IN THE UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WISCONSIN

MARK NEUSER and ARLAN and
MARCIA HINKLEMANN, individually
and on behalf Wisconsin
residents similarly situated,

Plaintiffs,

v.

MEMORANDUM AND ORDER
06-C-645-S

CARRIER CORPORATION,

Defendant.

Plaintiff Mark Neuser commenced this products liability class action in the Circuit Court for Dane County Wisconsin, alleging that defendant Carrier Corporation manufactures and sells high efficiency furnaces with defective secondary heat exchangers which fail prematurely. Plaintiff alleged claims for negligence, fraud and misrepresentation, violation of Wisconsin's deceptive and unfair trade practices law, breach of warranty and unjust enrichment. The case was removed to this Court pursuant to diversity of citizenship, 28 U.S.C. §§ 1332, 1441 and 1446. On December 8, 2006 a second amended complaint was filed adding Arlan and Marcia Hinklemann as plaintiffs. On March 29, 2007 plaintiffs filed a third amended complaint which abandons most of the previous claims, alleging a single contract claim for fraudulent inducement to purchase.

Plaintiff's motion to certify the class, originally filed on February 16, was delayed by the filing of the third amended complaint which necessitated a filing of additional briefs, the last of which was filed on April 6, 2007. On April 2, 2007 defendant moved for summary judgment on the single remaining claim. Both motions are now fully briefed and before the Court. The following facts are undisputed and relevant to one or both motions.

FACTS

Defendant manufactures and sells high efficiency furnaces. It markets its furnaces as high quality products, emphasizing and promoting the Carrier brand. Defendant is the largest furnace manufacturer in the United States and in 1990 held a 22% market share in gas furnaces. Defendant sells its high efficiency furnaces to independently owned distributors. Distributors resell the furnaces to independent dealers, who resell them to consumers. The expected useful life of a home furnace is twenty years. Defendant provides a manufacturer's warranty to the ultimate furnace purchaser. Defendant has sold hundreds of thousands of high efficiency furnaces in Wisconsin during the relevant period.

High efficiency furnaces employ secondary heat exchangers to extract heat from furnace gases through condensation thereby increasing efficiency from 80% to 90%. The condensate formed in the secondary heat exchanger of high efficiency furnaces is typically

acidic and corrosive. Hydrochloric acid is formed in the condensate if combustion air contains chlorides. Sulfuric acid is formed from sulfur in fuels and fuel odor additives. The type and strength of acid varies with the combustion components.

Prior to 1988 defendant's furnaces included secondary heat exchangers manufactured from corrosion resistant stainless steel, the standard material in the industry for that application. Beginning in about 1983 defendant undertook research to develop a material for secondary heat exchangers which would withstand the corrosive nature of the flue gas condensate for an acceptable number of years and would be less expensive than stainless steel. Defendants product development team ultimately endorsed a material consisting of less expensive galvanized steel laminated with corrosion resistant polypropylene. In February 1987 defendant applied for a patent on the PPL metal laminate heat exchanger, which issued as U.S. patent 4,738,307 on April 19, 1988. In October 1888, defendant's corporate engineering services department issued a report based on testing it had performed regarding the durability of PPL steel heat exchanger which concluded that PPL steel exchangers would have a service life of at least 20,000 hours, the design life of the furnace.

In 1988 defendant began manufacturing furnaces which included secondary heat exchangers made from PPL steel. In 1993 plaintiff redesigned its heat exchangers but continued to use PPL steel.

Beginning in 1995 defendant began receiving reports of field failures of PPL steel secondary heat exchangers, particularly in propane applications. By 2002 warranty claim rates were increasing, causing one of defendant's employees to note: "As much as I am hoping this is not the case, I fear that we have a PPL or product design issue to deal with." Product reputation suffered and market share declined. Failure rates for propane application were five times those of natural gas. By 2004 defendant estimated that the failure rate of the furnaces used with propane was nearly 50% over the twenty year life of a furnace. Failure rates for furnace models with multi-speed fans were higher than models with single speed fans. In 2005 defendant modified the design to replace the aluminized steel coupling box with stainless steel, but left the PPL steel secondary heat exchanger in place.

