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THE REMOTE PURCHASER OF MADE-TO-ORDER GOODS: THIRD-PARTY BENEFICIARY IN PRODUCTS LIABILITY LAW

In products liability cases, remote purchasers have traditionally been denied recovery for lost profits.¹ One type of commercial transaction, however, warrants special treatment: the purchase of made-to-order goods through a jobber. The purchaser of these goods can be compensated under traditional third-party beneficiary principles without opening the floodgates to recovery for consequential losses in all circumstances.

The principal concern in allowing any remote purchaser redress against the manufacturer is protection of the former's justifiable reliance on the capacity of the defective product. But an important factor which must be weighed against the purchaser's reliance is the prospect of subjecting the manufacturer to unpredictable liability.² Where the manufacturer has expressly warranted to the public that his product will adequately perform certain functions, he has apparently calculated the scope of his liability; the courts are generally not reluctant to compensate even for profit loss from the use of such an expressly warranted product.³ In the absence of any express warran-

¹ This loss is generally included with property damage and direct pecuniary loss under the heading "economic loss." Recovery for "economic loss" in products liability cases has been the source of much confusion and apparent conflict. See Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917, 943 (1966) for an analysis of the issues involved in recovery of "economic loss."

² Because the manufacturer normally lacks knowledge of the specific use to which his goods will be put, the nature and extent of profit loss is often unpredictable.

See, e.g., *Seely v. White Motor Co.*, 63 Cal. 2d 9, 16-17, 403 P.2d 145, 150-51, 45 Cal. Rptr. 17, 22-23 (1965); *Goldberg v. Kollsman Instrument Corp.*, 12 N.Y.2d 432, 436-37, 191 N.E.2d 81, 82-83, 240 N.Y.S.2d 592, 594-95 (1963). See also RESTATEMENT (SECOND) OF TORTS § 402A(2)(b) (Tent. Draft No. 10, 1964).

³ Two of the most significant cases in the area of modern products liability law, *Randy Knitwear v. American Cyanamid Co.*, 11 N.Y.2d 5, 181 N.E.2d 399, 226 N.Y.S.2d 363 (1962) and *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965), found manufacturers liable for lost profits on the basis of express representations. How far the California court went in awarding profit loss damages for breach of express warranties in *Seely* is not completely clear. At one point the court noted that profit loss liability accrued because the "warrantor repeatedly failed to correct the defect as promised." *Id.* at 14, 403 P.2d at 148, 45 Cal. Rptr. at 20. The court went on to maintain that damages awarded should be the loss directly and naturally resulting in the ordinary course of events from the breach of warranty. *Id.* at 14, 403 P.2d at 148, 45 Cal. Rptr. at 20. There the breach of "warranty" as set out in the purchase order was in the truck's failure "to be free from defects in material and workmanship" as expressly promised. Yet incidental damages were awarded because the manufacturer failed to comply with its own contractual limitation of remedy by failing to repair. See UCC § 2-719.

ties, however, there seem to be no cases awarding damages for profit loss due to defects in products marketed through intermediaries to the public at large.⁴ Usually, the purchaser in such a case has anonymously acquired a good in the public market and relied on its effective operation in a manner totally unforeseeable to the manufacturer. Reliance on the manufacturer's skill and knowledge is not, therefore, justifiable in this context. Moreover, where the manufacturer is unaware of the specific use to which his product will be put, unpredictability renders the remote purchaser and his proximate vendor better able to insure against defects, a reversal of the normal relationship.⁵

These considerations are probably inapposite when a jobber merely passes along a made-to-order product. Concededly, there may be cases where any reliance by the remote purchaser was solely on the jobber. If the manufacturer can demonstrate lack of contact with, or ignorance of, the remote purchaser for whom the goods are specifically produced, the made-to-order purchaser should be treated the same as the purchaser at large in a normal distributive chain. In the ordinary case, however, a purchaser buying through a jobber relies on both the jobber and the manufacturer. The remote purchaser may even specify the particular manufacturer from whom the jobber is to acquire the made-to-order goods.⁶ Although privity of contract is lacking between the remote purchaser and the manufacturer, the parties may have substantial contact in regard to specifications of the made-to-order product.⁷ In the context of such manufacturer-purchaser contact, any reliance by the purchaser is fair. The manufacturer should be adequately aware of the profit loss the remote purchaser will suffer if the made-to-order product proves defective.

