

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

U.S. PLASTIC LUMBER, LTD. and
THE EAGLEBROOK GROUP, INC.,

Plaintiffs,

v.

STRANDEX CORPORATION,

Defendant.

CINCINNATI INSURANCE COMPANY,

Intervening Plaintiff,

v.

STRANDEX CORPORATION,
U.S. PLASTIC LUMBER, LTD., and
THE EAGLEBROOK GROUP, INC.,

Defendants in Intervention.

OPINION AND
ORDER

02-C-211-C

In this civil action for monetary relief, plaintiffs U.S. Plastic Lumber, Ltd. and The Eaglebrook Group, Inc. seek damages for the alleged breach of their licensing agreement with defendant Strandex Corporation. The dispute arises out of problems that plaintiffs

experienced with defendant's formula and process for making a wood fiber and plastic composite building material, which plaintiffs used to manufacture outdoor decks. Jurisdiction is present. 28 U.S.C. § 1332(a)(1).

The case is presently before the court on defendant's motion for summary judgment. At issue are defendant's alleged breach of the provision in the license agreement warranting the accuracy of certain information set forth in exhibits to the agreement regarding the composite material's properties, defendant's alleged breach of its agreement to provide its "Know-How" to plaintiffs and defendant's alleged breach of the duty of good faith and fair dealing implicit in any contract. I conclude that plaintiffs waived their right to rescind the license agreement because they agreed instead to amend the agreement to provide substantial financial benefits to plaintiff Eaglebrook and in any case waited too long to seek rescission. In addition, I conclude that when the parties agreed to amend the license agreement in December 1998, the amendment operated as an accord and satisfaction of plaintiffs' claim that defendant breached the warranty in the license agreement regarding the properties of the composite material. Therefore, defendant will be granted summary judgment on that claim. Because it is unclear on the present record whether plaintiffs knew when they agreed to the December 1998 amendment that they had a claim for breach of the know-how disclosure provision, a jury will have to decide whether the parties intended the amendment to be an accord and satisfaction of that claim as well. To the extent defendant seeks

summary judgment on the merits of plaintiffs' know-how claim, its motion will be denied. However, defendant will be granted summary judgment on plaintiffs' claim for breach of an implied duty of good faith and fair dealing because I find that it is duplicative of their claim for breach of the know-how provision. Finally, I conclude that the license agreement's exclusion of liability for consequential damages prevents plaintiffs from seeking to recover their equipment costs as damages for the alleged breach of the know-how provision, but that they may seek to recover the cost of certain raw materials, fees and royalties they paid defendant.

For the purpose of deciding the pending motion, I find from the parties' proposed findings of fact that the following facts are material and undisputed.

UNDISPUTED FACTS

Plaintiff U.S. Plastic Lumber, Ltd. is a Delaware corporation with its principal place of business in Florida. Plaintiff The Eaglebrook Group, Inc. is a Delaware corporation with its principal place of business in Illinois. (Plaintiffs have not proposed any other facts describing plaintiff U.S. Plastic Lumber or the relationship between that entity and plaintiff Eaglebrook. At times plaintiffs refer in their proposed facts to plaintiff Eaglebrook; at other times they refer to plaintiff U.S. Plastic Lumber. From plaintiffs' amended complaint it appears that plaintiff U.S. Plastic Lumber's parent corporation acquired plaintiff Eaglebrook

sometime in late 1998 or early 1999. Nevertheless, plaintiffs refer to these entities interchangeably at times in their proposed facts even when the fact proposed predates the acquisition. I will refer uniformly to plaintiff Eaglebrook unless it appears that a fact postdates the acquisition and thus pertains specifically to both plaintiffs.) Defendant Strandex Corporation is a Wisconsin corporation with its principal place of business in Wisconsin. At all times relevant to this action, Terry Laver was defendant's president and Al England was defendant's executive vice president. George Stauffer was defendant's chief executive officer and primary investor. Michael Dahl was plaintiff Eaglebrook's president for an 11-year period ending in August 2000.

In the early 1990s, Terry Laver invented the "Strandex process," a method for manufacturing products from a wood fiber and plastic composite. The Strandex process involves mixing wood fiber, plastic and various other ingredients and then forcing the mixture through low-temperature extrusion equipment, through a system of dies and through supplementary cooling equipment to produce various products. The Strandex process is used to make products that have wood-like properties that can replace wood and other materials. Defendant employs fewer than 10 employees. It does not manufacture products, but licenses others to use the Strandex technology to manufacture and sell products to the licensees' customers.

On April 22, 1996, defendant and plaintiff Eaglebrook executed a license agreement.

Paragraph eight of the license agreement provides that as the licensor, defendant shall

a. Disclose and make available to the Licensee the Know-How regarding the Licensed Process and Licensed Products (which will include a reasonable amount of Technical Assistance and other support related to Licensee's start-up of its manufacturing of the Licensed Products) at no charge to the Licensee. Such disclosure shall enable the Licensee to produce the Licensed Product using the Licensed Process during the Term of this agreement. . . .

c. Provide the Licensee on an 'as needed basis,' with Technical Assistance during the Term of this Agreement. The Licensee shall, however, (except as set forth in Section 8.a. above) pay the Licensor its standard rates when applicable with regard to providing Technical Assistance, and shall pay all of the Licensor's reasonable expenses associated therewith

"Know-How" is defined in the license agreement as "any information, including, without limitation . . . research records and reports, development reports, experimental and other engineering reports . . . or any other information or other know-how relating to or concerning the Licensed Products or the Licensed Process."