The failure process of the PPL secondary heat exchangers is as follows. During the operation of defendant's furnaces PPL in the secondary heat exchanger is exposed to temperatures in excess of its tolerance and peels away from the mild steel, exposing the steel to corrosive condensate. The resulting corrosion introduces solids into the condensate which plugs the system causing the condensate to back up and damage other furnace components. This causes a variety of operational problems and ultimately causes the furnace to fail prematurely. In some instances the corrosion causes a perforation of the secondary heat exchanger and results in carbon monoxide leaking from the furnace.

In 2000 plaintiff Neuser purchased a home equipped with a Carrier high efficiency furnace which had been installed in 1993 or 1994. On April 1, 2006 the furnace began emitting carbon monoxide because the secondary heat exchanger had corroded and failed. On April 3, 2006 plaintiff Neuser purchased a new high efficiency Carrier furnace to replace the failed furnace. Pursuant to its warranty, defendant credited plaintiff with $400 against the purchase of the new furnace. At the time of purchase, plaintiff Neuser was provided with a limited warranty which provided:

> FIVE YEAR LIMITED WARRANTY – Carrier (hereinafter referred to as "Company") warrants this furnace to be free from defects in materials and workmanship. If a defect is found within five years from the date of original installation of furnace (whether or not use begins on that date) Company will provide a new or remanufactured part at Company's sole option, to replace any defective part, without charge for the part itself.
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> * * *
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> B. LIFETIME LIMITED WARRANTY ON HEAT EXCHANGER ONLY – The Company warrants to the original purchaser, during his or her lifetime, that the heat exchanger will be free from defects materials and workmanship: provided, however, this warranty will apply only to the original installation of the furnace in a single family dwelling ....
>
> The Company's warranty obligation in A or B above shall be, at its sole option, to provide a new heat exchanger without charge for the heat exchanger itself....

> None of these warranties include labor or other costs incurred for diagnosing, repairing, removing, installing, shipping, servicing or handling of either defective parts, or replacement parts, or new units.

On June 6, 1994, plaintiffs Arlan and Marcia Hinkelmann purchased a new carrier high efficiency furnace for use with propane. In fall of 2006 the secondary heat exchanger failed and the furnace could only warm the house to 51° F. The Hinkelmanns purchased a replacement furnace from a competitor of defendant without making a warranty claim.

MEMORANDUM

Plaintiffs pursue a contract claim for fraud in the inducement. To prevail on this claim each plaintiff must prove that defendant (1) knew the PPL secondary heat exchangers in its furnaces would probably fail before the end of the twenty year expected life of the furnaces; (2) intentionally concealed this fact with intent to induce the purchase; (3) purchaser relied on the assumed durability of the furnace components, including the heat exchangers, and was damaged by the purchase. See Ollerman v. O'Rourke Co., Inc., 94 Wis. 2d 17, 25-27, 288 N.W.2d 95 (1979). As contract remedies, plaintiffs seek recision of the furnace purchase contracts or damages for breach.

Plaintiffs seek to certify the following class of plaintiffs: All individuals and entities in the State of Wisconsin that own or

owned high-efficiency furnaces manufactured by Carrier since January 1, 1988. Plaintiff contends that common issues of fact and law predominate among members of this class and that it would be fair and efficient to proceed as a class. Defendant opposes class certification arguing that the class is inappropriately defined and that it does not satisfy the requirements of Rule 23.

Defendant seeks summary judgment on the basis that plaintiffs' claims are barred by the economic loss doctrine, that plaintiff had no duty to disclose the alleged defect and that no purchase contract exists between plaintiffs and defendant. Plaintiffs contend that the economic loss doctrine is inapplicable, that the elements of fraud in the inducement can be established and that defendant is contractually obligated to plaintiffs on an apparent agency theory.

Class Certification

Fed. R. Civ. P. 23 requires a two-step analysis to determine whether class certification is appropriate. See Rosario v. Livaditis, 963 F.2d 1013, 1017 (7th Cir. 1992). Determining whether class certification is appropriate first requires consideration of the four threshold prerequisites of Rule 23(a): numerosity, commonality, typicality and adequate representation. If the four threshold requirements are met, plaintiffs must satisfy at least one of the three subdivisions of Rule 23(b). Plaintiffs

seek certification based on Rule 23(b)(3): "Questions of law or fact common to members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."

