service man visited the Jaguar [boat] on various occasions before and during installation of the motor, and the service man participated in adjustments and corrections for the final trial run . . . . Under these circumstances, it is beyond dispute that Alaska Pacific's purchase of the motor from Murphy Diesel was upon the consideration that a merchantable motor, fit and suitable for the marine purposes of Kadiak, would be supplied. Kadiak thus became the beneficiary of the contract, with Alaska Pacific as the conduit through which the duty of ordinary care and the implied warranties of merchantability and fitness flowed.<sup>205</sup>

Frank's Maintenance & Engineering, Inc. v. C.A. Roberts Co., 408 N.E.2d 403 (Ill. App. 1980)<sup>206</sup>

Frank's Maintenance & Engineering, Inc. ("Frank's") manufactured motorcycle front fork tubes, a component part of a motorcycle that connects the front wheel to the frame. For its fabrication process, Frank's contracted to buy steel tubing from C.A. Roberts Co. ("Roberts"). Roberts in turn ordered the steel from Leland's Tube Company ("Leland's") and requested direct

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204. *Kadiak Fisheries Co. v. Murphy Diesel Co.*, 422 P.2d 496, 503 (Wash. 1967) (citing *Jeffrey v. Hanson*, 239 P.2d 346 (Wash. 1952)).

205. *Id.* at 503-04 (citation omitted).

206. The Illinois court cited and relied upon *Kadiak Fisheries Co. v. Murphy Diesel Co.*, 422 P.2d 496 (Wash. 1967).

shipment to Frank's. Leland's delivered accordingly. When Frank's began to use the steel for making front fork tubes, it discovered that the steel was pitted, corroded, and had cracks making it unfit for the high-stress purpose for which it had been ordered, and consequently useless to Frank's.<sup>207</sup> Frank's revoked acceptance under section 2-608 by notice to Roberts. When Roberts failed to respond, Frank's sold the steel tubing for scrap, and covered, paying a higher-than-contract price for substitute steel tubing. Frank's sued both Roberts and Leland's for breach of implied warranties claiming the purchase price, cover damages, and incidental damages. The trial judge granted summary judgment motions for both defendants, in Leland's case due to Frank's lack of privity.

An Illinois appellate court reversed and remanded on the grounds that the facts made Frank's an intended third party beneficiary of the Roberts — Leland's contract for sale. In relevant part, the court stated:

Leland . . . contends that it cannot be held liable to the plaintiff because it is not in privity with it. It is true that absent a situation falling within the scope of sec. 2-318 of the Uniform Commercial Code . . . privity only extends to the parties to the sale and implied warranties are not applicable between the buyer and a remote manufacturer. This is not true, however . . . where, as here, the manufacturer knew the identity, purpose, and requirements of the dealer's customer and manufactured or delivered the goods specifically to meet those requirements . . . . Here Leland was clearly aware that the order from Roberts was on behalf of plaintiff [Frank's] and it shipped the goods not to Roberts but directly to the plaintiff.<sup>208</sup>

Compare these cases to the hypothetical situation. Both *Kadiak* and *Frank's Maintenance and Engineering, Inc.* support Earl's claim to third party beneficiary rights. As in the precedents, the remote supplier (Great Western) was advised of buyer's particular requirements and impliedly or expressly represented that its product would meet those requirements. In *Kadiak*, the buyer

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207. *Frank's Maintenance and Eng'g, Inc. v. C.A. Roberts Co.*, 408 N.E.2d 403, 405 (Ill. App. 1980). It was also welded instead of seamless contrary to the terms of the Frank's — Roberts contract, so there was probably a breach of an express warranty under section 2-313.

208. *Id.* at 412.



suffered property damage as well as lost profits, so Kadiak's claim for third party recognition might appear stronger than Earl's claim in the hypothetical situation. However, Earl suffered direct harm to a growing crop (physical injury of a sort) which resulted in lost profits, so his claim is not materially different from Kadiak's claim. In any event, *Frank's*, which cited *Kadiak*, established third party standing for a party suffering *only* economic loss, namely, cover costs and incidental damages, along with a claim for return of the price. Thus, the precedents point toward allowance of Earl's claim as a third party beneficiary. As is evident in the language quoted from *Frank's Maintenance & Engineering*, section 2-318 was not deemed controlling; it did not limit or preclude a claim arising from the common law of third party beneficiaries.

The hypothetical situation and the two precedents discussed above may be analyzed from another perspective; namely, that the facts of each reveal a delegation of a contractual obligation. The dealers may be said to have delegated their obligations to supply goods appropriate to the buyers' disclosed needs by inviting their sellers to participate in ascertaining and defining those needs, and making direct delivery, or both. In each case, the dealer made a contract with the final buyer and then procured goods to meet that buyer's needs. In this sense, the cases and the hypothetical are similar to the facts of *Tarter v. MonArk Boat Co.*<sup>209</sup> where MonArk agreed to build a houseboat and subsequently delegated its obligations to AlumaShip through a corporate reorganization. AlumaShip assumed MonArk's obligations, but MonArk remained liable as a surety (secondary obligor) in the absence of a novation.<sup>210</sup> Tarter sued MonArk for breach of warranty and prevailed. However, Tarter could have sued AlumaShip, a party now liable to him as the primary obligor; in that case, he would have been suing as a third party beneficiary on the contract of delegation. Likewise, in the hypothetical situation, it is defensible to treat the dealer as a delegating party and Great Western as the delegate, thereby making Earl a third party beneficiary. This is precisely what the proposed comment to section 2-503 of the July 1999 draft expressly provided — a delegation would create third party beneficiary rights.<sup>211</sup> An obvious analogy is the sale of real

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209. 430 F. Supp. 1290 (E.D. Mo. 1977).

210. *Id.* The facts failed to establish a novation thus leaving MonArk liable for deficiencies in AlumaShip's construction. *Id.*

211. Proposed section 2-503 of the July 1999 draft would have codified certain principles pertaining to assignment and delegation. Proposed Comment 3 stated in relevant

estate where the buyer assumes seller's payment obligations, thereby making the holder of a note and mortgage a third party beneficiary of the buyer's promise to assume seller's payment obligations. So also when a seller plainly delegates an obligation to procure suitable goods, a third party beneficiary contract is created.

The courts will need to be aware of a danger, however, in the use of third party beneficiary doctrine in cases of upstream procurement. The danger is that in every retail sale, the buyer might contend that he or she was a beneficiary of an upstream supply contract, thereby instantly filling the marketplace with millions of such beneficiaries rendering section 2-318 and perhaps sections 2-313A and 2-313B superfluous. A necessary limitation is implied in the prior fact patterns. Third party beneficiary standing should supplement rights granted by Article 2 when the remote seller either participates in ascertaining, or at minimum is made aware of, a final buyer's particular needs, and undertakes to satisfy those needs by fabricating, selecting or procuring appropriate goods. Likewise, finding a true delegation should establish third party beneficiary status. There need not be facts sufficient to make out a warranty claim under section 2-315; but facts leaning in that direction, or a true delegation, must be evident for third party standing to be appropriate.

### *3. The Hypothetical and the Third Party Beneficiary Principle*

Let us consider the first branch of the third party beneficiary principle, ascertaining objectively the parties' enterprise objectives. Great Western and the dealer undertook to furnish and install a system capable of meeting Earl's irrigation needs. Otherwise, there would have been no reason for soil tests and related inquiries leading to an assessment upon which the irrigation system was recommended. Allowing Earl to enforce warranty obligations imposed by law upon Great Western is important to implement the parties' enterprise objectives. Allowing Earl a direct suit may be essential for implementing those objectives since the dealer has every incentive not to press Great Western very hard for a resolution of Earl's problems as this might jeopardize his

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part: "[I]f the third person accepts the delegation, an enforceable promise is made to both the delegator and the person entitled under the contract to perform those duties . . . . [I]n short, as to the person entitled under the contract a third party beneficiary contract is created." U.C.C. § 2-503 cmt. 3 (Proposed Draft, July 1999).

dealership. If a case against the dealer were not viable on account of a disclaimer, or if a substantial judgment against the dealer would be uncollectible, an action directly against Great Western is necessary to accomplish justice, i.e., satisfaction of Earl's expectation interest.<sup>212</sup> Earl is representative of many, many buyers who have had the misfortune of buying faulty goods from an immediate seller who either successfully disclaims all warranties or becomes insolvent, and is then met with a lack of privity defense on making a claim against an upstream warrantor.

The second branch of the third party beneficiary principle (policy and morality) tug in favor of empowering Earl to enforce warranties against Great Western. If the intermediary (dealer) cannot be held responsible for Earl's losses due to his power to disclaim warranties or due to his limited assets, and suit against Great Western is not allowed, then the legislatively imposed warranties (imposed for reasons of policy) become virtually worthless. Assuming no valid disclaimer, Earl's fate as a farmer should not be contingent upon the financial fortunes of the dealer alone. Both branches of the third party beneficiary principle point toward favoring Earl. As stated earlier in discussing precedent, allowing Earl third party rights against Great Western does not mean that every equipment buyer should have a direct action against every upstream supplier for breach of implied warranties. Finding third party standing under the evolving common law will be situation specific, taking into account enterprise objectives and public policy concerns.

