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NOTES

Commercial Transactions: UCC § 2-719: Remedy Limitations and Consequential Damage Exclusions

In today's typical sale of goods contract, a seller will likely include and a buyer will likely accept what has been called a "four-step" warranty.¹ According to one scholar, a "four-step" warranty is one which unfolds as follows:

1. Seller makes an express warranty that the goods are free from defects in material and workmanship;
2. Seller disclaims all other warranties, express or implied;
3. Upon breach of express warranty, Seller agrees to repair the goods or replace defective parts as the exclusive remedy for breach of warranty; and
4. Seller attempts to exculpate itself from any liability for consequential damages.²

This type of warranty is clearly permissible under the Uniform Commercial Code (UCC or the Code).³ A seller may disclaim all warranties other than the ones expressly stated,⁴ and he may disclaim all implied warranties, in-

1. Speidel, "Warranty Disclaimers and Limitations of Liability," at 141. Paper presented at UCC Seminar in Knoxville, Tenn. (June 11, 1977).

2. *Id.* An example of this type of warranty reads as follows: John Doe Corporation warrants: (1) John Doe Corporation has title to the equipment and the right to convey title to Customer; and (2) for a period of one year from shipment, the equipment shall be free from defects in material and workmanship under normal use and service.

Written notice and an explanation of the circumstances of any claim that the equipment has proved defective in material or workmanship shall be given promptly by Customer to John Doe Corporation. Customer's sole and exclusive remedy in the event of defect is expressly limited to the correction of the defect by adjustment, repair, or replacement at John Doe Corporation's election and sole expense, except that there shall be no obligation to replace or repair items which by their nature are expendable.

No representation or other affirmation of fact, including but not limited to statements regarding capacity, suitability for use, or performance of the equipment, shall be or be deemed to be a warranty or representation by John Doe Corporation for any purpose, nor give rise to any liability or obligation of John Doe Corporation whatsoever.

EXCEPT AS SPECIFICALLY PROVIDED IN THIS AGREEMENT, THERE ARE NO OTHER WARRANTIES EXPRESS OR IMPLIED INCLUDING BUT NOT LIMITED TO ANY IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL JOHN DOE CORPORATION BE LIABLE FOR LOSS OF PROFITS, INDIRECT, SPECIAL, CONSEQUENTIAL OR OTHER SIMILAR DAMAGES ARISING OUT OF ANY BREACH OF THIS AGREEMENT OR OBLIGATIONS UNDER THE AGREEMENT.

3. The Uniform Commercial Code has been adopted in whole or in part by all fifty states and the Virgin Islands; it is found at 12A OKLA. STAT. §§ 1-101 to 11-107 (1981).

4. U.C.C. § 2-316(1), which provides:

Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this article on parol

cluding the implied warranty of merchantability if it mentions merchantability and is conspicuous, and the implied warranty of fitness if it is in writing and is conspicuous.⁵ Further, a seller may limit the buyer's remedy for a breach of warranty to repair or replacement of the nonconforming goods.⁶ If the limited remedy is expressly agreed to be exclusive, then it is the sole remedy of the buyer.⁷ Finally, the seller may exclude all consequential damages to the extent the exclusion is not unconscionable.⁸

However, what happens in the situation in which a buyer has agreed to such provisions in his contract and the seller will not or cannot repair or replace the nonconforming goods or parts, or is unable to fix them within a reasonable time? Is the unfortunate buyer left with defective goods and no other recourse? Never fear, the Code also provides: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."⁹ But when does a limited remedy fail of its essential purpose? Of more importance to many sellers and buyers, what effect will such a failure have on an independent consequential damage exclusion?

This note will analyze the situations in which an exclusive limited remedy of repair or replacement fails of its essential purpose and the effect such a failure has on otherwise valid warranty and damage disclaimers.

*When a Limited Remedy of Repair or Replacement
Fails of Its Essential Purpose*

Section 2-719 of the UCC¹⁰ grants to contracting parties wide latitude in fashioning their remedies in the event of a breach. As noted previously, the parties must expressly agree that the remedies provided for in the contract are the only remedies.¹¹ This note will assume that the parties have done a sufficiently satisfactory job in pleasing the idiosyncrasies of the particular court in which they are litigating.

Although the parties may limit their remedies, it is axiomatic under the Code that a party must be left with a "minimum adequate remedy" or a

or extrinsic evidence (section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

5. U.C.C. § 2-316(2), which states in pertinent part:

Subject to subsection [3] to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous

6. U.C.C. § 2-719(1)(A), which provides: "[T]he agreement . . . may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to . . . repair and/or replacement of non-conforming goods or parts."