Implicit in the class certification process is determining whether an appropriate class exists and has been defined. Simer v. Rios, 661 F.2d 655, 669 (7th Cir. 1981); 7A Charles Alan Wright, Arthur R. Miller and Mary Kay Kane, Federal Practice and Procedure, § 1760 (3d ed. 2005); In re Copper Antitrust Litigation, 196 F.R.D. 348, 353 (W.D. Wis. 2000). The class cannot be so broad that it includes numerous individuals who are unlikely to have the claim being litigated. Wright, supra, § 1760 at n. 12. Adashunas v. Negley 626 F.2d 600, 604 (7th Cir. 1980). The class must be manageable in the sense that the court is able to identify and notify the members. Hardy v. City Optical, Inc., 39 F.3d 765, 771 (7th Cir. 1994).

Appropriateness of Class. The class proposed for certification is inappropriate because most of its members have no claim. Under the theory of liability a purchaser is damaged (an essential element of the claim) only if the purchaser bought a furnace with a PPL heat exchanger falsely believing that it had a twenty year life span because of defendant's failure to disclose the defective nature of the heat exchanger. The proposed class includes three categories of members who have no claim. First, a

number of the class members purchased a furnace which was equipped with a stainless steel heat exchanger. These include most 1988 purchasers because defendant did not incorporate PPL exchangers into its furnaces until sometime near the end of 1988. Purchases of non-PPL furnaces likely extended beyond 1988 as remaining inventory was sold.

Second, those class members who sold homes prior to furnace failure (like plaintiff Neuser's home seller) clearly sustained no damages and have no basis to rescind a contract for the purchase of a furnace they have subsequently resold. There are probably many class members in this category since the average period of home ownership is shorter than the average life of a furnace. The possible alternatives in dealing with the inevitable inclusion of these class members is inappropriate overpayment of damages, see In re Bridgestone/Firestone, Inc., 288 F.3d 1012, 1017 n. 10 (7th Cir. 2002), or an unmanageably cumbersome process of eliminating these class members from the class.

The most troubling category of class members who have no claim are those whose furnaces will last more than the expected twenty years. While there is wide factual dispute concerning these numbers it appears certain that most of the class falls in this category. The effect of the design defect is an increase in failure rate across models and applications of furnaces with PPL exchangers. While failure rates are certainly greater than the two percent warranty claim rate advanced by defendant's expert, it is

apparent that the failure rate is far less than half the furnaces based on the evidence that a possible 50% of propane applications will fail prematurely and that failure rates in propane applications are five times greater than those of natural gas applications.

Thus, most identified class members have no claim because they will fall within one of the identified categories of class members with no damages. The number of class members with no claim is too large to make the class reasonable. Furthermore, while it might be possible to specifically identify claimless class members in the first two categories, it is impossible to distinguish class members whose furnaces will fail from those who will not. The class of plaintiffs for which certification is sought is too broad and there is no reasonable means to reduce it to those individuals who might actually have claims similar to those of the named plaintiffs. Adashunas, 626 F.2d at 604. Even assuming that a reasonable and ascertainable class could be developed, the Rule 23 factors would not lead to class certification.

Numerosity. The number of potential plaintiffs is sufficiently numerous to warrant class certification.

Commonality. The principal factual issues in dispute are not common to the proposed class. Plaintiffs argue at length that the mechanism for failure of the PPL secondary heat exchangers is common among all furnaces and in all conditions. That is,

plaintiff contends that whether incorporating a single speed or multi-speed fan, whether used with natural gas or propane and regardless of environmental conditions, the ultimate process of deterioration of the heat exchanger is the same and therefore presents a common question of fact. The principal issue in the case, however, is not how or whether the component is likely to fail but when it is likely to fail. All furnaces will eventually fail. Furnaces which fail after twenty years do not support a claim.