Paragraph 20 of the license agreement sets forth a warranty and disclaimer of product warranties. Paragraph 20 provides that with limited exceptions,

Licensor makes no warranties or representation whatsoever regarding the Licensed Products produced using the Licensed Process, either express or implied, arising by law or otherwise, including but not limited to, implied warranties of merchantability or fitness for a particular purpose. In no event shall the Licensor have any obligation or liability to the Licensee with respect to the production or use of the Licensed Products arising from tort, or for loss of revenue or profit, or for incidental or consequential damages. Subject to the warranties set forth in the next sentence, the Licensee hereby acknowledges and agrees that it is familiar with the Licensed Process and the Licensed Products and has conducted sufficient due diligence with respect thereto prior to entering into this Agreement to satisfy itself as to the utility and

usefulness of the Licensed Process and the Licensed Products.

Licensor hereby represents and warrants to Licensee the accuracy of the information set forth in Exhibits A and B, and the test data attached as Exhibit E [to the license agreement], and acknowledges that the Licensee has relied upon the accuracy of such information and test data, but Licensee acknowledges that such information and test data is based upon tests conducted on Licensed Product produced in Licensor's test facility and that many factors, including without limitation: the type and quality of raw materials; the type of mixing, extrusion and cooling equipment being used; the experience and expertise of equipment operators; and the shape/dimension of the profile being extruded, can have a significant impact on the physical properties and performance properties of the Licensed Product.

Michael Dahl was the individual at plaintiff Eaglebrook primarily responsible for negotiating the license agreement.

Exhibit A to the license agreement is a description of the "performance properties for Strandex." The performance properties described in Exhibit A are those of the "general purpose compound" set forth in Exhibit B. Each of the performance properties described in Exhibit A is set forth with the test method used to derive it. Exhibit A to the license agreement states that (1) under test method ASTM D-1037, the water absorption of Strandex material will be 0.7% and its thickness swell will be 0.2%, and (2) under test method ASTM D-790, the modulus of elasticity will be 504,600 pounds per square inch. The specific test results from which these figures are derived are contained in Exhibit E to the license agreement. "ASTM" refers to the American Society for Testing and Materials and the test methods listed in Exhibit A for water absorption, thickness swell and modulus

of elasticity are protocols published by that organization. Under the ASTM D-1037 test, ponderosa pine, a wood commonly used to make decks, absorbs 17.2% moisture by weight and swells 2.6%. Defendant did not expect moisture absorption or swelling to be a problem with decks made from its material because the ASTM D-1037 test results for Strandex were so much lower than the results for ponderosa pine. Defendant chose the ASTM D-1037 test because it was the standard used to compare the performance of wood composite materials to the expected long-term performance of wood.

Exhibit A specifically notes that the performance property values contained therein represent test results generated by Professional Service Industries, Inc., an independent laboratory, on a general purpose Strandex compound. The independent laboratory tested both a control Strandex product and a Strandex product that had undergone an accelerated aging process for water absorption and thickness swell. At the time defendant and plaintiff Eaglebrook entered into the April 22, 1996 license agreement, defendant believed that the test results from the independent laboratory, attached as Exhibit E to the licence agreement, were completely accurate. It had no test results or information that indicated otherwise. Plaintiff Eaglebrook's president, Michael Dahl, was not aware of the test procedure under ASTM D-1037 and did not seek outside assistance to interpret the ASTM tests noted on Exhibit A and Exhibit E.

In spring 1995, Dahl contacted Laver, defendant's president, to discuss plaintiff

Eaglebrook's interest in becoming a licensee of defendant's Strandex process. In a visit to defendant that spring, Dahl saw the Strandex process being run. Some time before May 5, 1995, Laver gave Dahl a copy of the physical properties of the Strandex product. Between April 1995 and April 1996, when the parties executed the license agreement, defendant provided plaintiff Eaglebrook with samples of product made using the Strandex process.

After plaintiff Eaglebrook and defendant signed the license agreement, defendant provided assistance to Eaglebrook in setting up the necessary extrusion equipment, including mixing and cooling equipment. Laver spent significant time at plaintiff Eaglebrook's facility as it developed its infrastructure to produce Strandex products. Defendant and plaintiff Eaglebrook conferred on almost a daily basis between April 1996 and late 1997.

Crane Plastics Company was another of defendant's licensees. Crane was defendant's first licensee and plaintiff Eaglebrook was its second. By letter dated July 17, 1996, Tanny Crane of Crane Plastics informed defendant's chief executive officer, George Stauffer, of possible moisture absorption concerns with the Strandex material. Defendant's vice president, Al England, worked at Crane at least three days a week for the entire time Crane was involved with defendant. He advised Crane that the tongue-and-groove deck design it used might be a cause of the swelling because water stood on the deck for long periods of time, but subsequent changes to the deck design did not help. In the summer of 1997, plaintiff Eaglebrook noticed cross-sectional swelling of deck planks on test decks that

Eaglebrook had constructed with planks made using Strandex material. At an October 1997 trade show, Tanny Crane told Dahl that Crane had also experienced water absorption problems with deck planks made from Strandex material. When Tanny Crane told Dahl that there might be long-term absorption and swelling problems with Strandex material, Dahl immediately called Al England, defendant's vice president, who assured him that "there is no truth to that."