### *C. Cases Where Components Are Incorporated into Goods for Sale to a Downstream Buyer*

#### *1. The Hypothetical Situation*

Assume that a ferryman contracts with Atlantic Shipbuilders, Inc. ("Shipbuilders") for the construction and delivery of a new ferryboat for operation from a port city to an island nearby.<sup>213</sup> In

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212. See RESTATEMENT (SECOND) OF CONTRACTS § 344 (a) (1977) and U.C.C. § 1-106 (1) which set forth the expectation interest as the primary remedial goal of the Code and the common law of contracts.

213. The hypothetical is loosely based upon the facts of *Bay State-Spray & Provincetown Steamship, Inc. v. Caterpillar Tractor Co.*, 404 Mass. 103 (1989) combined with the facts of *Chestnut Hill Dev. Corp. v. Otis Elevator Co.*, 635 F. Supp. 927 (D.C. D. Mass. 1987). While the hypothetical situation may initially appear similar to *Murphy Diesel*, it sets up a distinctly different legal question. Note that in *Murphy Diesel*, the boat owner bought the engine through a dealer for installation into its pre-owned boat; Kadiak did not

order to meet current and anticipated federal and state laws respecting accessibility for the physically challenged, the contract includes an elevator capable of moving passengers in wheelchairs from one deck to another. Shipbuilders negotiates with Liftbuilders for America, Inc. ("Liftbuilders") for the design, construction, and incorporation of an elevator, disclosing the specific purpose and setting forth particular requirements. During negotiations, Liftbuilders sends a representative to ride the ferryboat, to view the passenger traffic as the ferryboat cruises and docks, and to assess generally the needs of the persons who would use the elevator. Thereafter, Shipbuilders and Liftbuilders sign a detailed supply contract. The supply contract contains express warranties running to Shipbuilders and a promise to remedy any problems occurring with the elevator during the first three years of operation. The agreed price is \$300,000. The ferryman is fully aware of the elevator specifications in his contract with Shipbuilders, and is advised generally of the warranties and service obligations in the supply contract.

The ferryboat is completed and put into service with the elevator incorporated into it. Shipbuilders pays Liftbuilders the \$300,000 price, and ferryman completely pays Shipbuilders. Within one year, the elevator begins to malfunction, slipping and scaring people greatly. Liftbuilders sends a representative who makes adjustments — none of which eliminate the problems. Finally, one hot summer day, the elevator becomes stuck between decks for more than an hour with several occupants trapped inside. Public authorities launch an investigation. Bad publicity follows and the ferryman decides to suspend operations while extensive repairs are made. Since Liftbuilder's representative demonstrates no competency in fixing the elevator, the ferryman hires a third party to make satisfactory repairs at a cost of \$30,000. Downtime results in lost profits of \$30,000. At this opportune moment, Shipbuilder files for bankruptcy. Naturally, ferryman wants to recover repair costs and lost profits from someone. On demand, Shipbuilder's lawyer produces the written supply contract containing Liftbuilder's express warranties and the promise of remedial work for three years from commencement of service of its elevators, if any complaint is made to Shipbuilders. Investigation reveals that the

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buy the boat with a faulty component part. The hypothetical situation and the precedents discussed in Part VI.C deal with the purchase and sale of a finished good wherein one component part proves defective.

express warranties of quality were violated because key components were of lesser quality than specified. Moreover, the implied warranty of merchantability (section 2-314) and the implied warranty of fitness for a particular purpose (section 2-315) were not effectively disclaimed by Liftbuilders in accordance with section 2-316.

As a result, assuming a design or manufacturing defect in the elevator, the question arises: Does the ferryman have a claim against Liftbuilders for direct damages (repair costs) and consequential damages (lost profits) for breach of the express and implied warranties and the broken remedial promise? Or is the ferryman stuck with fighting for whatever can be had, if anything, from Shipbuilder's bankruptcy estate? Although there are doctrinal wrinkles in the relevant opinions, there is case law pointing toward recovery by the ferryman against Liftbuilders, some of it based upon common law third party beneficiary principles. In the two following cases, the respective courts addressed the issue of vertical privity in components parts cases from very different perspectives. In the first, a third party beneficiary analysis was employed. In the second, the court said nothing about third party beneficiary law but for reasons of policy came to a similar conclusion through straight-forward abrogation of the vertical privity requirement. After analyzing the cases, I will contend that using non-Code third party beneficiary law can lead to more defensible results than simply depending upon policy concerns to override traditional privity rules.

Rhodes Pharmacal Co. v. Continental Can Co., 219 N.E.2d 726 (Ill. App. 1966)

The buyer ("Rhodes") needed aerosol cans for marketing a lotion called "Perform." Rhodes negotiated with G. Barr, Inc. ("Barr") for the acquisition of appropriate cans and distribution of Perform to retailers.<sup>214</sup> Barr advised Rhodes that it had developed a propellant suitable for use with Perform, but Barr soon advised that Perform caused unlined cans "to rust and corrode, resulting in discoloration and adulteration of the Perform solution."<sup>215</sup> Barr further represented that Continental Can Company ("Continental") made

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214. Rhodes Pharm. Co. v. Continental Can Co., 219 N.E.2d 726, 728 (Ill. App. 1966). The exact nature of the contractual obligations assumed by Barr is not clear from the reported opinion. It is clear, however, that Barr made a procurement contract to obtain cans for Perform and that the cans were a major component of the final product sold. *Id.*

215. *Id.* at 728.

cans with rust-proof lining, and that Barr's laboratory tests had proved conclusively that the discoloration and adulteration could be eliminated with use of these cans.<sup>216</sup> On the strength of these representations, Rhodes's agents met with Continental Can's representatives, agreed upon the design of the cans, and authorized Barr to package and distribute Perform in the rust-proof cans which Barr purchased from Continental. By virtue of Perform's composition, the cans were a significant component of the final product sold through retailers to the public.

Barr marketed Perform in the cans from Continental for about two years without complaint. Meanwhile, Pittsburgh Railways Company ("Pittsburgh") purchased Barr's assets and assumed its contractual obligations to Rhodes. During this time period, Pittsburgh advised Rhodes that Continental Can was modifying the can design to improve its appearance by putting the linings making the seal on the inside. Within two months, Rhodes began receiving complaints that the Perform cans were leaking, causing not only loss of Perform but damage to other products on the shelves in drug stores and other outlets. According to Rhodes's allegations, it was compelled for business reasons to refund substantial sums, had to destroy great quantities of Perform in cans, and suffered great economic losses because customers not only stopped buying Perform but its other products as well. Rhodes gave notice to Pittsburgh whose representatives concluded that the inside linings were probably destroying the rust-proofing.<sup>217</sup>

Rhodes sued, directing one count solely against Continental Cans based partly upon breach of the implied warranty of merchantability<sup>218</sup> and the implied warranty of fitness for a particular purpose.<sup>219</sup> The trial court granted Continental's motion to dismiss because the complaint failed to state grounds for any direct contractual relationship between Rhodes and Continental

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216. *Id.* There was a further representation that shelf life would be no less than three years. *Id.* The court characterized this representation and the others listed in the text as express warranties under section 2-313. *Id.*

217. *Id.* at 729.

218. The court noted:

Defendant Continental warranted by implication that the aerosol cans manufactured by it and delivered to defendant Pittsburgh Railways Company would be reasonably fit, useful and merchantable by plaintiff. Defendant Continental further warranted by implication that the aerosol cans would pass without objection in the trade; and that the cans would be fit for the ordinary purpose for which the cans would be used . . . .

*Id.* at 726. These allegations match the minimum requirements of the warranty of merchantability under section 2-314.

219. *Rhodes*, 219 N.E.2d at 729.

Can, and in the view of the court there was no legal basis to extend warranties from Continental Can to Rhodes.<sup>220</sup> The Illinois appellate court reversed, agreeing with Rhodes's argument that it was a third party beneficiary of the Continental-Pittsburgh contract for the sale of the cans. Since Illinois had adopted the Uniform Commercial Code about two years after the contract for sale had been made,<sup>221</sup> Article 2 was not the governing law for the case. The court, therefore, made its decision on non-Code law, but deemed its decision compatible with the policies implicit in Article 2.

The court's language is very instructive:

While plaintiff has not included in his complaint . . . the contract between Continental and Pittsburgh, this does not affect the validity of plaintiff's theory. We think these allegations, if proved, are sufficient to make plaintiff a beneficiary of implied warranties extended to Pittsburgh by Continental. It was for plaintiff's use that the cans were manufactured, and it was for plaintiff's purpose, known to Continental, that the cans were impliedly warranted to be fit. In these circumstances, the reliance by plaintiff was more than incidental.

We hold, therefore, that the implied warranty of fitness imposed by law on a manufacturer may be enforced directly against the manufacturer by a third party user where . . . the manufacturer (1) was aware of the purpose to which the product was to be put, and (2) knew of the third party user's reliance that the product would be fit for the purpose intended.<sup>222</sup>

Although the quoted language seems especially compatible with U.C.C. section 2-315, the appellate court allowed Rhodes's claim for breach of the implied warranty of merchantability (2-314) to succeed as well. Noteworthy is the two-fold requirement: The remote seller's awareness of purpose, and the third party's reliance. The latter point seems especially compatible with section 302, Restatement Second, comment d.<sup>223</sup> Thus, by an historical accident,

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220. *See id.* at 728-30.

221. Illinois adopted the Code in 1962. According to the opinion, the Continental-Barr contract to which Pittsburgh succeeded was entered into in 1960.

222. *Rhodes*, 219 N.E.2d at 732 (citation omitted).

