Extreme Contracting: A Master Class on Warranties and Limits of Liability in Transactions and Litigation

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Warranties

- The difference between express and implied warranties
- Disclaimer’s effect on each type of warranty if litigated
- The difference between representation, warranty, and covenant
Hypothetical

Company enters into a SaaS agreement with a software reseller, the Service Provider, to implement a third party's software. The third party software owner is not a party to the agreement. The Service Provider does not provide a warranty against infringement and specifically disclaimed all representations and warranties not given, including a warranty of non-infringement.

Service Provider provides an indemnity in the event of a patent infringement claim but carves out from its indemnity obligation any claims that relied on programs, data, or documentation that the Service Provider did not provide. Company receives a demand from a third party alleging that the software provided by the Service Provider infringed its patent. Company looks to the Service Provider to indemnify and defend it.

- Does the disclaimer of a warranty of title impact the indemnification provision?
- Assuming the indemnification provision survives, does the carve out provide a basis to deny a claim for indemnity?
- Who has the burden of proving that the carve out applies?
- Would a pass through indemnity have benefited Company?

Warranty (Pro Customer)

- The software will perform according to the licensor’s documentation and any agreed Customer specifications (implementation, testing, warranty, and support)
- The software documentation is complete and accurate
- All services will be provided in a timely, workmanlike manner, in conformity with industry best practices
- Licensor will perform work in accordance with applicable law
- Licensor will not share or disclose Customer data in any manner to any third party without first obtaining the Customer’s prior written consent
- The software will be free from viruses and other destructive code
- Neither the software nor the use of Licensor’s services will infringe the patents, copyrights or other intellectual property rights of any third party
Warranty (Pro Contractor)

- Limited to the Licensor’s material compliance with the Contractor documentation;
- Specifies that the Licensor’s provision of service repairs and modifications is the Licensor’s sole liability and the Customer’s exclusive remedy for breach of the service warranty;
- Avoid additional warranties, including warranties of non-infringement of third-party intellectual property rights;
- If the Customer insists on infringement protection, offer a limited indemnity instead.

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- consequential,
- incidental,
- indirect,
- punitive or exemplary losses or damages,
- or any liability for loss of revenue,
- loss of profit,
- loss of product,
- loss of replacement power or business interruption,
- loss of business opportunity,
- [any industry specific risks you seek to avoid].

howsoever caused, including negligence, gross negligence, and strict liability.
Typical Carve Outs

- Personal injury
- Property damage
- Direct damages
- Damages, costs and expenses arising from either party’s breach of confidentiality obligations including Personal Data
- Consider super cap for data security obligations under the agreement
- Claims for which the provider is insured
- Each parties’ respective indemnification obligations

Hypothetical

Buyer seeks defense against third party property rights claims, and indemnification of and hold harmless for all costs, etc. related to third party claims.

- Vendor wants to limit to third party U.S. property rights. What realistic exposure does the buyer retain?
- Vendor will only defend. What would buyer give up by forgoing indemnification and hold harmless?
- Vendor will only defend and indemnify for awards issued by a court of competent jurisdiction. What would buyer give up by agreeing to this?
- Vendor says the remedy is the sole remedy for such a claim. What other remedies might be available?
- Linking this back to the first hypothetical, does the analysis for any of the above change if buyer forgoes a warranty of title? If the buyer agrees to a disclaimer of warranty of title?
Supplemental Materials – Product Agreements

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I. **WHAT IS A BREACH OF WARRANTY CLAIM?**

A. **Article 2 Transactions** The UCC recognizes that breach of contract and breach of warranty are not the same cause of action. The remedies for breach of contract are set forth in section 2-711, and are available to a buyer where the seller fails to make delivery, repudiates, or the buyer rightfully rejects or justifiably revokes acceptance. The remedies for breach of warranty are available to a buyer who has finally accepted goods, but discovers that the goods are defective in some manner.

B. **Different damages:**

1. Suing under a breach of warranty claim requires acceptance of the goods. Rejection of the goods or revocation of acceptance is typically reserved for breach of contract claims. *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986) (“[A] claim of a nonworking product can be brought as a breach-of-warranty action. Or, if the customer prefers, it can reject the product or revoke its acceptance and sue for breach of contract.”).
2. IL Supreme Court has held that revocation of acceptance is only available against a seller of goods. *Mydlach v. DaimlerChrysler Corp.*, 226 Ill. 2d 307, 331-32 (2007).

3. According to the Illinois’ Uniform Commercial Code, “[t]he 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, unless special circumstances show proximate damages of a different amount.” 810 ILCS 5/2-714(2); *Cont’l Sand & Gravel, Inc. v. K & K Sand & Gravel, Inc.*, 755 F.2d 87, 91 (7th Cir. 1985); *IMI Norgren Inc. v. D & D Tooling & Mfg., Inc.*, 247 F. Supp. 2d 966, 971 (N.D. Ill. 2002)

C. **Different accrual dates:**

1. Both breach of contract for sale of goods and breach of warranty have 4 year limitation periods. *See* 810 ILCS 5/2-725(1) and (2).

2. The accrual dates differ:

   a. **Breach of Warranty (under the UCC):** The statute of limitations period usually accrues when the goods are delivered. However, where a warranty expressly extends to future performance of the goods, and discovery of the breach must await the time of that future performance, the cause of action accrues when the breach is or should have been discovered with reasonable diligence. 810 Ill. Comp. Stat. 5/2-725(2) (2010); *Cosman v. Ford Motor Co.*, 285 Ill. App. 3d 250, 257 (1st Dist. 1996).

   b. **Breach of warranty (Under Magnuson-Moss, not under the UCC):** limitations period began to run, when promised repairs were refused or unsuccessful, rather than when tender of delivery was made. *Mydlach v. DaimlerChrysler Corp.*, 226 Ill. 2d 307 (2007).

   c. **Breach of Contract:** The Limitations period begins to run at the time of the breach of contract, not when a party sustains damages. *Hermitage Corp. v. Contractors Adjustment Co.*, 166 Ill. 2d 72, 77 (1995).

      i. However, if a contract requires a demand for performance, accrual begins on the date the demand is

II. TYPES OF WARRANTIES

A. Express (limited or general):

1. Elements of a good express warranty:

   a. “REPAIR OR REPLACE” language:

      i. **Intent**: defendant will repair or replace certain defects in material or workmanship under certain conditions for a certain amount of time.

         1) It is not a promise that *nothing* will go wrong, but rather it is a promise to fix certain things that go wrong for a certain period of time.

      ii. Exclusions to consider adding to the warranty:

         1) “CUSTOMER CANNOT RECOVER DAMAGES CAUSED BY MISUSE OF PRODUCT”

            a) **Intent**: exclude damages arising from misuse of the equipment, including failure to follow instructions in the manuals and on-product labels.

         2) “EXCLUDE REMEDIES OTHER THAN THOSE PROVIDED UNDER A LIMITED WARRANTY”.

      iii. **CAPITALIZE** the language to make sure it is CLEAR and OBVIOUS and that the reader cannot miss it.

   b. **Timing**:

      i. Customer should receive warranty language before executing a sale contract.

         1) *Razor v. Hyundai Motor Am.*, 854 N.E.2d 607, 623 (Ill. 2006): makes it clear that if customer signs acknowledgment, the acknowledgment should (1) indicate that they have received and have
read the limited warranty, (2) confirm that the customer intends to be bound by it, and (3) understand that the warranty signed by the customer supersedes any unsigned warranty obligations.

ii. Provide a copy of the warranty for customer to keep.

