



Published: Mar 1, 2007

Warranty Provisions: It Broke! Are You Covered?

Upgrades, change-outs and expansions mean component warranties are more important than ever. A guide to what your warranty may (and should) include.

By Richard Thompson, Mercer Thompson LLC

A critical component of your facility just broke. Of the many issues you now face, a key one is: "Is this covered by my warranty?"

Despite the question's seeming simplicity, the answer, which will likely be found deep within the fine print of some contract or purchase order, can be very complex. What's more, whether the answer will be the affirmative one you are hoping for will no doubt depend on how well your procurement team negotiated the warranty terms all those months ago. It is with this hypothetical in mind that this article lays out a few pointers on protecting an owner's interests within the context of warranty provisions.

Warranties on physical equipment or components often address three different categories of defects: defects in materials, defects in workmanship and defects in design.

"Defects in materials" typically refer to imperfections in the raw materials that go into the component. "Defects in workmanship" generally denotes faulty component manufacture or production. A "design defect" typically refers to flaws in how a component is shaped or how the elements comprising a component are

arranged. Suppliers sometimes resist design warranties altogether, citing concerns that they may be required continually to update their product design. However, this concern may be addressed by clarifying that defects are to be measured against design standards existing on the date the warranty became effective. Other qualitative factors may also be covered by a warranty, depending on the component involved, including, for example, that the component must be new when first provided or that the component must comply with applicable laws or permits. In any event, an owner's guiding thought should be "the broader the better."

Many contracts involve the supply of services in addition to physical components. As a result, owners will often also look for warranty coverage on service. By their very nature, services cannot be the subject of material-workmanship-design defects as described above, since these refer to physical flaws. Instead, services warranties typically require that services be provided in accordance with a stated standard, such as prudently, safely, professionally, diligently, in a workmanlike manner or in compliance with applicable laws and permits. Owners would be well advised to think about how they can specifically describe the required standards for the particular services provided.

A Warranty “Breach”

On paper, a warranty is considered to be “breached” when a component (or service) fails to comply with the warranted qualities. So, when a component (despite proper operation) suddenly breaks, the question is whether the failure was caused by a defect in workmanship, materials or design (assuming these are the warranted qualities). In a case like this, it may not be too hard for a forensic analysis to reveal that a defect did indeed cause the failure.

Of course, the facts are not always that simple. For example, a component may not suddenly break. Instead, it may suffer from excessive deterioration or premature wear and tear. The question then becomes: if a component is supposed to be able to operate non-stop for a given duration, but wears out much sooner, is that a defect? Or perhaps a component begins to malfunction, so that it still operates but not “as advertised.” Is that a defect? Issues like these can quickly surface if a warranty is unclear on the twin subjects of long-term performance and functionality requirements.

Time Flies

Time is a key part of every warranty. After all, a practical limit always exists to a supplier’s willingness to take the risk of covering its products. The length of a given warranty is usually a matter of commercial negotiation that may be guided by the maxim “there is a price for everything.”

Whether coverage lasts for days or years, owners should keep in mind a few key points. First, be alert to the ramifications of any warranty period that expires within a given time after delivery of the component. If a component is purchased as a reserve spare, such a limitation may cause the

warranty to expire before the part is even put into operation. Second, be just as alert to a warranty period that expires within a given calendar time (for example, days or years) after a component’s “first use”. The warranty life may be more appropriately measured by operating hours than by mere “clock” hours (which would include hours when the component is not in use). Finally, a warranty period should never be stated in “months.” Because our Gregorian forefathers chose calendar months to have 28, 30 or 31 days, a warranty period stated merely in months can lead to disputes over when coverage actually ends. This kind of discrepancy is unnecessary and can be avoided by using “calendar days” as the warranty period measuring basis.

Whew, It’s Covered; Now What?

Assuming that a component’s failure falls under a warranty’s defect coverage and within the applicable warranty period, the critical issue then becomes how the supplier must respond. It is here that warranties often come up short in protecting owner interests. For example, some warranties fail to provide details as to:

- How quickly the supplier must respond
- Owner control over the schedule for performing warranty work
- Supplier’s obligations for transporting parts to or from repair facilities
- Supplier’s obligations for transporting new replacement parts to the site
- Supplier’s obligations for “in and out costs” and related labor

Further, many warranties often describe the supplier’s obligations in vague terms of

“correcting” the failure by “repairing or replacing” the defective item. While these concepts are not harmful to an owner’s interests on their face, their lack of detail can be. For example, what is meant by “repair?” Depending on the item, repair standards may vary. Although facetious, the question “Are we talking about duct-tape, superglue or welding?” illustrates this point quite well. Thus, an owner should give considerable thought to defining the standard of repair required for the given item. Ideally, this standard would create some level of certainty that a component’s initial failure will not recur. For example, the standard may include post-repair testing to demonstrate that the repair has (at least initially) achieved the desired result.