223. RESTATEMENT (SECOND) OF CONTRACTS § 302 cmt. d (1977). The comment states, "if the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary."

namely, the fact that Article 2 was not in effect, the common law of third party beneficiaries was imported (without the necessity of considering section 2-318) into the law of sales. This importation saved the case for Rhodes and serves as an illustration of an unusual use of third party beneficiary law: To allow the remote buyer an action against a breaching component parts supplier.

*Patty Precision Products Co. v. Brown & Sharpe Manufacturing Co.*, 846 F.2d 1247 (10th Cir., 1988), applying Oklahoma law<sup>224</sup>

Patty Precision Products Company ("Patty Precision") was awarded a contract by the United States for the manufacture of bomb racks. Patty Precision negotiated with Brown & Sharpe about the requirements of a machining center needed in the production of the bomb racks. Brown & Sharpe recommended General Electric Controls on the basis of prior experience. Patty Precision agreed. Eventually, Patty Precision ordered the machining center from Marsuco, Inc.; Marsuco contracted with Brown & Sharpe; and Brown & Sharpe contracted with General Electric for controls (components) of the machining center. In its contract with Brown & Sharpe, General Electric limited its liability to costs of repair or replacement of controls determined to be defective. This limitation was not passed on to Patty Precision. Neither did General Electric disclaim the implied warranty of merchantability. General Electric's employees knew the purpose for which the controls were fabricated, and they participated in the installation and start-up of machines run by General Electric controls at Patty Precision's plant.

After numerous problems with the machining center, Patty Precision sued, *inter alia*, Brown & Sharpe and General Electric for breach of warranties. The claim against General Electric was based upon an alleged breach of General Electric's implied warranty of merchantability on the controls. Over Patty Precision's objection, the jury was allowed to hear evidence of the disclaimer language (language limiting liability) from the Brown & Sharpe-General Electric contract.<sup>225</sup> Answering special interrogatories, the jury found for Patty Precision against Brown & Sharpe, but against Patty Precision in favor of General Electric. Patty Precision moved for a new trial claiming error in admitting

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224. *Patty Precision Prod. Co. v. Brown and Sharpe Mfg. Co.*, 742 F.2d 1260 (10th Cir. 1984), *rev'd*, 846 F.2d 1247 (10th Cir. 1988).

225. The language was, more precisely, a limitation of damages as allowed by section 2-719(1).



evidence of the limitation-of-liability language from the Brown & Sharpe-General Electric contract. The trial court denied the motion. On appeal the parties agreed that one main issue had to be addressed; namely, "whether General Electric's disclaimer applies to Patty Precision."<sup>226</sup> For this article, the underlying principle is very important, to wit: That in the absence of an effective disclaimer, the implied warranty of merchantability ran from General Electric to Patty Precision on the facts of this case.

On this underlying principle, that Patty Precision could sue the non-privity component parts supplier, General Electric, for breach of the implied warranty of merchantability after having incurred economic losses, the court cited the 1979 Oklahoma case, *Old Albany Estates v. Highland Carpet Mills*,<sup>227</sup> which had eliminated vertical privity as a defense against a claim for breach of warranty. In addition, the court quoted extensively from another case, *Elden v. Simmons*,<sup>228</sup> as follows:

[W]e note that the requirement of vertical privity as a prerequisite to suit on an implied or express warranty, both under the Uniform Commercial Code and outside the Code, is, given today's market structure, an antiquated notion. A manufactured product placed in the chain of distribution may literally pass through dozens of hands before it reaches the ultimate consumer. When the product is found to be defective, it makes little sense to allow the ultimate consumer redress against his immediate vendors only. If such were the case, the consumer's immediate vendor, if he were to have the full benefit of his bargain, would have to, in turn, sue his immediate vendor, who would, in turn, have to sue his vendor and so on up the chain until the party ultimately responsible for placing a defective product in the market is reached. It defies common sense to require such an endless chain of litigation in order to hold the party at fault responsible.<sup>229</sup>

Policy considerations sustained the cause of action against the non-privity component parts seller. According to the court, "market structure" in the current economy makes privity barriers antiquated. Furthermore, as to General Electric's disclaimer, the

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226. *Patty*, 846 F.2d at 1252.

227. 604 P.2d 849 (Okla. 1979).

228. 631 P.2d 739. (Okla. 1981).

229. *Patty*, 846 F.2d at 1253-54 (quoting *Elden v. Simmons*, 631 P.2d at 742 in its earlier opinion at 742 F.2d at 1263).

evidence showed that it extended only to Brown & Sharpe and was never expressed in writing to Patty Precision.<sup>230</sup> Patty Precision presented evidence to prove that this disclaimer was not disclosed to it prior to its purchase of the Brown & Sharpe machines. On this record, the court held, "that General Electric's disclaimer to Brown & Sharpe, undisclosed to Patty Precision, was irrelevant and that the district court erred in admitting it into evidence and instructing on it."<sup>231</sup> Therefore, Patty Precision had the benefit of the implied warranty of merchantability unadulterated by the disclaimer, and the case was remanded for a new trial. There was a dissent.<sup>232</sup> It is evident that the privity issue was resolved for policy reasons in light of Oklahoma precedent without any resort to non-Code third party beneficiary law.

Consider the two reported cases in relation to the hypothetical situation. Both precedents support allowing the ferryman a claim against Liftbuilders for breach of implied warranties, express warranties, and the promise of remedial work. In *Rhodes*,<sup>233</sup> the Illinois appellate court spoke the language of third party beneficiary law in allowing an action for damages when the cans, as modified, were defective. In *Patty Precision*, the Court of Appeals for the Tenth Circuit, applying Oklahoma law, spoke only about the elimination of privity for policy reasons. Yet, each court discerned and commented upon the significance of pre-contract and post-contract communications wherein particular needs were made known, and the remote seller sought to satisfy those needs in the fabrication of a component to be incorporated by another party into the final product. In *Rhodes*, the Continental Can Company sought to build a can fit for Perform. In *Patty Precision*, General Electric sought to build controls suitable for a machining center. True, the can was not a component part in the same way as the controls were in *Patty Precision*, but in each case the upstream supplier furnished a component of the final product sold downstream and that part proved defective giving rise to damage claims.

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230. Under section 2-316, the implied warranty of merchantability would need to be disclaimed in a conspicuous writing. Likewise, according to prevailing authorities, limiting language under section 2-719(1) must be conspicuous.

231. *Patty*, 846 F.2d at 1254.

232. In dissent, Judge Logan focused upon an apparent unfairness in imposing a warranty and not recognizing the limitations which the seller had negotiated surrounding the warranty. *Id.* at 1258 (Logan, J., dissenting).

233. *See supra* nn.217-23.

Thus, if the ferryman were to sue Liftbuilders for breach of warranties, express or implied, or for breach of its remedial promise, both cases would be persuasive authority for allowing the suit in the absence of vertical privity. Using a third party beneficiary analysis is preferable to a wholesale abolition of the privity requirement because there may be many situations in which suit against a third party component supplier should not be allowed. *Patty Precision* might have been such a case because General Electric was held to have made a warranty to a remote buyer from which its own disclaimer (limitation of damages) was judicially detached, a detachment of questionable fairness in the circumstances.<sup>234</sup>

## 2. *The Hypothetical and the Third Party Beneficiary Principle*

Consider the hypothetical situation with the ferryman in light of the first branch of the third party beneficiary principle. Is it necessary or important for implementing the contracting parties' objectives that the ferryman be empowered to enforce the express and implied warranties and the remedial promise against Liftbuilders? The answer is surely in the affirmative. A bankruptcy trustee would have no incentive to enforce Shipbuilders rights against Liftbuilder unless a victory would increase the bankruptcy estate. Enforcement may be essential as a means of enabling the ferryman to comply with significant federal and state laws, unless the entire economic burden of doing so is to be placed upon the ferryman as the aggrieved party. Had the parties initially bargained about enforcement rights, it should not have made any difference in price since Liftbuilder knew precisely the needs of the ultimate buyer. Neither does it seem that Shipbuilder would have had any motivation to ask for more money from the ferryman in the initial bargaining if the parties had assumed that the ferryman would have a direct right of enforcement against Liftbuilder. Realistically viewed, the hypothetical situation calls for third party

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234. The Oklahoma legislature must have thought that the result was unfair because it amended its version of section 2-318 (Alternative A) by adding the following two paragraphs:

(2) This section does not displace principles of law and equity that extend a warranty to or for the benefit of a buyer to other persons . . . (3) [A]n exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the buyer is also effective against any beneficiary designated under this section.

OKLA. STAT. ANN. tit. 86 § 83 (West 1988). This action by the legislature is, a fortiori, interesting for the purposes of this article because it first recognized the viability of third party rights in sales contracts but then limited a promisor's liability to the terms of its initial promise, express or implied. This seems fair.

empowerment in order for the objectives of the original parties to be implemented efficiently and fairly.

The second branch of the third party beneficiary principle points in the same direction inasmuch as it allows enforcement of warranties imposed by the legislature without trampling upon the parties' manifested intent. There is no disclaimer in the hypothetical situation; therefore, the question of whether a disclaimer in the contract between the promisor and promisee should bind a third party<sup>7</sup> not aware of the disclaimer need not be reached. However, if questions were posed concerning whether an implied warranty should extend to a third party and whether a negotiated limitation of damages for breach should be judicially detached from such an extension, the analysis would be different under a third party beneficiary theory than under the *Patty Precision* analysis. Under the third party beneficiary theory, third party claims would not rise higher than the terms of the promise to the promisee, meaning that the *Patty Precision* case would probably have been decided differently. For this reason, the third party beneficiary approach in *Rhodes* is preferable to the across-the-board elimination of vertical privity evidenced by *Patty Precision* because the analysis requires (i) that the original parties' objectives be ascertained, and (ii) that the court decide whether or not empowering the third party is essential or important for implementing the original parties objectives, and (iii) that the court consider public policy and moral concerns.

