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Daniel C. Hagen

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Notes

SECTIONS 2-719(2) & 2-719(3) OF THE UNIFORM COMMERCIAL CODE: THE LIMITED WARRANTY PACKAGE & CONSEQUENTIAL DAMAGES

[C]onsequential damages exclusions are hands down the most significant limitation of liability in a contract for the sale of goods. Potential liability for consequential damages in commercial contexts, usually in the form of the buyer's lost profits from the use or resale of the goods in its business, is enormous in comparison to the contract price of the goods. They can exceed, and most likely will exceed, the value of the goods by an unknown quantum, depending not so much on the actions and machinations of the seller as on the individual operating structure of the buyer and on the buyer's contracts and relationships with third parties.¹

I. INTRODUCTION

Bob's Bridge Builders, Incorporated, is in the business of building steel arch bridges and Sally's Steel, Incorporated, is in the steel manufacturing industry. Sally tells Bob that she has developed a type of steel that does not rust, making Sally's steel unique from other manufacturers' steel. This new product is ideally suited for Bob's needs because Bob is working with the city of Seattle, Washington to build a bridge that will not rust as quickly as other steel arch bridges. Apparently, the bridges in Seattle are overly susceptible to rust due to all of the rain and need to be rebuilt frequently. This new steel will be great for Bob's business because he has also been contacted about constructing a similar bridge for the city of Portland, Oregon if the Seattle bridge is a success. He believes that similar offers will follow. As a result, Bob and Sally contract for the steel needed to construct the bridge in Seattle. However, the rustproof steel turns out to be more like "sour, pale-yellow citrus fruit."² Bob asks Sally to repair or replace the steel many times, but Sally fails to provide Bob with steel that is both rustproof and strong enough to use for

1. Roy R. Anderson, *Failure of Essential Purpose and Essential Failure on Purpose: A Look at Section 2-719 of the Uniform Commercial Code*, 31 Sw. L.J. 759, 774 (1977).

2. WEBSTER'S NEW WORLD DICTIONARY 346 (Pocket-Size ed. 1987) (defining "lemon").

bridge building. If Bob sues Sally to compensate him for his lost jobs in Seattle and Portland, courts disagree on the question of whether Bob is entitled to this compensation as a result of Sally's breach of contract without a finding that Sally's conduct was unconscionable.³

The contract between Bob and Sally is governed by the Uniform Commercial Code ("Code").⁴ It is common for commercial sales contracts⁵ to contain a "limited warranty package."⁶ These warranty packages often provide that:

This constitutes [Seller's] only warranty in connection with this sale and is in lieu of all other warranties, express or implied, written or oral [Seller] will repair or replace at [Seller's] option . . . any [Seller's] parts defective in workmanship or materials It is agreed that such replacement or repair is the exclusive remedy available from [Seller] should any of [Seller's] products prove defective. [Seller] is not liable for damages of any sort, including incidental and consequential damages.⁷

There are four elements of this warranty package. First, the seller makes a limited express warranty that the goods are free from defects at the time of delivery.⁸ Second, the seller disclaims all other warranties, either express or

3. See, e.g., *International Fin. Servs. v. Franz*, 534 N.W.2d 261, 267 (Minn. 1995) ("The effect of the failure of a limited remedy to meet its essential purpose presents a most vexing problem that has plagued courts ever since the adoption of the Uniform Commercial Code.")

4. U.C.C. § 2-102 (1994) ("[T]his Article applies to transactions in goods"). Section 2-105 of the Code defines "goods" as follows:

(1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2-107).

U.C.C. § 2-105(1) (1996).

5. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. *Id.* § 2-106(1). A "sale" consists in the passing of title from the seller to the buyer for a price (Section 2-401). *Id.* A "present sale" means a sale which is accomplished by the making of the contract. *Id.*

6. Richard E. Speidel, *Warranty Disputes in the Seventh Circuit Under Article Two, Sales: Advantage Seller?*, 65 CHI.-KENT L. REV. 813, 833 (1989).

7. *Myrtle Beach Pipeline Corp. v. Emerson Elec. Co.*, 843 F. Supp. 1027, 1031-32 (D.S.C. 1993).

8. Sellers are not allowed to disclaim express warranties. U.C.C. § 2-316(1) (1996). This section protects buyers from disclaimers which seek to disclaim "all warranties, express and implied," to the extent that they are inconsistent with the language of express warranties. *Id.* § 2-316 cmt. 1. Unexpected and unbargained for language in disclaimers which is inconsistent with

implied.⁹ Third, the contracting parties agree to a limited or exclusive remedy in the case of a breach by the seller.¹⁰ Typically, repair or replacement of non-conforming goods is the buyer's exclusive remedy.¹¹ Fourth, the seller excludes any liability for incidental or consequential damages caused by a breach.¹² Consequential damages are typically lost profits that the buyer would have earned from transactions with third parties.¹³ These packages are so common that two leading commentators refer to them as "the standard warranty."¹⁴

express warranties will not be given effect. *Id.*

9. *See id.* § 2-316 (giving sellers the right to exclude implied warranties but not express warranties).

10. *See id.* § 2-719(1)(b) (stating that a remedy which is exclusive is the only remedy to which the buyer has recourse in the event of a breach by the seller). Section 2-719 of the Code states that "the agreement may . . . limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies . . . to return of the goods and repayment of the price . . . to repair and replacement of non-conforming goods or parts . . ." *Id.* § 2-719(1)(a).

11. Speidel, *supra* note 6, at 833. Goods or conduct, including any part of a performance, conform to the contract when they are in accordance with the obligations under the contract. U.C.C. § 2-106(2) (1996).

12. *See* U.C.C. § 2-715(1) (1996) (stating that incidental damages include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods the buyer rightfully rejects, as well as any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach). Incidental damages limitations are analagous to consequential damages limitations. *See Xerox Corp. v. Hawkes*, 475 A.2d 7, 10 (N.H. 1984) (concluding that waivers of consequential damages are not prohibited and stating that the same principle has, in the court's view, been assumed applicable to waivers of incidental damages). For the sake of simplicity, this note will focus only on consequential damages limitations. Section 2-715 defines consequential damages as follows:

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

U.C.C. § 2-715(2) (1996). Examples of consequential damages include: lost profits, down or idle time, interest and finance charges, loss of the use of goods, overhead, labor, equipment or other expenses incurred by a buyer as a result of a seller's breach. 67 AM. JUR. 2D *Sales* §§ 1310, 1335, 1341, 1345, 1348 (1985).

13. Melvin A. Eisenberg, *The Principle of Hadley v. Baxendale*, 80 CAL. L. REV. 563, 565 (1992).

14. ALAN SCHWARTZ & ROBERT E. SCOTT, *COMMERCIAL TRANSACTIONS* 189-96 (1982).

The Code deals with limitations of remedies in Section 2-719.¹⁵ More specifically, Section 2-719(1)(a) addresses the limitation of the seller's obligation to the repair or replacement of defective goods.¹⁶ Section 2-719(3) addresses the exclusion of the seller's liability for consequential damages.¹⁷ These two subsections of Section 2-719 are the focus of this Note. These two provisions contain advantages for both the buyer and the seller. For example, the seller is given an opportunity to make the goods conform to the contract while limiting exposure by excluding liability for other possible damages.¹⁸ The buyer is ensured that the seller will provide goods that conform to the contract.¹⁹ A conflict surfaces when the goods are defective, and the seller has failed to provide goods that conform to the contract after being given a reasonable time to do so.²⁰ Courts must then decide whether this failure to provide conforming goods invalidates the clause excluding consequential damages automatically, or whether the buyer must first show that it would be unconscionable not to

15. Section 2-719 of the Code provides:

(1) Subject to the provisions of subsections (2) and (3) of this section . . .

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

U.C.C. § 2-719 (1996).

16. *See id.* § 2-719 (1)(a)(2).

17. *See id.* § 2-719(3). Exclusive remedies, such as repair or replacement, are almost always accompanied by clauses that exclude liability for consequential damages. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 12-10(c), at 666 (4th ed. 1995). The distinction between warranty disclaimers and remedy limitations is important. *See id.* § 12-11, at 669. Disclaimer clauses are used to limit the seller's liability by reducing the number of situations in which the seller can be in breach of warranty. *Id.* A remedy limitation or exclusion restricts the buyer's remedies once a breach is established. *Id.*

18. Debra L. Goetz et al., *Article Two Warranties in Commercial Transactions: An Update*, 72 CORNELL L. REV. 1159, 1305 (1987).

19. *Id.*

20. This establishes a breach of the warranty that the goods are free from defects in materials and workmanship. This note assumes that this "first breach" is firmly established. The remaining question, and the question this note addresses, is what are the buyer's remedies for the breach of this warranty.

invalidate the clause.²¹

Section 2-719(2) of the Code provides that upon a failure of the limited remedy's essential purpose, the buyer is entitled to any Code remedy.²² One available remedy is consequential damages.²³ Generally, a failure of essential purpose occurs when a party to the contract is deprived of the substantial value of the bargain.²⁴ Thus, when a seller refuses or fails to repair or replace defective goods after repeated attempts, a failure of essential purpose has occurred. In these situations, Section 2-719(2) of the Code appears to allow the buyer to recover consequential damages.²⁵

However, Section 2-719(3) precludes the buyer from recovering consequential damages when the seller limits or excludes their recovery in the contract, unless the buyer can show that their exclusion is unconscionable.²⁶ To illustrate this problem, assume that the steel which Bob purchased from Sally turned out to suffer from a lack of strength, the effect of rustproofing the steel, and that Bob cannot use the steel to build bridges. If Sally cannot cure this defect,²⁷ the limited remedy of repair or replacement has failed its essential

21. See, e.g., *International Connectors Indus. v. Litton Sys.*, No. B-88-505, 1995 U.S. Dist. LEXIS 5769, at *28, *29 (D. Conn. Apr. 25, 1995) (stating that courts are split on the issue of the validity of consequential damages limitations when a limited remedy fails of its essential purpose).

22. U.C.C. § 2-719(2) (1996).

23. *Id.* § 2-714(3).

24. *Id.* § 2-719 cmt. 1.

25. See *id.* § 2-719(2) ("Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."). See also *id.* § 2-715 cmt. 2 (allowing the buyer any consequential damages which are the result of the seller's breach).

26. *Id.* § 2-719(3). Section 2-719(3) states that "[c]onsequential damages may be limited or excluded unless the limitation or exclusion is unconscionable." *Id.* Limitation of consequential damages for personal injury in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not. *Id.* Unconscionability is not defined in the Code, and the term necessarily invites speculation. *Myrtle Beach Pipeline Corp. v. Emerson Elec. Co.*, 843 F. Supp. 1027, 1046 (D.S.C. 1993). However, unconscionability usually includes an absence of meaningful choice on the part of one of the parties to the contract along with contract terms which are unreasonably favorable to the other party. *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965). Section 2-302 speaks of an unconscionable contract as follows:

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

U.C.C. § 2-302(1) (1996). See *infra* notes 87-99 and accompanying text.

27. See U.C.C. §§ 2-106, 2-508 (1996). The Code requires exact performance by the seller as a condition of the buyer's acceptance of the goods. *Id.* § 2-106 cmt. 2. However, section 2-508 gives the seller a reasonable time to make the defective goods conform to the contract. *Id.* § 2-508.

What is a reasonable time depends on the attending circumstances. *Id.* § 2-508 cmt. 3. The cure

purpose and Bob will seek consequential damages for the lost profits he would have earned from his contract with the city of Seattle and the contract he would have had with the city of Portland.²⁸ In this situation, the seller has failed to perform the only remedy available to the buyer, typically repair or replacement. It is unclear from the language of the Code and its comments whether courts should then follow Section 2-719(3) and apply a standard of unconscionability before allowing the buyer to recover consequential damages, or whether courts should follow Section 2-719(2) and hold that the failure of its essential purpose is sufficient to justify awarding consequential damages.²⁹

When confronted with a Code-related problem, courts presumably focus on the Code's underlying principles.³⁰ Further, the Code must be liberally construed to promote these principles.³¹ Therefore, courts must examine the relationship between Sections 2-719(2) and 2-719(3) of the Code with the goal of achieving uniformity, simplification and clarification among the various jurisdictions.³² This goal is unreachable, however, because the relationship between subsections (2) and (3) is susceptible to different interpretations.³³ Some courts treat the two sections as dependent on each other.³⁴ Under this approach, if the limited remedy fails its essential purpose, consequential

provisions of section 2-508 are designed to protect the seller from surprise, as when the buyer asserts a technicality which caused the goods to be non-conforming. *Id.* § 2-106 cmt. 2.

28. Bob would not be limited to consequential damages for lost profits, however. He can assert that he is entitled to consequential damages for any damages that were caused by the breach, such as expenses that resulted from down or idle time. *See id.* § 2-715(2)(a).

29. *See infra* notes 69-99 and accompanying text.

30. Section 1-102 of the Code provides that:

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) The underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

U.C.C. § 1-102 (1), (2) (1996).

31. *Id.* § 1-102(1).

32. A comment to section 1-102 provides in relevant part:

The Act should be construed in accordance with its underlying purposes and policies.

The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

Id. § 1-102 cmt. 1.

33. *See infra* notes 107-57 and accompanying text for a discussion of different interpretations of subsections (2) and (3) of § 2-719.