B. Implied warranties:

1. Implied warranty of merchantability:

   a. 810 ILCS 5/2-314:

      (1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

      (2) Goods to be merchantable must be at least such as

         (a) pass without objection in the trade under the contract description; and

         (b) in the case of fungible goods, are of fair average quality within the description; and

             NOTE: doesn’t have to be the BEST quality

         (c) are fit for the ordinary purposes for which such goods are used; and

             NOTE: This paragraph does not require that the goods purchased meet all of the buyer’s expectations, but merely provides for a minimum level of quality, that the goods be fit for the ordinary purpose for which they are used.

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promise or affirmations of fact made on the container or label if any.

**NOTE:** As a result of the use of the phrase “MUST BE AT LEAST SUCH AS” in subsection (2), the attributes of merchantability enumerated in this subsection are not exclusive, and a court may find additional attributes.

(3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

2. Implied warranty of fitness for a particular use:

a. 810 ILCS 5/2-315: Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller’s skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

3. Common law implied warranties:

a. Illinois courts extend common law implied warranties in fewer cases than other jurisdictions. For example, Illinois courts do not necessarily extend common-law implied warranties in all circumstances. *See, e.g., Fink v. DeClassis*, 745 F.Supp. 509, 516
(N.D. Ill. 1990) (finding Illinois courts have not recognized common-law implied warranty that would extend to sale of corporate assets).

b. One who contracts to perform construction work impliedly warrants that the work will be completed in a reasonably workmanlike manner. Harmon v. Dawson, 175 Ill. App. 3d 846 (4th Dist. 1988); Dean v. Rutherford, 49 Ill. App. 3d 768 (4th Dist. 1977).

4. Magnuson-Moss Warranty Act:


b. The Act prohibits a supplier from disclaiming an implied warranty when “at the time of sale, or within 90 days thereafter, such supplier enters into a service contract with the consumer which applies to such consumer product.” 15 U.S.C. § 2308(a).

c. Hamdan v. Land Rover North America, Inc., No. 03 C 2051, 2003 WL 21911244 (N.D. Ill. Aug. 8, 2003), the court held that a plaintiff cannot pursue an implied warranty claim under Magnuson-Moss if state law requires privity for the claim to succeed.

d. The Magnuson-Moss Warranty Act may also enlarge a consumer’s ability to sue a manufacturer.

   i. Mattuck v. DaimlerChrysler Corp., 366 Ill. App. 3d 1026 (1st Dist. 2006): the court held that although the U.C.C. requires privity to exist between the plaintiff and defendant in a breach of implied warranty suit, this requirement is relaxed when suit is brought under the Magnuson-Moss Act. This allowed the plaintiff/lessee to sue the manufacturer of the leased car, instead of being limited to suit against the dealership.
5. How to avoid attaching implied warranties to the contract:

a. Another purpose of a consumer acknowledgment: allows a manufacturer to enforce the disclaimer of implied warranties

b. 810 ILCS 5/2-316. Allows seller to exclude or modify implied warranties

   (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

   (2) Subject to subsection (3), to exclude or modify 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. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that “There are no warranties which extend beyond the description on the face hereof.”

   (3) Notwithstanding subsection (2):

      (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like “as is”, “with all faults” or other language which in common understanding calls the buyer’s attention to the exclusion of warranties and makes plain that there is no implied warranty; and

      (b) when the buyer before entering into the contract has examined the goods or the sample

   **REMEMBER:** when sophisticated buyer signs away implied warranties, the waiver is effective

   **PRACTICE TIP:** Be sure very clear as to what exactly as being limited because the court will strictly scrutinize this clause

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or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).

C. Pass-Through Warranties:

1. Elements of a good pass-through warranty:

   a. A well-written manufacturer warranty will provide that the manufacturer warranty is a pass-through warranty and that the manufacturer’s obligation to the customer is to submit and to pay warranty claims to the extent that the vendor supplier will honor them. In many cases, a manufacturer may do more than that, but it is much better for a manufacturer to do more than its contract requires than to have a contract that requires doing more than is appropriate.

   b. Manufacturer warranty should make it clear:

      i. that a seller is not authorized to make any representations or promises on behalf of the manufacturer,

      ii. that a seller is not authorized to modify the manufacturer’s warranty, and

      iii. that nothing the seller says is a representation by the manufacturer.

   PRACTICE TIP: consider offering additional warranty options

   -If customer fails to purchase it, it is their decision
   -Supports idea that customer evaluated how much risk it was willing to take
c. Seller documents:
   i. Should disclaim all implied warranties,
   ii. Should cross-reference manufacturer’s limited warranty, and
   iii. buyer should sign warranty acknowledgment (1) indicating that they have received and have read the limited warranty, (2) confirming that the customer intends to be bound by it, (3) understanding that the warranty signed by the customer supersedes any unsigned warranty obligations, and (4) indicating that the warranty is part of the sales transaction.

2. Drafting mistake:
   a. Manufacturer fails to review seller documents to ensure that they adequately protect manufacturer and seller

III. DISCLAIMERS

A. Must be conspicuous and properly phrased (810 ILCS 5/2-316(2)):
   1. § 2-316(2)

   (2) Subject to subsection (3), to exclude or modify 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. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that “There are no warranties which extend beyond the description on the face hereof.”

   (3) Notwithstanding subsection (2)

   (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like “as is”, “with all faults” or other language which in common understanding calls the buyer’s attention to

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the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade; and

(d) the implied warranties of merchantability and fitness for a particular purpose do not apply to the sale of cattle, swine, sheep, horses, poultry and turkeys, or the unborn young of any of the foregoing, provided the seller has made reasonable efforts to comply with State and federal regulations pertaining to animal health. This exemption does not apply if the seller had knowledge that the animal was diseased at the time of the sale.

2. While disclaimers should be in writing and conspicuous, there are no particular words necessary to exclude or modify an implied warranty. “Examples of conspicuousness include, a heading in capitals equal to or greater in size than the surrounding text, contrasting type, font, or color to the surrounding text of the same or lesser size, and language larger than surrounding text or contrasting in type, font, or color.” M. Block & Sons, Inc. v. Int’l Bus. Machs. Corp., No. 04 C 340, 2004 WL 1557631, at *9 (N.D. Ill. July 8, 2004); Wood v. Wabash Cty., 309 Ill. App. 3d 725 (5th Dist. 1999).

3. Conspicuous: with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it.

   a. Whether a term is “conspicuous” or not is a decision for the court. Conspicuous terms include the following:
i. A heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

ii. Language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language. 810 ILCS 5/1-201(b)(10).

b. Perry v. Gulf Stream Coach, Inc., 814 N.E.2d 634, 646 (Ind. Ct. App. 2004): upheld a disclaimer because the purchase agreement alerted the buyers to read the reverse side of the agreement, and the disclaimer of implied warranties “was contained in a paragraph entitled ‘Warranties,’ written in all capital letters, and underlined.” Since the Perry court held that the disclaimer was conspicuous, no implied warranties were applied.

B. The implied warranties, such as implied warranties of noninfringement and fitness for a particular purpose, can be effectively disclaimed by the display of phrases such as “AS IS” and “WITH ALL FAULTS” bundled with other conspicuous wording that identifies the specific warranties to be excluded.


2. A sales contract stating that all other guarantees were null and void did not disclaim implied warranties under Illinois law because the contract did not use the word “MERCHANTABILITY” and did not conspicuously disclaim the implied warranty. S.A.M. Elec., Inc. v. Osaraprasop, 39 F.Supp.2d 1074 (N.D. Ill. 1999).