Applying a third party beneficiary analysis to cases brought by remote buyers against component parts sellers should not mean an unlimited expansion of liabilities for such sellers. The third party beneficiary principle would in many cases *bar* liability against component parts suppliers, in the absence of unusual factors showing the suppliers awareness of, and implied or express promise to fulfill, downstream needs. Of course, in an unusual case, public policy might justify allowing a suit against a component parts supplier.

Using a third party beneficiary analysis to determine whether or not suit should be allowed against a non-privity component parts supplier might prove superior to the line-drawing in recent litigation wherein such suits have been barred for reasons of policy. For example, in *Hininger v. Case Corp.* buyers sued their dealer, the manufacturer ("Case"), and the wheel supplier ("Can-Am") in federal court for economic losses attributable to faulty drive

wheels.<sup>235</sup> The plaintiffs settled with the dealer and manufacturer but continued litigation against the remote component parts supplier, Can-Am, for breach of warranty and negligence. A jury found Can-Am liable on both theories. The trial judge granted Can-Am's motion for a judgment n.o.v. on the warranty claim, leaving the verdict resting only upon negligence. On appeal, the Court of Appeals for the Fifth Circuit, applying Texas law, held that the economic loss doctrine precluded suit in tort.<sup>236</sup> On plaintiffs cross-appeal, the issue was whether or not the trial judge had rightly granted defendants motion for a judgment n.o.v. on the warranty claim. The court decided that the motion had been rightly granted because the district judge had correctly decided that for reasons of policy a component parts manufacturer should not be subject to suit by a non-privy buyer.

The court noted:

Can a purchaser go upstream from the manufacturer of the finished product and assert an implied warranty claim for economic loss against a manufacturer of a component part? Although we find no Texas authorities directly addressing this question, we believe that the experienced Texas district judge in this case properly distinguished between the manufacturer of the finished product and the component part manufacturer. She reasoned that the Hiningers [buyers] bargained for a complete and functional Case combine, not wheels and axles and all the myriad components that make up the combine. Thus, the district court concluded that the Hiningers had no expectation that Can-Am or any of the other manufacturers of unbranded components would resolve any problem they might experience with the combines.<sup>237</sup>

As a result, the line drawn by the trial judge was sustained. However, the last sentence of the foregoing quotation provides a possible opening for an exception to the rule. Suppose the buyers had relied upon brand-name components? Suppose the drive wheels had been specially manufactured for the six combines purchased by these buyers? In either case, the court might have drawn the line differently. The court also noted, a footnote, that, "Mrs. Hininger [buyer] does not contend that she and her husband

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235. 23 F.3d 124 (5th Cir. 1994).

236. *Id.* at 125-27.

237. *Id.* at 128.

had any contact with Can-Am, that Can-Ams name was on the wheels, or that Can-Am advertised its product to the public at-large.”<sup>238</sup>

Again, the clear inference is that some factors might have altered the result, meaning that under different circumstances a claim against a non-privity component parts supplier might be viable under Texas law. The factors enumerated are consistent with the third party beneficiary analysis as applied to the hypothetical situation. Moreover, use of the third party beneficiary analysis advanced by Professor Eisenberg would give the court a framework for making decisions about the liability of component parts manufacturers rather than relying only on policy arguments. Because the text of Article 2 does not resolve the problem, at least in cases of implied warranties, and the text of revised Article 2 will probably not specifically address the issue, use of the common law of third party beneficiaries could prove very helpful for resolving difficult cases concerning component parts suppliers and downstream economic loss.

*D. Cases Arising from Construction and Repair Contracts Where the Contractor Procures Goods from a Supplier for Incorporation into the Project*

*1. The Hypothetical Situation*

Suppose a city on the Atlantic seaboard creates a non-profit corporation to own and operate a hospital. The hospital corporation (“hospital”) contracts with an American subsidiary of a European firm (“prime contractor”) for construction of a hospital to help meet the needs of a swelling urban population lacking adequate health insurance coverage. The construction contract includes an ultra-modern, efficient, heating/ventilation/air-conditioning system (“HVAC”) specified by the city’s architectural firm.<sup>239</sup> The general contractor procures the HVAC components from an American supplier (“Ultrasystems, Inc.”) for \$1.6 million and subcontracts with another contractor for their installation for the price of \$400,000, meaning the total cost of the

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238. *Id.* at 128 (citing *Spring Motors Distrib., Inc. v. Ford Motor Co.*, 489 A.2d 660 (1985)).

239. The seeds for this hypothetical situation, insofar as it involves the supplier, are found in the fact patterns of *Crest Container Corp. v. R.H. Bishop Co.*, 445 N.E.2d 19 (Ill. App. 1982); *Pierce Assoc., Inc. v. Nemours Found.*, 865 F.2d 530 (3d Cir. 1988); and *Freeman v. I.G. Navarre*, 289 P.2d 1015 (Wash. 1955).

installed system is \$2 million. The contract for purchase of the HVAC components is a contract governed by Article 2. We can assume that Ultrasystems made this supply contract after study of the applicable plans and specifications furnished by the hospital's architects. The service contract for their installation is governed by the common law of contracts. Assume simply that this arrangement is less expensive than subcontracting with an HVAC firm that in turn procures the components from a supplier. The general contractor is required to furnish and does furnish a performance bond. The installation of the HVAC components is rightly made, and the system works reasonably well for more than one year. Then, the system malfunctions, and eventually fails, due to defective components that deteriorated in an unacceptably short time. The hospital administrators demand help, but the contractor is unresponsive. In fact, while the American subsidiary, the prime contractor, is legally intact, it has ceased all operations and has virtually no assets because the parent corporation has siphoned off its subsidiary's resources for construction projects in other countries. The time for suit on the performance bond has run. Ultrasystems is close at hand and solvent, but declines to provide any remedial help, wrongly denying that its components were faulty. The hospital desperately needs a new system.

The hospital pays \$2 million to have a new HVAC system installed by another contractor who of necessity removes the faulty components. Ultrasystems refuses to retrieve the components, so the hospital in good faith sells them as salvage for \$100,000. Assume no pass-through warranties were made to the hospital by Ultrasystems, but that Ultrasystems made warranties of quality, express and implied, to the prime contractor. *Quaere*: Can the hospital make out a viable claim for breach of express or implied warranties against Ultrasystems for the costs of replacing the HVAC system less salvage or for any lesser damage? Or must the hospital be content to pursue the general contractor who now has negligible assets? Or must it try a longshot against the foreign parent corporation seeking to pierce the veil? There is precedent favoring common law third party beneficiary standing for the city in a claim against Ultrasystems.

## *2. The Precedents Allowing Owners to Sue as Third Party Beneficiaries*

Case law is conflicting on the question of whether or not an owner can sue a subcontractor or supplier on a third party

beneficiary theory. Reading the cases, it is difficult to discern, in the language of the Restatement (Second), any bright line between incidental and intended beneficiaries in the construction context. The opinions are rightly described by Professor Eisenberg as "picturesque."<sup>240</sup> There is case law approving third party suits by owners against subcontractors breaching service contracts and mixed (goods and services) contracts.<sup>241</sup> There is substantial case law denying third party claims by owners against subcontractors and suppliers.<sup>242</sup> The two following cases illustrate third party beneficiary standing in cases involving mixed contracts (goods and services commingled). The analysis of potential third party beneficiary claims should be the same when goods are the predominant factor in the subcontract making it simply an Article 2 sales contract as opposed to a service contract.

Gilbert Financial Corp. v. Steelform Contracting Co., 45 Cal. Rptr. 448 (Cal. Ct. App., 1978)<sup>243</sup>

Gilbert Financial Corporation ("Gilbert") contracted with Sheldon Appel Construction Company ("Appel") for the construction of a storage building for bank records. Appel subcontracted with Steelform Contracting Company ("Steelform") for the construction of the roof and certain structural components. The roof leaked causing damage to the building and its contents. To solve the problem, Gilbert ultimately had to dismantle and replace parts of

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240. See Eisenberg, *supra* note 29, at 1404. ("The bottom line is that the intent-to-benefit test has left the law in this area unsettled, and the analysis in the cases is most charitably described as picturesque."). For a good discussion of owners' claims against non-privy participants in construction projects, see William K. Jones, *Economic Losses Caused by Construction Deficiencies: The Competing Regimes of Contract and Tort*, 59 U. CIN. L. Rev. 1051, 1083-91 (1991).

241. See, in addition to the cases discussed in the text, the following cases recognizing owners as third party beneficiaries of prime-subcontractor contracts or at least recognizing that allegations of third party standing were sufficient to withstand a motion to dismiss: *Sears, Roebuck and Co. v. Jardel Co., Inc.*, 421 F.2d 1048 (3rd Cir., 1969); *Keel v. Titan Construction Corp.*, 639 P.2d 1238 (Okla. 1981); *Syndoulos Lutheran Church v. A.R.C. Industries*, 662 P.2d 109 (Ala. 1983); *Jardel Enterprises, Inc. v. Triconsultants, Inc.*, 770 P.2d 1301 (Colo. Ct. App. 1988); *Lin v. Gatehouse Construction Co.*, 616 N.E.2d 519 (Ohio App. 8th, Cuyahoga County, 1992).