Thus, under *Seely*, the Code's "Contractual Modification or Limitation of Remedy" was construed to expand, rather than limit, liability. In *Seely*, the attempt to limit liability to the expense of making good defective parts backfired, creating an additional express warranty, the breach of which left the manufacturer liable for direct and consequential losses. See UCC §§ 2-714, -715.

⁴ *But see* *Goldberg v. Kollsman Instrument Corp.*, 12 N.Y.2d 432, 435, 191 N.E.2d 81, 82, 24 N.Y.S.2d 592, 594 (1963), where Chief Judge Desmond stated, "The *Randy Knitwear* opinion at least suggested that all requirements of privity have been dispensed with in our State."

⁵ Note, *supra* note 1, at 964-66.

⁶ *Cf.* UCC § 2-315, Comment 5; UNIFORM SALES ACT § 15(4).

⁷ *E.g.*, *Rhodes Pharmacal v. Continental Can Co.*, 72 Ill. App. 2d 362, 119 N.E.2d 726 (1966). See *Ruud, Manufacturers Liability for Representations Made by Their Sales Engineers to Subpurchasers*, 8 U.C.L.A.L. REV. 251, 278-80 (1961), where the author supports the contention that in the circumstances where a product is procured through a jobber, substantial contact is likely between the remote purchaser and the manufacturer

Focusing on the jobber, the made-to-order purchaser's need for direct recourse against the manufacturer becomes more evident. If the jobber's principal asset is merely his personal ability to render a service of product distribution, his enterprise may not involve sufficient capital to cover losses caused by the distributed products—he may be judgment proof. Furthermore, if the purchaser of made-to-order goods is not forced to sue the intermediary, the time and expense of an additional law suit for indemnification is saved.⁸ Direct suits against manufacturers of made-to-order goods can be effectively implemented by the application of existing third-party beneficiary law.

In a recent Illinois case, *Rhodes Pharmacal v. Continental Can Co.*,⁹ plaintiff, a hair and beauty products dealer, sued the manufacturer of the defective containers in which he packaged his product for four hundred thousand dollars lost profits and other damages. Although there were no express representations to Rhodes and no privity, defendant knew the nature of its product's intended use and the likely damages that would be incurred should it not perform as expected. Basing its decision on plaintiff's reliance on the skill and judgment of the manufacturer and Continental's knowledge of plaintiff's intended use, the court awarded the lost profits. The court held that because defendant's implied warranties of fitness and merchantability were intended for plaintiff's benefit, "Plaintiff has a direct cause of action against Continental as the third-party beneficiary of the agreement for the sale of cans by Continental to [the intermediate seller]"¹⁰

or his agent. In analyzing the liability of the manufacturer to the remote purchaser for representations of his sales engineer-agent, the author explains:

He [the manufacturer's agent] may provide technical information and advice directly to an industrial purchaser to induce the latter to use the product in a situation in which the product will actually be marketed to the purchaser through a distributor or other independent sales intermediary

Id. at 253.

⁸ See, e.g., *Klein v. Asgrow Seed Co.*, 246 Cal. App. 2d 87, 54 Cal. Rptr. 609 (1966), where tomato growers sued immediate seed supplier, the immediate supplier got a judgment against the intermediate supplier, the intermediate supplier against the seed broker, and the seed broker against the seed producer. The appellate court in its synopsis of conclusions stated:

We hold that the trial court correctly awarded successive judgments under the facts found because of the breach by each seed supplier (including Asgrow) of successive warranties, both express and implied, but we conclude that the trial court incorrectly held that nonprivity relieved Asgrow of direct liability. We hold its liability, regardless of absence of privity, was direct and primary.

Id. at 90, 54 Cal. Rptr. at 611-12.

⁹ 72 Ill. App. 2d 362, 219 N.E.2d 726 (1966).

¹⁰ *Id.* at 367, 219 N.E.2d at 730. See also *Ward Baking Co. v. Trizzino*, 27 Ohio

This application of third-party beneficiary doctrine to the purchases of made-to-order goods does not substantially differ from its traditional use. In the landmark New York case of *Lawrence v. Fox*,¹¹ Holly, a third party, loaned three hundred dollars to the defendant in exchange for a promise that the defendant would repay the three hundred dollars to the plaintiff. The promise was exacted to satisfy a prior debt owed by Holly to the plaintiff. In light of Holly's prior debt to the plaintiff, the court permitted plaintiff to enforce defendant's promise. The initial contract obligation of the jobber to the remote purchaser of made-to-order goods is analogous to Holly's prior debt to the plaintiff, third-party beneficiary. Similarly, the manufacturer's promise to the jobber to supply a commodity to meet the needs and specifications of a specific remote purchaser parallels Fox's promise to pay Holly's creditor.¹²