Similarly, the remedy of “replacing” a component can also be vague. Should a replacement component be brand new or may it be refurbished? Must it be a “like-kind” component or can it be of a different model? Further, if a component fails due to defective design will the owner merely want a brand new, yet equally-as-defectively-designed component? Or must the supplier provide a redesigned part? Such issues are better addressed when a component is first purchased, rather than after it has failed.

Services warranties take a completely different approach to how a supplier must respond to a warranty breach. If a service warranty is breached, the supplier typically has performed work in an imprudent, illegal, negligent or unsafe manner. Merely to require the supplier to “re-perform” the defective service may be easier said than done. If, for example, the defect was a failure by the supplier to install a moving turbine component correctly, then perhaps this can be corrected by re-performance if the failure is noticed before operating the component. However, if the failure is not noticed until after the mis-installed

component has destroyed itself and caused collateral damage, then re-performance may be impossible. Thus, an owner must consider what remedies would be appropriate in light of the various scenarios that might comprise a breach of a services warranty.

Other Warranty Issues

Another component is re-warranty. This is the concept where, if a warranty correction is made (for example, if a component is repaired or replaced), then the corrected component is made subject to the original warranty coverage. This type of provision ends any confusion as to the warranty status of a repaired or replaced component. It may even act to extend warranty coverage past the original warranty period. The duration of such an extension is always a matter of commercial negotiation, just as the duration of the original warranty period. In this regard, all of the earlier points about warranty periods also apply.

Warranties are rarely open-ended promises from a supplier that a component will, no matter what, always function perfectly. Instead, most warranties include provisions that outline the supplier’s underlying assumptions. The most common is that the owner will operate the component (or the machine containing it) in a given manner, whether in accordance with prudent practices, a certain operating manual, or both. The idea is that the supplier is unwilling to take the risk of an operator error that results in a component’s failure.

While this concept has merit, an owner must be careful as to how it is presented in the contractual provisions. First, an owner must beware of language that is overly vague in defining assumed operational standards or requirements. Merely stating “prudent operation” may not be clear enough to guide

the owner's actions. Second, an owner must beware of provisions that fail to outline the cause and effect of non-compliant operation. For example, if a provision states that the warranties are predicated on prudent operation, does this mean that even a moment of imprudent operation voids the warranties in its entirety? One would hope not, but why leave this issue open for argument? A better approach would be to specify that a failure directly and solely caused by operator error (however that is defined) will not be covered by the warranty.

If you have ever read a warranty in its entirety, you will undoubtedly be familiar with the legalese that often appears in ALL-CAPS. This essentially says that the warranties are "exclusive" and "in lieu of all other warranties, whether implied or express." This so-called "exclusive warranties" language is driven by state laws that can, in the absence of the language, apply certain implied warranties (for example, warranty of "fitness for purpose") to the components. The language is also driven by laws that could cause any representations made prior to the sale to be seen as express warranties that must hold true after the sale. Essentially, exclusive warranties language can mean that, no matter what the owner was told and no matter how the owner thinks a component should operate, the coverage stated in the warranty provisions is the only coverage the owner will have. Seldom will one find a

sophisticated supplier who is willing to offer a contract without this language.

In addition to an "exclusive warranties" provision, many warranties will also include an "exclusive remedies" provision. The idea is subtle but important: This provision would make the obligations of the supplier as written in the warranty provisions the only obligations the supplier faces if a component fails to comply with the warranty. Ramifications of this provision can often be alarming. For example, an exclusive remedies clause may mean that the repair of collateral damage caused by a failed (yet warranted) component will not be the supplier's responsibility, unless expressly stated. Likewise, if a component fails and the stated remedy is "repair or replacement", such a clause may mean that a clearly necessary redesign is not an obligation. Finally, if negligent supplier behavior breaches a service warranty and if the remedy is "re-performance", then an exclusive remedies clause might be seen as disallowing recovery of property damage that result from the supplier's negligence.

The legal bottom line of exclusive warranties and remedies clauses is that the warranty provisions will almost certainly be considered to contain "all that there is" regarding both the promised quality and functionality of the components, and the obligations of the supplier if that promise is not met. As a result, owners must ensure that their warranty coverage and rights are as broad and as clear as possible.

Author: Richard "Chip" Thompson is the Managing Principal at Mercer Thompson LLC law firm and is based in Atlanta, GA. Over the past 15 years, he has regularly represented various energy companies in EPC, O&M and M&A matters.