242. Compare the following cases with those listed in footnote 241, *supra*, where the courts disallowed owners' claims against subcontractors or suppliers: *Vogel v. Reed Supply Co.*, 177 S.E.2d 273 (N.C. 1970); *Federal Mogul Corp. v. Universal Construction Co.*, 376 So.2d 716 (Ala. App. 1979); *Manor Junior College v. Kaller's Inc.*, 507 A.2d 1245 (Pa. Super. Ct. 1986); *Pierce Assocs., Inc. v. Nemours Foundation*, 865 F.2d 530 (3d Cir. 1988); *Lazovitz, Inc. v. Saxon Construction, Inc.*, 911 F.2d 588 (11th Cir., 1990); *In re Masonite Corp. Hardboard Siding Products Liability Litigation*, 21 F. Supp. 2d 593 (E.D. La. 1998).

243. 145 Cal. Rptr. 448 (Cal. Ct. App. 1978).



the roof and other structural components, paying a different contractor. Gilbert then sued Appel and Steelform. The trial court decided that negligence claims against Steelform were time-barred and dismissed Gilbert's implied warranty claims for lack of privity. On appeal, the California appellate court reversed, finding that the pleadings stated facts which would make Gilbert a third party beneficiary of the Steelform-Appel subcontract.<sup>244</sup> It is not clear whether the appellate court considered the subcontract to be predominantly for goods or services. It is clear from the opinion, however, that the appellate court allowed Gilbert to sue Steelform for breach of an implied warranty thereby implying that, at minimum, the warranty sections of the Code, or analogous common law principles, were part of the Appel-Steelform contract.<sup>245</sup>

Citing several California cases showing a broadening tendency to recognize intended third party beneficiaries, the court stated:

In the case at bar, the general contractor, Appel, had the duty under its contract with Gilbert to furnish all the material and labor necessary to construct the building in question. Steelform subcontracted with Appel to furnish the materials and labor necessary for the construction of the roof. Clearly, Steelform (the promisor) realized it was assuming Appel's (the promisee) duties for this phase of the construction, and that Gilbert was the ultimate beneficiary of its performance as the owner of the building. Under the Hartman<sup>246</sup> and Lucas<sup>247</sup> rules, Gilbert would obviously be a creditor beneficiary.<sup>248</sup>

In light of the Restatement (Second), it is no longer necessary to speak in terms of creditor versus donee beneficiaries. Instead, the inquiry would be whether Gilbert was an intended or incidental beneficiary. If the Restatement (Second) were applied, Gilbert would almost certainly be in the intended beneficiary category.

Oliver B. Cannon and Son, Inc. v. Dorr-Oliver, Inc., 336 A.2d 211

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244. The court perceived third party status in *Gilbert* as obviating the necessity of making any judgment about privity per se. According to the court: "Under the facts of this case we do not need to decide the issue of privity per se. Under the Civil Code section 1559 and the cases interpreting it, we conclude that Gilbert is a third party beneficiary of the contract between Appel and Steelform and therefore can sue for the breach of the implied warranty of fitness." *Id.* at 450.

245. *Id.* The third party status allowed a claim based upon a Uniform Commercial Code warranty in the contract between the supplier/subcontractor and the contractor.

246. *Hartman Ranch Co. v. Associated Oil Co.*, 73 P.2d 1163 (Cal. 1937).

247. *Lucas v. Hamm*, 364 P.2d 685 (Cal. 1961).

248. *Gilbert*, 145 Cal. Rptr. at 451.

(Del. 1975)<sup>249</sup>

The Barcroft Company ("Barcroft") owned chemical process tanks situated on its premises. Barcroft contracted with Dorr-Oliver Incorporated ("Dorr") for specified work on the tanks interiors. Dorr subcontracted the work of painting the interior tank linings to Oliver B. Cannon and Son, Inc. (Cannon) which had submitted an offer stating that it would use a product known as "Glid-Flake" for the painting. This was probably a service contract with an incidental inclusion of goods.<sup>250</sup> While the facts make the prime contract initially look like something other than a construction contract, it does fit the paradigm. An improvement was being made to structures (tanks). The prime contract was simply a repair contract rather than a contract for new construction, and the task of painting the linings was subcontracted. Hence, the prime contract can be conceived of as similar to a contract for repair or remodeling of a commercial building under which a painting subcontract would be common.

Cannon provided a shoddy application of the Glid-Flake. Within a year there were substantial lining failures.<sup>251</sup> An independent testing agent determined that Glid-Flake was acceptable for the job, and that Cannon's poor workmanship in applying Glid-Flake had caused the failures. In a multi-party suit, the trial judge found Cannon liable for defective workmanship and determined that Cannon was liable to Barcroft, the latter being a third party beneficiary of the Dorr-Cannon contract. Cannon appealed, arguing that it owed no legal obligation to Barcroft. The Supreme Court of Delaware sustained the trial court, agreeing that Barcroft was a third party beneficiary of the Dorr-Cannon contract.<sup>252</sup> In doing so, the court reviewed many specific provisions of the Dorr-Cannon contract that seemed to create obligations running from Cannon to Barcroft. For example, there were remedial provisions showing that Cannon assumed an obligation for post-application repair costs. By way of a summary, the court stated:

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249. 336 A.2d 211.

250. While the court does not make an analysis of the goods versus services components, there is no reason to think that the Glid-Flake, itself, was the predominant factor.

251. Substantial being about twenty per cent of the surface area, the categorization of the breach as partial or total is not essential.

252. *Cannon*, 336 A.2d at 211. "Our reading of the subcontract convinces us that Barcroft is, and was intended to be a third-party-creditor-beneficiary of the contract. We so hold." *Id.*

We think the contract manifests the requisite intent that Cannon's proper performance of the subcontract would, to that extent, discharge Dorr's duty to Barcroft.

We note the substantial similarity of the terms between the Cannon-Dorr agreement and the Hirsch-Robbins subcontract . . . .<sup>253</sup> Both contracts define 'owner' so as to apprise the promisor that the owner is the ultimate intended beneficiary of the subcontract.<sup>254</sup>

The court assumed that there was no breach of warranty on the Glid-Flake, but rather a breach of contract on its application. However, if the workmanship had been satisfactory and the Glid-Flake had been defective or unsuitable for the job in breach of an Article 2 warranty, express or implied, the same analysis would have allowed the owner an action against the subcontractor/supplier. Consider, also, that had there been an independent supplier that chose a defective coating and sold it to Dorr, knowing of its intended use for lining the tanks, and Dorr's own employees had made the application, such supplier likewise would have been liable to Barcroft for breach of warranty under the principles enunciated by the court.

The application of these precedents, by analogy, to the hypothetical hospital situation provides rays of hope for the hospital's case against the supplier of the defective heating system components. Indeed, the hospital could sue the prime contractor for breach due to the failure of the heating system, but collection would prove difficult and costly, and perhaps impossible because the contractor shut down U.S. operations and the time has passed for suit on the prime contractor's performance bond. In any event, if the contractor were sued, the contractor's lawyer would forthwith need to bring in the supplier whose components caused the heating system to fail. In this context, the foregoing precedents support a strong argument for a direct action by the owner against the supplier. True, the precedents involve the provision of services, as well as goods, but the analysis leading to third party empowerment did not turn in either case upon whether the subcontract was predominantly for goods or services. Hence, these precedents point toward blending the Code and the common law of third party beneficiaries in the construction context.

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253. The reference is to a subcontract in *Sears Roebuck and Co. v. Jardel*, 421 F.2d 1048 (3rd Cir. 1970).

254. *Cannon*, 336 A.2d at 215.

There is another case that strongly supports the same conclusion; however, the claim was made by a subcontractor against its remote supplier. The case is *Crest Container Corp. v. R.H. Bishop Co.*<sup>255</sup> The owner, Crest Corporation, entered into a construction contract with Northeast Construction Managers ("Northeast"). Northeast entered into a subcontract with R.H. Bishop Company ("Bishop") for the plumbing, heating, and air conditioning. The heating system did not work properly due to faulty heating coils and eventually had to be replaced, a cost for which Bishop was liable. Bishop had ordered the defective parts for the heating system from Clover Distributing who, in turn, had ordered them from Fedders-Climatrol ("Climatrol"). Thus, Bishop, as subcontractor, was not in vertical privity with the heating coils supplier, Climatrol, from which it sought recovery in a third party suit based upon breach of Article 2 warranties. The trial judge granted a directed verdict in favor of Climatrol. On appeal, one argument that Climatrol used to sustain the directed verdict in its favor was its lack of vertical privity with Bishop.

