



News & Types: Commercial, Competition & Trade Update

Another Dilatory Claimant Loses Out

1/3/2019

Practices: Commercial, Competition & Trade, Corporate, Finance & Acquisitions, Litigation

The 7th Circuit Court of Appeals has faced multiple claims in which the defendants raised a statute of limitations defense, with mixed success. For example, see our September 13, 2018 update, "Breach of Contract and Interference Claims Fail Due to Statute of Limitations" and our August 30, 2018 update, "Unsigned Contract Still a Written Contract".

The Appeals Court recently faced another case in which a claimant lost at least part of its case due to delay in bringing the claim. (*NewSpin Sports, LLC v. Arrow Electronics, Inc.*, 7th Circuit Court of Appeals, No. 18-1666, December 3, 2018) The question in these cases, almost always unanswered in the opinion, is why did the claimant wait so long?

NewSpin provides technology products to help athletes, such as golfers and tennis players, to analyze and improve their swings. In 2010, NewSpin began to develop a new sensor module, called "SwingSmart" that attaches to sports equipment and analyzes the user's technique, speed and angle. NewSpin began to look for manufacturers and distributors that could provide electronic components for SwingSmart.

NewSpin found the defendant, Arrow Electronics, which dealt in these types of electronic components. Arrow and NewSpin representatives met at least seven times in 2010 and 2011. Of course, NewSpin had to be satisfied that Arrow could provide the necessary components and Arrow assured NewSpin that Arrow had "successfully manufactured and provided substantially similar components for other customers."

NewSpin and Arrow signed a contract in August 2011 with the awkward title of "Materials and Manufacturing Management Agreement Board Assembly." Arrow was to procure components and other supplies for manufacture and assembly of "SwingSmart" through subcontractors on NewSpin's behalf "pursuant to detailed written specifications" to be provided by NewSpin and accepted by Arrow. Specifics of product shipments were left to purchase orders to be issued by NewSpin to Arrow. The Agreement included provisions on warranty, inspection of products, and ability to return products. The Agreement was governed by New York law.

NewSpin's first purchase orders were in late 2011 and Arrow shipped some components in mid-2012. NewSpin claimed that it discovered, too late, that the components were defective and failed to meet specifications. By the time NewSpin discovered the components were defective, it had built 7,500 SwingSmart units, of which only 3,219 were shipped, and of the 3,219 shipped units, 697 were inoperable. So, according to NewSpin, 4,281 units (well over 50%) were inoperable or defective. NewSpin alleged it paid Arrow \$598,388 for defective and inoperable components and incurred over \$200,000 in damages in customer support, testing, and repair. It also claimed damages in reputation and brand. Arrow never delivered \$130,000 worth of components.

NewSpin filed its complaint against Arrow on January 17, 2017. Before NewSpin could get to the merits of its complaint, it had some procedural hurdles to overcome, many self-inflicted. The district court had to determine whether the Agreement was primarily one for sale of goods or services. This was critical in applying the correct statute of limitations to the claims of NewSpin. A contract for the sale of goods is governed by the Uniform Commercial Code's four-year statute of limitations. A contract for services could have a longer limitations period, likely 10 years. The district court dismissed all of NewSpin's claims as untimely on summary judgment, applying the four-year statute of limitations. NewSpin appealed.

Judge Flaum, writing the opinion for the 7th Circuit, discussed an important procedural point that also came up in earlier cases. As noted, the Agreement applied New York law and Illinois courts respected this choice of law. But the applicable statute of limitations period was a procedural matter and, for this purpose, the law of the forum (i.e., Illinois) applied. This meant that the determination of the nature of the Agreement, sale of goods or services, and the statute of limitations period would be determined under Illinois law. (The district court, erroneously, applied New York law to the question as to whether the Agreement was for goods or services.)

Ultimately, Judge Flaum agreed with the district court that the Agreement was primarily one for goods and not services. Therefore, with respect to the claims of breach of contract, breach of implied covenant of good faith and fair dealing, and breach of warranty, the UCC's four-year statute of limitations applied.