3. Several Illinois courts have found the phrase “AS IS” sufficient to disclaim the implied warranty of merchantability, and that the prominent placement and size of the disclaimer in the purchase agreement is fatal to a plaintiff’s argument. See, e.g., Kinkel v. Cingular Wireless LLC, 223 Ill. 2d 1 (2006); Mitsch v. Gen. Motors Corp., 359 Ill. App. 3d 99 (1st Dist.
IV. LIMITATIONS OF LIABILITY

A. Limitation of liability clause: Limitations of liability attempt to limit, define or eliminate damages occasioned by a party’s conduct or breach of contract.

1. Specific Goals:
   a. Prohibit certain forms of monetary relief (i.e. consequential or punitive damages),
   b. Cap damages, and
   c. Prohibit non-monetary relief (i.e. injunctions, reformation, rescission).

2. Generally enforceable unless intentional wrongdoing (i.e. fraud or willful/malicious conduct): Parties are free to “bargain against liability for harm caused by their ordinary negligence in performance of contractual duty.” Nevertheless, it is unlikely that the courts will enforce an exemption from liability if it applies to “harm willfully inflicted or caused by gross negligence.”

B. Types of Limitations of Liability:

1. Waiver of Consequential Damages:
   a. Consequential damages: damages that do “not flow directly and immediately from the act of the party, but only from some of the consequences or results of such act.
   b. Provisions almost always exclude losses that may not even constitute consequential damages and may, in fact, constitute direct contract damages.
      i. In some cases, the parties specifically exclude “lost profits” in addition to, and not merely as a subset of, consequential damages by eliminating “INCLUDING” and instead using “OR ANY” in a waiver of consequential damages claims.
1) Imaging Sys. Int’l, Inc. v. Magnetic Resonance Plus, Inc., 227 Ga. App. 641, 643-44 (1997) (noting that there are two types of lost profits – “lost profits which are direct damages and represent the benefit of the bargain” and “lost profits which are indirect or consequential damages”).

2) But, the distinction between lost profits as a stand-alone exclusion and as a subset of consequential damages is generally lost, however, because many believe that all lost profits are consequential damages and vice versa.

c. Can a party waive punitive/exemplary damages?

   i. Illinois generally will only allow punitive damages in tort. There must also be proper allegations of malice, wantonness, or oppression. Morrow v. L.A. Goldschmidt Assocs. Inc., 112 Ill. 2d 87 (Ill. 1986). Punitive damages are also limited by statute to 3 times the amount of economic damages. 735 ILCS 5/2-1115.05.

   ii. Including “punitive” damages in a consequential damage waiver, at least to the extent the waiver relates to direct claims between the buyer and seller, typically does not affect contract damages between the parties (even though these types of damages are also not “consequential” damages).

   1) Because punitive damages are tort-based additional damages (beyond the actual damages caused by a wrongdoer’s conduct), they are generally awarded to punish particularly egregious conduct, not damages to compensate a non-breaching party to a contract for the breaching party’s failure to perform.
2) Most states do not award such non-compensatory damages for breach of contract, even in the absence of a waiver.

d. Can a party waive incidental damages? (know what you’re getting into . . .)

i. **Incidental damages**: limited to the expenses incurred by:
   (i) a buyer in connection with the rejection of non-conforming goods delivered by the seller in breach of contract, or (ii) by a seller in connection with the wrongful rejection by a buyer of conforming goods delivered by the seller to the buyer.

   1) All costs and expenses incurred by the non-breaching party to avoid other direct and consequential losses caused by the breach can be considered “incidental” damages.

   ii. A party can limit incidental damages as long as doing so would not be unconscionable.

e. Typically, a limitation of liability contains either a waiver or disclaimer of consequential damages

i. Disclaimers are more typical when dealing with UCC contracts.

ii. The distinction between **waiver** or **disclaimer** can be important: Clear and unambiguous waivers that are not unconscionable will be enforced in most breach situations.

   1) Section 2-719 expressly permits parties to modify or limit remedies, including consequential damages, subject to certain limited restrictions.

   2) Where a waiver of consequential damages is found inconsistent with statutory dictates, the waiver may be declared void as a matter of public policy.
2. **Liquidated Damages Clause:**

   a. **Liquidated damages**: sum which a contracting party agrees to pay, or a deposit which they agree to forfeit, if he or she breaches some promise.

   b. These are most often used in construction contracts to avoid the cost/expense of having to prove the amount of damages resulting from a construction delay (usually as a result of delay by contractor to owner, but reverse liquidated damages can provide for recovery by contractor from owner).

   c. Enforceable only if it actually provides for liquidated damages and not for a penalty.

      i. A penalty is also a sum which a party agrees to pay or forfeit in the event of a breach.

      ii. **Difference between penalty and liquidated damages**: the difference lies in that, in the case of a penalty, the stipulated amount is fixed, not as a bona fide estimate of actual damages, but as a punishment, the threat of which is calculated to prevent a breach.

         1) A liquidated damage provision that gives either party an option of accepting a fixed amount as liquidated damages or pursuing an action for actual damages is unenforceable as a penalty.

   d. Illinois courts will enforce a liquidated damages provision on a case-by-case basis if:

      i. the parties intended to agree in advance to the settlement of damages that might arise from the breach;

      ii. the amount of liquated damages was reasonable at the time of contracting, bearing some relation to the damages which might be sustained; and

      iii. actual damages would be uncertain in amount and difficult to prove.

**PRACTICE TIP**: early termination of a contract does not necessarily result in an award of liquidated damages.

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**GK Dev. v. Iowa Malls Fin. Corp., 2013 IL App (1st) 112802**

i. Appellate court found that the $4.3 million holdback constituted an unenforceable penalty clause because the provision amounted to a windfall recovery for buyer.

ii. The trial court had awarded the buyer the entire $4.3 million for a 91-day delay in approving construction permits even though the entire 20- to 45-year lease was still intact and the buyer would receive the benefits of that lease for the next 20 to 45 years. Under these circumstances, the liquidated damages awarded were grossly disproportionate to the buyer’s loss. In essence, the trial court had allowed the buyer to receive a double recovery by not paying the $4.3 million purchase price to the seller for the tenant lease, while still recovering the $4.3 million for the lease over the next 20 plus years. The appellate court held this was a penalty and refused to enforce the liquidated damages clause.

1) **Windfall recovery**: profit that occurs suddenly as a result of an event not controlled by the company or person realizing the gain from the event.

3. **No Damages for Delays**

a. **Purpose**: specifically excludes monetary compensation in the event of a delay for a reasonable amount of time and are most often used in construction contracts.

b. **Asset Recovery Contracting, LLC v. Walsh Const. Co. of Ill., 2012 IL App (1st) 101226**: courts will enforce “no damages for delays” clauses, but such clauses will be strictly construed against the party seeking to enforce the clause.

c. Exceptions to enforcement:

i. delays not within the contemplation of the parties;

ii. delay of an unreasonable duration;

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iii. delay attributable to inexcusable ignorance or incompetence of the party attempting to enforce;

iv. where a party is guilty of bad faith, fraud, concealment, misrepresentation or acts of hindrance; or

v. waived by conduct.