The first test deck that Crane built with Strandex material failed. (The parties do not agree on when the failure occurred). It absorbed moisture and swelled, pulling loose from its substructure. The failed first test deck consisted of 12-inch wide, hollow tongue-and-groove boards. At some point, Crane informed defendant of the test deck's failure. After the failure of the test deck, Crane began developing its own proprietary immersion test to determine how much moisture absorption and swelling the Strandex material might experience over time. Crane later informed defendant that it had developed such a test. Crane's proprietary immersion test is not a "boiling test," in which a plank is placed in boiling water and which both Crane and defendant regard as unreliable. In July 1996, Crane wrote to defendant that its immersion test showed that the Strandex material "absorb[ed] significantly (12-15 %) more moisture at elevated temperatures than both Trex [a similar product] and Southern Pine." In February 1997, Crane concluded that even solid boards made with Strandex experienced swelling of more than 1% and absorbed 25% moisture by

weight. After a full year of research, Crane concluded in February 1997 that the Strandex process would not work for a tongue-and-groove deck plank unless defendant changed its formula. When defendant missed a meeting in February 1997 with Tim Miller, Crane's vice president and general counsel, Miller sent defendant an update on the moisture problems he had intended to discuss at the meeting, noting that "since this issue may impact your other licensees or prospective licensees, I thought it would be prudent to send you the information now rather than wait until we next meet." Crane informed defendant in June 1997 of its belief that the use "of Strandex in product applications involving significant exposure to moisture can be inappropriate unless the material is painted, capped, coated, or otherwise clad."

Like Crane, plaintiff Eaglebrook used a tongue-and-groove design for its deck planks. Plaintiff Eaglebrook also used a deep brushing process on its planks to make them appear more "wood like" and to reduce slipperiness. Defendant discouraged plaintiff Eaglebrook from using the tongue-and-groove design and the deep brushing technique because the design allowed water to stand on the deck, potentially creating water absorption problems, but defendant never told Eaglebrook not to use a tongue-and-groove design. Defendant knew that plaintiff Eaglebrook planned to produce a hollow, tongue-and-groove deck board similar to Crane's.

Plaintiff Eaglebrook began commercial production of decking material made with the

Strandex process in approximately March 1997. Plaintiff Eaglebrook bought the type and quality of raw materials defendant told it to, used the mixing, extrusion and cooling systems that defendant had selected and used experienced equipment operators. Eaglebrook's first design was not tongue-and-groove, but after a test deck broke when someone jumped on it, Eaglebrook decided that safety concerns required a tongue-and-groove design to spread the impact on the boards so that they would not break under normal wear. The license agreement provides plaintiff Eaglebrook the right to make tongue-and-groove, hollow boards using defendant's process. In 1997, plaintiff Eaglebrook built test decks and observed some dimensional swell of the deck boards. In the summer of 1997, after plaintiff Eaglebrook asked about the swelling it had observed, Laver informed Dahl that Strandex deck boards may swell cross-sectionally up to 1.4%, rather than the 0.2% figure included in Exhibit A to the license agreement. Laver had hinted earlier that deck boards made with Strandex material may swell beyond 0.2% with a tongue and groove design. After defendant told plaintiff Eaglebrook that it might see cross-sectional swelling up to 1.4%, Eaglebrook undertook a costly redesign of its decks and its marketing and distribution strategy. The redesigned deck included spacing between the boards to accommodate the expected cross-sectional swell of 1.4%. In order to insure proper spacing during installation, plaintiff Eaglebrook had to limit distribution of its decking material to authorized, experienced deck builders, rather than selling the material to retail stores like Home Depot. This change

required plaintiff Eaglebrook to shift its marketing focus from homeowners to contractors.

When plaintiff Eaglebrook found in the summer of 1997 that its deck boards were showing a little swelling, defendant said the problem was that the tongue-and-groove design did not allow adequate draining and that the brushed surface retained water longer. Eaglebrook cut notches in the tongues and spaced the boards to allow draining, but problems persisted. Eaglebrook learned in 1998 that the Strandex material was swelling more than 5% in cross-section and 1.8% in length. In February 1998, Eaglebrook found that materials it made with the Strandex process were absorbing more than 10% moisture over 96 hours and over 16% moisture over 144 hours and that the materials were swelling to the point at which buckling deck boards “literally pulled the framing out of place.” In early 1998, plaintiff Eaglebrook informed defendant that it was experiencing some deck failures as a result of swelling. At the time plaintiff Eaglebrook was experiencing water absorption problems, defendant advised it about different raw material formulations that it could use, including using talc in the formulation and increasing the amount of plastic in its mixture. The formula changes that defendant suggested had no data to support them and were merely “seat of the pants” attempts to find a quick solution.

In a March 23, 1998 letter, defendant assured plaintiff Eaglebrook that plaintiff “had in no way been misled regarding the physical properties in Strandex” and that defendant was not “aware of any swell problems anywhere in the past other than when Crane boiled their

deck planks for an extended period of time.” On March 24, 1998, officials from defendant and plaintiff Eaglebrook met in an effort to resolve their outstanding differences. Stauffer, defendant’s chief executive, and Dahl, plaintiff Eaglebrook’s president, negotiated an agreement that both signed on March 24, 1998. The agreement provided for the waiver of the balance of the license fee plaintiff Eaglebrook owed defendant in the amount of \$320,000; a refund to Eaglebrook through credits in the amount of \$180,000, representing the portion of the license fee it had already paid to defendant; and a reduction of Eaglebrook’s royalty payments. On behalf of plaintiff Eaglebrook, Dahl agreed that in exchange for receiving reductions in the royalty rates and license fees, Eaglebrook would redouble its efforts to make the Strandex process work. The agreement became an amendment to the license agreement on December 3, 1998. Paragraph four of the amendment provides that the financial relief plaintiff Eaglebrook received did not in any way “modify the disclaimers set forth in Section 20 of the License Agreement or any other part of Section 20 of the license agreement.”

In the fall of 1998, plaintiff Eaglebrook decided to stop making deck boards with the Strandex process and to use that process only for deck railings and columns. The railings and columns were made with the formula that defendant said had improved moisture resistance. Defendant claimed that the problem with the deck boards was inadequate draining, and railings did not have that problem. Plaintiff Eaglebrook discovered after 1998

that even materials made with the improved formula were failing as a result of moisture absorption and swelling. In 1998, plaintiff Eaglebrook had just two warranty claims from customers whose decks failed due to water absorption. The number of claims increased sharply after that, with 55 new claims in 1999, 31 claims in 2000 and 41 claims in 2001. To date, plaintiffs have received 167 warranty claims since 1999. Plaintiffs abandoned the Strandex process altogether in September 2000. In the fall of 2000, plaintiffs wrote off their inventory of products made with the Strandex process and began trying to sell their equipment. In November 2001, plaintiffs wrote defendant that they would seek legal redress for the losses they suffered from defendant's alleged breach of warranty.