The claim at issue is that plaintiff expected a twenty year furnace life span, that the defendant's furnaces would not last twenty years, and that defendant knew the furnaces would not last twenty years at the time of the sale but intentionally failed to disclose this to deceive the purchaser. Assuming the mechanism of failure is the same, the time it takes for the failure to occur varies considerably depending on the model of the furnace and its application, and timing is the key factual issue in the case. Indeed, plaintiffs acknowledge that they "do not dispute that some models such as the variable speed model will fail earlier than others." plaintiff's class certification reply brief at 15. Even more dramatic is the distinction between failures of propane fired furnaces, which produce a five times higher condensate acid concentration than natural gas and is therefore likely to fail much sooner. Adding to the degree of difference between claims of

individual plaintiffs are the effects of installation and operation. Finally, warranty claims indicate that timing of failure varies considerable among the three generations of furnaces employing the PPL exchangers.

Considered together it is apparent that the variety of factors that influence the life expectance of a furnace will make the issue of likelihood of premature failure different for a wide variety of furnace models and uses. As a result there is little commonality between class members on the key issue in the case.

Typicality and adequacy of representation. Consideration of these categories, which are related to the commonality issue, further demonstrate why certification of the proposed class is inappropriate. Plaintiff Neuser presents two claims neither of which is typical of the majority of class members. Plaintiff Neuser's first claim is based on his home purchase which included a furnace. This claim is atypical insofar as the remaining claim depends on a finding of agency between his seller and defendant. That inquiry would be very different than in the typical case where a furnace was purchased from one of defendant's dealers.

Plaintiff Neuser's second claim is atypical because it involves a 2006 purchase of the third generation PPL furnace. This claim is not typical because very few of the other class members purchased the most recently designed furnace. It is also not typical because it will be far easier to prove defendant's

knowledge of defect in 2006 than for the great majority of earlier purchasers. By 2006 defendant had received decades of failure reports on the PPL exchangers which could support a claim of intentionally withholding information. In contrast, the evidence is scant that defendant believed the furnaces would fail when they first entered the market in 1989. In fact, it is highly unlikely that a rational manufacturer who has positioned its brand to represent high quality would intentionally sell a defective product which would inevitable damage the brand, lead to high warranty costs and lost market share. In light of this powerful inference, proof of Neuser's 2006 claim is far different than earlier purchasers and his adequacy of representation is diminished because he has no incentive to prove knowledge of defect in the earlier sales years.

The claim of the Hinkelmann defendants is atypical because their furnace was used in a propane application, a claim which is much stronger than and different from natural gas users who make up the majority of the proposed class. Per-sale testing and empirical evidence suggested that failure was much more for propane applications because of the high sulfur content of the fuel. AS a result, Hinkelmann's would have a much easier case to make of knowledge of defect.

The effect of these differences is that the representative plaintiff's claims are not typical of the majority of the class.

None of the named have incentive to pursue claims of purchasers who bought earlier than plaintiff Neuser but, unlike the Hinkelmann plaintiffs, used natural gas.

Finally, considering the requirements or Rule 23(b), the preceding discussion makes it clear that common questions of law and fact do not predominate over questions affecting individual members or small subgroups within the class. A class action is not superior to other available methods for the fair and efficient adjudication of the controversy.

Summary Judgment

For purposes of summary judgment defendant concedes the facts proposed by plaintiffs in support of the claims. Defendant's motion is based on three legal premises: (1) the economic loss doctrine bars fraud in the inducement claims; (2) contract remedies are unavailable from defendant because there is no purchase contract between plaintiffs and defendant; (3) Defendant owed no duty to speak. Plaintiffs directly refute arguments (1) and (3) and contend that a contract exists between the parties on the basis of apparent agency.

Summary judgment is appropriate when, after both parties have the opportunity to submit evidence in support of their respective positions and the Court has reviewed such evidence in the light most favorable to the nonmovant, there remains no genuine issue of

material fact and the moving party is entitled to judgment as a matter of law. Rule 56(c), Fed. R. Civ. P. A fact is material only if it might affect the outcome of the suit under the governing law. Disputes over unnecessary or irrelevant facts will not preclude summary judgment. A factual issue is genuine only if the evidence is such that a reasonable factfinder, applying the appropriate evidentiary standard of proof, could return a verdict for the nonmoving party. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 254 (1986). Under Rule 56(e) it is the obligation of the nonmoving party to set forth specific facts showing that there is a genuine issue for trial.