7. U.C.C. § 2-719(1)(B), which specifies: "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."

8. U.C.C. § 2-719(3), which provides in pertinent part: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable."

9. U.C.C. § 2-719(2).

10. See *supra*, notes 6, 7, 8.

11. *Supra* note 7 and accompanying text.

fair “quantum of remedy.” Official Comment One to section 2-719 provides:

[I]t is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this article they must accept the legal consequence there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions in an unconscionable manner is subject to deletion.¹²

Section 2-719(2) further provides: “where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this title.”¹³ In attempting to explain this amorphous provision, Official Comment One to section 2-719 provides: “Similarly, under subsection (2), where 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.”¹⁴

This comment makes clear that section 2-719(2) “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.”¹⁵ Official Comment One is especially important in this area as courts frequently resort to it when determining whether a particular limited remedy has failed of its essential purpose.

A typical situation involving the issue of whether an exclusive limited remedy of repair or replacement has failed of its essential purpose is the familiar “lemon” automobile case. In this case, the buyer buys a new automobile that the seller warrants will be free from defects in material and workmanship. The sole remedy for the breach of the warranty is repair or replacement. The car soon develops several defects that the seller either is unable to repair or that take an exceedingly long time to repair. The buyer then sues for breach of the warranty, alleging that the exclusive remedy has failed of its essential purpose.

An example of such a case is the decision of *Riley v. Ford Motor Co.*¹⁶ In *Riley*, the plaintiff purchased a new Ford automobile that soon developed several defects.¹⁷ After attempting to have his car fixed, Riley elected to sue

12. U.C.C. § 2-719, Official Comment One.

13. U.C.C. § 2-719(2).

14. *Id.*, Official Comment One.

15. 1 REPORT OF THE NEW YORK LAW COMM'N FOR 1955, at 584.

16. 442 F.2d 670 (5th Cir. 1971).

17. There was a noise in the rear end, a malfunctioning window, the air conditioning did not work, the speed control did not function, the power seats became inoperative, the radio aerial functioned spasmodically, the rear seat did not fit, the headlight panels were not synchronized, the cigarette lighter was missing, the engine knocked, the windshield wipers did not work, the transmission did not function properly, the gearshift lever would not function, and the left door would not close properly.

for breach of warranty and negligent repair. The contract between Riley and Ford contained the basic warranty provisions.¹⁸ In upholding the jury's finding that the limited remedy failed of its essential purpose, the Court of Appeals for the Fifth Circuit set the tone for later decisions by relying heavily on Official Comment One to section 2-719 and holding that to "enforce a limited remedy under circumstances where repeated efforts failed to correct the defect would deprive the buyer of the substantial value of his bargain."¹⁹ The court further stated:

We agree with the Appellee's contention that at some point after the purchase of a new automobile, the same should be put in good running condition, that is, the seller does not have an unlimited time for the performance of the obligation to replace and repair parts. This is no more than saying that at some point in time, it must be obvious to all people that a particular vehicle simply cannot be repaired or parts replaced so that the same is made free from defect. [Citations omitted.]²⁰

Another typical "lemon" case is *Jacobs v. Rosemount Dodge-Winnebago South*.²¹ The fact pattern is familiar. Plaintiff purchased a motor home that soon developed some twenty-one defects.²² Although Jacobs took the motor home in for repairs several times, only some of the defects were repaired; others were not, and still others appeared to be in worse condition after being in the shop for repairs. The buyer, disgusted with the seller's inability to repair, sued for revocation. However, the motor home was covered by two warranties limiting the remedy to repair or replacement of the defective parts. In upholding the jury's verdict that the limited remedy failed of its essential purpose and thus other remedies could be had, the Supreme Court of Minnesota enunciated the general rule that

an exclusive remedy fails of its essential purpose if circumstances arise to deprive the limiting clause of its meaning or one party of its substantial bargain. If the seller refuses to repair or replace within a reasonable time, the buyer is deprived of the exclusive remedy. Commendable efforts alone do not relieve a seller of his obligation to repair.²³

Although the issue of when a limited remedy fails of its essential purpose arises most frequently in the consumer automobile cases, in recent years it has also arisen in the commercial business context. Generally, the same analysis prevails. In *AES Technology Systems, Inc. v. Coherent Radiation*,²⁴ Coherent

18. 442 F.2d 670, 671 (5th Cir. 1971).