4. **Exculpatory Provisions Expressly Limiting Liability**:

a. **Exculpatory clauses**: a clause by which the parties to a contract agree that one party will not be held liable for damages for nonperformance of an aspect of the contract

i. To the extent that exculpatory contract provisions are enforceable, they must be explicit, and narrowly tailored, and specifically identify the acts which are subject to the exculpatory provisions.

ii. General exculpatory contract provisions typically will not be enforced.

b. **Evans v. Lima Flight Team, Inc., 373 Ill. App. 3d 407 (1st Dist. 2007)**: “Although exculpatory agreements are not favored and are strictly construed against the party they benefit, parties may allocate the risk of negligence as they see fit, and exculpatory agreements do not violate public policy as a matter of law. An exculpatory agreement will be enforced if: ‘(1) it clearly spells out the intention of the parties; (2) there is nothing in the social relationship between the parties militating against enforcement; and (3) it is not against public policy.’”

i. “An exculpatory agreement will not be enforced where it is found to contravene or thwart public policy considerations.”

ii. “An exculpatory agreement must contain clear, explicit, and unequivocal language referencing the type of activity, circumstance, or situation that it encompasses and for which the plaintiff agrees to relieve the defendant from a duty of care. However, the parties need not have
contemplated the precise occurrence which results in injury. The injury must only fall within the scope of possible dangers ordinarily accompanying the activity and, therefore, reasonably contemplated by the parties.”

C. **Elements of an enforceable Limitation of Liability:**

1. Broadly define the transaction to include the written agreement AND the implementation of the agreement.

2. Broadly identify potential risks of the implementation of the agreement and possible causes of action resulting from that implementation.

3. Identify each type of remedy you are precluding.

4. Limit arbitrator’s power to relief authorized by contract.

5. Add the award of attorneys’ fees and costs where one party seeks damages or relief expressly barred by the contract.

6. Damages:
   a. Specifically identify the type of damages being limited or prohibited.
   b. Consider whether damages can be quantified:
      i. If damages cannot be quantified, limitation of liability clause for monetary damages will likely be unenforceable
      ii. What about equitable relief? Should that be precluded?
      iii. Are lost profits consequential damages or direct expectation damages?
   c. Damage caps must be realistically related to the deal:
      i. Recitals can be used to support damage cap.

D. **Drafting Mistakes:**

1. Failure to check relevant governing law.

2. Failure to clarify which damages (monetary and/or equitable) are at stake and how the clause will address or limit such damage.

**PRACTICE TIP:** A prevailing party attorneys’ fee clause would likely adequately allow a the drafting party to recover its fees and costs associated with successfully litigating a breach of warranty claim.
V. DEFENDING YOUR WARRANTY

A. Plaintiff wants damages:

1. **Direct damages**: the necessary and usual result of the defendant’s wrongful act; they flow naturally and necessarily from the wrong (also known as general damages).

2. **Incidental damages**: charges, expenses, and other costs incurred responding to an alleged breach of warranty:
   a. IL Definition (tracks UCC language)
      i. **810 ILCS 5/2-710**: Seller’s Incidental Damages. Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer’s breach, in connection with return or resale of the goods or otherwise resulting from the breach.
      ii. **810 ILCS 5/2-715(1)**: Incidental damages resulting from the seller’s breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

3. **Consequential damages**: damages that do not flow directly from the act of the parties, but instead are a consequence or result of the act.
a. IL Definition (tracks UCC language):
   
i. 810 ILCS 5/2-715(2): Consequential damages resulting from the seller’s breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.

4. Limit damages by (1) specifically excluding them from breach of warranty actions; (2) limiting recoverable damages to the cost to repair or replace the defective product; and (3) putting a ceiling on the potential total recovery that is realistically related to the possible recovery.

B. Possible claims that Plaintiff will make:

1. **Negligence**: Should be dismissed pursuant to the economic loss doctrine where applicable.
   
a. **Economic loss doctrine**: Plaintiff cannot have a claim where the only injury is the damage to the product itself.

2. **Strict liability design defect** - Should be dismissed pursuant to the economic loss doctrine where applicable.

3. **Breach of contract** - Plaintiff can only recover economic damages for economic loss that arises from the failure of a product to perform to the level expected by the Plaintiff.

4. **Fraudulent/negligent misrepresentation**.

5. **NOW THAT YOU HAVE JUST THE BREACH OF WARRANTY CLAIMS**:
   
a. Common elements for breach of express and implied warranty
   
i. Generally, in an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was breached and that the breach of the warranty was the proximate cause of the loss sustained. In such an action an
affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

ii. Statute of limitations (810 ILCS 5/2-275):

(1) An action for breach of any contract for sale must be commenced within 4 years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party’s lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within 6 months after the termination of the first action unless the termination resulted from
voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This Section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this Act becomes effective.

iii. Notice of breach

1) Maldonado v. Creative Woodworking Concepts, Inc., 296 Ill. App. 3d 935, 939, 694 N.E.2d 1021, 1025 (3rd Dist. 1998): “In every action for breach of warranty, notice is an essential element and the failure to allege sufficient notice may be a fatal defect in a complaint alleging breach of warranty. Despite the fact that a plaintiff filed suit within the period described by section 2–725(1), he must also provide adequate notice under section 2–607.”

a) “Section 2-607(3)(a) imposes a duty upon every buyer who has accepted goods to give notice of an alleged breach of an implied warranty to his seller within a reasonable time after he discovers, or should have discovered, the breach lest his claim be barred from any remedy. The notice requirement serves to provide a seller an opportunity to cure a defect and minimize damages, protect his ability to investigate a breach and gather evidence, and to encourage negotiation and settlement. In the context of an action involving personal injury, it also informs the seller of a need to make changes in its product to avoid future injuries.”
b) “Turning to the prerequisites for adequate notice, section 2–607(3)(a) generally requires that the plaintiff contact the seller directly and inform the seller of the problems incurred with a particular product that he purchased. If the problem relates to an injury, the plaintiff must notify the seller that an injury has occurred. In doing so, the plaintiff is held to a standard of good faith. When delay in notification does not result in prejudice to the defendant, it is not generally viewed as unreasonable.”

i) NOTE: “There are two exceptions to the rule. Direct notice is unnecessary when (1) the seller has actual notice of the defect in a product, or (2) the seller is found to have been reasonably notified by the plaintiff’s complaint alleging a breach of warranty.”

iv. Damages: generally, the damages consist of the difference in value of the product as delivered vs the value of the product as warranted.

1) 810 ILCS 5/2-714:

(1) 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 as determined in any manner which is reasonable.

(2) 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, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

2) To support damages, Plaintiff must provide expert testimony about the difference in value.

b. Nuances for breach of express warranty claims:

i. Additional Elements: Requires proof that Defendant made an actionable representations and a breach thereof.


2) *Oggi Trattoria & Caffe, Ltd. v. Isuzu Motors Am., Inc.*, 372 Ill. App. 3d 354, 360 (1st Dist. 2007) (“in a breach of express warranty action under the [Illinois UCC], plaintiff must show a breach of an affirmation of fact or promise that was made a part of the basis of the bargain.”)

ii. Typically, plaintiff’s breach of express warranty claim is actually based on a design defect.