Plaintiffs paid defendant \$266,923 in licensing fees and royalties for a process that ultimately had no value to plaintiffs. Plaintiffs paid \$2,721,401.98 (net of salvage value) for the equipment that defendant said was necessary to produce its material and for the leftover raw material that they had no use for after they stopped using the Strandex process.

OPINION

A. Rescission of the License Agreement

The initial question on rescission is whether plaintiffs waited too long to exercise a right of rescission. In Wisconsin, "the right to rescind must be exercised within a reasonable time, or with 'reasonable promptness,' after discovery of the facts from which it arises."

McKearn v. Lerman Tire Service, Ltd., 32 Wis. 2d 329, 337, 145 N.W.2d 731, 736 (1966) (quoting 17 Am. Jur. 2d Contracts § 510); see also Thompson v. Village of Hales Corners, 115 Wis. 2d 289, 319, 340 N.W.2d 704, 718 (Wis. 1983); Michael B. Apfeld et al., Contract Law in Wisconsin § 14.23 (2d ed. 2002) (“A party seeking to rescind a contract must do so within a reasonable time or risk being found to have waived any right to rescind.”). Waiver may also occur if the party seeking to rescind the contract “affirms the agreement after learning of the fraud or mistake giving rise to the right of rescission.” Thompson, 115 Wis. 2d at 319, 340 N.W.2d at 718. If “the facts of a case are ‘practically undisputed,’ the question of waiver is one of law.” Grube v. Daun, 213 Wis. 2d 533, 551, 570 N.W.2d 851, 859 (1997).

It is undisputed that as early as the summer of 1997, after plaintiff Eaglebrook asked about the swelling it had observed in decks made with the Strandex material, defendant’s president, Terry Laver, informed plaintiff Eaglebrook that deck boards made from Strandex might swell cross-sectionally up to 1.4%, rather than the 0.2% figure cited in Exhibit A to the license agreement. As a result, in December 1998, defendant and plaintiff Eaglebrook agreed to amend the license agreement to give certain financial benefits to plaintiff Eaglebrook. In short, when plaintiff Eaglebrook learned that the quality of the deck boards produced with the Strandex material did not meet what it understood to be the requirements of the license agreement, it opted to obtain concessions from defendant by negotiating an

amendment to the license agreement instead of rescinding the agreement entirely. By “affirm[ing] the agreement after learning of the fraud or mistake giving rise to the right of rescission,” plaintiffs waived that right. Thompson, 115 Wis. 2d at 319, 340 N.W.2d at 718; Grube, 213 Wis. 2d at 551-52, 570 N.W.2d at 859-60. “A party is bound by its election when the party is aware or should have been aware of the facts necessary to make a knowing election between executing and rescinding a contract.” Apfeld et al., Contract Law in Wisconsin § 14.23 (2d ed. 2002).

Plaintiffs argue that they also have an independent right to rescind the license agreement because of defendant’s alleged intentional withholding of critical information, or “Know-How,” pertaining to the suitability of the Strandex process for decking applications. As an initial matter, plaintiffs admit in their briefs that they knew before they agreed to the amendment to the license agreement that defendant “had lied about not knowing about” swelling problems in Strandex deck planks. Plts.’ Br. in Opp’n to Dft.’s Mot. for Summ. J., dkt. #48, at 23. They argue, however, that they did not know the depth and extent of defendant’s alleged concealment and misrepresentation of facts. Even if I accept this argument, I would still conclude that plaintiffs waited too long to seek rescission on this basis. It is undisputed that plaintiffs abandoned the Strandex process altogether in September 2000. Nevertheless, plaintiffs waited more than a year, until November 2001, to notify defendant that they would seek legal redress for an alleged breach of warranty and

they did not file this suit until April 2002. In Thompson, 115 Wis. 2d 289, 340 N.W.2d 704, the Wisconsin Supreme Court considered the plaintiff's effort to rescind a lease for retail space that he used to operate a sandwich shop and video game arcade. A local ordinance prohibited minors from playing coin-operated video games unless they were accompanied by an adult. The plaintiff alleged that when he entered the lease in January 1978, the defendant lessor had represented that there were no legal impediments to the operation of the arcade. The plaintiff did not learn of the ordinance until March 1978. Nevertheless, he reaffirmed the lease in July 1978 and then sought rescission of the lease in November 1978. The court held that the plaintiff had waived his right to rescind by failing to assert it for a full six months after he learned of the ordinance's existence and by subsequently affirming the lease. Id. at 318-319, 340 N.W.2d at 718. By comparison, plaintiffs failed to file suit for nearly 18 months after they finally abandoned the Strandex process, a delay three times longer than the six-month delay found unreasonable for rescission purposes in Thompson. "A party's right to rescind for fraud or mistake is waived if he unreasonably delays in asserting that right *or* affirms the agreement after learning of the fraud or mistake giving rise to the right of rescission." Id. at 319, 340 N.W.2d at 718 (emphasis added); see also Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 440 (7th Cir. 1987) ("A prompt demand for rescission is important in allocating risk among parties. If the investor can wait before selecting the relief he wants, he can shift all of the ordinary

investment risk to the defendant.”). In this case, the 18-month delay by itself is enough to deny plaintiffs the remedy of rescission. Accordingly, I conclude that plaintiffs have waived their right to rescind the contract. Whether they have viable claims for breach of the contract is another question.