19. *Id.* at 673.

20. *Id.*, n.5.

21. 310 N.W.2d 71 (Minn. 1981).

22. *Id.* at 74.

23. *Id.* at 75.

24. 583 F.2d 933 (7th Cir. 1978).

sold AES a laser, warranting that the laser was to be free from defects in materials and workmanship. The court found that Coherent had warranted to AES that the laser was capable of producing 150 milliwatts in ultraviolet mode. Coherent limited the remedy for breach of this warranty to repair and replacement.²⁵ AES experienced trouble with the laser from the beginning, and after repeated efforts by Coherent were unsuccessful in bringing the laser up to the warranted specifications for other than short periods of time, AES sued Coherent for breach of warranty. In its decision, the court noted that by limiting the warranties and remedies available for breach of warranty, parties are able to provide a consensual allocation of risk in accordance with sound business practices, and thus AES could not say it was not bound by its terms.²⁶

However, the court further noted that no contract may deprive parties of minimum adequate remedies under the UCC, and stated:

In a case such as this, the warranty and remedy, while distinct, go hand-in-hand. In a properly functioning system, a defect is noticed (a small breach of warranty) and the repair or replacement is quickly made (the remedy). Within a reasonable period of time and after a reasonable number of failures, the steady-state performance should be reached whereby the product performs as specified. If after repeated efforts by a seller to place a product into warranted condition, and the seller cannot or will not do so, the remedy of repair or replacement may be deemed to have failed of its essential purpose and other remedies under U.C.C. may be called into play.²⁷

Thus, the court held that the limited remedy failed of its essential purpose because Coherent was unsuccessful, after repeated efforts, in bringing the laser to warranted specifications, and during the ten months that AES owned the laser, the laser had only sporadically performed as specified and warranted.

These cases illustrate the basic analysis used in determining whether a limited remedy has failed of its essential purpose. Almost uniformly,²⁸ the courts have utilized analyses demonstrated by *Riley*, *Jacobs*, and *AES*.²⁹

25. *Id.* at 938.

26. *Id.* at 939.

27. *Id.*

28. For cases that deviate from this analysis, see *Bosway Tube & Steel Corp. v. McKay Machine Co.*, 65 Mich. App. 426, 237 N.W.2d 488 (1975); *Eckstein v. Cummins*, 41 Ohio App. 2d 1, 321 N.E.2d 897 (1974); *Henderson v. Ford Motor Co.*, 547 S.W.2d 663 (Tex. Civ. App. 1977) (no writ); *Lankford v. Rogers Ford Sales*, 478 S.W.2d 248 (Tex. Civ. App. 1972) (*writ ref'd n.r.e.*).

29. Other representative cases using these analyses include *Delhome Indus., Inc. v. Houston Beechcraft, Inc.*, 669 F.2d 1063 (5th Cir. 1982); *Chatlos Systems, Inc., v. National Cash Register Corp.*, 635 F.2d 1081 (3d Cir. 1980); *S.M. Wilson & Co. v. Smith Intern*, 587 F.2d 1363 (9th Cir. 1978); *Soo Line R.R. v. Fruehauf Corp.*, 547 F.2d 1365 (8th Cir. 1977); *Beal v. General Motors Corp.*, 354 F. Supp. 423 (D. Del. 1973); *Custom Automated Machine v. Penda Corp.*, 537 F. Supp. 77 (N.D. Ill. 1982); *Office Supply Co. v. Basic Four Corp.*, 536 F. Supp. 766 (E.D. Wis. 1982); *Polycon Indus., Inc. v. Hercules, Inc.*, 471 F. Supp. 1316 (E.D. Wis. 1979);

The general rules may be summarized as follows. When a seller limits his remedy to repair or replacement and the goods develop various defects the seller either is unable to or will not repair, or does eventually repair the goods and place them into warranted condition but does so in an unreasonable time,³⁰ then the limited remedy of repair or replacement will probably be deemed to have failed of its essential purpose. In other words, if the seller does not, within a reasonable time, give the buyer goods that are substantially free from defects or in warranted condition, then the buyer will have been deprived of the substantial value of his bargain and the courts will find that the remedy has failed. Although seller's good faith in trying to place the goods in conformity with the contract is a factor in this determination, it alone will not shelter the seller from his obligation to repair. One reason the courts use this analysis is that "when the parties conclude a contract for sale within article two 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."³¹ If the buyer is left with defective goods, the courts simply feel that there is not a "fair quantum of remedy."