Three distinctions might be made between the classic third-party beneficiary case and that of the jobber: (1) Delivery would not necessarily be directly to the purchaser; (2) the jobber-manufacturer contract may not name the remote purchaser; and (3) the jobber deals with promised commodities, not cash. The proposed Restatement of Contracts (Second) indicates that these distinctions are not controlling.¹³

App. 475, 161 N.E. 557 (1928); 2 S. WILLISTON, CONTRACTS § 378 A at 969, 976 (3d ed. 1959). A similar result could possibly be reached under two other theories. First, because the jobber, under the *Rhodes* facts, is more of a matchmaker or conduit than a party, warranties given to him could be constructively given to the actual purchaser. Alternatively, some theory of special agency for the purpose of procuring a certain product would support extension of the warranties to the purchaser.

¹¹ 20 N.Y. 268 (1859).

¹² See Gillam, *Products Liability in a Nutshell*, 37 ORE. L. REV. 119 (1958). After discussing *Lawrence v. Fox* in demonstrating that contracts may create obligations to those not in privity, Professor Gillam notes:

If a debtor's promise to a creditor to pay the creditor's creditor can be enforced by the latter, it may be argued persuasively that the contractual obligation of a manufacturer to a retailer to supply goods suitable for resale to consumers should be enforceable by the retailer's customers.

Id. at 138.

¹³ RESTATEMENT (SECOND) OF CONTRACTS § 133 (Tent. Draft No. 4, 1968). The proposed revision of the Restatement abandons the terminology of "creditor" and "donee" beneficiary in an attempt to more clearly delineate a third party with rights under a contract as an intended beneficiary:

§ 133. INTENDED AND INCIDENTAL BENEFICIARIES.

(1) 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 intention 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

Concerning the delivery distinction, the Restatement maintains that where the intent of the parties is to benefit a third person, and the obligation exists from promisee to beneficiary, direct action by the beneficiary is appropriate "even though no intention is manifested [as in specifying delivery] to give the beneficiary the benefit" ¹⁴ In regard to the contract's failure to mention the intended beneficiary, the Restatement says:

It is not essential to the creation of a right in an intended beneficiary that he be identified [in the contract] when a contract containing the promise is made. ¹⁵

In making this same point Williston adds, "'[F]acts and circumstances surrounding the transaction [must] show clearly that a particular person (though not named) is the beneficiary.'" ¹⁶ Thus, although the beneficiary must be identified before he can enforce the contract, it is not necessary that he be named therein. ¹⁷ Finally, the Restatement recognizes a "[p]romise of a performance other than the payment of money" where it manifests an intention to give a third party the benefit of the promised performance. ¹⁸

Intent to benefit has thus become the guideline for establishing the rights of third-party beneficiaries. Although it may appear naive to imagine that a manufacturer or intermediate distributor enters sales contracts with intent to benefit anyone but himself, as Corbin noted, "[t]he question is not 'whose interest and benefit are primarily subserved,' but what was the performance contracted for and what is the best way to bring it about." ¹⁹

(b) the promise manifests an intention to give the beneficiary the benefit of the promised performance.

Comment b to § 133 suggests the applicability of this section to the jobber context:

In such cases the promisee is surety for the promisor, the promise is an asset of the promisee, and a direct action by beneficiary against promisor is normally appropriate to carry out the intention of the promisor and promisee, *even though no intention is manifested to give the beneficiary the benefit of the promised performance*. Promise of a performance other than the payment of money may be governed by the same principle if the promisee's obligation is regarded as easily converted into money, as in the cases of obligations to deliver commodities or securities which are actively traded in organized markets. Less liquid obligations are left to Subsection (1)(b). (Emphasis added.)

¹⁴ *Id.* § 133, comment b.

¹⁵ RESTATEMENT (SECOND) OF CONTRACTS § 139 (Tent. Draft No. 3, 1967). The original Restatement § 139 has the same provision in reference to "donee" and "creditor" beneficiaries.

¹⁶ 2 WILLISTON, *supra* note 10, § 378, at 1954-56 quoting *Marlboro Shirt Co. v. American District Tele. Co.*, 196 Md. 565, 77 A.2d 776 (1950) (parenthetical is Williston's).