B. Accord and Satisfaction

Defendant argues that it is entitled to summary judgment because the December 3, 1998 amendment to the license agreement operated as an accord and satisfaction of plaintiffs’ claims. In the amendment, the parties noted that plaintiff Eaglebrook had “experienced various problems with some of the Licensed Product it has manufactured” and granted Eaglebrook significant reductions in the royalty rates and license fees that it had agreed to pay defendant pursuant to the original agreement. “An ‘accord and satisfaction’ is an agreement to discharge an existing disputed claim; it constitutes a defense to an action to enforce the claim.” Flambeau Products Corp. v. Honeywell Information Systems, Inc., 116 Wis. 2d 95, 112, 341 N.W.2d 655, 664 (1984). Accord and satisfaction “is a long-standing doctrine resting not only on principles of contract law but on principles of sound public policy, that is, interests of resolving disputes informally without litigation and of fairness.” Id. at 110-11, 341 N.W.2d at 663. Plaintiffs argue that the amendment was not intended to discharge the particular claims at issue in this case, making the doctrine of

accord and satisfaction inapplicable. See Rusch v. Sentinel-News Co., 212 Wis. 530, 536, 250 N.W. 405, 407 (1933) (accord and satisfaction requires “a meeting of the minds of the parties”). “Whether, on a set of undisputed facts, the doctrine of ‘accord and satisfaction’ provides the basis for summary judgment[] presents an issue of law.” Zubek v. Edlund, 228 Wis. 2d 783, 788, 598 N.W.2d 273, 276 (Ct. App. 1999). Therefore, I must determine whether the undisputed facts show that the parties intended the amendment to the license agreement to discharge the claims at issue in this case.

From the undisputed facts, I conclude that the amendment to the license agreement was intended to discharge any claim that defendant had breached the warranty established in paragraph 20 of the license agreement regarding the accuracy of the information set forth in Exhibits A, B and E to the agreement. Exhibit A to the license agreement is a description of the performance properties for Strandex; the performance properties described in Exhibit A are those of the “general purpose compound” set forth in Exhibit B; Exhibit A states that the water absorption of Strandex material will be 0.7%, and its thickness swell will be 0.2%; and the specific test results from which these figures are derived are contained in Exhibit E to the license agreement. By the time the parties agreed to the amendment to the license agreement in December 1998, it is undisputed that all of the following had transpired: (1) plaintiff Eaglebrook knew that test decks it had built in 1997 showed some dimensional swell of the deck boards; (2) defendant had informed plaintiff Eaglebrook in 1997 that deck

boards made with Strandex material could swell cross-sectionally up to 1.4%, rather than the lower 0.2% figure included in Exhibit A to the license agreement; (3) plaintiff Eaglebrook learned in early 1998 that the Strandex material was swelling more than 5% in cross-section and 1.8% in length; (4) in February 1998, plaintiff Eaglebrook found that materials it made with the Strandex process were absorbing more than 10% moisture over 96 hours and more than 16% moisture over 144 hours; and (5) plaintiff Eaglebrook observed Strandex decking materials swelling so much that buckling deck boards “literally pulled the framing out of place.”

In light of these undisputed facts, it is simply not credible for plaintiffs to argue that the amendment was not intended to compensate plaintiff Eaglebrook for defendant’s failure to provide reliable information on the Strandex material’s properties in the original license agreement. By the time the parties agreed to the amendment, they were well aware that the information detailing these properties in the original license agreement was at best misleading and at worst flatly inaccurate. In the amendment, defendant acknowledged the “various problems” with “the Licensed Product [that plaintiff Eaglebrook] has manufactured” and agreed to provide Eaglebrook with significant financial concessions by way of compensation. If plaintiffs could recover on a breach of contract claim stemming from the misleading information in the license agreement’s exhibits even after extracting these concessions, they would be having their cake and eating it too. The only reasonable

conclusion is that one purpose of the amendment was to discharge any claim stemming from the unreliable information in the original agreement. Accordingly, defendant will be granted summary judgment as to this claim.

That leaves plaintiffs' claim that defendant breached the express provisions of paragraph eight of the license agreement, involving disclosure of the "Know-How" relating to the Strandex process, by withholding from plaintiffs critical information pertaining to the suitability of the Strandex process for decking applications. The question is whether the amendment to the license agreement was intended to operate as an accord and satisfaction of this claim too. For the following reasons, I conclude that factual disputes do not allow this issue to be resolved on summary judgment.

Paragraph eight of the license agreement provides that defendant will "[d]isclose and make available to the Licensee the Know-How regarding the Licensed Process and Licensed Products." "Know-How" is defined in the license agreement as "any information, including, without limitation . . . research records and reports, development reports, experimental and other engineering reports . . . or any other information or other know-how relating to or concerning the Licensed Products or the Licensed Process." The undisputed facts show that in February 1997, another of defendant's licensees, Crane Plastics, concluded from its immersion test that the Strandex process would not work for a tongue-and-groove deck plank unless defendant changed its formula. Crane's general counsel told defendant of its

conclusion (the parties dispute whether Crane disclosed only its conclusion or the actual test results as well), noting that “since this issue may impact your other licensees or prospective licensees, I thought it would be prudent to send you the information now rather than wait until we next meet.”