Although this proposition is basically sound, it is limited in two important respects. First, the logical starting point in determining whether a limited remedy has failed of its essential purpose is to ascertain precisely the purpose of the limited remedy. This is not done by most courts. The basic purpose of a limited remedy may be summarized as follows:

The purpose of an exclusive remedy of replacement or repair of defective parts, whose presence constitute a breach of an express warranty, is to give the seller an opportunity to make the goods conforming while limiting the risks to which he is subject by excluding direct and consequential damages that might otherwise arise. From the point of view of the buyer the purpose of the exclusive remedy is to give him goods that conform to the contract within a reasonable time after a defective part is discovered. When the warrantor fails to correct the defect as promised within a reasonable time he is liable for a breach of that warranty. . . . The limited, exclusive remedy fails of its purpose and is thus avoided under § 2-719(2), whenever the warrantor fails to correct the defect within a reasonable period.³²

Kohlenberger, Inc. v. Tyson's Foods, Inc., 510 S.W.2d 555 (Ark. 1974); Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Stutts v. Green Ford, Inc., 267 S.E.2d 919 (N.C. App. 1980); Ehlers v. Chrysler Motor Corp., 226 N.W.2d 157 (S.D. 1975); Moore v. Howard Pontiac Am., Inc., 492 S.W.2d 227 (Tenn. App. 1972); Murray v. Holiday Rambler, Inc., 83 Wis. 2d 406, 165 N.W.2d 513 (1978).

30. What constitutes a reasonable time is governed by U.C.C. § 1-204(2), which provides: "What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action."

31. U.C.C. § 2-719, Official Comment One.

32. Beal v. General Motors Corp., 354 F. Supp. 423 (D. Del. 1978).

Any complete analysis of this issue should begin by ascertaining the essential purpose of the limited remedy.

Second, although the above standard is usually "a sufficiently subjective standard to allow the courts a quantum of discretion in determining the continued validity of remedy limitations,"³³ it is not as flexible as it might be in covering unique situations. These situations occur in the commercial setting where the goods are either highly sophisticated and complex, or by their nature experimental, and parties of relatively equal bargaining power have freely negotiated an allocation of their risk of loss. A more complete analysis should include the several rules summarized earlier, in addition to the use of several factors suggested in *J. A. Jones Construction Co. v. City of Dover*.³⁴ These factors include: "the facts and circumstances surrounding the contract, the nature of the basic obligations of the party, the nature of the goods involved, the uniqueness or experimental nature of the items, the general availability of the items and the good faith and reasonableness of the provision."³⁵

By using these guidelines in addition to the tests set forth earlier, a court is better able to handle the situations where parties of relatively equal bargaining power have allocated their risks of loss in light of the complexity and the experimental or unique nature of the goods, the unique facts or circumstances that surround the contract, and the good faith and reasonableness of the provisions included. Thus, if the buyer agreed to the exclusive limited remedy as consideration for a lower price, a court should be more hesitant to find a failure of the limited remedy. Likewise, if the goods are highly sophisticated, experimental in nature, or in short supply, a limited remedy should less likely fail of its essential purpose.

Nevertheless, whatever the standard used by a particular court, the lesson is clear that "a limitation of remedy clause that takes too much away from a buyer may give him everything."³⁶ The seller should attempt to do three things in order to avoid excessive liability.

First, the seller should offer an alternative remedy of refund in the event it cannot repair or replace. This would allow the limited remedy to withstand judicial scrutiny and allow the seller to avoid a consequential damages issue. The success of such a provision can be found in the case of *Marr Enterprises v. Lewis Refrigerator Co.*³⁷

A second solution would be for the contract to state that the limited remedy provision and consequential damage disclaimer were given by the buyer in consideration for certain other aspects of the contract, such as a low price, unique or experimental goods, or other provisions favorable to the buyer.

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

34. 372 A.2d 540 (Del. Super. 1976), *app. dismissed* 377 A.2d 1 (Del. 1977).

35. *Id.* at 549.

36. J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* § 12-10, at 470 (1980).

37. 556 F.2d 951 (9th Cir. 1977).

By doing so, the parties have indicated that the provisions in the contract were the result of bargaining and, consequently, a court should be hesitant to find a failure of the limited remedy except in extreme circumstances. The reason is obvious; where a buyer has received favorable provisions in consideration for the limited remedy, the fewer the circumstances a court can find that the buyer has been deprived of the substantial value of his bargain.