34. *See, e.g.,* R.W. Murray, Co. v. Shatterproof Glass Corp., 758 F.2d 266, 272 (8th Cir. 1985) (stating that the failure of the limited remedy's essential purpose voids the consequential damages limitation). *See also infra* notes 107-14 and accompanying text.

damages may be recovered by the buyer, despite the clause in the contract excluding them.³⁵ The clause excluding consequential damages is not examined under the unconscionability standard of Section 2-719(3).³⁶ The clause is voided upon a failure of its essential purpose under Section 2-719(2).³⁷

Other courts treat Sections 2-719(2) and 2-719(3) as independent of each other.³⁸ Under this approach, a failure of the essential purpose of a limited remedy under Section 2-719(2) does not invalidate a clause excluding consequential damages.³⁹ The clause excluding consequential damages must be looked at independently under the unconscionability standard of Section 2-719(3).⁴⁰

Finally, some courts have rejected these two per se approaches, interpreting the two sections on a case-by-case basis.⁴¹ These courts emphasize "the type of goods involved, the parties, and the precise nature and purpose of the contract."⁴² The facts of each case are examined to determine whether or not

35. *See, e.g.*, *Riley v. Ford Motor Co.*, 442 F.2d 670, 673 (5th Cir. 1971) (stating that upon a failure of the essential purpose of a limited repair or replacement remedy, the buyer is entitled to any U.C.C. remedy, including consequential damages, and contractual exclusion of consequential damages is unenforceable).

36. *See, e.g.*, *Soo Line R.R. v. Fruehauf Corp.*, 547 F.2d 1365, 1373 (8th Cir. 1977) (holding that a failure of essential purpose under section 2-719(2) of the Code voids the clause excluding consequential damages).

37. *See, e.g.*, *Ragen Corp. v. Kearney & Trecker Corp.*, 912 F.2d 619, 624 (3d Cir. 1990) (stating that upon a failure of the limited remedy's essential purpose, the buyer is entitled to any remedy available under the Code, including consequential damages).

38. *See, e.g.*, *Canal Elec. Co. v. Westinghouse Elec. Corp.*, 756 F. Supp. 620, 626 (D. Mass. 1990) (holding that the disclaimer of consequential damages is enforceable even when a remedy fails of its essential purpose). *See also infra* notes 115-32 and accompanying text.

39. *See, e.g.*, *Ritchie Enters. v. Honeywell Bull, Inc.*, 730 F. Supp. 1041, 1049 (D. Kan. 1990) (stating that even if a limited remedy failed of its essential purpose, a clause excluding consequential damages would still be valid).

40. *See, e.g.*, *Chatlos Sys., Inc. v. National Cash Register Corp.*, 635 F.2d 1081, 1086 (3d Cir. 1980) (stating that the limited remedy of repair and the clause excluding consequential damages are two methods of limiting recovery for breach of warranty and each must be tested by separate Code provisions).

41. *See, e.g.*, *Smith v. Navistar Int'l Transp. Corp.*, 714 F. Supp. 303, 307 (N.D. Ill. 1989) (stating that an analysis to determine whether consequential damages are warranted must carefully examine the individual factual situation including the type of goods involved, the parties, and the nature and purpose of the contract) (quoting *AES Tech. Sys. v. Coherent Radiation*, 583 F.2d 933, 941 (7th Cir. 1978)); *Mid Continent Cabinetry, Inc. v. George Koch Sons, Inc.*, No. 87-1248-C, 1991 U.S. Dist. LEXIS 10644, at *40 (D. Kan. July 11, 1991) (noting the current trend of applying a case-by-case approach); *Stewart Sandwiches, Inc. v. MSL Indus., Inc.*, No. 87 C 3478, 1990 U.S. Dist. LEXIS 13926, at *17 (N.D. Ill. Oct. 19, 1990) (stating that an analysis to determine whether consequential damages are warranted must carefully examine the individual factual situation). *See also infra* notes 133-57 and accompanying text.

42. *AES Tech. Sys. v. Coherent Radiation*, 583 F.2d 933, 941 (7th Cir. 1978).

the contract met its purpose.⁴³ All of these approaches work well in some cases, but none of these approaches works well in every case.⁴⁴

Lower courts are divided on the question of whether buyers must show that a consequential damages exclusion is unconscionable before awarding the buyer consequential damages, or whether the failure of the limited remedy's essential purpose is enough to justify the award.⁴⁵ As a result of this division, three separate and distinct interpretations of the appropriate relationship between Sections 2-719(2) and 2-719(3) of the Code have emerged. Thus, buyers and sellers routinely contest the validity of consequential damage limitations.⁴⁶ This Note suggests that all three of the current interpretations should be reconciled. This can be accomplished by revising Section 2-719 to address this problem.⁴⁷ The proposed subsection (4) of Section 2-719 will mandate that

43. *Id.* at 939.

44. *See infra* notes 158-84 and accompanying text. This note addresses only commercial losses. It does not address liability for personal injury or property damage, and it focuses on contracts between two commercial entities, not contracts involving consumers. Article 2 of the Code does not even define "consumer goods." Section 9 of the Code provides, however, that "[g]oods are 'consumer goods' if they are used or bought for use primarily for personal, family or household purposes." U.C.C. § 9-109(1) (1996). The Code states that limitations on consequential damages for personal injury in a consumer goods setting is prima facie unconscionable, but that limitations on damages where the loss is commercial is not. *Id.* § 2-719(3). Professors White and Summers have stated that where a consumer suffers personal injury, "even wild horses could not stop a sympathetic court from plowing through the most artfully drafted and conspicuously printed disclaimer [of a consequential damages] clause in order to grant relief." WHITE & SUMMERS, *supra* note 17, § 12-12, at 681.

45. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 12-10, at 599-600 (3d ed. 1988). *See, e.g.,* McNally Wellman Co. v. New York State Elec. & Gas Corp., 63 F.3d 1188, 1197 (2d Cir. 1995) (stating that courts are split on whether subsections (2) and (3) of section 2-719 operate independently or whether the failure of an exclusive remedy precludes enforcement of a consequential damages exclusion); International Fin. Servs. v. Franz, 534 N.W.2d 261, 267 (Minn. 1995) (stating that the effect of the failure of a limited remedy to meet its essential purpose presents a problem for courts trying to determine the buyer's remedies); International Connectors Indus. v. Litton Sys., No. B-88-505, 1995 U.S. Dist. LEXIS 5769, at *28 (D. Conn. Apr. 25, 1995) (stating that courts are split on the issue of the validity of consequential damages limitations when a limited remedy fails of its essential purpose). *See also infra* notes 100-57 and accompanying text.

46. Daniel Scott Schecter, *Consequential Damage Limitations and Cross-Subsidization: An Independent Approach to Uniform Commercial Code Section 2-719*, 66 S. CAL. L. REV. 1273, 1275 (1993). "[I]t is hard to find any provision in Article 2 that has been more successfully used by aggrieved buyers in the last [25] years than Section 2-719(2)." WHITE & SUMMERS, *supra* note 17, § 12-10, at 659-60. The failure of essential purpose doctrine is extremely important because of the prevalence of warranties providing for the exclusive remedy of repair or replacement. *Id.* If the product turns out to be a lemon and the seller cannot repair the goods within a reasonable time or refuses to repair the goods, buyers routinely argue that Section 2-719 of the Code makes consequential damages available despite a separate provision in the contract which disclaims liability for consequential damages. *Id.*

47. *See infra* notes 185-221 and accompanying text.

courts first look to the language of the contract.⁴⁸ If the contract does not express an intention to allocate the risk of the limited remedy failing of its essential purpose, the Code will presume that the clause excluding consequential damages is void. This new subsection will also provide that the parties may allocate the risk of this failure in the contract.⁴⁹ If the contract does allocate the risk that the limited remedy may fail, then the Code will presume that the clause excluding consequential damages is valid. This revision will simplify, clarify and modernize the current state of the law.⁵⁰ Further, and more importantly, this revision will make the Code more predictable.⁵¹ This added predictability will serve to benefit buyers, sellers and courts.

Section II of this Note will look at the nature of damages for breach of contract.⁵² Section II will also examine the background of the concepts involved in Sections 2-719 (2) and (3) of the Code.⁵³ The three basic approaches courts use to resolve the ambiguity in Section 2-719 will then be examined in Section III.⁵⁴ Section IV of this Note will analyze the problems with each of these approaches.⁵⁵ Finally, Section V of this Note proposes the addition of a new subsection to Section 2-719 which would reconcile the three approaches that the courts currently use to resolve the conflicting language of Section 2-719.⁵⁶ Section V also asserts that these revisions will make the Code more predictable and useful, thereby allowing buyers, sellers and courts to resolve the conflicting language of Sections 2-719 (2) and (3).⁵⁷

II. BACKGROUND TO THE CONFLICT: CONTRACTUAL DAMAGES AND THE AMBIGUITY OF CODE SECTION 2-719

A. *General Damages versus Consequential Damages*

There are two types of damages for breach of contract. The first type is

48. See *infra* notes 185-221 and accompanying text.

49. See *infra* notes 185-221 and accompanying text.

50. Section 1-102 states that the Code shall be liberally construed to promote its underlying purposes and policies, which include simplifying, clarifying and modernizing the law governing commercial transactions. U.C.C. § 1-102(1),(2)(a) (1996).

51. The Code aims "to make uniform the law among the various jurisdictions." *Id.* § 1-102(2)(e).

52. See *infra* notes 58-68 and accompanying text.

53. See *infra* notes 69-99 and accompanying text.

54. See *infra* notes 100-57 and accompanying text.

55. See *infra* notes 158-84 and accompanying text.

56. See *infra* notes 185-206 and accompanying text.

57. See *infra* notes 207-34 and accompanying text.

for general, or direct damages, and the second is for consequential damages.⁵⁸ General damages are based on the value of the performance itself⁵⁹ and are measured by looking at the market for the goods involved.⁶⁰ Consequential damages arise as a secondary consequence of the breach, and result from special circumstances of the injured party.⁶¹ Consequential damages are typically lost profits that would have been earned from transactions with third parties but for the breach.⁶²

General damages are the standard measure of damages for a non-breaching party and are awarded for damages directly related to the transaction, such as the cost of repairing or replacing a good, or the cost of acquiring substitute goods from a different supplier.⁶³ Most courts allow buyers to recover consequential damages if the buyer incurs other losses which were "a probable result of the breach" at the time of contracting.⁶⁴ Consequential damages result from the frustration of general or particular requirements and needs of which the

58. Roy Ryden Anderson, *Incidental and Consequential Damages*, 7 J.L. & COM. 327, 351 (1987). See Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 867-68 (1992); Arthur G. Murphey, Jr., *Consequential Damages in Contracts for the International Sale of Goods and the Legacy of Hadley*, 23 GEO. WASH. J. INT'L L. & ECON. 415, 431-32 (1989).

59. See Anderson, *supra* note 58, at 328-29.

60. See 1 DAN B. DOBBS, LAW OF REMEDIES § 3.3(3), at 297 (2d. ed. Practitioner Treatise Ser. 1993) ("General damages are market-measured damages. They value the plaintiff's entitlement by looking at its value on some real or supposed market."). A buyer's general damages are based on the difference between the market price and the contract price (U.C.C. § 2-713(1)), the difference between the cover price and the contract price (U.C.C. § 2-712(2)), or the diminution in the value of the goods or services caused by the breach (U.C.C. § 2-714(2)). U.C.C. §§ 2-713(1), 2-712(2), 2-714(2) (1996). A seller's general damages are based on the difference between the contract price and the market price (U.C.C. § 2-708(1)), or the difference between the contract price and the resale price (U.C.C. § 2-708(2)). *Id.* § 2-708(1), (2).

61. 1 DOBBS, *supra* note 60, § 3.3(4), at 65.

62. Eisenberg, *supra* note 13, at 565. See Schecter, *supra* note 46, at 1277 n.18 (stating that "[l]ost profits may . . . be the quintessential example of consequential damages.") (quoting Nyquist v. Randall, 819 F.2d 1014, 1017 (11th Cir. 1987)). Consequential damages may also include: down or idle time, interest and finance charges, loss of use of goods, interest and finance charges, overhead, labor and equipment expenses, lost goodwill, third-party claims brought against the buyer of defective goods, loss of use of defective property, and attorney's fees. 67 AM. JUR. 2D Sales §§ 1310, 1335, 1341, 1345, 1348 (1985). The burden of proving consequential damages is on the buyer and must simply be reasonable under the circumstances. U.C.C. § 2-715 cmt. 4 (1996).

63. Schecter, *supra* note 46, at 1276. See U.C.C. §§ 2-712, 2-713, 2-714 (1996).

64. See, e.g., Enlow v. Sears Roebuck & Co., 822 P.2d 617, 623 (Kan. 1991); Stone v. Chicago Title Ins. Co., 624 A.2d 496, 501 (Md. 1993); Gagliardi v. Denny's Restaurants, 815 P.2d 1362, 1373 (Wash. 1991).

seller had reason to know and which could not reasonably be prevented by cover or otherwise.⁶⁵

The Code distinguishes consequential damages for commercial loss, such as lost profits, from loss caused by injury to person or property.⁶⁶ Also, with respect to commercial loss, the breaching party is usually the seller.⁶⁷ Courts usually address the issue of consequential damages as a question of foreseeability, allowing recovery if damages are foreseeable and denying recovery if they are not.⁶⁸ Before deciding the amount of consequential damages the buyer is entitled to, however, courts must first determine if they are warranted at all. This inquiry focuses on the nebulous relationship between subsections (2) and (3) of Code Section 2-719.

B. Section 2-719: Failure of Essential Purpose and Unconscionability

When a limited remedy fails of its essential purpose, buyers are usually unsatisfied with simply avoiding the repair or replacement limitation. Typically, buyers want consequential damages as well.⁶⁹ As a result, courts must analyze the contract within the framework of Section 2-719 of the Code, which deals with contracts limiting the buyer's remedies.⁷⁰ Section 2-719 allows contracting parties to limit the buyer's available remedies in the event of a

65. U.C.C. § 2-715(2)(a) (1996). See RESTATEMENT (SECOND) OF CONTRACTS § 351(1), (2)(b) (1979) (stating that consequential damages may be recovered if they were "a probable result of the breach when the contract was made . . . as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know."). A buyer can "cover" by purchasing or contracting to purchase goods in substitution for those due from the seller. U.C.C. § 2-712(1) (1996).