The Illinois appellate court reversed the trial court for erroneously granting a directed verdict, holding that Bishop was a beneficiary of Climatrol's warranties:

Privity requires that the party suing has some contractual relationship with the one sued. Although the supreme court has done away with the requirement in cases involving personal injury in tort, it has not expressly done so in cases involving purely economic loss. In this case, Bishop purchased the coils from Clover, a company independent of Climatrol, and is therefore not in privity with Climatrol. In spite of this general rule, we believe the exception stated by the first district is applicable here. The court held that privity is not required when the remote manufacturer knows the identity, purpose and requirements of the dealer's customer and manufactured or delivered the goods specially to meet those requirements. Bishop's specifications were sent to Climatrol. In fact, Climatrol selected the proper coil based on information supplied by Bishop. Climatrol knew the coils must be able to handle 30 pounds of pressure. The coils were custom made for the job and were delivered directly to the jobsite. Fedders-Climatrol argues that *Frank's Maintenance* is not

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255. 445 N.E.2d 19 (Ill. App. 1982).

authority here because the court relied on a case, *Rhodes Pharmacal Co. v. Continental Can Co.*, that abrogated the privity requirement on a third party beneficiary theory. However, *Rhodes* made it clear that when the party pleaded that it relied on the manufacturer's expertise to select the product, that was sufficient to make the party a beneficiary of the warranties.<sup>256</sup>

As a buyer with a complaint against a non-privity seller, Bishop's position is analogous to the owner's (hospital's) position in the last hypothetical. In this factual setting, third party standing was allowed against a non-privity supplier of goods whose contract was governed by Article 2. Moreover, the court recognized *Frank's Maintenance* as authority even though it arose from a procurement of goods outside of the construction context. And the court recognized *Rhodes Pharmacal*, which arose from procurement of component parts (containers), as authority also. As a result, the court discerned a principle underlying the three paradigmatic situations discussed in Part VI: Whether the case involves procurement of the good as a whole, or procurement of a component part for fabrication or packaging of another good, or procurement of goods for incorporation into a construction project, a third party beneficiary claim may be appropriate, depending upon the particular facts of the case.

### 3. *The Third Party Beneficiary Principle and the Hypothetical Situation*

Is it necessary or important for implementing the original contracting parties' objectives that the hospital have a direct action against the contractor's supplier? Looking at this situation with a reasonable degree of objectivity, the answer is in the affirmative despite the contractor's after-the-fact indifference. The joint objective was a functioning hospital. Loosely analogizing to section 2-314 of the Code, the owner (hospital) needed facilities fit for ordinary purposes. Ordinary purposes in a hospital include keeping the room temperatures suitable for sick persons. Meeting that objective requires enforcement of the HVAC component supplier's obligations. As to the second branch of the third party beneficiary principle, moral and social concerns strongly pull in favor of enforcement. Otherwise, a major public hospital must bear the cost

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256. *Crest*, 445 N.E.2d at 25 (citations omitted).

of the supplier's default which in turn drives up health care costs. Therefore, the case for empowering the owner as a third party beneficiary is strong.

A word of caution is in order, however, if the question of empowering owners against remote suppliers is put generally. The question of whether or not owners generally should be empowered as third party beneficiaries of non-privy suppliers' contracts with contractors (or with subcontractors) is a delicate question not susceptible to a universally satisfactory answer derived from Professor Eisenberg's explication of the third party beneficiary principle. A positive answer for all cases would err by being overly inclusive. A negative answer would preclude some meritorious claims. In the normal course, the answer should often be negative. Although upstream suppliers contracting with general contractors and subcontractors commonly know the purpose and destination of their supplies, especially when they are delivered directly to a job site, it seems an unjustified leap to assume automatically that every owner is a third party beneficiary of every upstream supply contract. The owner contracts with one prime contractor for multiple reasons: One is to buy the coordination and administrative work necessary for the building project with the materials and skills required. When the owner makes that contract, it should in the normal course bargain for any and all warranties it wants from the contractor with the exception of pass-through warranties on appliances or components that retain their identity when the construction is completed. The contractor usually is, and should be, free to shift fungible supplies from one job to another, just as workers are moved from job to job, unless certain supplies have been paid for by the owner. Consequently, in the garden variety case, empowering an owner to sue a non-privy supplier is neither necessary nor desirable to implement contractual or policy objectives.

On the other hand, an owner sometimes specifies particular components. Components sometimes must be specially manufactured for an owner's needs. In such situations, the owner can rightly contend that the enterprise objectives manifested by the supplier and its promisee (contractor or subcontractor) can best be achieved by empowering the owner to sue the supplier if the goods are defective. Hence, the first branch of the third party beneficiary principle will favor some owners. Moreover, when a job is done and the owner and the contractor have finished making payments upstream, things can go wrong due to defects in goods

incorporated into a project. At this point, if the contractor is not amenable to suit, or if suit or collection would be unduly expensive, there is a case for allowing a direct action by the owner against a supplier by invoking the third party beneficiary principle, especially its second branch. In language where the term "subcontractor" is functionally equivalent to my use of "supplier" in the hypothetical situation, Professor Eisenberg would allow third party suits. He states in relevant part:

[W]hen the defect in the subcontractor's work is discovered only after the owner has paid the full contract price and the prime contractor has become insolvent, the second branch of the principle is applicable. As a matter of corrective justice, as between the owner and the subcontractor, the cost of repairing the defective performance should be placed on the subcontractor. Were it not for the adventitious insolvency of the prime contractor, that is exactly where the cost would have been placed, because the owner would have sued the prime contractor, the prime contractor would have sued the subcontractor, and the owner would have been made whole at the subcontractor's ultimate expense.<sup>257</sup>

In sum, third party beneficiary rights should not affix to an owner whenever and wherever the contractor makes a contract for services or supplies required for a building project. Rather, a third party suit should be allowed (i) when the facts show something more than the upstream purchase of fungible goods; for example, trusses, carpet, chandeliers, or whatever, chosen or fabricated especially for the owner; or (ii) when the owner in an equitable sense needs the rights of a third party beneficiary to gain its expectation without undue delay, inconvenience, or cost. Case law in this area needs to grow up from situation sense, Karl Llewellyn's cardinal judicial virtue.<sup>258</sup>

Sometimes there is fundamental fairness in letting the owner have a direct action against a non-privity supplier. It is interesting to compare recent case law allowing a subcontractor an action against an owner under restitution theory. In a 1997 case, *Commerce Partnership 8098 Ltd. Partnership v. Equity Contracting Co.*,<sup>259</sup> a Florida appellate court considered the claim

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257. Eisenberg, *supra* note 29, at 1405.

258. See KARL N. LLEWELLYN, *THE COMMON LAW TRADITION* 121-32 (1960).

259. 695 So.2d 383 (Fla. Dist. Ct. App. 1997).

of a stucco subcontractor against an owner when the subcontractor had failed to perfect a mechanic's lien but had arguably enriched the owner. The court held that a restitution claim against the owner would be allowed only (i) if the owner had not paid its contractor for the work, and (ii) the subcontractor had exhausted its efforts to collect from the contractor. By analogy, it would seem fair that an owner should be allowed a claim against a non-privy supplier or subcontractor as a third party beneficiary if (i) the owner has paid for goods or services which prove defective, and (ii) efforts to collect from the contractor have been exhausted or will prove unduly costly, time-consuming, or inconvenient. There is also case law, albeit sparse, where a subcontractor has been allowed to sue an owner as a third party beneficiary of the owner-prime construction contract.<sup>260</sup> Hence, there seems to be a growing judicial recognition that justice sometimes demands the creation of rights and remedies between non-privy parties on the construction site. In the construction and repair cases, where owners are aggrieved due to defective goods, judges will need to be particularly thoughtful and careful about blending the law of sales and the common law of third party beneficiaries.

#### VII. REFLECTIONS ON THE USE OF REJECTION AND REVOCATION OF ACCEPTANCE OR FUNCTIONALLY EQUIVALENT REMEDIES AGAINST SELLERS NOT IN VERTICAL PRIVITY WITH CLAIMANTS

In Part V, I made arguments for allowing the full array of Code remedies for third party beneficiaries beyond the final buyer in the normal distribution chain.<sup>261</sup> Those arguments, for the most part, pertain to the hypothetical situations discussed in Part VI, and will not be repeated here. However, the situations discussed in Part VI raise with clarity an issue peculiar to fact patterns where vertical privity is lacking: Can the goods-oriented remedies of rejection (section 2-602) and revocation of acceptance (section 2-608) be employed against non-privy sellers, such as manufacturers and distributors, assuming sale to the final buyer went through a dealer or construction contractor? In Part VII, I will briefly explore the main difficulties with using rejection and revocation of acceptance

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260. See *Midwest Dredging Co. v. McaAninch Corp.*, 424 N.W.2d 216 (Iowa. 1988); *Port Chester Elec. Constr. Corp.*, 357 N.E.2d 983 (N.Y. 1976).

261. The hypothetical situations addressed in Part V involved questions of horizontal privity, not vertical privity. Claimants would not have been faced with want of vertical privity as a defense.



against non-privity sellers and will then argue that courts can and should fashion equitable variations on Code-based and common law remedies, in order to protect disappointed buyers' reasonable expectations.<sup>262</sup>

I have twice launched arguments in law review articles in favor of allowing the so-called goods-oriented remedies, rejection and revocation of acceptance, against non-privity sellers for breaches of warranties or other contractual obligations.<sup>263</sup> My arguments received judicial recognition in North Dakota,<sup>264</sup> and were looked upon with favor by the Supreme Judicial Court of Massachusetts.<sup>265</sup> My viewpoint also received favorable comment from Professor Donald Clifford in an article about express warranties.<sup>266</sup> However, Professor Harry M. Flechtner strongly criticized my doctrinal arguments in an article about pass-through warranties although he agreed that the policies I had advanced were strong and that there was a need for improvement in remedies generally allowed against remote (non-privity) warrantors.<sup>267</sup> Thus, even among persons sparring on legal theory, there is a recognized need for a remedy that accomplishes the objectives of rejection and revocation of acceptance, coupled with refund, in those cases where the claimant is not in vertical privity with the seller in breach. The need was recognized by the drafting committee for revised Article 2 in the mid-nineties, but efforts to solve the problem by textual changes were aborted.<sup>268</sup>

To illustrate the need, let us consider briefly the three hypothetical situations from Part VI and the generally accepted remedial options if goods sold are seriously defective. First, there was Earl, the farmer, who bought an irrigation system for \$400,000

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262. The arguments made in Part VII pertain to common law third party beneficiaries but also pertain to any persons qualifying as third party claimants under any jurisdiction's version of section 2-318.