Although defendant is seeking summary judgment on the ground that it disclosed all relevant information to plaintiffs, it has failed to demonstrate that it actually did so. This omission may be particularly relevant given that in March 1997, plaintiff Eaglebrook began manufacturing decking using the Strandex process and shortly thereafter began using a similar tongue-and-groove design for its deck boards. Moreover, in June 1997, it is undisputed that Crane informed defendant of its belief that the use “of Strandex in product applications involving significant exposure to moisture can be inappropriate unless the material is painted, capped, coated, or otherwise clad.” Again, there is no evidence that defendant told plaintiff Eaglebrook about Crane’s belief. In October 1997, Crane’s president told plaintiff Eaglebrook’s president that Crane was experiencing water absorption problems with Strandex deck planks, but when plaintiff Eaglebrook asked defendant’s vice president, Al England, about this, England assured Eaglebrook that “there is no truth to that.” Finally, in a March 23, 1998 letter, defendant assured plaintiff Eaglebrook that it was not “aware of any swell problems anywhere in the past other than when Crane boiled their deck planks for an extended period of time,” even though defendant knew that the information Crane had

reported to it was a result of an immersion test, rather than the discredited boiling test.

All of these facts suggest that plaintiffs are correct in contending that the parties did not intend the December 3, 1998 amendment to the license agreement to be an accord and satisfaction of claims stemming from defendant's failure to fulfill its obligations under the know-how provision. At the time plaintiff Eaglebrook agreed to the amendment, it was unaware of the information that defendant allegedly withheld. A party cannot reach an accord resolving claims of which it is unaware. However, there is one hitch: plaintiffs admit in their proposed findings of fact that on December 2, 1998, the day before the amendment to the license agreement was formalized, plaintiff Eaglebrook learned from Crane that "Crane had significant swelling problems that it had shared with Strandex" and that "Crane had developed swelling data that it shared with Strandex." Plts.' Proposed Findings of Fact, dkt. #45, at ¶ 97. Thus, plaintiffs admit that "Eaglebrook did learn on December 2, 1998 that Strandex had lied about not knowing about other swelling problems." Plts.' Br. in Opp'n to Dft.'s Mot. for Summ. J., dkt. #48, at 23. Therefore, a reasonable jury might conclude that plaintiffs were aware that defendant had violated its obligation to provide know-how and that the parties intended to address the claim in the amendment to the license agreement that was signed the next day. Plaintiffs counter this argument by maintaining that when Eaglebrook signed the amendment it was unaware of the *full extent* of defendant's alleged failure to provide know-how. Plaintiffs argue, for instance, that

plaintiff Eaglebrook was unaware that Crane had informed defendant specifically that a tongue-and-groove design would not work unless defendant altered the original Strandex formula. As it now stands the record does not permit a determination of precisely what information plaintiff Eaglebrook and defendant each possessed when they signed the amendment on December 3, 1998. Neither party has made it clear what discussions they had and what information was disclosed regarding know-how before they signed the amendment. Accordingly, it will be necessary for a jury to decide whether the amendment to the license agreement constitutes an accord and satisfaction of plaintiffs' claims that defendant breached the agreement's know-how provision by withholding important information. See Johann v. Milwaukee Electric Tool Corp., 264 Wis. 447, 454, 59 N.W.2d 637, 640 (1953) (question whether agreement amounted to accord and satisfaction is for jury where facts point in both directions).

C. Express Duty to Disclose Information

_____ Defendant argues that even if the amendment to the license agreement was not an effective accord and satisfaction, it is entitled to summary judgment on plaintiffs' claim that it breached its express promise to disclose know-how regarding the licensed process and products. As an initial matter, I note that plaintiffs' amended complaint does not contain a claim specifically alleging a breach of the know-how provision. Rather, in their amended

complaint, plaintiffs refer to defendant's alleged failure to disclose information as a breach of an implied duty of good faith. However, plaintiffs' reliance on a new legal theory is unproblematic because they raised the issue of a breach of the express know-how provision clearly in their summary judgment brief. See Plts.' Br. in Opp'n to Dft.'s Mot. for Summ. J., dkt. #48, at 8, 13-14 (plaintiffs' "claim is that Strandex breached the *express* provisions of the contract, including the duty to disclose information about its process and products.") (emphasis in original); Albiero v. City of Kankakee, 122 F.3d 417, 419 (7th Cir. 1997) (noting that "a plaintiff may substitute one legal theory for another without altering the complaint" and "may supplement the complaint with factual narration in an affidavit or brief"). Defendant responded to plaintiff's new theory by arguing that the know-how provision's disclosure obligations were limited in scope and that in any case it had disclosed all relevant information to plaintiff Eaglebrook. See Dft.'s Reply Br. in Supp. of Summ. J. Mot., dkt. #55, at 41-45.

I will deny defendant's summary judgment motion on plaintiffs' claim for breach of the know-how provision. Summary judgment is inappropriate on the current record. As discussed earlier, paragraph eight of the license agreement provides that defendant will disclose know-how to plaintiffs, defined as "any information, including, without limitation . . . research records and reports, development reports, experimental and other engineering reports . . . or any other information or other know-how relating to or concerning the

Licensed Products or the Licensed Process.” Too many facts are disputed regarding precisely what information defendant received about the licensed process from its other licensees, when it received the information and to what extent it disclosed it to plaintiffs. Moreover, there exist undisputed facts that could lead a reasonable jury to conclude that defendant breached the know-how disclosure provision. For instance, for purposes of defendant’s summary judgment motion, it is undisputed that in a March 23, 1998 letter, defendant assured plaintiff Eaglebrook that it was not “aware of any swell problems anywhere in the past other than when Crane boiled their deck planks for an extended period of time,” even though defendant knew that the information Crane had reported resulted from an immersion test, rather than an unreliable boiling test. In addition, I find unpersuasive defendant’s half-hearted argument that paragraph eight of the license agreement “seems to mean” that the parties limited the know-how disclosure provision’s obligations to some undefined “start-up” period. Accordingly, trial will go forward on plaintiffs’ claim that defendant breached the “Know-How” disclosure provision of the license agreement.