66. U.C.C. § 2-715(2)(b) includes "injury to person or property proximately resulting from any breach of warranty." U.C.C. § 2-715(2)(b) (1996). This note only addresses commercial loss, because cases involving consequential damages for personal injury or property damage are rare.

67. Section 1-106 of the Code states that "consequential . . . damages may [not] be had except as specifically provided in this Act or by other rule of law." *Id.* § 1-106(1). The Code provides for a buyer's recovery of consequential damages (U.C.C. §§ 2-713(1), 2-714(3) and 2-715(2)), but is silent with respect to a seller's recovery of consequential damages. This silence has led courts to conclude that the Code prohibits sellers from recovering consequential damages. See generally *Associated Metals & Minerals Corp. v. Sharon Steel Corp.*, 590 F. Supp. 18, 21-22 (S.D.N.Y. 1983); *Nobs Chem. U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 216 (5th Cir. 1980); *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358, 1368 (7th Cir. 1985); *Florida Mining & Materials Corp. v. Standard Gypsum Corp.*, 550 So. 2d 47, 49 (Fla. Dist. Ct. App. 1989). For purposes of simplicity, this note assumes that the breaching party is the seller.

68. See generally *Hendricks & Assoc., Inc. v. Daewoo Corp.*, 923 F.2d 209, 214-15 (1st Cir. 1991); *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 912 F.2d 643, 653 (3d Cir. 1990); *Fidelity & Deposit Co. v. Krebs Eng'rs*, 859 F.2d 501, 506-07 (7th Cir. 1988); *Taylor & Gaskin, Inc. v. Chris-Craft Indus.*, 732 F.2d 1273, 1278 (6th Cir. 1984); *Blue Circle Atl., Inc. v. Falcon Materials, Inc.*, 760 F. Supp. 516, 523 (D. Md. 1991).

69. *WHITE & SUMMERS*, *supra* note 17, § 12-10(c), at 666.

70. See U.C.C. § 2-719 (1996).

breach by the seller.⁷¹ For instance, an agreement may “[limit] the buyer’s remedies to return of the goods or repayment of the price or to repair and replacement of [defective goods].”⁷² The Code encourages parties to shape their agreements according to their particular needs,⁷³ but makes it clear that the buyer must be given “at least minimum adequate remedies.”⁷⁴ Reasonableness and fairness are the only parameters set out by the Code in this respect.⁷⁵ This lack of clarity is prevalent throughout Section 2-719 when read in the context of contracts which limit the buyer’s remedies and also limit the seller’s liability for consequential damages.

The uncertainty in Section 2-719 is evident in many of its provisions and comments, but the section does manage to clearly state that contract provisions which give the buyer an exclusive remedy of repair or replacement are valid under the Code.⁷⁶ However, where circumstances cause an exclusive or limited remedy to fail of its essential purpose, that “remedy may be had as provided” in the Code.⁷⁷ Generally, a limited remedy fails of its essential purpose when an event occurs which was not bargained for at the time of contracting, and that event defeats the purpose of the contract.⁷⁸ For example, in the contract between Bob and Sally, Bob’s remedies are limited to the repair or replacement of the defective steel. If Sally is unable to make steel that is both rustproof and strong, then their limited remedy fails of its essential purpose because Sally is unable to make the goods conform to the contract.⁷⁹ This

71. See *id.* Remedy limitations restrict the buyer’s remedies once a breach is established. WHITE & SUMMERS, *supra* note 45, § 12-11, at 529. In contrast, a warranty disclaimer is used by sellers to reduce the number of situations in which a breach will be found. *Id.* The issue of whether a breach has occurred is resolved first by examining the warranties and disclaimers in the contract. *Id.* Once a breach is established, the extent of the seller’s liability is examined by looking at the clauses in the contract which limit the buyer’s remedies for the breach. *Id.* This note is concerned with the second prong of this examination, the limitations on the buyer’s remedies.

72. U.C.C. § 2-719(1)(a) (1996).

73. *Id.* § 2-719 cmt. 1.

74. *Id.*

75. *Id.* “Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.” *Id.* However, the parties to the contract “must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract.” *Id.*

76. *Id.* § 2-719(2).

77. *Id.*

78. U.C.C. § 2-719 cmt. 1 (1996). “[W]here an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.” *Id.* See ROY R. ANDERSON, UNIFORM COMMERCIAL CODE 45 n.10 (3d ed. 1984).

79. See, e.g., *Chatlos Sys., Inc. v. National Cash Register Corp.*, 635 F.2d 1081, 1085 (3d Cir. 1980) (finding that when a contract limits the buyer’s remedies to the correction of design or implementation flaws and the seller is either unwilling or unable to correct the defects within a reasonable time, the limited remedy has failed of its essential purpose); *Wilson Trading Corp. v.*

circumstance defeats the purpose of the contract because the purpose was to provide Bob with steel that would not rust, enabling him to build bridges in Seattle and Portland that would withstand the effects of repeated rains better than conventional bridges. Sally's inability to make steel that has the strength of conventional steel and is rustproof was not bargained for by Bob.

The Code's "failure of essential purpose" standard for addressing the validity of limited remedies is confusing.⁸⁰ In general, courts consider the agreed upon remedy, the purpose for which that remedy was chosen, and what circumstances led to that remedy failing or being impaired.⁸¹ The facts of each case are evaluated in light of these considerations.⁸²

Under Section 2-719(2) of the Code, if a limited remedy fails of its essential purpose, then the buyer is entitled to all of the remedies provided in the Code, including consequential damages.⁸³ Because consequential damages can

David Ferguson, Ltd., 23 N.Y.2d 398, 404 (1968) (finding a failure of essential purpose where a product has a latent defect which goes undetected until after the warranty has expired). The limited warranty may itself be inadequate under the circumstances. See 3 WILLIAM HAWKLAND, UNIFORM COMMERCIAL CODE SERIES 444 (1994). One commentator has suggested a three-step process to be utilized: first, a court must determine the purposes of the contract; second, the court must decide if the limited remedy will further these purposes; finally, the court must decide if applying the remedy leads to an unconscionable result. Jonathan A. Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 CAL. L. REV. 28, 58 (1977).

80. John E. Murray, Jr., *The Revision of Article 2: Romancing the Prism*, 35 WM. & MARY L. REV. 1447, 1504 (1994) (stating that "[i]n light of the confusion in the case law and commentary concerning 'failure of essential purpose,' . . . that section requires considerable clarification"). Comment 1 to Section 2-719 merely provides that the buyer enjoy "minimum adequate remedies" and "a fair quantum of remedy." U.C.C. § 2-719 cmt. 1 (1996). The standards provided by the Code "are of limited assistance to the drafter or interpreter." WHITE & SUMMERS, *supra* note 17, § 12-10, at 660.

81. Schecter, *supra* note 46, at 1278 n.24. "[T]his provision 'is not concerned with arrangements which were oppressive at their inception, but rather with the application of an agreement to novel circumstances not contemplated by the parties.'" WHITE & SUMMERS, *supra* note 17, § 12-10, at 660 (quoting 1 N.Y. STATE COMM'N, 1955 REPORT 584 (1955)).

82. See, e.g., *McDermott, Inc. v. Clyde Iron*, 979 F.2d 1068, 1073 (5th Cir. 1992) (stating that when repair or replacement remedies take too long, this may cause the limited remedy to fail of its essential purpose); *Chailos Sys.*, 635 F.2d at 1085-86 (stating that persistent defects with the goods that have not been remedied after a reasonable time cause a failure of the essential purpose of the limited remedy); *Liberty Truck Sales, Inc. v. Kimbrel*, 548 So. 2d 1379, 1384 (Ala. 1989) (stating that the limited remedy fails of its essential purpose when the seller fails to make repairs within a reasonable time or refuses to make repairs pursuant to the warranty); *Clark v. International Harvester Co.*, 581 P.2d 784, 798-99 (Idaho 1978) (stating that seller's inability to repair the good within a reasonable time caused the limited remedy to fail); *Middletown Eng'g Co. v. Climate Conditioning Co.*, 810 S.W.2d 57, 60 (Ky. Ct. App. 1991) (stating that an unreasonable time for repair may cause a failure of essential purpose, but 126 days in and of itself is not unreasonable).

83. U.C.C. §§ 2-719(2), 2-714(3) (1996).

be extremely high in comparison to other available remedies,⁸⁴ sellers routinely exclude them from contracts.⁸⁵ This is probably "the most significant limitation on liability in [contracts]."⁸⁶

Section 2-719(3) of the Code states that "[c]onsequential damages may be limited or excluded unless this limitation or exclusion is unconscionable."⁸⁷ While Section 2-302 of the Code does not define the term "unconscionable,"⁸⁸ it establishes guidelines for courts to use when defining it.⁸⁹ From these guidelines, two types of unconscionability have evolved: procedural and substantive.⁹⁰ Procedural unconscionability assesses the bargaining process that led to a term's inclusion,⁹¹ whereas substantive unconscionability is concerned

84. Schecter, *supra* note 46, at 1274. "Potential damages may and most often do exceed the value of goods by an unknown quantum." *Id.* at 1275 n.10.

85. See SCHWARTZ & SCOTT, *supra* note 14, at 189-96; Speidel, *supra* note 6, at 833 (stating that sellers are often successful in "obtaining buyer assent" to clauses excluding consequential damages).

86. Anderson, *supra* note 1, at 774.

87. U.C.C. § 2-719(3) 1996.

88. Section 2-302 states:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Id. § 2-302.

89. "The basic test is whether . . . the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract." *Id.* § 2-302 cmt. 1. Courts need to look at the commercial background of the parties as well as the particular needs of the parties or the industry. *Id.*

90. These categories were first created by Professor Arthur Allen Leff, who described "procedural unconscionability" as "bargaining naughtiness" and "substantive unconscionability" as "evils in the resulting contract." Arthur Allen Leff, *Unconscionability and the Code — The Emperor's New Clause*, 115 U. PA. L. REV. 485, 487 (1967).

91. *Id.* The factors courts use to assess procedural unconscionability are typically: "1) the parties and their characteristics, 2) the way the contract states and packages the substantively offensive terms, and 3) the seller's sales tactics." Michael J. Phillips, *Unconscionability and Article 2 Implied Warranty Disclaimers*, 62 CHI.-KENT L. REV. 199, 217 (1985). Disparity of bargaining power is an important consideration under the first category; its absence typically suggests that the contract is conscionable, but its presence is just one factor to a finding of unconscionability. *Id.* Unfavorable contract terms which are hidden in fine print or unintelligible to an ordinary person fall under the second category. *Id.* at 218. The third category describes "sales induced by Seller trickery, guile, and high-pressure tactics." *Id.* See, e.g., *John Deere Leasing Co. v. Blubaugh*, 636 F. Supp. 1569, 1573 (D. Kan. 1986) (noting that procedural unconscionability involves a lack of voluntariness); *Croce v. Kurnit*, 565 F. Supp. 884, 893 (S.D.N.Y. 1982) (stating that haste and high-pressure sales tactics would support a finding of unconscionability); *Northwest Acceptance*

with the effect a contract term has on the contract.⁹² For a contract term to be unconscionable, it is generally agreed that elements of both procedural and substantive unconscionability must be satisfied.⁹³

The Code provides that when consumers are involved, a limitation on consequential damages is *prima facie* unconscionable.⁹⁴ However, in the commercial context, limitations on consequential damages are not *prima facie* unconscionable.⁹⁵ Consequently, most claims alleging unconscionability in commercial cases fail because courts expect the parties to possess a greater understanding of contracts than consumers.⁹⁶ For example, in *Kaplan v. RCA*

Corp. v. Almont Gravel, Inc., 412 N.W.2d 719, 724 (Mich. Ct. App. 1987) (noting that a lack of bargaining power is a significant factor in unconscionability determinations); *Bank of Ind. v. Holyfield*, 476 F. Supp. 104, 109-10 (S.D. Miss. 1979) (noting that a lack of opportunity to study the terms of a contract demonstrates a lack of knowledge and that this lack of knowledge may come from the use of fine print, complex language, or lack of sophistication).

92. "Substantive unconscionability looks to the oppressiveness or one-sided nature of the transaction and simply restates the basic requirement that the substantive terms must [not] be unreasonably favorable to one party or unduly burdensome to the other." Harry G. Prince, *Unconscionability in California: A Need for Restraint and Consistency*, 46 HASTINGS L.J. 459, 473 (1995). These terms typically include: excessive price terms, termination-at-will clauses, and add-on security clauses. *Id. See, e.g., Amoco Oil v. Ashcraft*, 791 F.2d 519, 522 (7th Cir. 1986) (stating that gross inequality of bargaining power and unreasonably one-sided terms will support findings of unconscionability); *Avildsen v. Prystay*, 574 N.Y.S.2d 535, 535-36 (App. Div. 1991) (finding that an oppressive term resulting from gross inequality in bargaining power supports a finding of unconscionability).

93. Schecter, *supra* note 46, at 1278-79. *See WHITE & SUMMERS, supra* note 45, § 4-2, at 128 (stating that most courts take a balancing approach to the unconscionability question and that, for a finding of unconscionability, "a certain quantum of procedural plus a certain quantum of substantive unconscionability" is required). *See, e.g., Collins v. Click Camera & Video*, 621 N.E.2d 1294, 1299 (Ohio Ct. App. 1993) (noting that a "quantum" of both substantive and procedural unconscionability is required); *Rite Color Chem. Co. v. Velvet Textile Co.*, 411 S.E.2d 645, 648-49 (N.C. Ct. App. 1992) (stating that both procedural and substantive unconscionability are required); *WXON-TV, Inc. v. A.C. Nielsen Co.*, 740 F. Supp. 1261, 1264 (E.D. Mich. 1990) (stating that substantive and procedural unconscionability are required). *But see Gillman v. Chase Manhattan Bank, N.A.*, 534 N.E.2d 824, 829 (N.Y. 1988) (stating that an outrageous substantive provision may suffice for a finding of unconscionability); *Resource Management Co. v. Weston Ranch & Livestock Co.*, 706 P.2d 1028, 1043 (Utah 1985) (stating that in rare cases, unfair surprise may be enough). *See also John E. Murray, Jr., Unconscionability: Unconscionability*, 31 U. PITT. L. REV. 1 (1969).