A final possible solution would be to include a provision in the contract delineating precisely the purpose behind the exclusive remedy and further stating that such remedy will not fail of its purpose if the seller is willing and able to repair the goods in the prescribed manner. Such a provision would force the courts to abide by the parties' contractual provisions and further narrow the circumstances where a limited remedy can fail of its essential purpose.

*Effect of a Failure of Essential Purpose on
Otherwise Valid Warranty Disclaimers*

If a court finds that an exclusive limited remedy of repair or replacement has failed of its essential purpose, the question arises as to what effect such a failure will have on otherwise valid warranty disclaimers.³⁸ The answer generally is and should be none.

Logically, a failure of essential purpose of a remedy should have no effect on a disclaimer of a warranty. Limitation of remedies is governed by section 2-719³⁹ of the Code, while disclaimer of warranties is governed by section 2-316⁴⁰ of the Code. A limitation of remedy provision will not come into play until there is a breach of warranty. If all implied and express warranties are disclaimed, there can be no breach of warranty and therefore no liability may arise. Thus, if in deciding whether there has been breach of warranty, a court upholds the validity of the warranty disclaimers, there can be no breach other than a breach of a warranty that goods will be free of defects in material and workmanship. A failure of the essential purpose of the limited remedy should have no aftereffect on the validity of the warranty disclaimers. As one court has stated:

Under the Uniform Commercial Code a seller of goods may limit his contractual liability in two ways. He may disclaim or limit his warranties . . . or he may limit the buyer's remedies for a breach of warranty These methods are closely related and in many cases their effect may be substantially identical. Conceptually, however, they are distinct. A disclaimer of warranties limits the seller's liability by reducing the number of circumstances in breach of the contract; it precludes the existence of a cause of action. A limitation of remedies, on the other hand, restricts the remedies

38. See *supra* note 2 for an example of such disclaimers.

39. See *supra* notes 5, 6, 7.

40. *Supra* note 4.

available to the buyer once a breach is established. [Citations omitted.]⁴¹

Further, as one court has noted, if not unconscionable, a party may disclaim *all* warranties, thus insulating itself from all contractual liability.⁴² Any court that holds that a failure of a limited remedy would nullify proper and valid warranty disclaimers is attacking the problem backwards. A court must first look at the warranties given, at whether the disclaimer of other warranties was valid, and then find a breach of any warranty expressly given or not properly disclaimed before it can even begin to analyze whether the limited remedy has failed of its essential purpose.

Unfortunately, one case has held that where a limited remedy has failed of its essential purpose, then all exclusions on the seller's warranties and liabilities must be disregarded.⁴³ In that case the court stated, without an iota of logic or legal authority to support its proposition: "[W]e note that if Plaintiffs are able to . . . prove that the limited remedy has failed of its essential purpose the trial court could disregard not only the exclusion of consequential damages but also the disclaimer of implied and other express warranties."⁴⁴

*Failure of Essential Purpose and Its Effect on Otherwise
Valid Consequential Damage Exclusions*

The most difficult and unsettled question is whether an independent, otherwise valid consequential damages disclaimer⁴⁵ will stand or fall upon a failure of essential purpose of a limited remedy. In other words, once a court finds that an exclusive limited remedy has failed of its essential purpose, may the court then award consequential damages despite an otherwise conscionable consequential damages disclaimer? It is submitted that the answer should be no, and that a consequential damages disclaimer should be governed by its own Code standard of unconscionability,⁴⁶ independent of whether a limited remedy has failed. There are two very good reasons for this result.

First, from the parties' standpoint the exclusion of consequential damages may be the most significant limitation of liability in the contract. In the commercial setting, potential liability for consequential damages⁴⁷ can be enormous compared to other available remedies. Potential consequential damages may and most often do exceed the value of the goods by an unknown quantum, the amount depending not so much on the seller's activities or goods but on the individual structure of the buyer and the buyer's contracts and his rela-

41. *Murray v. Holiday Rambler, Inc.*, 83 Wis. 2d 406, 265 N.W.2d 513 (1978). See also J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 12-11, at 471-72 (1980).

42. *Tuttle v. Kelley-Springfield Tire Co.*, 585 P.2d 1116 (Okla. 1978).

43. *Clark v. International Harvester Co.*, 581 P.2d 784 (Idaho 1978).

44. *Id.* at 802 n.14.