1) Defendant needs to convince the court that the plaintiff is alleging a design defect claim under a tort theory that is masquerading as a breach of warranty claim.

a) *Voelker v. Porsche Cars N. Amer.*, 353 F.3d 516 (7th Cir. 2003):

   i) Plaintiff brought suit for breach of warranty (among other things) after an automobile crash where,
allegedly, the airbags failed to deploy.

ii) 7th Circuit found that Plaintiff failed to state a claim for breach of express warranty by relying on the allegedly defective design of the airbag system because Plaintiff could point to nowhere in the record where a warranty against design defects was part of his contract with any defendant.

b) Difference between manufacturing defect and design defect:

i) Manufacturing defect: item is produced in a substandard condition and often identified when it fails to perform as other units in the same production line.

ii) Design defect: item is produced in accordance with the intended specifications, but the design itself is inherently defective.

iii. Plaintiff may claim that the express warranty fails of its essential purpose, which means that plaintiff is likely seeking a breach of an implied warranty and wants consequential damages but needs to avoid the statutory limitations for damages:

1) Plaintiff’s attorney will argue that the warranty did not fulfill its purpose because multiple attempts to repair the product failed; the issue then becomes whether the warranty process provided a sufficient remedy.

2) Initial inquiry: what is the warranty’s purpose?

PRACTICE TIP: customer’s issues outside of the warranty do not mean that the warranty failed of its essential purpose → reviewing the warranty claims should reveal that the manufacturer paid them all and the manufacturer probably went above and beyond its obligations for customer relationship reasons
a) A limited warranty is NOT intended to guarantee a product or imitate insurance; instead, its purpose is to obligate manufacturer to repair or replace specific defects in materials or workmanship.

3) When does a warranty fail of its essential purpose?

   a) When it deprives the buyer of the substantial benefit of his or her bargain.

   b) Plaintiff 

   .. must prove: defendant was not able to cure the claimed defect in a reasonable amount of time or that repairs by a manufacturer are unsuccessful/would be futile.

4) Damages for failing at essential purpose:

   a) 810 ILCS 5/2-719(3): Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

   i) Therefore, this section forbids an unconscionable limitation on consequential damages; the inquiry is one regarding unconscionability- if unconscionable, then cannot limit or exclude consequential damages.

   ii) Unconscionability defense to breach of contract is recognized in Illinois and can be found on procedural
(defects in process of forming contract) or **substantive** (defects in actual terms of the contract) grounds.

5) When a limited remedy fails its essential purpose, Plaintiff may seek a remedy pursuant to 810 ILCS 5/2-719(2):

   a) 810 ILCS 5/2-719(2): where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.
      i) The inquiry is one regarding failure of essential purpose; if the warranty fails of its essential purpose, then a remedy cannot be limited.

6) Does § (2) invalidate the limitations of damages in § (3) (or, stated differently, does the failure of essential purpose of a limited remedy mean that any damage award shall include consequential damages?).

   a) NOTE: courts are split, but evolving view, including Illinois’s view is that (2) does not invalidate (3) because the elements are different for each section and focus on different points of time.

   b) (2): whether damages limitation is valid or unconscionable is judged as of the time of performance (which makes sense because it questions whether the seller complies with the terms of the warranty).

   c) (3): whether damages limitation is valid or unconscionable is based on the time of the contract’s formation (which makes sense
because it deals with the procedure and substance of the contract).

d) *Razor v. Hyundai Motor Am.*, 854 N.E.2d 607, 618 (Ill. 2006): held that the elements of (2) and (3) are independent and the failure of Hyundai’s warranty’s essential purpose did not automatically invalidate the warranty’s damages limitation provided that the exclusionary provision was not unconscionable.

7) Disclaimers vs limitations of remedies:

a) **Disclaimers of warranties**: attempt to limit the circumstances of liability.

b) **Limitations of remedies**: restrict buyer to certain forms of relief and/or amount of damages.

c) **NOTE**: when limited warranty fails of its essential purpose, § (2) only abrogates the remedy limitation, not the warranty disclaimers.

8) *AES Tech. Sys. v. Coherent Radiation*, 583 F.2d 933 (7th Cir. 1988): Held that the failure of essential purpose of a limited remedy does not automatically mean that a damage award will include consequential damages; failure of the limited remedy does not invalidate the damages limitation.

9) *Sunny Indus., Inc. v. Rockwell Int’l Corp.*, 175 F.3d 1021 (7th Cir. 1999): when a limited warranty fails to provide the benefits that the buyer expected, a court may, on a case-by-case basis, consider the equality of bargaining power
between the parties and determine whether it warrants consequential damages.

c. Nuances for breach of implied warranty claims:

i. Additional elements for breach of implied warranty of merchantability:

1) the good was not merchantable at the time of sale;

2) the plaintiff suffered damages as a result of the defective good; and

3) the plaintiff gave notice to defendant seller of the defect.

ii. To successfully claim a breach of implied warranty of merchantability, plaintiff must show that the defect in the goods existed when the goods left the seller’s control because “[a] product breaches the implied warranty of merchantability if it is not fit for the ordinary purposes for which such goods are used.”


a) “Plaintiff is not required to prove a specific defect; rather, a defect may be proven inferentially by direct or circumstantial evidence.”

b) “A prima facie case is made by proof that in the absence of abnormal use or reasonable secondary causes[,] the product failed ‘to perform in the manner reasonably to be expected in light of its nature and intended function.’”

iii. Whether an implied warranty has been breached is a question of fact for the trier of fact. Check v. Clifford

iv. Many states, including IL require **privity** as an element of a claim for breach of implied warranty.

1) **EXCEPTIONS:**

a) Personal injury suit where suing for compensation of personal injuries. *Jensen v. Bayer AG*, 371 Ill. App. 3d 682, 690–91 (1st Dist. 2007): The court noted that privity need not exist when the plaintiff brings a personal injury suit. This exception cannot be used, however, unless the plaintiff actually sues for compensation of personal injuries. In *Jensen*, plaintiff admitted he was suing for purely economic loss.


2) *Adkins v. Nestle Purina PetCare Co., Prod. Liab. Rep.*, No. 12 C 2871, 2013 WL 5420972, (N.D. Ill. Sept. 27, 2013): the court held that privity was not necessary where the packages were sealed by the manufacturer, demonstrating that the defect existed when the product left defendants’ control.
Supplemental Materials – Service Agreements

Extreme Contracting: A Master Class on Warranties and Limits of Liability in Transactions and Litigation

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I. Warranties

A. Promise that certain facts are truly as they are represented to be and that they will remain true, subject to any specific limitations.

B. Key is to make the specific limitations part of the transaction

C. Sample warranty language (specific limitations highlighted):

1. Warranty for Contractor’s Delivery of Services or Work Product drafted by Contractor:

   Warranty. Contractor warrants that it will perform all Services in a professional and workmanlike manner and provide Work Products that conform in all material respects to the specifications set forth in the SOW. Unless other acceptance terms are specified in an SOW, the Services or Work Products shall be deemed accepted 10 business days after delivery to the Customer. To receive warranty remedies, Customer must report any deficiencies to Contractor in detail in writing within forty-five (45) days from the date of Contractor’s delivery of the services or Work Products. **Customer’s exclusive remedy and Contractor’s entire liability is to provide Services to correct the deficiencies.** If Contractor is unable to correct the deficiencies, Customer is entitled to recover the fees paid to Contractor for the deficient portion of the Services or Work Product.