94. U.C.C. § 2-719(3) (1996).

95. *See id.* This note only addresses the more controversial case of limitations of consequential damages in the commercial context.

96. *See WHITE & SUMMERS, supra* note 17, § 12-11(a), at 672 (stating that "findings of unconscionability should be and are rare in commercial settings"). When a business entity seeks consequential damages from another business entity, despite a clause in the contract which bars their recovery, courts are likely to believe that "the buyer is hardly the sheep keeping company with wolves that it would have us believe." *Id.* (quoting *K & C, Inc. v. Westinghouse Elec. Corp.*, 263 A.2d 390, 393 (Pa. 1970)). *See, e.g., Canal Elec. Co. v. Westinghouse Elec. Co.*, 973 F.2d 988, 996-97 (1st Cir. 1992) (making no finding of unconscionability where the parties to the contract

Corp.,⁹⁷ the buyer argued that a clause in the contract which excluded consequential damages was unconscionable.⁹⁸ The court held that the exclusionary clause was not unconscionable, however, and reasoned that the loss was commercial, the buyers were experienced businesspeople, and that the clause was reasonable considering both the sale price and the risk of consequential damages.⁹⁹

While subsections (2) and (3) of Section 2-719 both suffer from a lack of clarity, they do adequately address the limitations on remedies and consequential damages, respectively. When read in isolation, Section 2-719(2) clearly contemplates the failure of a limited remedy's essential purpose. Similarly, Section 2-719(3) contemplates clauses in contracts which limit or exclude consequential damages. However, when read in the context of contracts which contain both of these provisions, Sections 2-719(2) and (3) are too contradictory to provide courts with any guidance. As a result, the substantial majority of courts have simply conceded this point and resigned themselves to applying only one of the two contradictory subsections mechanically. Other courts refuse to adopt either of these categorical approaches, and resolve this conflict based simply on their opinions of the parties' allocation of risk in the contract. The Code must recognize the problems particularly associated with contracts containing both a limited remedy provision which has failed of its essential purpose and a separate provision which excludes consequential damages. These problems should be addressed in a separate subsection to Section 2-719 of the Code. This will allow courts to be guided by Section 2-719 rather than confused by it.

were "highly sophisticated business entities"); *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264, 265 (E.D. Mich. 1976) (stating that unconscionability is an extraordinary remedy and is usually reserved for unsophisticated and uneducated consumers, not business people).

97. 783 F.2d 463 (4th Cir. 1986). In *Kaplan*, a television station brought an action against the seller of a defective antenna.

98. *Id.* at 464.

99. *Id.* at 467. See also *M/V Am. Queen v. San Diego Marine Constr.*, 708 F.2d 1483, 1490 (9th Cir. 1983) (holding that the limitation of remedy provision in the contract was not unconscionable because the contract involved a commercial transaction between two commercial entities); *Transamerica Oil Corp. v. Lynes, Inc.*, 723 F.2d 758, 764 (10th Cir. 1983) (holding that the limitation of damages clause in the contract was not unconscionable because loss was commercial, both parties were experienced business entities, and limitation language was clear and concise). *But see A&M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 493 (1982) (holding that the consequential damages exclusion clause in the contract was unconscionable because of unfair surprise, unequal bargaining power, and lack of conspicuousness). In the contract between Bob and Sally, Bob would almost certainly fail on a claim that the clause excluding consequential damages was unconscionable. This would be due primarily to the fact that rustproof steel is not an ordinary good in the sense that Bob can expect it to be free from defects. Experimental goods, specially manufactured goods and highly technological goods which fail to work properly are not uncommon. Thus, they do not lend themselves to notions of oppression and unfair surprise.

III. JUDICIAL TREATMENT OF THE RELATIONSHIP BETWEEN CODE SECTIONS 2-719 (2) & (3)

When a limited remedy fails of its essential purpose, the buyer has recourse under Section 2-719(2),¹⁰⁰ which allows the buyer to receive consequential damages for the seller's breach.¹⁰¹ However, if a separate clause in the contract excludes consequential damages, sellers may have recourse under Section 2-719(3). That section allows sellers to exclude consequential damages unless this exclusion is unconscionable.¹⁰² Whether a failure of the essential purpose of a limited remedy automatically voids the clause excluding consequential damages is the crucial question that courts must answer in this situation. Unfortunately, Section 2-719 of the Code does not provide courts with the means to answer this question with any certainty because it does not address this problem explicitly.

This ambiguity in the Code has manifested itself in the case law addressing this issue. Three different approaches have emerged for interpreting the appropriate relationship between Sections 2-719(2) and 2-719(3): the dependent approach, the independent approach, and the case-by-case approach.¹⁰³ Courts applying the dependent approach hold that when a limited remedy fails of its essential purpose, the buyer can recover consequential damages despite a separate provision in the contract which excludes consequential damages.¹⁰⁴ Courts applying an independent approach hold that, despite a limited remedy's failure of its essential purpose, the buyer cannot recover consequential damages unless he proves that their exclusion is unconscionable.¹⁰⁵ Courts utilizing the case-by-case approach examine the facts and circumstances of each case to determine whether the allocation of risk in the contract should be disturbed.¹⁰⁶ In order to understand the distinctions between the three approaches, this Note will review each approach separately.

100. See U.C.C. § 2-719(2) (1996) ("Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.").

101. See *id.* § 2-714.

102. *Id.* § 2-719(3).

103. See *infra* notes 107-57 and accompanying text.

104. See *infra* notes 107-14 and accompanying text.

105. See *infra* notes 115-32 and accompanying text.

106. See *infra* notes 133-57 and accompanying text.

A. The Dependent Approach

A substantial minority of courts have adopted the dependent approach.¹⁰⁷ Courts utilizing this approach void clauses excluding consequential damages upon a finding that the limited remedy has failed of its essential purpose.¹⁰⁸ Although the minority approach, it is supported by Section 2-719(2) and the official comments. Section 2-719(2) provides that a buyer is entitled to any Code remedy, one of which is consequential damages, when a limited remedy fails of its essential purpose.¹⁰⁹ The comments to Section 2-719 add that “it is of the very essence that at least minimum adequate remedies be available” and that “when an apparently fair and reasonable clause because of circumstances fails in its purpose, . . . it must give way to the general remedy provisions” of the Code.¹¹⁰

The Eighth Circuit Court of Appeals has been the strongest advocate of the dependent approach. In one of the Eighth Circuit’s leading cases, *Soo Line Railroad v. Fruehauf Corp.*,¹¹¹ the defendant claimed that the plaintiff’s damages should be limited to the reasonable cost of repairing the defective goods, relying on the warranty “package” which expressly limited the buyer’s remedies to repair and replacement and excluded liability for consequential damages.¹¹² The court, in awarding the buyer lost profits as a result of the breach, stated that the fundamental intent of Section 2-719(2) was to make available all contractual remedies, including consequential damages, when limited remedies failed of their essential purpose.¹¹³ The court reasoned that the defendant, though called upon to make the necessary repairs, had not done

107. See, e.g., *Ragen Corp. v. Kearney & Trecker Corp.*, 912 F.2d 619, 625 (3d Cir. 1990) (stating that since the buyer’s exclusive remedy failed of its essential purpose, the buyer could recover consequential damages, despite a provision in the contract which excluded them); *Murray v. Holiday Rambler*, 265 N.W.2d 513, 525 (Wis. 1978) (When the limited remedy fails of its essential purpose, the buyer is entitled to any remedy that the U.C.C. provides. This includes consequential damages under § 2-715.). See generally *Riley v. Ford Motor Co.*, 442 F.2d 670 (5th Cir. 1971); *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364 (E.D. Mich. 1977); *Koehring v. A.P.I. Inc.*, 369 F. Supp. 882 (E.D. Mich. 1974); *Beal v. General Motors Corp.*, 354 F. Supp. 423 (D. Del. 1973); *Clark v. International Harvester Co.*, 581 P.2d 784 (Idaho 1978); *Adams v. J.I. Case Co.*, 261 N.E.2d 1 (Ill. App. Ct. 1970); *Massey-Ferguson, Inc. v. Evans*, 406 So. 2d 15 (Miss. 1981); *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157 (S.D. 1975).

108. See, e.g., *R.W. Murray v. Shatterproof Glass*, 758 F.2d 266, 271-72 (8th Cir. 1985) (stating that the limited remedy’s failure of essential purpose voids the consequential damages exclusion).

109. U.C.C. § 2-719(2) (1996).

110. *Id.* § 2-719 cmt. 1.

111. 547 F.2d 1365 (8th Cir. 1977). In *Soo Line*, the plaintiff had purchased some railroad cars from the defendant, and the cars never worked properly. *Id.* at 1368.

112. *Id.* at 1365-68.

113. *Id.* at 1373.

so, and no rational buyer would enter into a contract knowing that the sole remedy available to him would be rendered a "nullity."¹¹⁴ Under the dependent approach, once a court finds that the limited remedy has failed of its essential purpose, the buyer is entitled to consequential damages despite a separate provision in the contract which excludes their recovery. This conclusion is the same whenever the dependent approach is used, so the result in one case is analagous to the results in every case based on this approach.

B. The Independent Approach

In contrast to the dependent approach, courts applying an independent approach only allow consequential damages if their exclusion is unconscionable. A majority of jurisdictions follow this approach, evaluating the limited remedy of repair or replacement under the failure of its essential purpose standard under Section 2-719(2) and the consequential damages exclusion under the unconscionability standard of Section 2-719(3).¹¹⁵ Courts using this approach uphold clauses excluding consequential damages unless it is unconscionable to

114. *Id.* at 1369, 1373. See also *Hartzell v. Justus Co.*, 693 F.2d 770, 773-74 (8th Cir. 1982) (In awarding consequential damages despite a clause in the contract excluding their recovery, the court stated that when goods (a log home construction kit) fall short of the seller's promises, and where repairs do not make it right, the seller's liability cannot be limited to the cost of repairs.); *R.W. Murray, Co. v. Shatterproof Glass*, 758 F.2d 266, 271-72 (8th Cir. 1985) (holding that the failure of the limited remedy's essential purpose automatically voids the consequential damages limitation); *Matco Mach. & Tool Co. v. Cincinnati Milacron*, 727 F.2d 777, 780 (8th Cir. 1984) (holding that the buyer was entitled to consequential damages despite an express contract provision excluding their recovery).

115. See, e.g., *Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable and Cold Storage Co.*, 709 F.2d 427, 435 (6th Cir. 1983) (stating that Section 2-719(2) turns on the limited remedy's failure of essential purpose and Section 2-719(3) turns on a judicial determination of unconscionability). See generally *McNally Wellman Co. v. New York State Elec. & Gas Corp.*, 63 F.3d 1188 (2d Cir. 1995); *Riegel Power Corp. v. Voith Hydro*, 888 F.2d 1043 (4th Cir. 1989); *Kaplan v. R.C.A. Corp.*, 783 F.2d 463 (4th Cir. 1986); *Coastal Modular Corp. v. Laminators, Inc.*, 635 F.2d 1102 (4th Cir. 1980); *S.M. Wilson & Co. v. Smith Int'l Inc.*, 587 F.2d 1363 (9th Cir. 1978); *McKernan v. United Techs. Corp.*, 717 F. Supp. 60 (D. Conn. 1989); *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572 (D.D.C. 1974); *Ritchie Enters. v. Honeywell Bull, Inc.*, 730 F. Supp. 1041 (D. Kan 1990); *Lincoln Pulp & Paper Co. v. Dravo Corp.*, 436 F. Supp. 262 (D. Me. 1977); *U.S. Fibres, Inc. v. Proctor & Schwartz, Inc.*, 358 F. Supp. 449 (E.D. Mich. 1972), *aff'd*, 509 F.2d 1043 (6th Cir. 1975); *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435 (S.D.N.Y. 1976); *County Asphalt, Inc. v. Lewis Welding & Eng'g Corp.*, 323 F. Supp. 1300 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372 (2d Cir. 1971); *Myrtle Beach Pipeline Corp. v. Emerson Elec. Co.*, 843 F. Supp. 1027 (D.S.C. 1993); *Polycon Indus., Inc. v. Hercules, Inc.*, 471 F. Supp. 1316 (E.D. Wis. 1979); *Canal Elec. Co. v. Westinghouse Elec. Corp.*, 548 N.E.2d 182 (Mass. 1990); *Kearney & Trecker Corp. v. Master Engraving Co.*, 527 A.2d 429 (N.J. 1987); *Cayuga-Harvester, Inc. v. Allis-Chalmers Corp.*, 95 A.2d 5 (N.Y.S.2d 1983); *Schurtz v. BMW of N. Am., Inc.*, 814 P.2d 1108 (Utah 1991).

do so.¹¹⁶ Support for this approach can also be found in the Code and its official comments. Section 2-719(3) states that “consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.”¹¹⁷ Further, the comments to Section 2-719 state that parties are free to shape their remedies to their particular requirements,¹¹⁸ and that terms limiting or excluding consequential damages are merely allocations of unknown risks.¹¹⁹ Professors White and Summers prefer this approach because they advocate parties being able to freely negotiate contract terms.¹²⁰ They feel that judicial rewriting of contract terms is contrary to the Code’s policy of according “primacy to the terms of the contract.”¹²¹

A leading case advocating the independent approach is *Chatlos Systems, Inc. v. National Cash Register Corp.*¹²² In *Chatlos*, the plaintiff purchased a computer system from the defendants which was allegedly designed to solve inventory problems and save labor costs. The limited remedy provisions of the warranty package provided that for twelve months after delivery of the computer, the computer would be free from defects in materials, workmanship and operational failure resulting from ordinary use.¹²³ The contract also excluded the recovery of consequential damages.¹²⁴ The defendants made repeated attempts to fix the defective computer, but after one and one-half years, the computer still did not operate as warranted.¹²⁵ The court first found that the limited remedy failed of its essential purpose, citing Section 2-719(2) of the Code.¹²⁶ The court then stated, however, that the consequential damages exclusion was governed by Section 2-719(3) of the Code and would be voided only if it was unconscionable.¹²⁷ The court reasoned that the limited remedy of repair and the consequential damages exclusion are two different methods of limiting recovery for breach of warranty and that each is tested by separate Code

116. See, e.g., *Kearney & Trecker Corp. v. Master Engraving Co.*, 527 A.2d 429, 436 (N.J. 1987) (stating that the consequential damages disclaimer is an independent provision and is valid unless unconscionable).