263. See Gary L. Monserud, *Rounding Out the Remedial Structure of Article 2: The Case for a Forced Exchange Between a Buyer and a Remote Seller*, 19 U. DAYTON L. REV. 353 (1994) ("Monserud I") and Gary L. Monserud, *Judgment Against a Non-Breaching Seller: The Cost of Outrunning the Law to Do Justice Under Section 2-608 of the Uniform Commercial Code*, 70 N.D. L. REV. 809 (1994) ("Monserud II"). The articles mainly focus upon allowing revocation of acceptance and refund against non-privity sellers.

264. See, e.g., *Fode v. Capital RV Ctr., Inc.*, 575 N.W.2d 682 (N.D. 1998).

265. See *Jacobs v. Yamaha Motor Corp.*, 649 N.E.2d 758 n.4 (Mass. 1995).

266. Donald L. Clifford, *Express Warranty Liability of Remote Sellers: One Purchase, Two Relationships*, 75 WASH. U. L.Q. 413, 447-51 (1997).

267. Harry M. Flechtner, *Enforcing Manufacturers' Warranties, 'Pass Through' Warranties and the Like: Can the Buyer Get a Refund?*, 50 RUTGERS L. REV. 397 (1998) ("Flechtner").

268. See Flechtner, *supra* note 267.

that was repairable for \$100,000 though corn yields were also reduced. Suppose, however, that the non-conformities substantially impaired its value to him and that repairs at any price would not solve the system's inherent deficiencies. To grant Earl his lost expectancy, he would need not only consequential damages under section 2-715(2) (lost profits) but enough money to take out the old system and to install a functioning replacement system. The seemingly logical approach would be to allow Earl revocation of acceptance under section 2-608 against Great Western, allowing also full refund of the \$400,000 price (section 2-711(1)) plus cover costs (section 2-712) and incidental damages (section 2-715(1)). If Earl cannot revoke acceptance against the dealer (no breach by dealer) and cannot revoke against Great Western (no privity), and has no way to obtain a full refund, he will be stuck with unworkable goods and the remedies allowed by section 2-714 — the value differential (what the goods would have been worth as warranted less their actual value). *Even if* the value of the old system were deemed to be zero, he could not gain cover costs for a new system under the standard application of section 2-714(2). Therefore, the goal of protecting Earl's justified expectations, the accepted remedial goal under section 1-106(1), points in favor of allowing revocation of acceptance and refund which could be followed by cover costs.<sup>269</sup>

The case would be the same with the ferryman in the next hypothetical situation if the elevator were not repairable for \$30,000 as stipulated but rather had to be removed and disposed of due to the severity of its defects. The same reasoning would follow for the hospital in the last hypothetical if revocation of acceptance or an equitable variation of it were not allowed. The hospital sold the defective HVAC components for salvage for the price of \$100,000 and hired another contractor to install a totally new system that cost \$2 million. To meet the objective of protecting an aggrieved buyer's lost expectancy when revocation of acceptance and refund against an immediate seller is not practical, creative use of revocation of acceptance, or a remedy akin to it, against a remote seller seems appropriate.<sup>270</sup> Courts in several jurisdictions have discerned the need in cases similar to those outlined above and have sought to creatively use revocation of acceptance and

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269. Rejection under section 2-602 would have provided the appropriate relief if the malfunctions had appeared soon after installation of the system.

270. In some cases, the same arguments would sustain use of rejection against a non-privity seller, namely, when the acceptance of the goods had not occurred.

refund for protection of an aggrieved buyer's lost expectancy in litigation against non-privity sellers.<sup>271</sup>

One of the chief objections commonly raised against allowing buyers to employ revocation of acceptance (or rejection) and refund against non-privity sellers is that these remedies are inextricably connected to the last contract for sale and simply do not fit the facts when a seller is remote.<sup>272</sup> Precisely because a buyer rightly rejecting or revoking acceptance may cancel and gain a refund under section 2-711(1), a problem arises: The buyer has paid a retail price, and her seller owes or has paid the manufacturer or distributor a wholesale price, normally a lesser price, assuming profit was built into each resale. Advocates of allowing revocation of acceptance (or rejection) against remote sellers will face a problem for the perceptive critic will ask: To which price does refund pertain? If we answer the wholesale price paid by the intermediate seller to the remote seller, then the buyer rejecting or revoking acceptance winds up short of her expectancy if she has made full payment of a higher price. If we answer the retail price, we are met inevitably with the jibe that a demand is being made for the manufacturer or distributor (non-privity seller) to refund something it never received to someone with whom it had no sales contract. Hence, the argument for allowing revocation of acceptance (or rejection) against non-privity sellers is made to look silly. The critics have laid claim to a simple truth: That revocation of acceptance and rejection and refund were truly designed as remedies for immediate parties to a contract for sale and consequently do not fit easily when applied between remote parties. This requires careful reflection before advocating revocation of acceptance or rejection as remedies for the third party beneficiary claimants in the hypothetical situations created in Part VI where there is a lack of vertical privity, even though use of revocation of acceptance (or rejection) and refund seems necessary for the protection of the buyer's full expectancy.

An uneasiness with the fit should not stifle all creativity relating to the use of Code remedies.<sup>273</sup> On reflection, however, the best

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271. See Monserud I, *supra* note 263, at 365-72, and Flechtner, *supra* note 267, at 436-38.

272. It is also sometimes asserted erroneously that rejection and revocation of acceptance are the functional equivalents of common law rescission. This is not true insofar as neither rejection under section 2-601 nor revocation of acceptance under section 2-608 puts an end to the contract for sale.

273. In my view, the utilization of judicial creativity and a constant eye on section

answer to the question of which price should be refunded is, simply, that there should be no "refund." Rather, when the buyer has fully paid a retailer (or a contractor), and is a third party beneficiary,<sup>274</sup> a court should compute the buyer's total lost expectancy with reference to section 2-714. Efforts to expand the use of revocation of acceptance, and by implication rejection, beyond immediate buyers and sellers were probably ill-conceived. Courts moving in that direction may have taken a doctrinally false step in order to do justice in particular cases. Even when the remedial objective is laudable, expanding the goods-oriented remedies for use against sellers not in vertical privity creates doctrinal knots difficult to untie, and in any event, has proved to be politically unacceptable to many people in favor of statutory law reform.

Recognizing the justice of his criticisms and our common aims, I propose to adopt and expand upon the approach advanced by Professor Flechtner in his Rutgers Law Review article. Professor Flechtner's solution to the problem is to make use of section 2-714(2), and to expand creatively upon the case law developed under it.<sup>275</sup> He starts with the simple formula in section 2-714(2) which states that the measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted. Citing several cases, he notes that courts have allowed three methods of proof under this formula: (1) testimony on the value differences, including expert testimony and testimony by aggrieved buyers, (2) fair market value as warranted (however established) less salvage value, often established by a good faith salvage sale, and (3) a buyer's actual or hypothetical repair costs.<sup>276</sup> Professor Flechtner notes that use of the second and third methods of assessing the value differential place a practical, judicial gloss upon the statutory language. He suggests that courts can go further by allowing a buyer to tender (turnover)

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1-106(1) would have allowed revocation of acceptance and rejection to be adapted for use against third party warrantors.

274. The argument pertains to common law third party beneficiaries as discussed in this article and to third party beneficiaries recognized under section 2-318.

275. Flechtner, *supra* note 267, at 455-68. His explanation of his proposal in lieu of allowing revocation of acceptance or rejection against remote parties is very clear and should be consulted by anyone who seriously considers my proposal in Part VII. In this academic argument, I yield to his approach, but I want to expand upon it as I do not think he fully meets his stated goal of protecting the buyer's lost expectancy in all situations.

276. Flechtner, *supra* note 267, at 458-62.

defective goods to the breaching non-privity seller claiming thereby a value differential: The retail purchase price (assumed value as warranted) less zero (having no goods after turnover) which will yield damages equal to the retail price. Seller's loss would be reduced by whatever the seller could get for the defective goods. Liability to the buyer could be reduced below the retail price if seller proved depreciation prior to turnover or that the goods at the time of acceptance would have had a value less than the contract price even if they had been as warranted.<sup>277</sup>

Consider some numbers affixed to this theory. Suppose a lawyer has paid \$100,000 for a specially fabricated modular home, the components of which were warranted by the manufacturer but sold through a dealer who effectively disclaimed all warranties under section 2-316.<sup>278</sup> The modular home was bought by the lawyer to serve as a country law office. Assume the manufacturer was paid \$90,000 by the dealer. Assume further that the defects appearing after acceptance have substantially impaired the value of the home rendering it virtually useless to the buyer. Assume that the materials could be salvaged for an undetermined amount and that a replacement modular unit would cost \$110,000. Assume further that the buyer cannot revoke acceptance against the dealer who has made no warranties, and that the jurisdiction has not allowed revocation of acceptance against a non-privity seller. In accordance with Professor Flechtner's thinking, the buyer could, nonetheless, turn over the goods to the breaching manufacturer, and demand \$100,000 pursuant to section 2-714(2) — this would be the difference between the contract price (assumed value) and zero, buyer having nothing after the turnover. Seller could try to maximize the value of the components turned over, either by re-use in another modular home or by resale. Moreover, if the seller could prove that the lawyer enjoyed use of the building for a significant time, before the problems were evident, a set-off would be in order. Finally, if the seller could prove that the lawyer initially made a bad deal, for example, by paying \$100,000 for something worth \$85,000 in the marketplace, a downward adjustment would be allowed. Assuming no set-offs were proved by the seller, the lawyer in this hypothetical situation would have a just claim for \$100,000, the full purchase price, under Professor Flechtner's approach.<sup>279</sup>

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277. *Id.* 463-66. Professor Flechtner rightly points to *Gauthier v. Mayo*, 258 N.W.2d 748 (Mich. Ct. App. 1977), as a precedent that tends to sustain his approach.