2. Warranty terms begin upon Customer’s Acceptance of Services or Work Product, **drafted by Customer:**
Warranty. Contractor warrants that it will perform all Services in a professional and workmanlike manner and provide Work Products that conform in all material respects to the specifications set forth in the SOW. To receive warranty remedies, Customer must report any deficiencies to Contractor in detail in writing within ninety (90) days from the date of Customer’s acceptance of the services or Work Products. Unless other acceptance terms are specified in an SOW, the services or Work Products shall be deemed accepted 10 business days after delivery to the Customer. **Customer’s exclusive remedy and Contractor’s entire liability is to provide Services to correct the deficiencies. If Contractor is unable to correct the deficiencies, Customer is entitled to recover the fees paid to Contractor for the deficient portion of the Services or Work Product.**

3. Require that Customer give specific written notice to Supplier/Manufacturer/Licensor of any warranty claim (including the nature of the defective condition) within XX days of the claim or be barred from all warranty remedy (this prevents warranty claims which are not asserted in a timely fashion, both by Customer and its customers).1

D. Third-Party Vendor2 or Pass Through Warranties and Disclaimers

1. A well-written warranty will provide that a Contractor is basically a pass through of third-party warranties and that the Contractor’s obligation to the customer is to submit and to pay warranty claims to the extent that the third party will honor them.

2. In many cases, a Contractor may do more than that, but it is much better for a Contractor to do more than its contract requires than to have a contract that requires doing more than is appropriate.

3. Key is that any third party vendor warranty is exclusive remedy.

4. Sample third-party vendor warranty and disclaimer language:

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1 Steven B. Winters, “Diving Deeper Into Complex License and Business Agreements” (Jan. 2013).

2 Consider review of standard language disclaiming third party beneficiaries and reconcile.
Customer understands that Contractor is not the manufacturer of these Products and the only warranties offered are those of the manufacturer, not Contractor. Warranty remedies offered by Third Party are Customer’s exclusive remedies.

Contractor HEREBY EXPRESSLY DISCLAIMS ALL WARRANTIES EITHER EXPRESSED OR IMPLIED, RELATED TO THIRD-PARTY VENDOR PRODUCTS, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTY OF TITLE, ACCURACY, MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, OR WARRANTY OF NONINFRINGEMENT. THE DISCLAIMER CONTAINED IN THIS PARAGRAPH DOES NOT AFFECT THE TERMS OF ANY MANUFACTURER’S WARRANTY.

Customer expressly waives any claim that it may have against Contractor based on any Third-Party Vendor Product liability or infringement or alleged infringement of any patent, copyright, trade secret or other intellectual property rights with respect to any Third-Party Vendor Product and also waives any right to indemnification from Contractor against any such Claim made against Customer by another party.

5. You may need to offer more protection for third-party products/services. Warranties in this case are often referred to as “pass-through warranties”. Sample language (in order of increasing obligation of Contractor):

- - 5 -

www.thompsoncoburn.com
a) **Example No. 1**: Limited obligation of Contractor —

Customer’s sole recourse is with manufacturer

Except as otherwise provided above, Contractor makes no warranty, express or implied, with regard to third party hardware or software and **expressly disclaims the implied warranties or conditions of merchantability or, merchantable quality, fitness for a particular purpose, title, infringement and those arising by statute or otherwise in law.** Customer’s sole recourse for warranty claims is with the manufacturer of the Product. However, **Contractor agrees to pass through any third party warranty that Contractor receives from the manufacturer of the Products to customer.** The extent of any third party warranty details, terms and conditions, remedies and procedures may be expressly stated on, or packaged with, or otherwise accompanying the Products.

**EXCEPT AS SET FORTH HEREIN, CONTRACTOR MAKES NO WARRANTIES, EXPRESSED OR IMPLIED, AND BUYER ACKNOWLEDGES THAT NO REPRESENTATIONS, WARRANTIES, PROMISES OR STATEMENTS HAVE BEEN MADE BY [Contractor], WITH RESPECT TO THIS PRODUCT, OR ANY PART OR PORTION THEREOF. IN ADDITION, Contractorb MAKES NO WARRANTY OF MERCHANTABILITY OF THIS PRODUCT OR ANY PART OR PORTION THEREOF, FOR ANY PURPOSE, NOR ANY WARRANTY WHICH EXTENDS BEYOND THE DESCRIPTION ON THE FACE HEREOF.**

b) **Example No. 2**: Moderate Obligation of Contractor -

Contractor offers some support

If Contractor provides any products, materials or services covered by a third party warranty or indemnity, Contractor shall: (a) provide Customer with a copy of each such warranty or indemnity; and (b) if such warranty or indemnity does not, by its terms, pass through to the end user, then to the extent permitted by the third party, assign to Customer or otherwise cause the third party to grant to Customer all warranties and/or indemnities provided by such third party. These are Customer’s exclusive warranty remedies with respect to such third party materials.

**THIRD PARTY COMPANY** products and materials and other commercial off-the-shelf ("COTS") products and materials are provided by Contractor exclusively on the license and warranty terms offered by **THIRD PARTY COMPANY** and the COTS sellers. No additional terms or warranties are offered.
c) **Example No. 3:** High level of obligation of Contractor – Contractor acts as liaison.

With respect to all third-party software or hardware integrated into the Products and Services provided by Contractor to Customer under this Agreement, Contractor shall pass through to Customer and End Users the rights Contractor obtains from the vendors of such hardware and software (including warranty and indemnification rights), all to the extent that such rights may be reasonably obtained from the corresponding third party. In the event of a third-party software or hardware nonconformance under such pass through warranties, Contractor will coordinate with and be the point of contact for resolution of the problem through the applicable third-party and, upon becoming aware of a problem, will notify such third-party and use commercially reasonable efforts to cause such third-party to promptly repair or replace the nonconforming item in accordance with such third-party’s corresponding warranty. Without diminishing its other obligations under the Agreement, if any warranties or indemnities may not be passed through, Contractor shall, upon the request of Customer, take commercially reasonable action to enforce (not to include any obligation to initiate litigation or formal dispute resolution) any applicable warranty or indemnity that is (i) reasonably relevant and applicable to the nonconforming hardware or software and (ii) enforceable by Contractor in its own name.

d) Customers should consider requiring written disclosure of all third party products or intellectual property embedded in the deliverables, and that such disclosure in particular of open source software licensed under GNU or be subject to specific penalties.

II. **DISCLAIMERS OF WARRANTY**

A. Any statement intended to specify or delimit scope of rights and obligations,

B. Parties to high value contracts generally anticipate some level of uncertainty, waiver, or risk,

C. Vulnerability to express and/or implied warranties can be reduced somewhat through the use of disclaimers.
D. The presence of a disclaimer in a legally binding agreement does not necessarily guarantee that the terms of the disclaimer will be recognized and enforced in a legal dispute. There may be other legal considerations that render a disclaimer void either in whole or part.

Contractor DISCLAIMS ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING, BUT NOT LIMITED TO, IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR PARTICULAR PURPOSE. Contractor makes no warranties regarding any portion of any deliverable developed by Customer or by any third party, including any third party software, hardware, or other third party products provided by Contractor.