117. U.C.C. § 2-719(3) (1996).

118. *Id.* § 2-719 cmt. 1.

119. *Id.* § 2-719 cmt. 3.

120. WHITE & SUMMERS, *supra* note 17, § 12-10, at 667-68 (“Those cases are most true to the Code’s general notion that the parties should be free to contract as they please. . . . In our view, the parties, better than the state, can allocate the loss to the one who can avoid it at the least cost. The state’s agents should respect that allocation.”).

121. *Id.* This is particularly true when a knowledgeable buyer is using an expensive machine or consuming a commodity in a business setting. *Id.* at 668.

122. 635 F.2d 1081 (3d Cir. 1980).

123. *Id.* at 1084.

124. *Id.* at 1085.

125. *Id.*

126. *Id.* at 1086.

127. *Id.*

provisions.¹²⁸ The court considered whether it was unconscionable for the buyer to retain the risk of consequential damages upon a failure of the essential purpose of the exclusive repair remedy.¹²⁹ The court held that there was nothing in the formation of the contract or the circumstances resulting in failure of performance which made it unconscionable to enforce the parties' allocation of risk.¹³⁰ The court reasoned that there was no disparity in the bargaining power of the parties, and the buyer should have, and probably did have, some appreciation of the problems that might be encountered with a computer system.¹³¹ Under the independent approach, courts will not award consequential damages to the buyer unless the clause in the contract excluding their recovery is unconscionable, and this is rare.¹³² Like the dependent approach, the independent approach uses the same analysis in every case decided under it. Therefore, all of the cases decided under the independent approach are analogous in their reasoning.

In an effort to avoid the tension between Sections 2-719 (2) and (3), some courts reject the application of either the dependent or independent approaches, instead looking at the facts and circumstances of each case to determine whether an award of consequential damages is justified. Unlike the dependent or independent approaches, the case-by-case analysis is applied differently among the courts. Therefore, it provides less predictability than the dependent or independent approaches.

C. *The Case-By-Case Approach*

The case-by-case approach has been applied relatively infrequently by lower courts.¹³³ When courts employ this approach, they look at the facts and

128. *Chatlos Sys., Inc. v. National Cash Register Corp.*, 635 F.2d 1082 (3d Cir. 1980).

129. *Id.* at 1087.

130. *Id.*

131. *Id.* The court went on to say that "this is not an instance of an ordinary consumer being misled by a disclaimer hidden in a 'linguistic maze.'" *Id.* (quoting *Gladden v. Cadillac Motor Car Div.*, 416 A.2d 394, 403 (N.J. 1980)).

132. *See, e.g.*, *Associated Press v. Southern Ark. Radio Co.*, 809 S.W.2d 695, 697 (Ark. Ct. App. 1991) (upholding the trial court's determination of unconscionability, but expressing reservations about finding unconscionability in cases involving merchants); *Construction Assocs. v. Fargo Water Equip. Co.*, 446 N.W.2d 237, 242 (N.D. 1989) (stating that courts should be skeptical of unconscionability in commercial cases, but finding unconscionability). *See supra* notes 87-99 and accompanying text.

133. *See, e.g.*, *Milgard Tempering, Inc. v. Selas Corp.*, 902 F.2d 703, 709 (9th Cir. 1990) (holding that the plaintiff could recover consequential damages because two and one half years of unsuccessful repair efforts were not part of the bargained for allocation of risk); *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 547 (9th Cir. 1985) (holding that the buyer was entitled to consequential damages because "the facts justify the result"); *Fiorito Bros., Inc. v. Freuhauf Corp.*, 747 F.2d 1309, 1315 (9th Cir. 1984) ("Judging each case and each contract on its own merits will

circumstances of each case to determine whether the clause excluding consequential damages should be excluded. This approach is not supported by the Code or its official comments. Courts using the case-by-case approach usually do not address the tension between Sections 2-719 (2) and (3) of the Code.¹³⁴ Instead, these courts focus primarily on the allocation of risk as revealed by the warranty “package” and are hesitant to disturb consensual allocations of risks in contracts.¹³⁵ If the contract excludes the seller’s liability for consequential damages by allocating the risk of consequential damages to the buyer, the buyer has a tough task in seeking to convince the court that it should invalidate the clause excluding consequential damages, despite a failure of repair or replacement.¹³⁶

The Seventh Circuit Court of Appeals articulated the case-by-case approach in *AES Technology Systems, Inc. v. Coherent Radiation*.¹³⁷ In *AES*, the contract explicitly stated that the buyer’s only remedy would be repair or replacement of defective parts, and the court found that this exclusive remedy impliedly excluded the recovery of consequential damages.¹³⁸ In place of addressing the tension between Code Sections 2-719 (2) and (3), the court considered whether this was a “proper case” for awarding consequential damages. This inquiry was further reduced to whether either party had been deprived of a substantial benefit of the bargain.¹³⁹ The court found that the intent of the parties, as revealed by the contract, was for the plaintiff to bear the risk of the project.¹⁴⁰ In upholding the exclusion of consequential damages, the court stressed that courts should not rewrite contracts and ignore the parties’

better allow courts to give effect to the parties’ intentions regarding the risk allocation and will lead less frequently to unjust results.”); *Smith v. Navistar Int’l Transp. Corp.*, 714 F. Supp. 303 (N.D. Ill. 1989) (“The rationale underlying the case-by-case approach is compelling” and “[a]ccordingly, . . . a buyer may seek consequential damages . . . despite a disclaimer to the contrary if the buyer can demonstrate that the warranty fails of its essential purpose and the parties did not contractually allocate all attendant risks.”). See generally, *Mid Continent Cabinetry, Inc. v. George Koch Sons, Inc.*, No. 87-1248-C, 1991 U.S. Dist. LEXIS 10644 (D. Kan. July 11, 1991).

134. See, e.g., *Waters v. Massey Ferguson*, 775 F.2d 587, 591-93 (4th Cir. 1985) (deciding the case based on contractual construction without reference to the “perceived statutory tension” between sections 2-719(2) and 2-719(3)).

135. See, e.g., *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933, 941 (7th Cir. 1978) (stating that “Section 2-719 was intended to encourage and facilitate consensual allocations of risks associated with the sale of goods”).

136. See *Speidel*, *supra* note 6, at 840 (stating that this approach “indulges a presumption in favor of the excluder clause”).

137. 583 F.2d 933 (7th Cir. 1978). This case involved a contract for the sale of a highly complex laser which never worked properly. The warranty explicitly limited the plaintiff’s remedies to repair or replacement. From this exclusive remedy, the court found that the contract impliedly excluded consequential damages. *Id.* at 941 n.9.

138. *Id.* at 941.

139. *Id.* at 940 n.7, 941.

140. *Id.* at 941.

intent; rather, they should interpret the existing contract as fairly as possible when unexpected events occur.¹⁴¹ The court specifically rejected both the dependent and independent approaches.¹⁴² Conspicuously missing from the court's opinion was any indication of whether the type of goods involved or the bargaining power of the parties should influence courts' decisions.¹⁴³

In *S.M. Wilson & Co. v. Smith International, Inc.*,¹⁴⁴ the Ninth Circuit Court of Appeals also employed the case-by-case approach and expressed similar concerns that courts should be reluctant to disturb the allocation of risk in contracts.¹⁴⁵ The court in *Wilson*, like the court in *AES*, held for the seller.¹⁴⁶ However, unlike the court in *AES*, the *Wilson* court indicated that "good reasons" may invalidate a consequential damages exclusion.¹⁴⁷ "Good reasons" offered by the court included the following: a disparity in the bargaining power of the parties, a contract drafted solely by one of the parties, unreasonable delay on the part of the seller, or goods whose defects would normally not be anticipated.¹⁴⁸

Conversely, in *Waters v. Massey-Ferguson*,¹⁴⁹ the Fourth Circuit Court of Appeals advocated the case-by-case approach and held that the buyer was entitled to consequential damages despite a provision in the contract excluding them.¹⁵⁰ This court also avoided the statutory tension between Sections 2-719

141. *Id.*

142. *See* *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933, 941 (7th Cir. 1978) ("[W]e reject the contention that failure of the essential purpose of the limited remedy automatically means that a damage award will include consequential damages."). *See also id.* at 940 n.7 (stating that the contract would not undergo an unconscionability analysis).

143. In a footnote, the court indicated that the bargaining power of the parties was irrelevant. *Id.* (stating that it did not matter that the contract was between commercial parties and did not involve a consumer). Also, while the court stated that the goods involved were highly complex, they were not inclined to treat the case differently than cases involving ordinary goods. *Id.* at 939-40. The court stated that it was only concerned with "whether a party was deprived of a substantial benefit of the bargain." *Id.* at 940 n.7.

144. 587 F.2d 1363 (9th Cir. 1978).

145. *Id.* at 1375-76.

146. *Id.* at 1375.

147. *Id.*

148. *Id.*

149. 775 F.2d 587 (4th Cir. 1985).

150. *Id.* at 593. The court noted:

We treat these points only in interpreting the litigated contract between *Waters* and *Massey-Ferguson*. We accordingly advance no general opinions about the enforceability of another warranty that does purport to exclude seller liability for consequential damages. As in so many other situations, sound advice may be found in the truism that "each case must stand on its own facts."

Id. (quoting *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363, 1376 (9th Cir. 1978)).

(2) and (3) of the Code.¹⁵¹ The court first noted that limited warranty “packages” are commonplace.¹⁵² The court then looked at the “limited warranty package” from three different interpretive perspectives: (1) the language of the agreement itself; (2) the creative context of the agreement in order to determine which party drafted the written terms in question and place upon that party the duty to articulate the contract precisely; and (3) the commercial context with emphasis upon the precise nature and purpose of the contract and the type of goods involved.¹⁵³ The court concluded that the exclusion of consequential damages did not extend to situations in which the seller failed to repair the goods as required by the warranty; since the contract indicated that the parties contemplated repair would be possible, the parties did not anticipate any need to limit damages from the failure of this remedy.¹⁵⁴

Since the court found that the parties had not allocated the risk of the limited remedy failing of its essential purpose, the court disregarded the clause excluding consequential damages.¹⁵⁵ The court reinforced its finding with the fact that the contract was written entirely by the defendant.¹⁵⁶ The court added that the contract was for a tractor and not complex or experimental goods, and that it was reasonable to assume neither the buyer nor the seller anticipated that repairs would be impossible.¹⁵⁷

All three of the current approaches are well supported. For example, the independent and dependent approaches are supported by the Code and its official comments. However, the case-by-case approach is valid because it recognizes that Section 2-719 is too contradictory to deal with the problems unique to contracts containing separate clauses limiting the buyer’s remedies and excluding the recovery of consequential damages. However, all three approaches are incompatible with these particular contracts. The dependent and independent

151. *Id.* at 591-93 (stating that the threshold inquiry was one of contractual construction and deciding the case based on this construction).

152. *Id.* at 590.

153. *Id.* at 591-92.

154. *Id.* at 592.

155. *Waters v. Massey-Ferguson*, 775 F.2d 587, 591-92 (4th Cir. 1985).

156. *Id.* at 592. The defendant had the duty to articulate the agreement precisely. “If a clause reasonably admits of two different meanings, ambiguity must be resolved against the drafting party.” *Id.* (quoting *Williams v. Teran Inc.*, 221 S.E.2d 526, 529 (S.C. 1976)).

157. *Id.* The court noted:

[The tractor] is built from familiar technology, manufactured to standard specifications, and sold to trusting consumers; most importantly, sellers routinely restore such tractors to working order. Given these mechanical and marketing characteristics of the tractor, the premise that the warranty foresaw only repair is a commercially reasonable construction. For another product, and particularly for complex, delicate, or jointly designed equipment, the same premise might not be commercially reasonable.

Id.

approaches reflect the problems with applying a mechanical test to every situation. The case-by-case approach reflects the problems with attempting to devise a test without the guidance of the Code.

IV. CURRENT PROBLEMS WITH CURRENT JUDICIAL TREATMENT OF THE RELATIONSHIP BETWEEN CODE SECTIONS 2-719 (2) & (3)

The preceding Section of this Note illustrates the difficulty courts have had with the question concerning whether buyers are entitled to consequential damages upon a failure of the limited remedy's essential purpose and whether they must first show that the exclusion of consequential damages is unconscionable. While all three approaches suffer from different deficiencies, they can all be attributed to the ambiguous language of the Code itself. The official comments to Section 2-719 purport to allow the buyer to recover consequential damages when a contract which limits the buyer's remedies is unreasonable.¹⁵⁸ In contrast, Section 2-719(2) purports to allow the buyer's recovery of consequential damages only when the limited remedy fails of its essential purpose.¹⁵⁹ Finally, Section 2-719(3) precludes the buyer's recovery of consequential damages unless their exclusion is unconscionable.¹⁶⁰ Looking at each of the three approaches reveals the serious problems caused because of the conflicting subsections of Section 2-719.

