

# COMMERCIAL & BUSINESS LITIGATION

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## ■ Reducing Litigation Risks in Renewable Energy Power Purchase Agreements

BY GREGORY S. RICCIARDI

Recent extensions of federal tax credits for renewable energy projects pursuant to the Energy Improvement and Extension Act of 2008<sup>1</sup> and an increase in state programs designed to further subsidize the development of renewable energy projects to meet sustainable energy goals and renewable energy portfolio standards have increased the use and importance of power purchase agreements (PPAs) in renewable energy projects.<sup>2</sup> PPAs are used in a variety of circumstances to effect different power

generation, site financing, and risk allocation terms between parties in an energy transaction. PPAs are used in all kinds of renewable energy projects, including solar, geothermal, wind, and biomass energy. Increases in renewable energy project opportunities have also led to an increase in litigation over the terms and provisions contained in PPAs. This article highlights key terms that should be included in any PPA and identifies some of the prevalent litigation pitfalls in PPAs.

Put plainly, a PPA is a contract to buy the electricity generated by a power plant. However, these complex agreements are fraught with possibilities for disputes beyond typical purchase agreements and contracts. PPAs typically include provisions on installation, interconnection, renewable energy incentives, and renewable energy resource access. In addition, traditional contract issues take on a different light in the context of PPAs.

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## ■ U.C.C. Section 2-318: The ABCs of Defense

BY SHAWN M. BATES AND DEBORAH J. KARAKOWSKY

With the roller-coaster ride of oil prices and the retraction of the world economy over the past year, one thing that litigators in the energy industry know is that business is booming. Our clients are suing and being sued with increasing frequency, as deals, projects, and company finances go good and bad. In the oil patch alone, many billions of dollars are spent each year on heavy equipment, much of it sold by manufacturers through middlemen to remote end users. As disputes arise over such equipment, the remote purchaser often wishes to sue the manufacturer. The manufacturer will, of course, not want to be pursued by a remote purchaser. Among the many legal considerations in such a dispute is whether the remote purchaser must have contractual privity with the manufacturer to sue successfully for breach of warranty.

### Is the Remote Purchaser Vertically Challenged?

There are two types of privity: horizontal and vertical. Vertical privity is implicated when a remote purchaser wants to sue the manufacturer for breach of warranty. Prior to the adoption of the Uniform Commercial Code, an injured purchaser was required to establish privity with the manufacturer to recover for breach of warranty. This, of course, is difficult to accomplish when the ultimate user of

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## The ABCs of Defense

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defective equipment is not the direct purchaser. To counter the harsh result of this rule, the model code was revised in 1952 to include section 2-318.<sup>1</sup> However, many states declined to adopt section 2-318 as it was first drafted. In response, the model code was again amended in 1966 to include two more optional variations of 2-318. The Uniform Commercial Code now contains three different versions of section 2-318, known as Alternatives A, B, and C.

The general purpose of model section 2-318 is to extend the coverage of a manufacturer's warranty to end users that can be expected to use a product even if they are not in privity with the seller. Section 2-318 permits certain non-privity plaintiffs to bring their warranty claims as third-party beneficiaries of the upstream warranties.<sup>2</sup> Of course, the devil is in the details, as always. That is because different states have adopted different versions of section 2-318, and California, Louisiana, and Texas have not adopted the section at all.<sup>3</sup>

Inevitably, then, consideration of whether privity is present or even required in your client's particular dispute will center on the question: What's the governing law?

### "A" Spells "Conservative"

Alternative A, the most conservative version of section 2-318, has been adopted by 28 states (listed in the sidebar). Alternative A "reflects only a limited abolition of privity and is not intended to allow recovery by all persons foreseeably affected by the defects in the seller's product."<sup>4</sup> Alternative A limits the class of potential plaintiffs in several ways that are of particular importance to corporate entities. First, the plaintiff must be a "natural person."<sup>5</sup> Accordingly, Alternative A of section 2-318 is of no help to corporations and partnerships.<sup>6</sup> Second, the plaintiff must have sustained personal injury; if the damage is only to property or the loss merely economic, the plaintiff must establish privity. Finally, the defendant must be a "direct" seller; thus, vertical privity is required.