¹⁷ 4 A. CORBIN, CONTRACTS § 781, at 70 (1951).

¹⁸ RESTATEMENT (SECOND) OF CONTRACTS § 133, comment b (Tent. Draft No. 4, 1968).

¹⁹ 4 CORBIN, *supra* note 17, § 776. See also RESTATEMENT (SECOND) OF CONTRACTS § 133,

PROPOSED APPLICATION OF THIRD-PARTY BENEFICIARY
AND THE UNIFORM COMMERCIAL CODE

Under the Uniform Commercial Code, the remote purchaser of a made-to-order product who seeks compensation for profit loss would premise his suit on the implied warranties of merchantability²⁰ and fitness²¹ in the contract between the manufacturer and the jobber. By the nature of a contract for a made-to-order product, there likely will be an express warranty to the extent of the specifications described in the jobber-manufacturer contract. Should the product not conform to such specifications, the express warranty by description would be breached.²² It is more difficult when the made-to-order product, notwithstanding its conformity to the contract description, is defective. Under the Code, "merchantability" and "fitness" warranties thus become relevant. Application of third-party beneficiary doctrine in this context would comport with the Code to the extent that the Code addresses the issue of liability to remote purchasers.²³ Although section 2-318, concerning third-party beneficiaries and warranties, expressly refers only to personal injuries to members or guests of family or household,²⁴ the comments declare that

the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to

Illustration 5 (Tent. Draft No. 4, 1968). Commentators have previously taken the position that third-party beneficiary rights should encourage effective implementation of the performance contracted for, e.g., Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406, 428 (1957); Note, 31 TEXAS L. REV. 210 (1952).

²⁰ UCC § 2-314.

²¹ *Id.* § 2-315. See also Donovan, *Recent Developments in Products Liability Litigation in New England: The Emerging Confrontation Between the Expanding Law of Torts and the Uniform Commercial Code*, 19 MAINE L. REV. 181, 198 (1967).

²² This reliance on merchantability and fitness warranties presumes no express warranties arising from the manufacturer's express promises concerning the product's capacities. UCC § 2-313(a). Where the express warranty is of this type, liability to the remote purchaser is more easily established in current case law. See note 3 *supra* and accompanying text.

²³ The drafters' comment states: "[T]he warranty sections of [article 2] 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." UCC § 2-313, Comment 2.

Although the fitness warranty is couched in terms of "buyer" and "seller" while the merchantability warranty refers only to "seller," both implied warranties seem equally applicable to the third-party beneficiary in the made-to-order goods context. The comment suggesting that warranty liability may extend beyond parties to the sales contract refers to "warranty sections" of Article 2 of the Code.

²⁴ UCC § 2-318.

his buyer who resells, extend to other persons in the distributive chain.²⁵

Where the Code leaves products liability to the evolving body of case law, it purports to supply "useful guidance in dealing with further cases as they arise."²⁶ Particularly relevant in this regard is the section on implied warranty of fitness for particular purpose.²⁷ Since the vendor's liability increases with knowledge of the particular purpose to which a good will be put,²⁸ the Code arguably would support a distinction between the remote purchaser at large and the remote purchaser of made-to-order goods. The seller's knowledge of reliance on his "skill or judgment to furnish suitable goods" is the determinative element. Finally, lost profits are not referred to in the Code's section on damages for breach of warranty.²⁹ In "special circumstances," however, different proximate damages³⁰ and incidental expenses³¹ (which may include any other reasonable expense incident to the breach)³² may be recovered.

PROTECTION FOR THE MANUFACTURER

Use of the common law doctrine of third-party beneficiary would not leave the manufacturer at the mercy of remote purchasers of made-

²⁵ *Id.* Comment 3. The scope of § 2-318 has long been the subject of debate. Currently, according to its text, it stands as a limited extension of horizontal non-privity in personal injury cases. A much broader third-party beneficiary section in the 1949 draft of the Code was rejected. It would have extended the scope of horizontal non-privity and applied to injury to person or property.

The 1966 official recommendations for amendments of the Code included a proposal that the states choose one of three forms of § 2-318. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REPORT No. 3, at 13 (1967). Alternative *A* is the present § 2-318. Alternative *B* is similar to the 1949 proposal but suggests applicability to vertical as well as horizontal non-privity by substituting the words "person who may reasonably be expected to use" for the 1949 language "person whose relation to the buyer is such as to make it reasonable to expect that such person may use." Alternative *B* also is distinguishable from the 1949 proposal, in that its scope is limited to personal injury.