Courts applying the dependent approach find authority for voiding consequential damages exclusions when a limited remedy fails of its essential purpose in Code Section 2-719(2), which makes available all Code remedies, including consequential damages, upon this occurrence.¹⁶¹ The comments support this conclusion, stating that a "fair quantum of remedy for breach" must be available.¹⁶² Conversely, courts utilizing an independent approach cite Section 2-719(3), which allows consequential damages exclusions unless doing so is unconscionable.¹⁶³ Section 2-719(1) and the comments to Section 2-719 also support, and arguably encourage, this conclusion.¹⁶⁴

158. U.C.C. § 2-719 cmt. 1 (1996) ("[P]arties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect."). It should be noted that this author could find no case which was decided on a "reasonableness" standard. At a minimum, courts require that the buyer show that the limited remedy has failed of its essential purpose.

159. *See id.* § 2-719(2).

160. *See id.* § 2-719(3).

161. *See id.* § 2-719(2).

162. *Id.* § 2-719 cmt. 1.

163. *See id.* § 2-719(3).

164. *See U.C.C. § 2-719(1)* (1996) (stating that the agreement may limit the measure of damages recoverable). *See also id.* § 2-719 cmt. 1 (stating that parties are free to shape their remedies to their particular requirements).

The question which both of these approaches fail to address adequately is how to interpret the parties' intent with regard to the risk that consequential damages will be excluded upon a failure of the limited remedy's essential purpose. Applying these approaches in a mechanical fashion invariably leads to faulty assumptions being made regarding the parties' allocation of risks in the limited warranty package. "Dependent" courts assume that the parties did not contemplate the limited remedy failing of its essential purpose at the time of contracting.¹⁶⁵ The clause excluding consequential damages is only operative to the extent that the defective goods can be repaired or replaced.¹⁶⁶ Once it is shown that repair or replacement will not cure the defective goods, the buyer is entitled to consequential damages.¹⁶⁷ These courts assume that parties intended for the seller to bear the risk of the failure of the limited remedy.¹⁶⁸

The "independent" courts assume just the opposite; namely that the parties must have contemplated the failure of the limited remedy's essential purpose. Otherwise, the contract would not have explicitly excluded the seller's liability for consequential damages.¹⁶⁹ These courts assume that the contract allocated the risk to the buyer.¹⁷⁰ The assumptions drawn by both the dependent and independent approaches fail to contemplate and reconcile the parties' true intent regarding allocations of risk their respective approaches mandate.¹⁷¹ As a result of this neglected intent, a need exists for the Code to endorse an approach which contemplates that the parties agreed to an allocation of risk, something the Code is incapable of in its present form.

The case-by-case approach is commendable for inquiring into the allocation of risk by the parties. However, the method by which these courts assign this

165. *See, e.g.,* Soo Line R.R. v. Fruehauf Corp., 547 F.2d 1365, 1373 (8th Cir. 1977) (stating that the buyer would not have entered into the contract had he known that the only remedy available to him would be rendered a "nullity").

166. *See, e.g.,* R.W. Murray, Co. v. Shatterproof Glass Corp., 758 F.2d 266, 272-73 (8th Cir. 1985) (holding that a failed limited remedy voids the clause excluding consequential damages).

167. *See, e.g.,* Jones & McKnight Corp. v. Birdsboro Corp., 320 F. Supp. 39, 44 (N.D. Ill. 1970) (holding that the seller's failure to meet its repair or replacement obligations under the contract precludes the seller from avoiding liability under the clause excluding consequential damages).

168. *See, e.g.,* Soo Line R.R. Co., 547 F.2d at 1373 (stating that the buyer could not anticipate that the sole remedy available to him (repair or replacement) would be rendered a "nullity").

169. The comments arguably support this assumption. *See* U.C.C. § 2-719 cmt. 3 (1996) ("[S]uch terms are merely an allocation of unknown or undeterminable risks.").

170. *See, e.g.,* Chatlos Sys. v. NCR Corp., 635 F.2d 1081, 1087 (3d Cir. 1980) (finding that the buyer retains the risk of consequential damages upon the failure of essential purpose and the only question is whether or not this is unconscionable); *Kearney & Trecker Corp. v. Master Engraving Co.*, 527 A.2d 429, 433 (N.J. 1987) (stating that the seller's right to exclude consequential damages is recognized as a beneficial risk-allocation device designed to reduce the seller's exposure in the event of breach).

171. *See supra* notes 161-68 and accompanying text.

risk is suspect. For example, in *AES Technology Systems, Inc. v. Coherent Radiation*,¹⁷² the leading Seventh Circuit case,¹⁷³ the court found that the "limited warranty package" which limited the buyer's remedies to repair or replacement impliedly excluded the recovery of consequential damages as well.¹⁷⁴ It did not matter to the court that the clause limiting damages did not refer specifically to consequential damages.¹⁷⁵ This court, like other courts employing the case-by-case approach, did not address the tension between Sections 2-719 (2) and (3) of the Code.¹⁷⁶ Instead, the court allocated the risk of the loss to the buyer based on its own opinion of what was important in the factual background and the parties' agreement,¹⁷⁷ which did not even have a separate provision excluding consequential damages, much less an express intention of who should bear the risk of these damages.¹⁷⁸

Some legal scholars have argued that the flexibility inherent in Article Two of the Code allows too much latitude for courts to become policymakers.¹⁷⁹ One commentator has been particularly disappointed with the Seventh Circuit's

172. 583 F.2d 933 (7th Cir. 1978).

173. See *id.*, cited with approval in *Smith v. Navistar Int'l Transp. Corp.*, 714 F. Supp. 303 (N.D. Ill. 1989); *Stewart Sandwiches, Inc. v. MSL Indus., Inc.*, No. 87 C 3478, 1990 U.S. Dist. LEXIS 13926 (N.D. Ill. Oct. 19, 1990).

174. *AES*, 583 F.2d at 941 n.9.

175. *Id.* Support for this conclusion can be found implicitly in the Code, because Section 2-719 does not mandate that remedy, limitations be conspicuous. See U.C.C. § 2-719(1) (1996) (stating that the agreement may limit the buyers remedies and may limit or alter the measure of available damages); *Id.* § 2-719 cmt. 1 (stating that reasonable agreements will be given effect). But cf. *id.* § 2-316 (requiring that disclaimers of the implied warranties of merchantability and fitness for a particular purpose be conspicuous).

"[M]ost courts have required remedy limitations to be *conspicuous* in order to be effective." DOUGLAS J. WHALEY, *PROBLEMS AND MATERIALS ON COMMERCIAL LAW* 125 (4th ed. 1995). See, e.g., *Stauffer Chem. Co. v. Curry*, 778 P.2d 1083, 1093 (Wyo. 1989) (finding that any other result would be absurd). But see *Apex Supply Co. v. Benbow Indus.*, 376 S.E.2d 694, 698 (Ga. Ct. App. 1988) (finding that conspicuousness is not required because limitations of remedies are not as serious as disclaimers of warranties).

176. *AES*, 583 F.2d at 941 (reducing the inquiry to whether it was a "proper case" for awarding consequential damages). See also *Waters v. Massey-Ferguson*, 775 F.2d 587, 591 (4th Cir. 1985) (stating that "[a]lthough the parties urge us to consider a perceived statutory tension between the relief that may be opened to a buyer by § [2-719(2)] and the relief that may be closed to a buyer by § [2-719(3)], the threshold inquiry is always one of contractual construction"). The *Waters* court decided the case based on its analysis of the contractual construction. *Id.*

177. *Id.* at 941.

178. The warranty language disputed in *AES* stated that "[t]he foregoing warranty is exclusive and in lieu of all other warranties, whether written, oral or implied, and shall be the buyer's sole remedy and seller's sole liability on contract or warranty or otherwise for the product . . ." *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933, 941 n.9 (7th Cir. 1978).

179. See, e.g., C. Paul Rogers III & Lee Elizabeth Michaels, *Symposium on the Seventh Circuit as a Commercial Court: Article Two Warranty Disputes in The Seventh Circuit: Advantage Seller or Disadvantage Court*, 65 CHI.-KENT L. REV. 849, 870 (1989).

handling of warranty disputes.¹⁸⁰ These criticisms focused on the court's analysis in *AES*. The court tried to support its conclusions by stating that the purpose of the courts is not to rewrite contracts by ignoring the parties' intent.¹⁸¹ Ironically, this is exactly what the court did. The court "rewrote" the contract when it found that the limited remedy clause impliedly contained a clause excluding consequential damages, and it "ignored the parties' intent" when it held that this phantom clause allocated the risk that consequential damages would be excluded to the buyer. The buyer in *AES* could not possibly have assumed the risk that consequential damages would be excluded because no clause in the contract addressed, much less disclaimed, the seller's liability for consequential damages.

To summarize, the case-by-case approach and its goal of allocating the risk of consequential damages based on the parties' agreement is laudable. However, the judicially imposed allocations of these risks are susceptible to unjust inconsistencies, as evidenced by the leading case of *AES Technology Systems, Inc. v. Coherent Radiation*. Giving these courts, and the courts applying dependent and independent approaches, more guidance by revising Section 2-719 would alleviate this problem.

All three approaches, the dependent approach, the independent approach and the case-by-case approach, seek to fairly allocate the risk that the limited remedy might fail. However, all three fail to adequately accomplish this task. The dependent and independent approaches are constrained by their narrow readings of Sections 2-719 (2) and (3).¹⁸² Further, although those courts employing a case-by-case approach are not constrained by any Code provisions, they suffer from a lack of guidance altogether.¹⁸³ These problems illustrate the need to revise the Code to adequately deal with the problem of whether

180. The following methodological flaws can be found in the Seventh Circuit's handling of warranty disputes, such as the one in *AES*:

- (1) Analysis is limited to just a few sections, omitting others of relevance, and, frequently, Article 2 is treated as if it were an ancillary rather than the primary source of law;
- (2) Statutory language and key definitions have been ignored;
- (3) There are no references to the history of the concept at stake or the legislative history of the sections being interpreted;
- (4) The comments are sometimes ignored or mischaracterized;
- (5) Cases from other jurisdictions interpreting the same sections are rarely developed and contrary precedents are frequently ignored;
- (6) References to important secondary sources, such as *J. WHITE & R. SUMMERS*, . . . are sparse and rarely used to the best advantage.

Speidel, *supra* note 6, at 847 n.158.

181. *AES*, 583 F.2d at 941.

182. See *supra* notes 158-68 and accompanying text.

183. See *supra* notes 169-78 and accompanying text.

buyers should be entitled to consequential damages when a limited remedy fails of its essential purpose, or whether they must first show that the consequential damages exclusion is unconscionable. Students and commentators have urged many different approaches in an effort to resolve this conflict. Some argue for intermediate approaches similar to the case-by-case approach, while others argue that the independent approach is the best way to deal with this problem.¹⁸⁴ This Note seeks to break new ground altogether, by reconciling all three interpretations in a new subsection to Section 2-719. This addition will lead to contracts being more carefully drafted, will give courts more guidance on how to interpret Section 2-719, and will lead to more consistent results in all jurisdictions.

V. A PROPOSED AMENDMENT TO CODE SECTION 2-719

The Code allows parties to freely contract, enabling them to allocate risks in the event that the contract is not performed as planned.¹⁸⁵ Therefore, attempts to reallocate these risks because of changed circumstances should be viewed with skepticism.¹⁸⁶ Section 2-719 of the Code was designed to allow parties wide latitude in shaping their agreements and states that "reasonable

184. See, e.g., Eddy, *supra* note 79, at 58-60 (arguing that a sliding scale should be implemented, wherein the more suspect method by which a term entered the contract during the bargaining process, the less "one sidedness" should be tolerated); Howard Foss, *When to Apply the Doctrine of Failure Essential Purpose to an Exclusion of Consequential Damages: An Objective Approach*, 25 DUQ. L. REV. 551, 594-95 (1987) (arguing that reasonable assumptions and intentions should be assigned to the parties at the time of contracting and that subsequent events should determine how to allocate risk of the limited remedy's failure of essential purpose based on those reasonable assumptions and intentions); Schecter, *supra* note 46, at 1275 (arguing that "cross-subsidization concerns justify an independent approach to consequential damage limitations"); Kathryn I. Murtagh, Note, *UCC Section 2-719: Limited Remedies and Consequential Damage Exclusions*, 74 CORNELL L. REV. 359, 376 (1989) (arguing that courts should look at the bargain struck by the parties and retain consequential damage exclusions as long as the buyer has a fair measure of relief based on the contract terms); Karl S. Yohe, Note, *The Inherent Ambiguity of Uniform Commercial Code Section 2-719: "Failure of Essential Purpose" v. "Unconscionability,"* 1987 U. ILL. L. REV. 523, 535 (1987) (arguing that for consumer contracts, there should be a rebuttable presumption that the consequential damages exclusion was intended to be voided upon a failure of the limited remedy's essential purpose and that for commercial contracts, there should be a rebuttable presumption that the consequential damages exclusion was intended to be valid, even upon a failure of the limited remedy's essential purpose).

185. See U.C.C. § 2-719 (1) cmts. 1, 3 (1996).

186. See WHITE & SUMMERS, *supra* note 17, § 12-10, at 667. The Code does not favor reallocating the risks in contracts which have been freely negotiated. *Id.* The buyer is the person who operates the machine or uses the goods. *Id.* at 668. The buyer "operates the machine, adjusts it, and understands the consequences of its failure." *Id.* When goods become defective, many causes can be traced to the buyer: buyer neglect, inadequate training and supervision of operators, failure to report difficulties or improper use all support this proposition. *Id.* When two commercial parties enter into a contract, courts should not disturb the allocation of risk in the contract. *Id.*

agreements limiting or modifying remedies are to be given effect.”¹⁸⁷ However, a buyer must be given a fair remedy when a seller breaches.¹⁸⁸ Section 2-719 attempts to provide for the situation where a seller has been either unwilling or unable to repair or replace defective goods, and the sales contract excludes the buyer’s recovery of consequential damages. As the preceding sections of this Note have shown, however, Section 2-719 has failed. This failure is due primarily to the lack of guidance Section 2-719 provides for courts resolving contract disputes when one clause in the contract limits the buyer’s remedies upon a failure of the limited remedy’s essential purpose and another clause excludes the buyer’s recovery of consequential damages.¹⁸⁹

Arguments can be made for all three approaches that courts have taken in resolving this issue: the dependent approach,¹⁹⁰ the independent approach,¹⁹¹ and the case-by-case approach.¹⁹² However, each approach is uniquely problematic.¹⁹³ This Note proposes that Section 2-719 of the Code be revised to reconcile all three approaches and solve the problems which are unique to each approach. Although cumbersome formalities accompany any changes to the Code,¹⁹⁴ the need for this revision cannot be overstated.

