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GETTING WHAT YOU BARGAINED FOR: HOW COURTS MIGHT PROVIDE A COHERENT BASIS FOR DAMAGES THAT ARISE WHEN REMEDIES FAIL OF THEIR ESSENTIAL PURPOSE

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INTRODUCTION.....	132
I. LIMITATIONS ON CONSEQUENTIAL DAMAGES: STATUTORY CONSTRUCTION	137
II. JUDICIAL INTERPRETATION OF THE LIMITATION OF REMEDIES.....	142
A. Failure of Essential Purpose	143
B. Essential Consequential Damages?.....	149
III. A BETTER REASONED APPROACH	160
A. Unconscionability and breach of remedial promise alone can give rise to consequential damages if the parties excluded consequential damages for breach of warranty.....	160
B. A limited remedy in the form of a promise to repair and replace may be a warranty explicitly extending to future performance of goods.....	163
C. Providing a “Fair Quantum of Remedy”.....	166

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CONCLUSION	168
APPENDIX A.....	170
APPENDIX B.....	172

*“It is a settled and invariable principle, that every right, when withheld, must have a remedy, and every injury its proper redress.”*¹

INTRODUCTION

THE freedom to bind oneself and others to presumed mutually beneficial obligations by agreement is a cornerstone of contract law. This principle, known as “freedom of contract,” is essential to the existence of a free market economy, because—assuming parties are fully informed and sophisticated in dealing—such freedom is requisite to establishing an efficient and reliable allocation of resources, risks, and benefits. Such “freedom of contract” includes within its scope the power to harm significantly one’s own interests. The law permits individuals to voluntarily limit their opportunities, to legally obligate themselves to detrimental promises, so long as they bargain freely for a benefit in return.² The return benefit must not even attain a marketable value, as the classic case *Hamer v. Sidway* illustrates.³

Freedom of contract presumes that a party may not escape from a bargain merely because the bargain resulted in a loss for that party. That is, the losing party cannot unwind a fairly bargained-for deal on account of hardship alone.⁴ Indeed, it is customary for parties to use a contract to

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1. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 147 (1803).
 2. See James Gordley, *Contract, Property, and the Will—The Civil Law and Common Law Tradition*, in *THE STATE AND FREEDOM OF CONTRACT* 66, 83–84 (Harry N. Scheiber, ed., 1998).
 3. 27 N.E. 256, 257–58 (N.Y. 1891) (holding that self-restraint from material pleasures was valid consideration for a return promise of a cash payment).
 4. See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 591 (1991) (“[A] freely negotiated private international agreement, unaffected by fraud, undue influence, or overweening bargaining power . . . should be given full effect.”) (quoting *M/S Bremen v.*

allocate the risk of loss associated with their bargain. However, damages for breach of contract have the potential to greatly exceed the value of the benefit obtained from the damaged party, depending on the damaged party's specific circumstances and the nature and severity of the breach. In light of parties' ability to enter into binding obligations, there arises the dilemma of how the justice system may be fairly employed when enforcement of a contractual right will result in serious detrimental consequences to a contracting party.

The law must declare the extent to which it will compromise, in the name of equity, a party's ability to contract freely with confidence that contractual terms will be honored. Certain normative standards inevitably bear upon this balance. For example, courts review and cancel the enforcement of contracts that are against public policy or laden with substantive or procedural unfairness, deception, or coercion.⁵ Our courts in the United States are by no means the first to have embraced the doctrine of unconscionability to reject a blatantly unbalanced deal.⁶ If the contract is a product of underhanded dealings it may well be argued that it was not borne of freedom; striking it down would be consistent with the underlying principle of freedom of contract. While this rationale may be compelling in cases of deception and duress, it is less convincing in situations where a contract is determined to be unconscionable due to substantial unfairness. In these situations, the inherent subjectivity that attends such a standard can cause the jurisprudence to appear more paternalistic than just.

This Article addresses an area in commercial law where the Uniform Law Commissioners (the "Commissioners") in the United States have determined that it is proper to invade the freedom of sales contracts to prevent certain loss. In most sales situations, merchants are required by law to provide warranties to the buyer in recognition that the buyer desires a contractual remedy for losses incurred by nonconforming goods.⁷ When contracts substantially limit remedies that a party might otherwise be entitled to by law, and there is evidence that the party waived the right because it

Zapata Off-Shore Co., 407 U.S. 1, 12–13 (1972), *overruled on other grounds by* *Lauro Lines v. Chasser*, 490 U.S. 495 (1989)).

5. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449–50 (D.C. Cir. 1965).
6. See generally Dando B. Cellini & Barry L. Wertz, Comment, *Unconscionable Contract Provisions: A History of Unenforceability From Roman Law to the U.C.C.*, 42 TUL. L. REV. 193 (1967).
7. The Uniform Commercial Code provides two implied warranties. First, the product must be merchantable under section 2-314. Second, the product must be fit for any particular purpose for which the seller knows the buyer needs the goods to conform and for which the buyer relies on the seller's skill or judgment to provide the proper goods, under section 2-315. The sales contracts addressed in this Article are assumed to involve merchant sellers, as defined in section 2-104(1).

lacked a real choice in the matter, courts may employ the doctrine of unconscionability to restore a remedy.⁸ However, the Commissioners and the state legislatures that have adopted Article 2 of the Uniform Commercial Code (the “UCC” or “Code”) have determined that even in cases where there is no unconscionability and both parties are sophisticated to deal in the purchase and sale of goods, if such parties agree upon a limited remedy as a substitute for statutory remedies, and such limited remedy fails of its essential purpose, the injured party may have access to the statutory remedies that would otherwise have been available to it for breach of warranty under the UCC.⁹ This may have the unintended consequence of rendering the result of a failed remedy strikingly similar to that obtained by a successful judgment that holds a contract remedy unconscionable. The UCC thus limits the freedom of contract when a limited remedy fails of its essential purpose.

This Article addresses the result of the operation of three provisions in Article 2 of the UCC that reflect the tension between freedom of contract and the doctrine of unconscionability (i.e., the duty of the law to intervene and frustrate freedom of contract when fairness so requires). The first provision, section 2-719(1), allows parties to contract for remedies in addition to, or in substitution for, those provided in the statute. It also permits parties to limit the measure of damages otherwise recoverable under Article 2 of the UCC. The second provision, section 2-719(2), ensures that where any exclusive or limited remedy fails of its essential purpose, a party can claim remedies it would have been entitled to under the Code as if it had not agreed to the limited remedy. The third provision, section 2-719(3), permits the limitation or exclusion of consequential damages unless such limitation or exclusion is unconscionable.¹⁰

Thus, in cases where parties agree to limit or alter the measure of damages otherwise provided by statute for breach of warranty and substitute other terms intended to remedy a breach of warranty, if the substituted remedy fails to provide the essential relief it was intended to provide, the

8. *See, e.g.*, *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 84–97 (N.J. 1960) (holding unconscionable a disclaimer of liability for personal injuries due to breach of an automobile warranty).

9. *See* U.C.C. § 2-719(2). Unless otherwise noted, this Article addresses the law as embodied in the amended Uniform Commercial Code (2005) and not as actually applied by the separate States.

10. UCC section 2-719(3) asserts that only limitation for injury to person in the case of consumer goods is *prima facie* unconscionable, whereas limitation of damages where the loss is commercial is not.

injured party is entitled to claim the statutory damages that such party in fact waived. Consequential damages are available to injured buyers for a seller's breach of warranty and breach of contract,¹¹ but they are also excludable by agreement unless such exclusion is unconscionable (e.g., liability arising from personal injury).¹² The issue thus arises whether consequential damages might nevertheless be included in the statutory remedy for ineffective remedies if the parties agreed to exclude them in the sales contract.

Courts have responded to this issue in two ways. Most U.S. courts of appeals have determined that when a remedy fails of its essential purpose, consequential damages may be awarded even if the parties had bargained them away in the sales contract. Two U.S. courts of appeals, however, have determined that such a result is inappropriate and have precluded any consequential damages if the parties waived them for breach of warranty in the sales contract; one of these courts has flip-flopped on the issue.¹³ This Article argues that no federal appellate courts have approached the failed remedy situation in a manner that adheres to the intent of the parties (as embodied in the contract) and the law of sales. We bear in mind that commercial law is state law, and that the federal courts must apply the law of the respective state that governs the contract. The state supreme courts have the ultimate responsibility to interpret their respective state codes, and the U.S. courts of appeals do so only to the extent they must predict how the state supreme court would interpret the code. For ease of analysis, this Article uses the rulings of the U.S. courts of appeals to compare and analyze the interpretations of the remedies provided by the laws of the states that have adopted UCC Article 2.

Part I of this Article explains the statutory framework that determines remedies for breach of warranty under the UCC and examines the inherent tension between section 2-719(2), which restores remedies provided under the UCC if a limited remedy agreed by the parties fails of its essential purpose, and section 2-719(3), which specifically enables the exclusion of consequential damages. Part I explains that principles of statutory construction require that these provisions act independently of one another, which would deny consequential damages for breach of warranty under all circumstances if the parties lawfully agreed to waive them.