45. See *supra* note 2 for an example of such disclaimer.

46. U.C.C. § 2-719(3).

47. Such damages are usually in the form of lost profits or resale of the goods in business.

tionships with third parties. Thus, when parties of relatively equal bargaining power freely negotiate and agree to an allocation of risk of consequential damages to one party, this allocation should not be disturbed unless unconscionable. Risk shifting is socially expensive and a court should not undertake to shift a freely negotiated risk provided for in the contract in the absence of good reason. Further, it is clear that the Code sanctions such an allocation of risk in the area of consequential damages. Official Comment Three to section 2-715 provides: "In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages *Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.*"⁴⁸ Also, section 2-719 "recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. *Actually such terms are merely an allocation of unknown or undeterminable risks.*"⁴⁹

The second reason that a failure of a limited remedy should not affect a consequential damage disclaimer is that the two provisions are governed by different sections of the Code. Limitation of remedies is governed by section 2-719(2),⁵⁰ and damage exclusions are governed by section 2-719(3).⁵¹ There is a good reason for the separation. As one court has noted, comparing the limited remedy clause with the damage exclusion clause is like comparing apples with oranges.⁵² The limitation of remedy analysis is not concerned with arrangements that were oppressive at their inception but is concerned with novel circumstances not contemplated by the parties. On the other hand, consequential damages disclaimers are permitted by section 2-719(3)⁵³ unless unconscionable, i.e., oppressive at their inception. The determination of the former is for the jury,⁵⁴ while determination of the latter is a question for the court.⁵⁵ Simply stated, the two provisions are materially different and should be treated so, and the invalidity of one clause should have no effect on the other. Three recent cases illustrate the above reasoning.

In *Chatlos Systems, Inc. v. National Cash Register Corp.*,⁵⁶ the court, in upholding the damages disclaimer, reasoned as follows:

It appears to us that the better reasoned approach is to treat the consequential damage disclaimer as an independent provision, valid unless unconscionable. This poses no logical difficulties. A contract may well contain no limitation on breach of warranty damages but specifically exclude consequential damages. Con-

48. U.C.C. § 2-715, Official Comment Three (emphasis added).

49. U.C.C. § 2-719, Official Comment Three (emphasis added).

50. See *supra* note 6.

51. See *supra* note 7.

52. *Johnson v. John Deere Co.*, 306 N.W.2d 231 (S.D. 1981).

53. U.C.C. § 2-719(3).

54. *Johnson v. John Deere Co.*, 306 N.W.2d 231, 239 (S.D. 1981).

55. *Id.* at 238. See U.C.C. § 2-302.

56. 635 F.2d 1081 (3d Cir. 1980).

versely, it is quite conceivable that some limitation might be placed on a breach of warranty award, but consequential damages would expressly be permitted.

The limited remedy of repair and a consequential damages exclusion are two discrete ways of attempting to limit recovery for breach of warranty. [Citations omitted.] The Code, moreover, tests each by a different standard. The former survives unless it fails of its essential purpose, while the latter is valid unless it is unconscionable. We therefore see no reason to hold, as a general proposition, that the failure of the limited remedy provided in the contract, without more, invalidates a wholly distinct term in the agreement excluding consequential damages. The two are not mutually exclusive.⁵⁷

And, as the court stated in *S. M. Wilson & Co. v. Smith Intern, Inc.*:

The issue remains whether the failure of the limited repair remedy to serve its purpose requires permitting the recovery of consequential damages as sections 2714(3) and 2715 permit. We hold it does not. In reaching this conclusion we are influenced heavily by the characteristics of the contract between Smith and Wilson Parties of relatively equal bargaining power negotiated an allocation of their risks of loss. Consequential damages were assigned to the buyer, Wilson. The machine was a complex piece of equipment designed for the buyer's purposes. The seller Smith did not ignore his obligation to repair; he simply was unable to perform it. This is not enough to require that the seller absorb losses the buyer plainly agreed to bear. Risk shifting is socially expensive and should not be undertaken in absence of a good reason. An even better reason is required when to so shift is contrary to a contract freely negotiated. The default of the seller is not so total and fundamental as to require that its consequential damage limitation be expunged from the contract.⁵⁸

In *American Electric Power Co. v. Westinghouse Electric Corp.*,⁵⁹ the court, in upholding the consequential damages disclaimer, noted that when an exclusive remedy fails of its essential purpose, it may be ignored, and other clauses in the contract that limit remedies for breach may be left to stand or fail independently of the stricken clause. The court made the following observation:

Further, the rule that the agreed-upon allocation of commercial risk should not be disturbed is particularly appropriate where, as here, the warranted item is a highly complex, sophisticated, and

57. *Id.* at 1086.