It should be noted, however, that some Alternative A states have expanded the class of potential plaintiffs and defendants relying on the Official Comments to section 2-318. Thus, the application of the privity requirement may vary if the jurisdiction has altered the parameters of the statute with case law.<sup>7</sup>

## SECTION 2-318 ALTERNATIVES AND ADOPTION BY STATE

Alternative A: "A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty."	Alaska, Arizona, Arkansas, Connecticut, Florida, Georgia, Idaho, Illinois, Indiana, Kentucky, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Tennessee, Washington, West Virginia, Wisconsin
Alternative B: "A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty."	Alabama, Delaware, Kansas, New York, South Carolina, Vermont
Alternative C: "A seller's warranty whether express or implied extends to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty."	Colorado, Hawaii, Iowa, Minnesota, North Dakota, South Dakota, Utah, Wyoming
Alternative C, paraphrased version	Maine, Massachusetts, New Hampshire, Rhode Island, Virginia
Section 2-318 not adopted	California, Louisiana, Texas

In those jurisdictions, the adoption of Alternative A does not necessarily foreclose warranty claims by purchasers against remote manufacturers. Several jurisdictions that have adopted Alternative A have abolished the vertical privity requirement for implied warranty, such as Alaska, Florida, Indiana, Montana, Nebraska, Nevada, New Jersey, Oklahoma, Pennsylvania, and West Virginia. Other states, such as Alabama, Arizona, Idaho, Kentucky, North Carolina, Oregon, Tennessee, and Wisconsin have retained the common-law vertical privity rule.<sup>8</sup>

### **“B” a Bit More Broad**

Alternative B has been adopted by six states. Alternative B goes further and extends coverage to “any natural person who may reasonably be expected to use, consume or be affected by the goods,” thereby extending the class of potential plaintiffs and the class of potential defendants. However, Alternative B, like Alternative A, requires that the plaintiff be a natural person and have sustained a personal injury, rendering Alternative B just as unhelpful to corporate entities as Alternative A.<sup>9</sup> In addition, Alternative B expands the class of potential defendants to include remote sellers, eliminating the vertical privity requirement.

### **“C” the Defense to a Warranty Claim Disappear**

Alternative C has been adopted by 13 states. Alternative C weakens the lack of privity defense the most. Like Alternative B, Alternative C eliminates the vertical privity requirement. However, Alternative C is more liberal than either of the other versions because it does not require personal injury. Thus, non-privity plaintiffs who have sustained only property damage or economic loss may have standing to use under Alternative C.<sup>10</sup> In addition, unlike Alternatives A and B, Alternative C is not limited to “natural persons”; rather, it applies to corporations, partnerships, and other types of organizations.<sup>11</sup> Thus, in states that have adopted Alternative C, privity poses only a very narrow obstacle to a plaintiff’s warranty claim.<sup>12</sup>

### **The Bottom Line**

As the foregoing shows, if your energy industry litigation involves a purchaser’s claim against a manufacturer that did not directly sell to the purchaser, you should look to the state law governing your dispute to determine which version of section 2-318 (if any) has been adopted. In the context of corporate clients, this will quickly tell you whether privity is a requirement for a breach of warranty claim. In light of the privity restrictions enforced in states that have adopted

Alternatives A and B, generally speaking only in disputes where the governing law is provided by an Alternative C state should a remote purchaser reasonably expect to avoid the privity defense. Of course, these guidelines are general, and you should carefully check the applicable jurisdiction’s law to determine the merits of your particular dispute. In any event, as we litigators continue to be knee-deep in lawsuits for our energy industry clients, we should always be aware of the ABCs of a privity defense.

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### **Endnotes**

1. HAWKLAND’S UNIFORM COMMERCIAL CODE SERIES § 2-318:1 (2001); *Hyundai Motor Am., Inc. v. Goodin*, 822 N.E.2d 947, 954–55 (Ind. 2005).
2. A third-party beneficiary of a warranty under section 2-318 differs from a third-party beneficiary of a contract. It is generally easier for a non-privity plaintiff to obtain standing to sue under section 2-318 than under common-law third-party-beneficiary doctrines.
3. California has omitted the section entirely but has created another statute that is similar in effect to Alternative C.
4. *Lukwinski v. Stone Container Corp.*, 726 N.E.2d 665, 670 (Ill. Ct. App. 2000).
5. U.C.C. § 2-318.
6. *St. Paul Fire and Marine Ins. Co. v. Elkay Mfg. Co.*, 2003 WL 139775 (Del. Super. Ct. 2003).
7. *See Tex Enters., Inc. v. Brockway Standard, Inc.*, 66 P.3d 625, 628 (Wash. 2003).
8. *See Hyundai Motor Am., Inc. v. Goodin*, 822 N.E.2d 947, 957 n.8 (Ind. 2005).
9. *Westfield Ins. Co. v. HULS Am., Inc.*, 714 N.E.2d 934, 950 (Ohio Ct. App. 1998).
10. *Stoney v. Franklin*, 2001 WL 683963, \*7 (Va. Cir. Ct. 2001).
11. U.C.C. §§ 1-201(30) and 1-201(28).
12. As noted previously, California has adopted a statute that is similar in effect to Alternative C. Louisiana has never adopted any version of 2-318 but has abolished the vertical privity requirement for breach of warranty. *See Aucoin v. S. Quality Homes, LLC*, 984 So. 2d 685, 692–93 (La. 2008). Texas’s version of 2-318 takes no position on privity, leaving it instead to the courts to decide. TEX. BUS. & COM. CODE § 2.318.