1. Case law where warranty disclaimers under the UCC were rendered void, and which may be applicable to a services agreement:

a) Cooley v. Big Horn Harvestore Sys., Inc., 813 P.2d 736, 748 (Colo. 1991) (when a remedy fails its essential purpose, the buyer is entitled to consequential damages notwithstanding a general contractual disclaimer to the contrary; allowing damages for repairs); Caudill Seed and Warehouse Co., Inc. v. Prophet 21, Inc., 123 F. Supp. 2d 826 (E.D. Pa. 2000) (if a limited remedy fails its essential purpose, consequential damages may be recovered by the buyer, despite any clause in the contract excluding them); Caudill Seed & Warehouse Co. v. Prophet 21, Inc., 123 F. Supp. 2d 826, 832 (E.D. Pa. 2000) on reconsideration in part sub nom. Caudill Seed & Warehouse Co. v. Prophet 21, Inc., 126 F. Supp. 2d 937 (E.D. Pa. 2001) (“when an exclusive remedy fails, a buyer may seek the entire range of remedies available under the UCC.”).
b) **Example No. 1: No warranty (“as is”)**

**DISCLAIMER OF WARRANTY:** To the maximum extent permitted by applicable law, [PRODUCT/SERVICE] is provided “as is” without warranties, conditions, representations or guaranties of any kind, either expressed, implied, statutory or otherwise, including but not limited to, any implied warranties or conditions of merchantability, satisfactory quality, title, noninfringement or fitness for a particular purpose. Contractor does not warrant the operation of its offerings will be uninterrupted or error free. You bear the entire risk as to the results, quality and performance of the service should the service prove defective. No oral or written information or advice given by a Contractor authorized representative shall create a warranty. This disclaimer of warranty constitutes an essential part of the license agreement. [PRODUCT/SERVICE] was designed to be a supplementary educational tool. You are advised to not solely rely on the [PRODUCT/SERVICE] service for any reason.

c) **Example No. 2: No warranty from Customer’s perspective**

Customer acknowledges that Customer made the selection of the property based on its own judgment and is not relying on Contractor’s skill or judgment to select or furnish goods suitable for any particular purpose. Customer acknowledges that Contractor has not made and does not make any warranties, express or implied, directly or indirectly, including, without limitation, the warranty of merchantability and of fitness, capacity or durability for any particular purpose, and warranties as to the design or condition of the property and the quality of the material or workmanship of the property. Contractor shall have no liability to Customer for any claim, loss or damage of any kind or nature whatsoever, including any special, incidental or consequential damages, to any extent whatsoever, relating to or arising out of the selection, quality, condition, merchantability, suitability, fitness, operation or performance of the property. No defect in or unfitness of the property shall relieve Customer of its obligations under the purchase agreement.
d) **Example No. 3:** Simplified Disclaimer – This disclaimer can be used in contracts that either are *de minimus* either in fees or time.

Contractor specifically disclaims all warranties of any kind, express or implied, arising out of or related to this agreement, including without limitation, any warranty of marketability or fitness for a particular purpose, each of which is hereby excluded by agreement of the parties.

III. **LIMITATIONS OF LIABILITY**

A. The sky is not the limit. Limitation of liability clauses may allow you to cap your contractual liability.

1. Most companies use insurance to protect themselves from potential lawsuits and other claims that may arise out of a contract.

2. Not all claims are insurable. For those that are not, the use of a limitation of liability clause may be the ONLY solution.

3. The limit may apply to all claims arising during the course of the contract, or it may apply only to certain types of causes of action. Limitation of liability clauses typically limit the liability to one of the following amounts: (i) the compensation and fees paid under the contract; (ii) an agreed upon amount of money; (iii) available insurance coverage; or (v) a combination of two or more of the above.
Courts have upheld the following clause:

The Customer agrees that to the fullest extent permitted by law, [Contractor’s] total liability to the Customer shall not exceed the amount of the total lump sum fee due to negligence, errors, omissions, strict liability, breach of contract or breach of warranty.³

1. Examples of clauses that the court struck down, i.e., the provision was ambiguous or unconscionable; the parties’ intentions were not clearly expressed; one party had unequal bargaining powers or a higher level of sophistication; and/or there was a public policy or statute prohibiting the enforcement of the provision. See, e.g., *Kleinwort Benson N. Am., Inc. v. Quantum Fin. Servs., Inc.*, 285 Ill. App. 3d 201, 216 (Ill. App. Ct. 1996) aff’d, 181 Ill. 2d 214 (1998) (limitations of liability for fraud are void as against public policy); see also *First Fin. Ins. Co. v. Purolator Sec., Inc.*, 69 Ill. App. 3d 413, 418 (1979) (citing cases for limiting or absolving of liability as against public policy where there are certain special relationships, including cases involving common carriers (*Checkley v. Illinois Central R.R. Co.* (1913), 257 Ill. 491, 100 N.E. 942; Ill.Rev.Stat 1977, Ch. 27, par. 1), and employer-employee relationships (*Campbell v. Chicago, Rock Island & Pacific Railway Co.* (1910), 243 Ill. 620, 90 N.E. 1106)).

2. A limitation of liability clause is only as valuable as its ability to be enforced; therefore, drafting is key. Increasing the likelihood that a limitation of liability clause will be enforced may simply be a matter of observing the following drafting guidelines:

   a) Make the Clause Conspicuous: Set the clause in bold face print or underline or otherwise place the clause apart from the rest of the text on the page on which it appears so that the other party is aware of its existence.

³ *SAMS Hotel Grp., LLC v. Environ*, Inc., 716 F.3d 432, 433 (7th Cir. 2013) (limited liability clause limited damages to just $70,000 of a claimed loss of $4.2 million); *P.H. Glatfelter Co. v. Voith, Inc.*, 784 F.2d 770, 777 (7th Cir. 1986) (enforcing limit on liability clause); *Music Dealers, LLC v. Sierra Bravo Corp.*, 1:12-CV-00712, 2012 WL 4017950 (N.D. Ill. Sept. 10, 2012) (enforcing limitation of liabilities clause for software development project and denying consequential damages).
b) Make the Language Clear and Concise: Make sure that the clause is concise and unambiguous as it relates to the contract as a whole.

c) Negotiate the Clause: Discuss the clause with the party that is signing the agreement and negotiate if there is a discrepancy.

d) Retain Drafts of Revisions: Keep drafts of any revisions made to the limitation of liability clause so that you have proof that the clause was negotiated.

3. Courts have upheld the following clause:

> With respect to claims for breach of contract and each other’s property damage, neither Party and their parents, affiliates and subsidiaries shall be responsible to the other for consequential, incidental, indirect, punitive or exemplary losses or damages, or any liability for loss of revenue, loss of profit, loss of product, loss of replacement power or business interruption, loss of business opportunity, howsoever caused, including negligence, gross negligence, and strict liability.

a) A recent Eighth Circuit decision reflects the enforceability of limitation of liability clauses above. Hallmark Cards, Inc. v. Monitor Clipper Partners, LLC, 2014 WL 3408853, at *5 (8th Cir. July 15, 2014) (finding no double recovery because prior arbitration award and settlement could not have compensated plaintiff for use of trade secrets because of a limitation of liability clause barring incidental and consequential damages).
b) Such contractual limitations of liability are enforceable unless the clause is ambiguous, unconscionable, or contrary to public policy. Roy A. Elam v. Fru-Con Constr. Corp., 922 S.W.2d 783, 789 (Mo. Ct. App. 1996). “Clear, unambiguous, unmistakable, and conspicuous limitations of negligence liability do not violate public policy.” Purcell, 59 S.W.3d at 509. In fact, when sophisticated businesses negotiate at arm’s length, they “may limit liability without specifically mentioning ‘negligence,’ ‘fault,’ or any equivalent.” Id. (citing Alack v. Vic Tanny Int’l of Mo., Inc., 923 S.W.2d 330, 338 n.4 (Mo. 1996)). The validity and construction of a limitation of liability contractual provision is an issue of law for the court to decide. Purcell, 59 S.W.3d at 508; Sports Capital Holdings (St. Louis), LLC, 2014 WL 1400159 at *2.