Alternative *C* reads like *B* but would include any injury as opposed to only personal injury.

One commentator would broaden the third-party beneficiary section of the Code to eliminate the evolving overlap between the Code and tort law. Weaver, *Allocation of Risk in Products Liability Cases: The Need for a Revised Third Party Beneficiary Theory in UCC Warranty Actions*, 52 VA. L. REV. 1028, 1059-60, 1066-67 (1966).

²⁶ UCC § 2-313, Comment 2.

²⁷ *Id.* § 2-315.

²⁸ Compare *id.* §§ 2-315 & 2-314.

²⁹ *Id.* § 2-714(2).

³⁰ *Id.*

³¹ *Id.* § 2-714(3).

³² *Id.* § 2-715(1).

to-order goods. Conceivably, the manufacturer could disclaim liability for defects in his made-to-order products.³³ In practice, however, it is unlikely that an intermediate jobber would accept a contract with such a disclaimer.³⁴ Were he to do so, the jobber might be left without recourse against the manufacturer for rejected unfit or unmerchantable goods or for damages recovered by his aggrieved buyer. Furthermore, a disclaimer would encourage the remote purchaser to sue the jobber rather than the manufacturer. If the jobber and the remote purchaser were to assent to a valid disclaimer³⁵ in the process of bargaining for their respective contracts, it would seem reasonable to give force to such disclaimers.³⁶

Alternatively, the manufacturer's interests are protected to the extent that the remote purchaser only acquires rights from the contract between the jobber and the manufacturer where the performance contracted for demonstrates the requisite intent to benefit. The manufacturer can clearly establish in the jobber contract that there is no intent to benefit parties not in privity to the immediate transaction.³⁷

In a recent Second Circuit case, *Hylte Bruks Aktiebolag & Ny-molla v. Babcock & Wilcox Co.*,³⁸ plaintiff sued for \$836,000 lost profits caused by the defective operation of custom-made machinery. Plaintiff attempted to establish itself as the third-party beneficiary of the sales contract between the manufacturer and plaintiff's parent corporation. The court held that plaintiff had no right to enforce its parent's contract because it failed to make out the necessary intent to benefit; in its contract with the intermediate, defendant manufacturer had

³³ *Id.* § 2-316.

³⁴ In a recent article, in which the author contends that the Code should effectively occupy the field of products liability cases, it is maintained that the availability of seller disclaimers would not render the aggrieved remote purchaser helpless. Manufacturers exhibit no widespread desire to draw public attention to potential dangers in their products. Also, "[t]he disclaimer has generally not been held to bar anyone other than the actual contract buyer, and the trend will certainly be against expanding disclaimer disabilities." Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 STAN. L. REV. 974, 1011 (1966).

³⁵ *But cf.* UNIFORM COMMERCIAL CODE § 2-302 whereby in the discretion of a court a clause or whole contract can be rendered unenforceable on grounds of unconscionability.

³⁶ A difficult question arises where the jobber has accepted a disclaimer in his contract with the manufacturer and omitted the same in his contract with the remote purchaser. The purchaser is injured thereby only if the jobber is judgment proof. Otherwise, the jobber's interest dictates elimination of disclaimers.

³⁷ The Restatement provision for third-party beneficiary rights begins: "Unless otherwise agreed between promisor and promisee . . ." RESTATEMENT (SECOND) OF CONTRACTS § 133 (Tent. Draft No. 4, 1968).

³⁸ 399 F.2d 289 (2d Cir. 1968).

specifically asserted its desire not to be a party to any further agreement which would create liability to third parties.

The question thus arises, what would prevent the manufacturer from simply boiler-plateing the jobber contract with a clause to undermine the rights of a remote purchaser of made-to-order goods seeking third-party beneficiary status. Again the relative bargaining power of the jobber in protecting not only the remote purchaser's but ultimately his own interest would serve to prohibit wholesale contractual avoidance of responsibility.

Where parties manifest intent to limit the scope of their transaction, obligations beyond such intention should not be judicially imposed: the *Hylte Bruks* decision is a sensible one. Yet the Second Circuit's reasoning in *Hylte Bruks* is in no way incompatible with that of the *Rhodes* court. Normally when a remote purchaser is the intended beneficiary of a sale of a made-to-order product to a jobber, foreseeable reliance on responsible performance by the manufacturer should not go unprotected.

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