But when did the claim accrue? Unfortunately for NewSpin, the latest date that could be considered the accrual of the claim was "mid-2012", the date Arrow shipped defective components to NewSpin. NewSpin filed its complaint on January 17, 2017. This meant that NewSpin's claims for a) breach of contract, b) breach of the implied covenant of good faith and fair dealing and c) breach of warranty, all failed as being well after the UCC's four-year statute of limitations.

But NewSpin wasn't done. It added tort-based claims against Arrow for unjust enrichment, negligent misrepresentation, fraud, and fraudulent misrepresentation. The district court viewed these as dressed-up contract-based claims. So the district court applied the four-year limitations period and also dismissed these tort-based claims as untimely.

Judge Flaum, viewing the complaint as true (as required at the summary judgment stage), took a different approach. First was the complicated analysis as to choice of law and the applicable limitations period. In Illinois, "tort claims that are dependent upon the contract are subject to a contract's choice-of-law clause regardless of the breadth of the clause. . . . In determining whether a tort claim is contract-dependent, 'courts examine whether the action alleges a wrong based upon interpretation and construction of the contract, or whether the claim alleges elements constituting an independent tort.'" Since the tort-based claims depended on the agreement, New York law applied to the substance of the tort-based claims, although Illinois law still determined the statute of limitations.

Judge Flaum agreed with the district court that the unjust enrichment claim was really a disguised breach of contract claim and could not be separated from the breach of contract claim that was dismissed as untimely. So the unjust enrichment claim failed.

Next up was the negligent misrepresentation claim. Here Judge Flaum went in a different direction. Rather than analyzing whether the negligent misrepresentation claims should be dismissed as untimely, Judge Flaum looked at the economic loss rule as applied under New York law. Under New York law, damages characterized as “economic loss” are not recoverable in a tort action for negligent misrepresentation. The alleged misrepresentations of Arrow solely related to the subject matter of the Agreement. The only damages flowing from the alleged misrepresentations were the same damages for breach of contract, i.e., economic loss. So NewSpin could not recover purely economic losses for the tort-based claim of negligent misrepresentation.

Finally, Judge Flaum ruled on NewSpin’s fraud claims. Recall that the district court dismissed the fraud claims as untimely, viewing them as disguised breach of contract claims. Here, Judge Flaum reversed the district court and left NewSpin’s claims at least alive, if not on life support.

In New York, there is no fraud when the claim relates to a breach of contact. But, reading NewSpin’s complaint as true, Judge Flaum cited a New York case to note that: “a misrepresentation of present fact which is the inducement for a contract is collateral to said contract and can support a separate fraud claim.” Judge Flaum analyzed New York law as distinguishing between a misrepresentation of present facts and a misrepresentation of future intent to perform under the contract. A fraud claim duplicates a breach of contract claim when the only fraud alleged is that the promise to perform was not sincere.

Judge Flaum interpreted NewSpin’s allegations as claims that Arrow misrepresented its experience and past dealings with customers and the status of its own components as they relate to their suitability to NewSpin’s products.

“Taking NewSpin’s allegations as true, as we must at this stage, NewSpin has alleged Arrow materially misrepresented the currently-existing state of its own experience and materials, Arrow knew these misrepresentations were untrue, Arrow made these statements to induce NewSpin to enter into the Agreement, and NewSpin relied upon these misrepresentations in doing so. These allegations are sufficient to maintain NewSpin’s fraud claims independent of its contract-based claims.”

The statute of limitations for fraud claims is five years. The date NewSpin discovered Arrow’s alleged fraud was not clear, but could not have been before mid-2012, when NewSpin received the first batch of defective components. With a complaint filed in January 2017, NewSpin filed within the five-year limitations period. So NewSpin’s fraud claims were permitted to continue.

But all of NewSpin’s breach of contract and contract-related claims are gone. Again, the decision does not discuss the reasons for NewSpin’s delay in filing, so we can only speculate. Regardless of the ultimate outcome, it is clear that NewSpin’s delay was very costly.