187. U.C.C. § 2-719 cmt. 1 (1996).

188. *Id.* “If the parties intend to conclude a contract for sale within this Article, they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract.” *Id.*

189. *See supra* notes 158-84 and accompanying text.

190. *See supra* notes 107-14 and accompanying text.

191. *See supra* notes 115-32 and accompanying text.

192. *See supra* notes 133-57 and accompanying text.

193. *See supra* notes 158-84 and accompanying text.

194. In 1987, Article 2A was added to the Uniform Commercial Code. It represents a major development in commercial law, addressing the leasing of personal property. U.C.C. § 2A foreword. Section 2A was a major undertaking and cannot be confused with a simple amendment of one Code section, but the process by which it was ultimately approved is indicative of how tough it is to update the Code to adequately deal with current problems in commercial law. Article 2A was presented “upon the recommendation of the Permanent Editorial Board for the Uniform Commercial Code, by the National Conference of Commissioners on Uniform State Laws and the American Law Institute.” U.C.C. § 2A foreword. However, the entire process took nine years. The foreword states:

The final product . . . has proceeded, following recommendations by the Conference’s Study Committee in 1981, through preparation and review by the Conference’s Drafting Committee first of a proposed free-standing Uniform Personal Property Leasing Act, which was approved by the Conference, and later of Article 2A, which proceeded through the Permanent Editorial Board, the Executive Committee of the Conference, the Conference, and the Council of the Institute and the Annual Meeting of the members of the Institute.

Id. The original version of Article 2A contained so many flaws that it was redrafted in 1990. WHALEY, *supra* note 175, at 27 n.6.

This revision would make the Code more predictable to the benefit of buyers, sellers and the courts. Proposed subsection (4) will address contracts which contain a limited remedy provision which has failed of its essential purpose, and a separate clause in the contract which limits the seller's liability for consequential damages. Courts will be guided by Code Section 2-719 rather than confused by it. This Note Section will first detail the proposed subsection (4) to Code Section 2-719. Part B will discuss the ways in which this subsection reconciles the dependent, independent and case-by-case approaches courts currently use to resolve this conflict. Part C will detail the benefits of adding subsection (4), and part D will preview its practical application.

A. U.C.C. Section 2-719(4)

The ambiguity in Section 2-719, with regard to contracts containing a clause which limits the buyer's remedies for the seller's breach of warranty and a separate provision which excludes the buyer's recovery of consequential damages when the limited remedy fails of its essential purpose, can be alleviated by adding a fourth subsection to Section 2-719 which addresses this problem specifically. After this amendment, Code Section 2-719 will read as follows:

- (1) Subject to the provisions of subsections (2), (3) and (4) of this section and of the preceding section on liquidation and limitation of damages,
 - (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
 - (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.
- (2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.
- (3) Consequential damages may be limited or excluded unless their limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

(4) When an agreement contains both a provision which limits the non-breaching party's available remedies, by limiting the buyer's remedies to repair or replacement of non-conforming goods or parts, and a provision which excludes the breaching party from liability for consequential damages, the effect of a failure of the limited remedy's essential purpose on the exclusion of consequential damages provision is presumed to be

(a) governed by subsection (2) of this section when the written expression of the agreement between the parties as revealed by the contract terms themselves does not contemplate the failure of the limited remedy's essential purpose; and

(b) governed by subsection (3) of this section when the written expression of the agreement between the parties as revealed by the contract terms themselves contemplates the failure of the limited remedy's essential purpose.¹⁹⁵

In addition, Official Comment (4) will be added:

4. This section was added in 1996 to address the problem of whether courts should apply a standard of unconscionability before allowing a buyer to recover consequential damages when the seller has failed to perform the only remedy (repair or replacement) available to the buyer, or whether the failure of essential purpose is enough. Subsection (4)(a) creates a presumption that when a limited remedy fails of its essential purpose, the provision excluding consequential damages automatically fails as well, and the buyer is entitled to consequential damages. Subsection (4)(b) creates a presumption that the provision excluding consequential damages remains valid unless its inclusion is unconscionable. If the parties intend for the provision excluding consequential damages to be independent of the overall package of warranty and remedy limitations, this must be clearly expressed. The presumptions created by subsection 4 can be rebutted

195. A presumption shifts the burden of producing evidence. JOHN W. STRONG, MCCORMICK ON EVIDENCE § 343, at 580 (4th ed. 1992). "[A] presumption is based not only upon the judicial estimate of the probabilities but also upon the difficulties inherent in proving that the more probable event in fact occurred." *Id.* Presumptions shift the burden of producing evidence with respect to the presumed fact, and if sufficient evidence is produced by the party against whom the presumption operates, the presumption is spent and disappears. *See id.* § 344, at 583.

by clear and convincing evidence.¹⁹⁶

B. Reconciliation of the Dependent, Independent and Case-by-Case Approaches

The dependent approach, the independent approach and the case-by-case approach are all represented in this new proposed subsection. Under proposed subsection (4)(a), the dependent approach is presumed to apply when the contract fails to specifically address what happens upon a failure of the essential purpose of the limited remedy.¹⁹⁷ It is reasonable to presume in this situation that the parties assumed that the defective goods could be repaired or replaced, and it is wrong to place the loss on the buyer in this situation. Therefore, the buyer is presumed to be entitled to consequential damages for the seller's breach, despite the consequential damages exclusionary clause in the contract.¹⁹⁸ This is the best situation for buyers and the fairest solution based on the parties' intent.

A rebuttable presumption would similarly apply in the seller's favor under proposed subsection (4)(b). Under this proposed subsection, the independent approach is presumed to apply when the contract specifically addresses what happens upon a failure of the limited remedy's essential purpose. For instance, the contract may provide:

The sole purpose of the stipulated exclusive remedy shall be to provide the buyer with free repair and replacement of defective parts in the manner provided herein. If this exclusive remedy fails of its essential purpose, the buyer is entitled only to a refund of the purchase price.

This is the best situation for sellers and the fairest based on the parties' intent. Buyers would be required to show that it is unconscionable to prevent their recovery of consequential damages. This presumption respects the parties explicit acknowledgement that the limited remedy may fail of its essential purpose.¹⁹⁹ The proposed subsections 4 (a) and (b) stop short of codifying the

196. The clear and convincing standard is possibly best understood as being something that is highly probable. See *id.* § 340, at 575-76. Clear and convincing proof is defined as:

That proof which results in reasonable certainty of the truth of the ultimate fact in controversy. Proof which requires more than a preponderance of the evidence but less than proof beyond a reasonable doubt. Clear and convincing proof will be shown where the truth of the facts asserted is highly probable.

BLACK'S LAW DICTIONARY 251 (6th ed. 1991).

197. See *supra* notes 107-14 and accompanying text.

198. See *supra* notes 107-14 and accompanying text for an analysis of the dependent courts' approach.

199. See *supra* notes 115-32 and accompanying text for an analysis of the independent courts' approach.

dependent and independent approaches because these proposed subsections recognize the problems with applying any test mechanically in every situation.²⁰⁰ To alleviate these problems, the proposed subsections would be rebuttable presumptions. The case-by-case approach would be particularly appropriate for cases involving unusual circumstances or facts. These types of cases require a more specific inquiry into the parties' intent.

The inclusion of rebuttable presumptions will force the party against whom the presumption operates to present clear and convincing evidence to the court that the parties' contract does not represent the parties' true intent regarding the allocation of risk. If the presumption is not overcome, the courts can resolve this aspect of the contract dispute easily by looking to either Section 2-719(2) or Section 2-719(3), without the need to attempt to distinguish them from each other. However, if clear and convincing evidence is produced by the party against whom the presumption operates, then the presumption is overcome and this issue will be decided by employing the case-by-case approach.²⁰¹

When either the buyer or the seller has overcome the presumptions working against it in subsections 4 (a) or (b), then the court must look at all of the facts and circumstances surrounding the contract in order to make its own determination of whether consequential damages are warranted. This inquiry should look at the contract from three perspectives: the language of the agreement itself, the creative context of the agreement to determine which party drafted the written terms in question, and the commercial context with emphasis upon the precise nature and purpose of the contract.²⁰² If the court finds enough of the "good reasons" enumerated in *S.M. Wilson & Co. v. Smith International, Inc.*²⁰³ to conclude that the buyer has "been deprived of a substantial benefit of the bargain,"²⁰⁴ the buyer should be awarded consequential damages despite the provision in the contract which excludes them.²⁰⁵ Otherwise, the court should not disturb the risk allocation in the

200. For a discussion of the problems inherent in the dependent and independent approaches, see *supra* notes 158-71 and accompanying text.

201. See *supra* notes 133-57 and accompanying text.

202. *Waters v. Massey-Ferguson Inc.*, 775 F.2d 587, 591 (4th Cir. 1985).

203. 587 F.2d 1363, 1375 (9th Cir. 1978). Good reasons to award consequential damages in this situation include: a disparity in the bargaining power between the buyer and the seller, a contract drafted solely by the seller, unreasonable delay on the part of the seller, or defective goods which would not normally be expected to be problematic. *Id.*

204. *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933, 940 n.7 (7th Cir. 1978).

205. The case-by-case approach described in *supra* notes 199-201 and accompanying text represents this author's consolidation of the maxims in three leading cases applying the case-by-case approach. See *Waters v. Massey-Ferguson*, 775 F.2d 587 (4th Cir. 1985); *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363 (9th Cir. 1978); *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933 (7th Cir. 1978). See *supra* notes 133-57 and accompanying text. Leaving too much discretion to a court's application of the case-by-case approach is also problematic. For a discussion

contract, respecting the contract's terms and precluding the buyer's recovery of consequential damages.

Under the case-by-case approach, the buyer will seek to show a lack of good faith, reasonableness, diligence or care on the part of the seller.²⁰⁶ The best case scenario for the buyer is when (1) the seller has a substantial advantage in bargaining power, (2) has drafted the entire agreement, (3) the defect is substantial, (4) the seller has made no effort or an unreasonable effort to cure, (5) the goods are such that they would normally not be susceptible to defects, and (6) no other adequate remedy is available. The seller will attempt to show that it has acted in good faith and reasonably performed all of its obligations under the contract. The best case scenario for the seller in this situation is when (1) the agreement was drafted as a joint effort between the seller and the buyer, (2) the parties have relatively equal bargaining power, (3) the seller has made a good faith but unsuccessful effort to cure, or is still willing to cure, (4) the goods were highly complex, experimental, or specially manufactured, and (5) the defect was not substantial, or, if it was, the buyer could obtain restitution of the price or direct damages.

The proposed subsection (4) resolves the ambiguity in Section 2-719 by making the dependent and independent approaches presumed, rather than absolute, and tailoring their application to protect the parties' intent with regard to the risk that the limited remedy may fail of its essential purpose. If the party against whom a presumption operates can overcome the presumption, then the issue will be decided on its own particular facts and circumstances. This proposed subsection alleviates the current ambiguity in the Code with regard to contracts which contain a limited remedy provision which has failed of its essential purpose and a separate provision which limits the seller's liability for consequential damages. As the next part of this Note discusses, however, this proposed subsection would lead to many other positive changes in commercial law.

C. The Benefits of Adding Subsection (4) to Code Section 2-719

As the preceding part of this Note details, adding the proposed subsection (4) to Section 2-719 of the Code would reconcile the courts' current approaches to resolving contracts which contain a limited remedy provision which has failed of its essential purpose and a separate provision which excludes the buyer's

of the problems with courts' applications of the case-by-case approach, see *supra* notes 172-84 and accompanying text.

206. See U.C.C. § 1-203 ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."); U.C.C. § 1-204 (1996) (dealing with reasonableness of time).

recovery of consequential damages. However, if the proposed subsection does not improve the law governing commercial transactions, then reconciling the courts' approaches serves no purpose. Fortunately, this subsection does improve the law governing commercial transactions.

One drawback of the proposed subsection is that sellers have the onerous task of drafting contracts which carefully exclude the buyers' recovery of consequential damages in the event that the limited remedy fails of its essential purpose. If not carefully excluded, the seller is presumably liable for consequential damages under subsection (4)(a). This is beneficial to the seller as well as the buyer, however, because if parties are contracting for goods which are susceptible to problems, this can be addressed at the negotiation stage of the contract's formation.

This increased disclosure will lead to contracts which more closely resemble the parties' intentions.²⁰⁷ If the seller knows that it is dealing with a high-risk buyer, the seller can increase the contract price, limit its liability in the contract, or forego the contract altogether.²⁰⁸ Addressing the potential problems with contracts at the negotiation stage would allow the parties to draft a contract consistent with their particular needs and desires. Buyers and sellers would be discouraged from using form contracts, leading to clearer language in contracts regarding the parties' intentions.²⁰⁹ The parties could be confident that the terms of the contract would be enforced when they bargain for specific clauses.

207. See Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 113 n.45 (1985) ("Disclosure . . . allows the other party to take extra precautions or to charge appropriate compensation for bearing increased risk.").

208. Thomas A. Diamond & Howard Foss, *Consequential Damages for Commercial Loss: An Alternative to Hadley v. Baxendale*, 63 FORDHAM L. REV. 665, 688 (1994).