58. 587 F.2d 1363, 1375 (9th Cir. 1978).

59. 418 F. Supp. 435 (S.D.N.Y. 1976).

in some ways experimental piece of equipment. Moreover, compliance with a warranty to repair or replace must depend on the type of machinery in issue. In the case of a multi-million dollar turbine-generator, we are not dealing with a piece of equipment that either works or does not, or is fully repaired or not at all. On the contrary, the normal operation of turbine-generator spans too large a spectrum for such simple characterizations.⁶⁰

Although these results may seem harsh if applied to a consumer transaction, as a practical matter the courts are much more inclined to find unconscionability in the case of the downtrodden consumer than with the commercial businessman who presumably has a far more meaningful choice.⁶¹

Despite the rather obvious differences between the two provisions, several courts have held that when a limited remedy fails of its essential purpose, the full array of Code remedies apply, including consequential damages, despite an otherwise valid damages disclaimer.⁶² Most of these courts rely on the reasoning in the cases of *Adams v. J. I. Case Co.*,⁶³ and *Jones & McKnight Corp. v. Birdsboro Corp.*⁶⁴ In *Adams*, the court stated:

Had they reasonably complied with their agreement contained in the warranty they would be in a position to claim the benefits of their stated limited liability and to restrict plaintiff to his stated remedy. The limitations of remedy and of liability are not separable from the obligations of the warranty It should be obvious that they cannot at once repudiate their obligation under their warranty and assert its provisions beneficial to them. . . . It is clear that an implied warranty for reasonably prompt and timely repairs upon breach of the express warranty may arise under [UCC 2-316]. Though excluded by the written warranty as authorized in

60. *Id.* at 458. For other representative holdings that a consequential damages disclaimer withstands the failure of a limited remedy, see *V.M. Corp. v. Bernard Dist. Co.*, 447 F.2d 864 (7th Cir. 1971); *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572 (D.D.C. 1974), *rev'd men. and remanded*, 527 F.2d 853 (D.C. Cir. 1975); *County Asphalt, Inc. v. Lewis Welding & Eng'g Co.*, 323 F. Supp. 1300 (S.D.N.Y. 1970); *Office Supply Co. v. Basic Four Corp.*, 538 F. Supp. 766 (E.D. Wis. 1982); *Polycon Indus., Inc. v. Hercules, Inc.*, 471 F. Supp. 1316 (E.D. Wis. 1979); *Stutts v. Green Ford, Inc.*, 267 S.E.2d 919 (N.C. App. 1980).

61. The buyer of a consumer product is also protected by the Magnuson-Moss Act, 15 U.S.C. §§ 2301-2312 (1976).

62. For other cases holding an independent consequential damages disclaimer ineffective upon the failure of the limited remedy, see *Soo Line R.R. v. Fruhauf Corp.*, 542 F.2d 1365 (8th Cir. 1977); *Beal v. General Motors Corp.*, 354 F. Supp. 423 (D. Del. 1973); *Custom Automated Mach. v. Penda Corp.*, 537 F. Supp. 771 (N.D. Ill. 1982); *Kohlenberger Inc. v. Tyson's Foods, Inc.*, 510 S.W.2d 555 (Ark. 1974); *Jacobs v. Rosemount Dodge-Winnebago South*, 310 N.W.2d 71 (Minn. 1981); *Durfee v. Rod Baxter Imports, Inc.*, 262 N.W.2d 349 (Minn. 1977); *Goddard v. General Motors Corp.*, 60 Ohio St. 2d 41, 396 N.E.2d 761 (1979); *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157 (S.D. 1975); *Murray v. Holiday Rambler, Inc.*, 265 N.W.2d 513 (Wis. 1978).

63. 261 N.E.2d 1 (Ill. 1970).

64. 320 F. Supp. 39 (N.D. Ill. 1970).