The economic loss doctrine does not bar a contract claim seeking rescission for fraud in the inducement. Tietsworth v. Harley-Davidson, Inc., 2004 WI 32, ¶36, 270 Wis. 2d 146, 677 N.W.2d 233 (2004). Defendant's first argument for summary judgment fails.

The second issue is whether as a matter of law the facts can sustain a contract claim for fraud in the inducement. Plaintiffs seek to rescind their furnace purchase contracts. However, plaintiffs furnace purchase contracts were with dealers, not with defendant. Plaintiffs have unilateral contracts providing them the warranty rights contained in the express manufacturer's warranty extended in consideration for entering the purchase contract with the dealer. Paulson v. Olson Implement Co., Inc. 107 Wis. 2d 510, 518, 319 N.W.2d 855 (1982); Ball v. Sony Elec., Inc. 58 UCC rep.

Serv. 2d 494, 2005 WL 2406145 (W.D. Wis. 2005). However, plaintiffs do not seek to rescind these warranty contracts nor do they pursue claims based on them. Rather, they seek to rescind, or affirm and sue for breach of, purchase contracts to which this defendant is not a party.

Plaintiffs correctly note that a tort claim may exist if a misrepresentation is relied upon by a third party to enter a contract. See State v. Timblin, 2002 WI APP 304, ¶31, 259 Wis. 2d 299, 657 N.W.2d 89. However, Kaloti Enterprises, Inc. v. Kellog Sales Co., 2005 WI 111, ¶31-32, 283 Wis. 2d 555, 699 N.W.2d 205, unequivocally bars tort claims for fraud in the inducement where, as here, the misrepresentation concerns the quality of goods in the contract induced. Accordingly, Timblin affords plaintiffs no help.

There is no support in Wisconsin contract law for a rescission claim against a defendant who is not a party to the contract. A contract action for rescission arises when one contracting party fraudulently induces the other to enter a contract. It is premised on improper bargaining behavior between the contracting parties. See Farnsworth, Contracts § 4.10 (2004)(cited with approval in Bank of Sun Prairie v. Esser, 155 Wis. 2d 724, 731, 456 N.W.2d 585 (1990). Not surprisingly, although Tietsworth v. Harley-Davidson, Inc., 2002 WI 32, mentions the availability of a contract action for rescission based on fraud in the inducement, Id. at ¶ 37, only tort claims are pursued in the case presumably because Harley

Davidson, like defendant, was not plaintiffs' seller. In contrast, when the contracting parties were before the Court in Harley-Davidson Motor Co., Inc. v. PowerSports, Inc., 319 F.3d 973 (7th Cir. 2003), the Court recognized that plaintiff had a viable contract claim for fraud in the inducement not barred by the economic loss doctrine. A contractual claim for rescission goes to the contract formation between the contracting parties and is thus available only against a party to the contract.

Plaintiffs cite no case which has permitted a contract claim for rescission against a non-party to the contract which is sought to be rescinded. The only cases remotely suggesting the possibility are not contract claims but cases approving rescission-like damages for statutory securities fraud torts. See Pinter V. Dahl, 486 U.S. 622, 647 (1988), Halling v. Hobert & Svoboda, Inc., 720 F. Supp. 743, 745 (E.D. Wis. 1989). Neither case is persuasive for the proposition that a contractual rescission claim is available against an outsider to the contract. Accordingly, unless some theory of agency could alter the parties to the purchase contract, any cause of action for rescission would lie only against the dealer-seller.

To overcome this flaw in their claims, plaintiffs argue in the alternative that defendant's dealers were its apparent agents who were acting on defendant's behalf when they entered purchase contracts. To establish that the dealers from which plaintiffs

purchased their furnaces were defendant's apparent agents plaintiffs must prove: (1) acts by the dealers or by defendant justifying plaintiff's belief in the agency, (2) knowledge of these acts by the defendant, (3) reasonable reliance on these acts by plaintiffs to believe that defendant was the principal. Iowa Nat. Mut. Ins. Co. v. Backens, 51 Wis. 2d 26, 34, 186 N.W.2d 196 (1971)(quoting Harris v. Knutson, 35 Wis. 2d 567, 574-75, 151 N.W.2d 654 (1967)). "Apparent authority results from conduct by the principal which causes a third party reasonably to believe that a particular person, who may or may not be the principal's agent, as authority to enter negotiations or make representations as his agent." Id.