278. The hypothetical is loosely based upon the facts of *Gauthier*, 258 N.W.2d at 748.

279. I believe this example corresponds with Professor Flechtner's view. In addition to

I contend that Professor Flechtner's proposal should be extended because further adjustments would sometimes be in order to protect fully a buyer's lost expectancy. To gain her full expectancy, the modular home buyer must be awarded enough money to purchase a replacement modular home. Since the price has gone up \$10,000, this amount should be added to the \$100,000 discussed above; in effect, buyer should get the economic equivalent of cover costs. Additionally, if the seller does not accept a good faith and timely tender for turnover, the buyer should be allowed to make a good faith and commercially reasonable salvage resale with notice.<sup>280</sup> The buyer would be entitled to the proceeds which would be a credit against the buyer's claim against the seller. On the other hand, if the goods were toxic or for any reason there were disposition costs in light of environmental or land use laws, and consequently resale gave the goods a negative value, this should be added to the value differential and "cover" costs calculated above. All adjustments would be aimed at hitting the target set in section 1-106(1), putting the aggrieved party in the economic position that party would have been in if both parties had fully performed. The foregoing suggested adjustments expand slightly upon Professor Flechtner's proposal, but are consistent with it.

It would have been desirable for the drafting committee for a revised Article 2 to tackle this problem with an amendment such as that proposed by Professor Flechtner. However, judges could implement the foregoing remedial approach, including an award of cover costs, without textual changes in Article 2. There are at least two text-based reasons for this. First, section 2-714 is quite flexible and open-ended. After stating the difference-in-value formula, section 2-714(2) ends with the words, "unless special circumstances show proximate damages of a different amount." Moreover, section 2-714(1) states, "Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach determined in any manner which is reasonable." In cases which could otherwise qualify as revocation of acceptance cases, if the action were against an immediate seller, the language of section 2-714(1) and (2)

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the text of his article, he set out a model statutory provision embodying his approach in an appendix. See Flechtner, *supra* note 267, at 471.

280. Section 2-706 sets the rules for resale by an aggrieved seller and for a buyer selling pursuant to an Article 2 security interest created under section 2-711(3). A court by analogy could judge the propriety of the sale by reference to section 2-706.

provide an acceptable textual footing for the functional equivalent of a refund and cover costs supplemented by incidental or consequential damages, when proved. Second, section 1-103 is an open door to principles of law and equity where the Code has not displaced them.<sup>281</sup> The general expectancy formula contained in Restatement (Second) Contracts, section 347, furnishes common law principles sufficient to sustain the approach recommended above;<sup>282</sup> provided, however, that the court recognizes an inherent equitable power to either order seller to accept a turnover or to calculate damages taking account of the turnover. Admittedly, this is not statutorily established as a buyer's right. In cases involving component parts, and in the construction cases, applying the principles just stated could be tricky because turnover would necessarily involve detachment of a component part or severance of goods from real estate. In many cases, this should be fairly simple as in the case of tires, or even a motor. Likewise, a furnace or water heater should be easily severable and should present no particular difficulties for turnover. However, establishing the value such goods would have had they been as warranted will require upstream inquiries or formal discovery or proofs apart from any contract price, for the complaining buyer will have paid for the defective component as part of a more complex good or as part of a construction price. Moreover, in such cases, repair would replace cover as the meaningful concept to make a buyer whole unless "cover" can be used flexibly to mean replacement of a component as well as replacement of the whole of a good as finally sold. The lodestar should always be section 1-106(1).

Let us reconsider briefly how the approach to damages recommended by Professor Flechtner could be applied to the hypothetical situations in Part VI. The farmer, Earl, could turn over his defunct system to Great Western by notice. The court could compute Earl's direct loss as the total price paid for the system

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281. U.C.C. § 1-103 (1995) states: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." *Id.*

282. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1977) provides in pertinent part: Subject to the limitations stated in sections 350-353, the injured party has a right to damages based on his expectation interest as measured by (a) the loss in value to him of the other party's performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform. *Id.*

(price as assumed value less zero) plus the increase in cost of an acceptable, roughly equivalent, replacement system. Depending on the jurisdiction, pre-judgment interest might be allowed. If Great Western did not recognize the turnover, Earl could make a good faith, commercially reasonable resale with notice in accord with section 2-706. The damages would then be reduced by any salvage value to Earl. Earl could rightly claim lost profits from reduced yields and incidental damages. Of course, if Great Western's representatives thought that the components could be resold for more than the salvage value Earl would likely receive, or that the components retrieved could be responsibly integrated into another system for resale, there would be an incentive to accept the turnover because it would mean immediate cash on resale which would reduce Great Western's loss accordingly.

Consider now the more difficult case of the ferryman with the elevator specially made as one component of the ferryboat. If the elevator could not be repaired, but could be detached, the ferryman should turn over the defective goods to Liftbuilders, Inc. The ferryman could then demand the purchase price of the component plus the difference between the cost of cover (replacement installed) and the contract price. However, the ferryman would in the normal course have no way of ascertaining what percentage of its price was attributable to the component. Alternatively, the ferryman could demand the total repair/replacement price which would approximate a refund and additional cover costs if a component were not involved. Likewise, with the last hypothetical about the defective heating system components that were salvaged, the hospital should be entitled to the full costs of replacement (materials and labor) less proceeds of the salvage sale. Again, this would approximate refund and the additional costs of cover in a situation not involving a component of a construction project. In any of these hypothetical situations, if salvage had a negative value, meaning there was a disposition expense, the aggrieved buyer should have that expense as well, assuming timely notice, since this expense could have been avoided if the breaching seller had taken possession and made his own disposition of the defective goods by resale or otherwise.

On first glance, Professor Flechtner's proposal, as I have extended it, may strike some readers as harsh against non-privity sellers, or as an anti-business attitude. But why should this be considered harsh or anti-business? The foregoing suggestions are nothing more, or less, than the logical implications of the



expectancy principle incorporated by section 1-106(1) which directs a judge to put the aggrieved party where that party would have been had there been no breach. This principle is exactly the same as that agreed upon in Restatement (Second) section 344(a) and implemented in section 347 as the accepted norm for monetary damages. Moreover, the integration of law and equity need not spell the death of equity. Equity is available to supplement the Code's provisions; section 1-103 so states with specificity. Section 2-716(1) allows an expansive judicial liberty for specific enforcement. Equity via section 1-103 should, with equal liberty, allow a court to enforce turnover, a sort of reverse specific performance when a seller is in breach. In appropriate cases, the court should say in effect to the breaching non-privity seller: "Pick up the defective goods and pay that aggrieved buyer her costs for substitute goods, plus installation if necessary; if you do not pick them up, your liability will be adjusted for salvage value and disposition costs, if any." That approach delivers justice according to the expectancy principle.

#### CONCLUSION

I began this article with a brief history of the common law of third party beneficiaries. This history shows that third party claims on contracts have an abiding strength. Classical contract law was incompatible with third party claims but could not wholly snuff out judicial recognition of such claims. Furthermore, over many generations, there was an outward thrust in third party beneficiary decisions meaning the coverage of third party beneficiary doctrine expanded. In the twentieth century, the Restatements validated and sharpened third party beneficiary law. At the beginning of the twenty first century, this law is still evolving, searching for its outer limits. Meanwhile, the Code's drafters partially codified third party beneficiary law in official section 2-318 with its Alternatives. History shows many just claims for economic loss which do not fit within these alternatives but would be recognized under common law principles.

The revision of Article 2 is an important project. The pressures that have been brought to bear upon the drafters have been significant. Nobody should fault them for not tackling every festering issue of sales law, including problems associated with third party beneficiaries. What courts and lawyers should recognize, however, is that an incompleteness or openness in the text of Article 2, current or revised, means more responsibility in

advocating and judging.

A primary judicial task will be the continuing, careful blending of the common law of third party beneficiaries with Article 2, current or revised. A related task will be the fleshing out of the remedial structure. For third party beneficiaries outside the chain of distribution, the full array of Code remedies should be available. For third party beneficiaries at the end of the distribution chain, with a lack of vertical privity problem, special attention must be given to building appropriate remedial mechanisms on the foundation of the Code and supplementary common law principles. To accomplish the foregoing, I have urged that the two-pronged third party beneficiary principle, as developed by Professor Eisenberg, be employed, and that on the remedial questions arising from cases involving lack of vertical privity, the path charted by Professor Flechtner be given special consideration. By blending their insights with the text of the Code, and the best of case law, a workable and coherent blend of sales law and the law of third party beneficiaries can slowly be achieved.