D. Implied Duty of Good Faith

Plaintiffs maintain that in failing to disclose know-how regarding the licensed process and products, defendant breached an implied duty of good faith and fair dealing. Wisconsin common law reads a duty of good faith into every contract. See Market Street Associates

Limited Partnership v. Frey, 941 F.2d 588, 592 (7th Cir. 1991). In other words, “a contract obligates the parties to cooperate in its performance in ‘good faith’ to the extent necessary to carry out the purpose of the contract.” Id. at 596; see also Wisconsin Natural Gas Co. v. Gabe’s Construction Co., Inc., 220 Wis. 2d 14, 21, 582 N.W.2d 118, 121 (Ct. App. 1998) (a contract’s express terms “must be performed subject to [the] implied covenant”).

Plaintiffs’ good faith claim is little more than a repackaging of their claim that defendant breached the know-how provision of the license agreement by failing to disclose information concerning the licensed process. Good faith “is a compact reference to an implied undertaking not to take opportunistic advantage in a way that could not have been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties.” Market Street, 941 F.2d at 595 (quoting Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351, 1357 (7th Cir. 1990)). It applies most urgently to unforeseen circumstances that arise during the performance of a contract, when “the explicit terms of the contract become progressively less apt to the governance of the parties’ relationship.” Id. at 595-96. Here, by contrast, the parties negotiated an explicit provision governing the disclosure of know-how. Plaintiffs maintain that defendant breached that provision. Defendant argues that it complied with it. Which party has the better of the argument remains to be determined, but there is no contractual gap to fill through application of the good faith doctrine. See Kham & Nate’s Shoes, 908 F.2d at 1357. Any

breach of contract might conceivably be viewed as a violation of the obligation to act in good faith, but that would rob the implied duty of good faith of any distinctive function and give “every plaintiff . . . an incentive to include bad faith allegations in every contract action.” Northview Motors, Inc. v. Chrysler Motors Corp., 227 F.3d 78, 92 (3rd Cir. 2000). As the Court of Appeals for the Seventh Circuit has explained, “[i]nequitable conduct’ in commercial life means breach *plus* some advantage-taking, such as the star who agrees to act in a motion picture and then, after \$20 million has been spent, sulks in his dressing room until the contract has been renegotiated.” Kham & Nate’s Shoes, 908 F.2d at 1357. An obvious parallel would arise if plaintiffs were alleging that defendant withheld critical information concerning the suitability of the Strandex material for decking applications in an effort to force plaintiffs to agree to make higher royalty payments. But that is not the case. The dispute is whether defendant complied with the explicit know-how provision that the parties inserted into the license agreement. Accordingly, I will grant defendant’s motion for summary judgment as to plaintiffs’ good faith claim.

E. Damages Limitation

Defendant argues that regardless whether it breached the license agreement’s know-how provision, it is entitled to summary judgment because all of the damages that plaintiffs seek to recover are excluded expressly by the terms of the agreement. Paragraph 20 of the

license agreement provides that defendant is not liable “to the Licensee with respect to the production or use of the Licensed Products arising from tort, or for loss of revenue or profit, or for incidental or consequential damages.” The issue is whether plaintiffs’ losses are appropriately characterized as “direct” damages rather than consequential ones and thus not excluded by the contract.

Two preliminary points. First, Wisconsin common law recognizes a distinction between direct and consequential damages. See, e.g., Ollerman v. O’Rourke Co., Inc., 94 Wis. 2d 17, 53, 288 N.W.2d 95, 112-113 (1980) (noting that in intentional misrepresentation case plaintiff may recover for indirect or consequential damages caused by misrepresentation in addition to or in lieu of direct damages); Trio’s Inc. v. Jones Sign Co., Inc., 151 Wis. 2d 380, 381-82, 444 N.W.2d 443, 444 (Ct. App. 1989) (noting that appeal covered only consequential damages rather than direct damages awarded by jury). Second, a disclaimer of consequential damages in a contract does not operate as a disclaimer of liability for direct damages as well. See Turk v. H.C. Prange Co., 18 Wis. 2d 547, 565, 119 N.W.2d 365, 376 (1963) (contractual exclusion of liability for consequential damages does not also serve to exclude liability for direct damages).

Assuming for the moment that the license agreement was breached, the question is whether the licensing fees and royalties plaintiffs paid and the money they spent on the equipment and raw materials are appropriately categorized as direct or consequential

damages under Wisconsin law. In Rexnord Corp. v. DeWolff Boberg & Assocs., Inc., 286 F.3d 1001, 1004 (7th Cir. 2002), the Court of Appeals for the Seventh Circuit noted that “[c]ontract law distinguishes between direct and consequential damages, the difference lying in the degree to which the damages are a foreseeable (that is, a highly probable) consequence of a breach.” Direct damages are “utterly foreseeable” and an ordinary result of a breach, while consequential damages are less foreseeable. Id. Consequential damages arise from “special circumstances” and are typically unrecoverable unless the defendant was notified of their existence. Evra Corp. v. Swiss Bank Corp., 673 F.2d 951, 955-56 (7th Cir. 1982). Rexnord and Swiss Bank are cases applying Indiana and Illinois law, respectively, but the situation is no different in Wisconsin. “In the event that there are special circumstances surrounding the contract, and damages result in consequence of those special circumstances, such consequential damages are recoverable if, and only if, those special circumstances were communicated to or known by both parties to the contract at the time they entered into the contract.” Apfeld et al., Contract Law in Wisconsin § 13.28. That is the rule of Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854), which defendant labels “old and trite,” but which nonetheless is adhered to by Wisconsin courts. See, e.g., State Farm Mutual Automobile Insurance Co. v. Ford Motor Company, 225 Wis. 2d 305, 327, 592 N.W.2d 201, 210 (1999) (citing Hadley for proposition that “consequential damages such as lost profits[] must be a foreseeable result of a breach of the contract”).