As a matter of law none of these elements have been sufficiently supported to survive summary judgment. The only facts of record are that defendant promoted and advertised its brand and provided training and information to its dealers and distributors. As a matter of law, creating and supporting a brand name is not enough to create apparent agency. In this case, the evidence is that plaintiffs' sellers were independent dealers selling multiple furnace brands further eliminating any appearance that they were a mere agent of defendant. "An automobile dealer or other similar type of dealer who... merely buys goods from manufacturers or other suppliers for resale to the consuming public is not his supplier's agent." Bushendorf v. Freightliner Corp., 13 F.3d 1024, 1026 (7th

Cir. 1993). Nothing in the facts distinguished the dealers in this case from that category.

Concerning the second element, even if other services were provided by defendant to dealers or distributors which might lead someone to believe the relationship was one of agency, there is no evidence that plaintiffs knew about such conduct. Because plaintiff's knowledge at the time of purchase leading them to believe agency exists is the critical inquiry, there is no basis to argue that further discovery is necessary to develop evidence of apparent agency.

Finally, no plaintiff has provided evidence that he or she in fact believed that the person who sold the furnace was Carrier's agent. Certainly, plaintiff Neuser did not believe that the homeowner from whom he purchased his house was defendant's agent. In light of the relationships with dealers who appeared to be independent of the brands it carried, there was no reasonable basis to believe that the selling dealers were acting as agents of defendant. The relationship is exactly what it appears to be – a national furnace brand manufacturer selling its products through independent heating contractors.

In a more confusing but equally unpersuasive argument plaintiffs assert a claim under the theory that they are third party beneficiaries to sales contracts between defendant and its unidentified distributors, who resold furnaces to dealers who sold

them to plaintiffs. Ignoring the apparent lack of relationship between the argument and plaintiffs' sole cause of action for fraud in the inducement, as a matter of law plaintiffs do not have standing as third party beneficiaries to sue for breach of the contracts between the defendant and its distributors. Ultimate purchasers of products are not third party beneficiaries of sales contracts up the chain of distribution. "The fact that a seller knows than an intermediate buyer of its products will immediately resell the product is not sufficient to make the ultimate buyer an intended beneficiary of the original sales contract." Cooper Power Systems, Inc. v. Union Carbide Chemicals & Plastics Co,. Inc., 123 F.3d 675, 680 (7th Cir. 1997).

Finally, plaintiffs' move in the alternative to amend their complaint to reallege a claim for unjust enrichment. Plaintiffs initially brought an alternative unjust enrichment claim and voluntarily dismissed it in its amended pleadings. Apparently, plaintiffs dismissed the claim based on the following language in this Court's prior decision in Ball v. Sony, 2005 WL 2406145:

> The doctrine of unjust enrichment is a quasi contractual theory which applies only in the absence of a contract. Continental Cas. Co. v. Wisconsin Patients Compensation Fund, 164 Wis. 2d 110, 118, 473 N.W.2d 584 (Ct. App. 1991). There is no question that plaintiffs entered into contracts for the purchase of their camcorders. Plaintiffs believe that they paid more than the camcorders were worth because they were defective. However, under such circumstances any remedy must be based on the law of contract and warranty, not unjust

> enrichment. Unjust enrichment is not a mechanism for supplementing that which a purchaser perceives as inadequate contractual remedies.

There does not appear to be any basis to permit amendment.

The reasoning of Ball applies equally even though plaintiffs contract claim has failed. Plaintiffs have purchase contracts with dealers but have chosen not to proceed on breach of contract claims against them. They have an express warranty contract with defendant but have not pursued a breach of that contract. In the face of these existing contracts there is no unjust enrichment claim available. Nothing about the failure of the fraud in the inducement claim changes the analysis. If that was the basis for its dismissal there is no reason to permit amendment to reallege the claim.

ORDER

IT IS ORDERED that plaintiffs' motion to certify a class is DENIED.

IT IS FURTHER ORDERED that defendant's motion for summary judgment is GRANTED and that judgment be entered dismissing plaintiffs' complaint with prejudice and costs.

Entered this 15th day of May, 2007.

BY THE COURT:

S/

JOHN C. SHABAZ
District Judge