209. For a discussion of the vexing problems form contracts present, see Murtagh, *supra* note 184, at 369-70. She states:

The widespread use of standard form contracts in commercial [contracts] . . . undermines both the independent and dependent courts' sole reliance on contract language to determine the parties' intended allocation of consequential loss upon the failure of a limited remedy. Standard form contracts often contain both limited remedy and consequential damage exclusion clauses. The use of pre-drafted forms, rather than documents specifically tailored to meet the individual requirements of a transaction, complicates contractual interpretation because parties often agree to the pre-drafted language with little or no bargaining. Often, the Seller can impose its form contract on the Buyer because of its superior bargaining position. When this occurs, the terms may fail to adequately reveal the actual agreement of the parties. Thus, standard form language often fails to demonstrate the parties' true intent. Under such circumstances, the contractual language itself provides an insufficient basis from which courts can presume intent.

Id.

This reliability on the bargain the parties struck is crucial to both buyers and sellers because they could plan in advance on the assumption that their contract would be enforced.²¹⁰ Professor Farnsworth has observed that contracts are of little value if they cannot be relied upon.²¹¹ The proposed subsection (4)(a) protects buyers' expectation interests, a hallmark of contract law.²¹² Similarly, proposed subsection (4)(b) protects sellers from liability for consequential damages when they carefully exclude them in contracts.²¹³

Buyers and sellers would both benefit from this added predictability.²¹⁴ Business planning costs can be significantly reduced by making contract law more certain and predictable.²¹⁵ Unfortunately, consequential damages are by their very nature highly unpredictable,²¹⁶ and there is little sellers can do to

210. *Lloyd v. Murphy*, 153 P.2d 47, 50 (Cal. 1944). Justice Traynor observed that it is important that businesses be able to rely with certainty on their contracts because they are constantly planning for the future. *Id.* See also Eisenberg, *supra* note 13, at 574 (recognizing the importance of the reliability of contracts in economic planning).

211. E. ALLEN FARNSWORTH, *CONTRACTS* § 1.6, at 18 (2d ed. 1990).

212. See *id.* § 12.3, at 842. Damages for breach of contract are designed to put the buyer in as good a position as if the contract would have been fully performed. *Id.* See also U.C.C. § 1-106 (1996) (stating the general philosophy of the Code, which is to put the aggrieved party in as good a position as if the other party had fully performed on the contract). See also RESTATEMENT (SECOND) OF CONTRACTS § 344(a) (1979).

213. Professors White and Summers have noted the value of clauses carefully drafted to limit the seller's liability:

Of course, a determined court can find any clause too vague or ambiguous, and a court always has the option of refusing to enforce a clause as unconscionable. Nevertheless, the more explicit the limitation-of-remedy clause is, the more likely it will be enforced. Moreover, even if an explicit clause would be a loser before an appellate court, it might win the case in negotiations or at the trial level. In sum, a well-drafted remedy limitation clause will in most situations protect the seller against enormous damage judgments.

WHITE & SUMMERS, *supra* note 17, § 12-9, at 659.

214. See *Foley v. Interactive Data Corp.*, 765 P.2d 373, 399 n.33 (Cal. 1988) ("The generally predictable and circumscribed damages available for breaches of contract reflect the importance of this value in the commercial context."). Accord *Vernon Fire & Cas. Ins. Co. v. Sharp*, 349 N.E.2d 173, 180 (Ind. 1976); *General Motors Corp. v. Piskor*, 381 A.2d 16, 22 (Md. Ct. Spec. App. 1977); *Gaglidari v. Denny's Restaurants*, 815 P.2d 1362, 1373 (Wash. 1991). See also Larry Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277, 330 (1990) ("[P]roviding an efficient and profitable commercial environment depends on the parties' ability accurately to foretell their rights and liabilities under [the] contract.").

215. Tamar Frankel, *The Legal Infrastructure of Markets: The Role of Contract and Property Law*, 73 B.U. L. REV. 389, 395 (1993).

216. "Potential liability, . . . usually in the form of the buyer's lost profits from the use or resale of the goods in its business, is enormous in comparison to the contract price of the goods." Anderson, *supra* note 1, at 774.

predict the amount of consequential damages for which they may be liable.²¹⁷ However, the proposed subsection (4) would give parties the ability to predict with more certainty than before when a court is likely to award consequential damages to the buyer. However, the proposed subsection (4) of the Code cannot predict with absolute certainty when a court will invalidate a clause excluding the buyer's recovery of consequential damages. This is because occasionally the parties' contract will not reflect the parties' intended allocation of the risk that the limited remedy may fail of its essential purpose. In order to protect the parties' true intentions in these cases, the Code must remain somewhat flexible. This is why the proposed subsection contains rebuttable presumptions rather than conclusive presumptions.

This proposed revision would "simplify, clarify and modernize the law governing commercial transactions," three of the Code's main objectives.²¹⁸ The proposed revision would also "make uniform the law among the various jurisdictions."²¹⁹ This would enable courts to decide this issue consistently, in contrast to the confusion which has resulted from the three different approaches currently being employed.²²⁰ Article Two of the Code was designed to ensure that the law conform to prevailing commercial standards and adapt when these customs and practices change.²²¹ It is time for the Code to adapt to confront the particular problems of contracts containing a limited remedy clause which fails of its essential purpose and a separate provision which limits the seller's liability for consequential damages. Proposed subsection (4) will allow the Code to recognize this problem. As a result, the courts will be guided by the Code instead of confused by it. It is clear from this discussion that buyers, sellers and courts would all benefit from this evolution of the Code. In addition to added predictability, the courts would also benefit from carefully drafted contracts, because the parties' allocation of risks will be clearly expressed in the contract. If parties contemplate the problems with these contracts at the negotiation stage of the contract's formation, the courts will be more able to interpret disputed contracts.

In summary, the categorical approaches advocated by the dependent and independent approaches are made rebuttable presumptions under the proposed subsection (4) to Section 2-719. When these presumptions are overcome by

217. Consequential damages "can exceed, and most likely will exceed, the value of the goods by an unknown quantum, depending not so much on the actions and machinations of the seller as on the individual operating structure of the buyer and on the buyer's contracts and relationships with third parties." *Id.*

218. U.C.C. § 1-102 (2)(a) (1996).

219. *Id.* § 1-102(c).

220. See *supra* notes 158-84 and accompanying text.

221. Rogers & Michaels, *supra* note 179, at 850-51.

clear and convincing evidence, the case-by-case approach will resolve the parties' conflict. This represents the best solution to the question of whether buyers are entitled to consequential damages when a contract contains a limited remedy clause which has failed its essential purpose and a separate provision which precludes the buyer's recovery of consequential damages for the seller's breach. The next part of this Note will predict how two typical contracts would be resolved under the proposed subsection (4).

D. A Brief Application of the Proposed Subsection (4) of Section 2-719 of the Code

Two hypotheticals illustrate the application of the proposed subsection (4) to Section 2-719. Assume that in the previously discussed contract between Bob and Sally, the contract provided:

It is agreed that such replacement or repair is the exclusive remedy available from Sally should any of Sally's products prove defective. Sally is not liable for damages of any sort, including consequential damages.²²²

Under Section 2-719, as amended by subsection (4), courts will presume that Bob is entitled to consequential damages if the limited remedy of repair or replacement fails of its essential purpose because the contract terms do not contemplate the repair or replacement remedy failing of its essential purpose. If Sally cannot make steel that is both rustproof and strong enough to use for bridge building, then repair or replacement has become impossible, and the limited remedy of repair or replacement fails of its essential purpose. Section 2-719(4)(a) would mandate that the court presume that the contract is governed by Section 2-719(2), which provides that "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act,"²²³ and one available remedy is consequential damages.²²⁴ If Sally can present clear and convincing evidence that Bob bargained for the risk that the limited remedy might fail, then she can overcome this presumption. For instance, Sally may have charged a cheaper price for the steel based on Bob's willingness to assume the risk that the limited remedy may fail.²²⁵ Sally may also argue that the parties understood that the exclusion of consequential damages would remain in effect even if repair or replacement failed to cure the defects in the steel. Because rustproof steel is, in this

222. This is a part of the "standard warranty" in the commercial industry. See *supra* notes 6-14 and accompanying text.

223. U.C.C. § 2-719(2) (1996).

224. See *supra* notes 108-14 and accompanying text.

225. See *supra* note 208 and accompanying text.

hypothetical, an experimental good specially manufactured for Bob, Sally can argue that Bob was not unfairly surprised to find out that it lacked the strength of conventional steel.²²⁶

If Sally can present clear and convincing evidence that the contract terms were understood by both parties to allocate the risk of consequential damages to Bob, then she will have overcome the presumption that Bob be entitled to consequential damages. If Sally overcomes the presumption operating against her, the Code cannot predict the outcome of the case. The case will then be decided by the court using the case-by-case approach.

Changing the facts only slightly, Sally could have protected herself by insisting on a clause in the contract which specifically contemplated a failure of the limited remedy's essential purpose. For instance, the contract could provide:

Bob's exclusive remedy against Sally shall be for the repair or replacement of defective parts. No other remedy, including but not limited to incidental or consequential damages for lost profits, lost sales, or any other incidental or consequential damages, shall be available to Bob. This limitation remains in full force and effect if the limited remedy fails of its essential purpose.

Under Section 2-719, as amended by subsection (4), the court would presume that Bob is not entitled to consequential damages because the contract terms contemplate a failure of the limited remedy's essential purpose. Section 2-719(4)(b) would mandate that courts presume that the contract is governed by Section 2-719(3), which states that "consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable."²²⁷ If Bob can present clear and convincing evidence that he and Sally never agreed to this limitation, despite the fact that they signed the contract, then he can overcome this presumption. Because Bob signed the contract, however, it is unlikely the

226. Professors White and Summers argue that courts misapply Section 2-719(2) of the Code when they hold that experimental goods which fail to work as planned necessarily fail of their essential purpose. They have stated:

Where the goods are experimental, the remedy is less likely to fail of its essential purpose because that purpose will not be a guarantee that the goods will work as hoped. Similarly, sometimes buyers buy for special purposes and even provide detailed specifications. In these cases, the limited or exclusive remedy may be only a promise that the seller will attempt to provide a remedy so that the goods will serve the special purposes.

WHITE & SUMMERS, *supra* note 17, § 12-10(a), at 665.

227. U.C.C. § 2-719(3) (1996).

court would be persuaded.²²⁸ If the price of the steel is exorbitant, even for rustproof steel, then Bob could argue that he paid the higher price because the parties agreed that Sally would bear the risk that the limited remedy may fail. However, the court interpreting the contract between Bob and Sally, a contract which expressly allocates the risk of consequential damages to Bob upon a failure of the limited remedy's essential purpose, is unlikely to find clear and convincing evidence rebutting the presumption.

Therefore, Section 2-719(3) would govern the interpretation of the contract and Bob would need to show that it is unconscionable to allow Sally to avoid paying for the consequential damages resulting from the breach.²²⁹ Bob could argue that Sally drafted the entire agreement, that she took advantage of his unequal bargaining power,²³⁰ and that he is left without any remedy if the court disallows the consequential damages. The experimental nature of the goods, combined with the fact that contracts between commercial parties are rarely found to be unconscionable,²³¹ would likely lead the court to enforce the contract's allocation of the risk that the limited remedy may fail of its essential purpose. This would preclude Bob from recovering consequential damages from Sally.

These presumptions would encourage people in Bob's and Sally's positions to bargain in advance for contract terms that they find appealing.²³² The parties would be more likely to insist on provisions which are beneficial to them and avoid contracting at all if the other party refuses.²³³ If the parties cannot agree, this author recommends that the parties put a clause in the contract such as the following: If the limited remedy fails of its essential purpose, the buyer is entitled to a refund of the purchase price of the goods.

This provision would provide the buyer with an adequate remedy upon the limited remedy's failure of its essential purpose and would limit the seller's liability.²³⁴ The court's task of interpreting these contracts when all events do not occur as planned would be easier because the parties would have

228. Professors White and Summers have noted that "[o]nce a disclaimer has been expressed so conspicuously that a buyer's 'attention can reasonably be expected to be called to it,' the buyer can hardly complain that he or she was unfairly surprised or that the disclaimer was unexpected." WHITE & SUMMERS, *supra* note 17, § 12-11(b), at 673 (quoting U.C.C. § 1-201(10) cmt. 10 (defining "conspicuous")).

229. See U.C.C. § 2-719(3) (1996).

230. See *supra* notes 91-92 and accompanying text.

231. See *supra* note 96 and accompanying text.

232. See *supra* notes 207-21 and accompanying text.

233. See *supra* notes 207-21 and accompanying text.

234. See WHITE & SUMMERS, *supra* note 17, § 12-10, at 665 (suggesting other alternatives, such as replacement with alternative or different goods or reasonable liquidated damages).

contemplated the failure of the limited remedy's essential purpose at the negotiation stage of the contract's formation. The presumptions of Section 2-719(4) would lead to predictability in an area of commercial law that is fraught with ambiguity, confusion and uncertainty.

VI. CONCLUSION

Any proposed solution to the tension between Sections 2-719 (2) and (3) of the Code must ensure that parties' allocations of risk are protected. All three of the current approaches attempt to protect parties' allocations, but all fail because the Code is not equipped to deal with the problem. Amending Section 2-719 of the Code to provide for the parties' allocations of risk would enable courts to deal with this problem more efficiently and make the Code more predictable. Further, by making the presumptions rebuttable, no party would be denied the opportunity to argue that the intent of the parties is not manifested in the agreement. If the court is persuaded by clear and convincing evidence, the court would isolate the case and evaluate its individual facts and circumstances to determine how best to allocate the risk of consequential damages in light of the bargaining power of the parties, the complexity of the goods, the reasonableness of the effort made by both parties to effectuate cure, and the time spent trying to cure the non-conforming goods. This revision would reconcile all three of the current interpretations and add predictability to the Code. It represents the best possible solution for all interested parties: buyers, sellers and courts.

Daniel C. Hagen