UCC Section 2-316, defendants' repudiation for failure to reasonably comply avoids the exclusion.⁶⁵

The *Jones* court chose to follow *Adams* for the following reasons:

Although the plaintiff-buyer purchased and accepted the machinery and equipment with the apparent knowledge that the seller had properly limited its liability to repair or replacement, and although plaintiff does not allege any form of unconscionability in the transactions which led to the purchase, plaintiff also was entitled to assume that defendants would not be unreasonable or wilfully dilatory in making good their warranty in the event of defects in the machinery and equipment. It is the specific breach of the warranty to repair that plaintiff alleges caused the bulk of its damages. This Court would be in an untenable position if it allowed the defendant to shelter itself behind one segment of the warranty when it has allegedly repudiated and ignored its very limited obligations under another segment of the same warranty, which alleged repudiation has caused the very need for relief which the defendant is attempting to avoid. If the plaintiff is capable of sustaining its burden of proof as to the allegations it has made, the defendant will be deemed to have repudiated the warranty agreement so far as restricting plaintiff's remedies, and the exclusive remedy provision of the contract will be deemed under the circumstances to have failed of its essential purpose, thus allowing plaintiff the general array of remedies under the Code.⁶⁶

The results in these two cases are probably correct because in both cases there was a *willful* refusal to perform. Where a willful refusal to perform *causes* the consequential damages alleged, then the enforcement of such a provision would be unconscionable. When the parties contracted and the risk of consequential damages was allocated to the buyer, the seller promised to repair or replace defective parts or nonconforming goods. Further, under the Code, he was required to do so within a reasonable time⁶⁷ and thus would have mitigated the consequential damages of the buyer. The buyer has not agreed to assume liability for open-ended consequential damages, but only those that occurred while the seller was attempting to put the goods in conformity with the contract. Where it is the seller's willful conduct that causes the consequential damages, it would be unconscionable to exclude the seller's liability for these damages.⁶⁸

As the above analysis suggests, *Jones* and *Adams* were correctly decided not because the limited remedy had failed of its essential purpose but because

65. 261 N.E.2d 1, 7-8 (Ill. 1970).

66. 320 F. Supp. 39, 43-44 (N.D. Ill. 1970).

67. U.C.C. § 2-309(1).

68. This causal distinction is made in respect to incidental damages by the buyer of a consumer product in the Magnuson-Moss Act, 15 U.S.C. 2304(d) (Supp. V 1975).

the enforcement of consequential damages provision was unconscionable. Nevertheless, several cases have jumped on the *Adams* and *Jones* bandwagon despite the fact there was no willful failure to perform.⁶⁹ These cases provide three reasons to support their decision. The first is section 1-106 of the Code,⁷⁰ which provides that the remedies provided by the Code shall be liberally administered. The second reason is that section 2-719(2) of the Code⁷¹ provides that where circumstances cause an exclusive remedy to fail of its essential purpose, remedy may be had as provided in this title. Finally, the courts are relying on the Official Comment to section 2-719, which provides that all parties must accept the legal consequence that there be a fair quantum of remedy upon breach; where the exclusive remedy fails in its purpose or operates to deprive a party of the substantial value of the bargain, it must give way to the general remedy provisions of the Code.⁷²

Thus, these courts hold that when the repair or replacement remedy failed, everything connected with it failed as well. Unfortunately, as suggested above, these courts are ignoring that the two clauses are materially different and are governed by separate sections of the Code, and thus are disturbing freely negotiated risk allocations without good reason.

Conclusion

Although the general rules concerning a limited remedy of repair and replacement are reasonably well settled, the practitioner should be aware that whether a particular limited remedy has failed depends upon a number of considerations. These considerations include the surrounding circumstances of the contract, the nature of goods involved, the nature of the basic obligations of the parties, the general availability of the items, the uniqueness or experimental nature of the items, and the good faith and reasonableness of the provisions. Thus, as is readily apparent in all aspects of the law, the result of each case will hinge on its own set of facts. If the limited remedy is found to have failed of its essential purpose, such a failure will generally have no effect on an otherwise valid warranty disclaimer.

However, the law is in a state of flux concerning the effect of a failure of the limited remedy's essential purpose on a consequential damage disclaimer. One line of cases holds that the disclaimer is ineffective, relying on the liberal remedies of the Code, the explicit language of section 2-719(2), and Official Comment One to section 2-719. The other line of cases analyzes the disclaimer independent of the failure of the limited remedy and upholds the disclaimer, unless unconscionable, reasoning that the limited remedy and consequential damage provisions are governed by separate sections of the Code; the Code specifically sanctions allocation of risk of loss of consequential damages; and this allocation should not be disturbed unless unconscionable. The latter reasoning is far more persuasive.

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69. See *supra* note 62.

70. U.C.C. § 1-106.

71. U.C.C. § 2-719(2).

72. *Id.*, Official Comment One.