Plaintiffs rely primarily on Rexnord, 286 F.3d 1001, a case that suggests that plaintiffs cannot recoup their entire investment in equipment and raw materials. Rexnord involved the breach of a contract between a manufacturer and a consulting firm. In the contract, the consulting firm promised the manufacturer that it would design and install effective management systems, train supervisors and determine optimal staffing requirements. The consulting firm estimated that its work would result in an annual savings to the manufacturer of four million dollars, but if these savings failed to materialize, the consulting firm agreed to refund a portion of its fees. The four million in savings never materialized because of the consulting firm's "breaches . . . of specific promises in the" contract. Rexnord, 286 F.3d at 1003. Nevertheless, the firm refused to refund any part of its fee. Id. The court of appeals concluded that the consulting firm's refusal to refund any part of its fee was an example of direct damages, because it meant that the manufacturer had paid more for the consulting firm's services than it had agreed to in the contract. By contrast, the damages stemming from the firm's breach of the various promises in the contract (e.g., the consulting firm's failure to determine optimal staffing requirements) were consequential, because they were more difficult to foresee and "depended to a large extent on matters internal to the" manufacturer. Id. at 1004.

Similarly, plaintiffs cannot recoup their entire investment in equipment and raw materials because these damages do not flow directly from defendant's alleged breach of the

license agreement's know-how provision and were thus not an entirely foreseeable result of that breach. Know-how is defined broadly in the license agreement as any information relating to the licensed process. No reasonable jury could conclude that at the time the parties entered into the license agreement they understood that if defendant failed at any time to disclose *any information* regarding the licensed process, defendant would be on the hook for the entire cost of plaintiffs' equipment and raw materials. See E. Allan Farnsworth, Farnsworth on Contracts § 12.14 at 257 (2d ed. 1998) ("The question is not what was foreseeable at the time of the breach, but what was foreseeable at the time of contracting."). Indeed, the equipment necessary to produce the Strandex material was not sold under the terms of the license agreement. Rather, the license agreement simply notes that it is up to plaintiff Eaglebrook to select the necessary equipment, albeit with defendant's assistance. For this reason, the full cost of the equipment and materials was not an "utterly foreseeable" result of the breach of the know-how provision and therefore cannot accurately be characterized as direct damages.

In addition, "the party seeking to establish damages has the burden to demonstrate that the damages were caused by the breach." Apfeld et al., Contract Law in Wisconsin § 13.27. There is no indication that plaintiff purchased any equipment *after* defendant allegedly breached the know-how provision. Accordingly, even if defendant had complied with the know-how provision, plaintiffs would still be stuck with the equipment that plaintiff

Eaglebrook purchased to manufacture the licensed product. In this sense the know-how provision differs materially from the warranty established in paragraph 20 of the license agreement dealing with the Strandex material's physical properties. If, as plaintiffs allege, the Strandex process was incapable from the beginning of producing usable material of a quality consistent with the license agreement's warranty, plaintiffs would have a good argument that the money they spent on equipment and materials in reliance on the warranty is recoverable. However, as noted above, plaintiff Eaglebrook bargained away such a warranty claim when it agreed to amend the license agreement. By contrast, the know-how provision represents an ongoing obligation on the part of defendant to disclose a broad range of information. It was not breached until some time after plaintiff Eaglebrook purchased its equipment. According to plaintiffs' theory, any breach of this obligation, no matter when it occurred, entitles them to retroactively recover all of their initial investment in equipment. This theory ignores the requirement that plaintiffs are entitled to only those damages "necessarily flowing from the breach." Denhart v. Waukesha Brewing Co., 21 Wis. 2d 583, 595, 124 N.W.2d 664, 670 (1963). Plaintiffs cannot recover their manufacturing equipment costs because they did not purchase equipment as a result of defendant's alleged failure to disclose know-how.

However, plaintiffs may be able to recover a limited amount of damages representing the cost of raw materials they purchased *after* the know-how provision was breached, if any.

If a jury finds that defendant breached the know-how provision by failing to disclose information indicating that the Strandex material was not suitable for building decks, it could reasonably conclude that any money plaintiffs spent on raw materials following the breach is a foreseeable item of direct damage, because proper disclosure might have led plaintiff Eaglebrook to halt production of the Strandex material.

Plaintiffs also seeks to recover the licensing fees and royalties they paid defendant. Unlike the equipment and raw materials, which were not sold under the license agreement, the licensing fees and royalty rate are described in detail in the agreement. Plaintiffs paid the fees and royalties partly in consideration for defendant's commitment to disclose know-how. Defendant's alleged failure to uphold its end of the bargain means plaintiffs paid for something that they did not receive. When, as a result of a seller's breach, a buyer pays more for a service than it agreed to in the contract, the overpayment is an item of direct damages. Rexnord, 286 F.3d at 1004. Accordingly, this item of damages is not excluded by the contract. In summary, plaintiffs are not precluded by the terms of the license agreement from seeking damages to compensate them for the raw materials they purchased following the alleged breach of the know-how provision and for the sums they paid to defendant in the form of royalties and licensing fees. This is not to say that plaintiffs are entitled to these damages. That is for a jury to decide.

ORDER

IT IS ORDERED that

1. Defendant Strandex Corporation's motion for summary judgment on plaintiffs U.S. Plastic Lumber, Ltd.'s and The Eaglebrook Group, Inc.'s claim that defendant breached the warranty established in paragraph 20 of the license agreement regarding the accuracy of the information set forth in Exhibits A, B and E to the license agreement is GRANTED;

2. Defendant's motion for summary judgment on plaintiffs' claim for breach of the "Know-How" disclosure provision of the license agreement is DENIED; and

3. Defendant's motion for summary judgment on plaintiffs' claim that defendant breached an implied duty of good faith and fair dealing is GRANTED.

Entered this 7th day of February, 2003.

BY THE COURT:

BARBARA B. CRABB
District Judge