C. Drafting Solutions:

1. **Example No. 1** – absolute limit of liability, prohibiting damages based on contractual liability, no carve outs

   LIMITATION OF LIABILITY: To the maximum extent permitted by applicable law, in no event and under no legal theory shall Contractor or any other person who has been involved in the creation, production, or delivery of [PRODUCT/SERVICE] and its offerings be liable to Contractor or any other person for any general, direct, indirect, special, incidental, consequential, cover or other damages of any character arising out of the licensing agreement or the use of or inability to use the service, including but not limited to, personal injury, loss of data, loss of profits, loss of assignments, data or output from the service being rendered inaccurate, failure of the [PRODUCT/SERVICE] service to operate with any other programs, server down time, damages for loss of goodwill, business interruption, computer failure or malfunction, or any and all other damages or losses of whatever nature, even if Contractor has been informed of the possibility of such damages.

2. **Example No. 2** – No liability for indirect damage, carve out for personal injury or property damage, cap on direct damages
Except for claims for personal injury or physical property damage caused by the consulting personnel while on the CUSTOMER’s premises, Contractor’s total liability for tort, contract and other damages shall not exceed the total amount of all fees paid to Contractor by Customer under this agreement and only where Contractor has received written notice by CUSTOMER of such claim. In no event shall Contractor be liable for lost profits or other incidental or consequential, indirect, special, exemplary or punitive damages under any circumstances whatsoever, even if [name of service provider] had been advised of the possibility of such damages or if they were otherwise foreseeable. In addition, Contractors shall not be liable for any claim or demand against CUSTOMER by any third party except if otherwise provided herein. These limitations of liability shall apply to all claims against Contractor in the aggregate (not per incident) and together with the disclaimer of warranties above shall survive failure of any exclusive remedies provided in this agreement.

3. Example No. 3 - Limitation of remedy with respect to licensing, includes breach of contract claim and excludes right to terminate license
The rights and licenses granted to CUSTOMER and its Affiliates hereunder are perpetual and irrevocable and Company cannot directly or indirectly terminate them for any reason or no reason, except as provided in this Section, items (a) through (e) below. Otherwise, in the event of any breach or alleged breach of this Agreement by CUSTOMER or its Affiliates, Company’s sole and exclusive remedy shall be to seek damages, and Company shall not (and shall have no right to) terminate this Agreement or the rights and licenses granted herein, or to enjoin CUSTOMER or its Affiliates or licensees from exercising such rights and licenses.\(^4\)

D. Distinguishing between direct and indirect damages under state law.

1. In determining damages for breach of contract, California courts distinguish between direct damages (called “general damages”) and indirect damages (called “special damages”). Lewis Jorge Construction Management, Inc. v. Pomona Unified School Dist., 34 Cal. 4th 960, 961 (Cal. 2004).

2. Direct damages are those that “flow directly and necessarily from a breach of contract, or that are a natural result of a breach.” Id. Direct damages are those that are within the contemplation of the parties at the time of contracting. Id. The parties do not have to have contemplated the exact consequence that occurred, but any consequences that the parties would have thought were likely to follow a breach of the contract would be included. Id. According to California statute, direct damages are those that “in the ordinary course of things, would be likely to result” from a breach. Cal. Civ. Code § 3300.

3. Indirect damages are those that do not flow directly from a breach of a contract. Indirect damages are “secondary or derivative losses arising from circumstances that are particular to the contract or to the parties.” Id. In order for indirect damages to be recovered, the special circumstances that created the indirect damages must have either 1) been communicated to or known by the breaching party (a subjective test) or 2) the breaching party should have been aware of them at the time of contracting (and objective test). Id. In other words, the indirect damages must have been foreseen or reasonably foreseeable. Id. Indirect damages do not include those damages that are beyond the parties’ expectations.

IV. PRICE — TARGETED RISK ALLOCATION AND DUE DILIGENCE

A. Occurs on both the buyer’s and the seller’s side

B. Affirmative statement that risk allocation is part of the price/financial terms

Example 1. Affirm risk allocation

YOU UNDERSTAND AND AGREE THAT THE PROVISIONS CONTAINED HEREIN REPRESENT AN AGREED ALLOCATION OF RISK WHICH IS REFLECTED IN THE OBLIGATIONS HEREUNDER SUCH AS THE DISCLAIMER OF ALL WARRANTIES AND THE LIMITATIONS ON LIABILITY. COMPANY COULD NOT PROVIDE ITS PRODUCTS OR SERVICES TO YOU AT THE AGREED UPON FINANCIAL TERMS “BUT FOR” YOUR AGREEMENT TO THESE TERMS AND CONDITIONS.⁵

Example 2. Simplified version – applicable when customer has agreed to the principal of reasonable risk allocation and will be willing to work out problems as they occur:

⁵ Ibid.
To the maximum extent permitted by law, the CUSTOMER agrees to limit the Contractor’s liability for the CUSTOMER’s damages to the sum of $_____ or the Contractor’s fee, whichever is greater. This limitation shall apply regardless of the cause of action or legal theory pled or asserted.

Example 3. More detailed version that incorporates most of the features necessary to give you sufficient protection while being relatively acceptable to most Customers:

In recognition of the relative risks and benefits of the project to both the CUSTOMER and the Contractor, the risks have been allocated such that the CUSTOMER agrees, to the fullest extent permitted by law, to limit the liability of the Contractor to the CUSTOMER for any and all claims, losses, costs, damages of any nature whatsoever or claims expenses from any cause or causes, including attorneys’ fees and costs and expert witness fees and costs, so that the total aggregate liability of the Contractor to the CUSTOMER shall not exceed $_____, or the Contractor’s total fee for services rendered on this project, whichever is greater. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by law. Additional limits of liability of $____ may be made a part of this Agreement for a fee of ___% of the total fees included herein.

1. For high risk projects or projects that involve hazardous materials:
LIMITATION OF LIABILITY

To the fullest extent permitted by law, and not withstanding any other provision of this Agreement, the total liability, in the aggregate, of the Contractor and the Contractor's officers, directors, partners, employees and subcontractors, and any of them, to the CUSTOMER and anyone claiming by or through the CUSTOMER, for any and all claims, losses, costs or damages, including attorneys' fees and costs and expert-witness fees and costs of any nature whatsoever or claims expenses resulting from or in any way related to the Project or the Agreement from any cause or causes shall not exceed the total compensation received by the Contractor under this Agreement, or the total amount of $_____, whichever is greater. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by law.

C. Express Protection against Limitations

Notwithstanding anything in this Agreement to the contrary, Customer and Licensor expressly agree that any partial or total failure of the Software to meet or exceed Customer's final configuration requirements (including but not limited to scalability, response times, access, scripting, user interface integration, and expected system performance) shall constitute, on the one hand, a general breach of this Agreement and/or, on the other hand, a breach of the Software warranty herein.⁶

D. Warranty, Disclaimers, Limitations on Liability in the Licensing Context for specialized Intellectual Property, tied to Contractors limited affirmative statement on Intellectual Property infringement

⁶ Ibid.
E. Affirmative statement of Customers access to due diligence

Customer acknowledges, covenants and agrees that it has not been induced in any way by Contractor Licensor, its directors, officers, employees, agents, Contractors, predecessors, successors, assigns or representatives to enter into this Agreement. Customer has conducted sufficient due diligence with respect to all items and issues pertaining to this Agreement, including without limitation the enforceability and validity of the Patent Rights; and, Customer has adequate knowledge and expertise, or has used knowledgeable and expert Contractors, to adequately conduct such due diligence, and agrees to accept all risks inherent herein. 

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7 Ibid.
8 Ibid.