11. See U.C.C. §§ 2-712(2), -713(1), -714(3).

12. See U.C.C. § 2-719(3).

13. See discussion *infra* Part II(B).

Part II examines how courts have handled the conflict between the two provisions. This involves a discussion of how courts define the “essential purpose” of a remedy and how they incorporate section 2-719(2) into the parties’ agreement. This Part considers the practical effect of court orders that transform a seller’s exclusively promised remedy into a guarantee for the buyer against consequential damages suffered by the buyer, even if the buyer waived his right to them and such waiver was not unconscionable. Here, the Article demonstrates how party certainty is undermined by the threat that courts might overrun a fairly negotiated allocation of risk by an award of consequential damages in such circumstances.

Part III offers a proposal for interpreting the statute in such a way as to minimize disruption of the parties’ bargain. By adopting the proposal, courts could provide a coherent approach to the interaction between sections 2-719(2) and (3). Part III also provides an argument that sellers might utilize against buyers in courts that support the reinstatement of consequential damages in failed remedy situations to limit the time from which such courts would reinstate the consequential damages. The argument makes use of a line of reasoning under the Code as currently adopted by the states instead of challenging the courts’ interpretation of section 2-719(2). Part III ends by considering the Commissioners’ proposed revisions to section 2-719(2). These proposed amendments reveal the depth of conflict between sections 2-719(2) and 2-719(3) that most courts have failed to address.

This Article concludes that an alternative, uniformly applied approach to calculating damages under section 2-719(2) would restore certainty to the bargaining table. This approach makes room for a limited application of consequential damages. Consequential damages should be available when a limited or exclusive remedy fails of its essential purpose (1) only if the parties have not waived them for breach of warranty and/or breach of contract and (2) only as of the date the essential purpose of the limited remedy fails. All other statutory remedies are made available as provided by section 2-719(2). Most importantly, the goal of this approach is to implement the parties’ original allocation of risk more effectively than does current sales law jurisprudence in most states, thereby reinforcing confidence in the freedom of contract and restoring the certainty of the bargain.

I. LIMITATIONS ON CONSEQUENTIAL DAMAGES: STATUTORY CONSTRUCTION

The General Obligation and Construction of Contract in the UCC informs us that “[r]emedies for breach of warranty can be limited in accordance with the provisions of [Article 2] on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).”¹⁴ That is, the right to a remedy made available by law may be limited by a contract’s express and implied terms, and in some cases may fundamentally conflict with the parties’ bargained-for rights as set forth in the four corners of a sales contract. This conflict becomes a practical concern for contracting parties because the law of sales provides the contractual right to limit remedies while also providing the legal right to restore them in certain situations.¹⁵ When the law operates to restore a bargained-away right and the parties contract with awareness of such operation, then the possibility of restoration may in fact be a basis of the parties’ bargain. This is a central issue of analysis discussed in Part III. First, we turn to the remedies themselves.

When a party breaches a warranty under a sales contract, the injured party has recourse under the UCC or as defined in the contract. The law provides a basic calculation of damages as a remedy for nonconforming goods in section 2-714(2): “The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.” This remedy is meant to match the value of the goods received with the value paid for them (the value as warranted). The Code also provides for incidental damages that occur as a result of the breach.¹⁶ Incidental damages can be thought of as the costs incurred in connection with remedying the breach. The most valuable remedy offered, however, is consequential damages. They include “any loss resulting from general or particular requirements . . . which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover . . .”¹⁷ They also include injury to person or property proximately resulting from the breach of warranty.¹⁸ Because

14. U.C.C. § 2-316(4).

15. *See* U.C.C. § 2-719(1)–(3).

16. *See* U.C.C. § 2-714(3).

17. U.C.C. § 2-715(2).

18. *Id.*

consequential damages often far exceed the value of the product sold, sellers are anxious to exclude them as an available remedy.

A closer examination of the interworking of the subparts of section 2-719 is necessary to understand how the tension between section 2-719(2) and section 2-719(3) should be resolved as a matter of statutory interpretation. Section 2-719(1) enables sellers to limit the damages available for their breach of warranty or contract as follows:

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

However, section 2-719(2) ensures, "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." Thus, if the seller's goods are nonconforming and the remedy offered to and accepted by the buyer fails to meet its intended purpose, the buyer will be protected as otherwise provided in the Code. Here we must distinguish between a limited or exclusive remedy and liquidated damages. A limited or exclusive remedy does not purport to liquidate damages by assessing a sum to be received by the injured party upon breach, but rather seeks to limit the remedy to an agreed upon course of action.

Section 2-719(3) explicitly provides, "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." Sections 2-719(2) and (3) are, on their

face, contradictory. Section 2-719(2) restores remedies in a very specific manner: *as provided under the Code*. The Code provides for consequential damages *and also provides that the parties may exclude them unless circumstances render their exclusion unconscionable*.

In our effort to piece together the proper relationship between section 2-719(2) and (3), we begin by examining how the principle of statutory construction *expressio unius est exclusio alterius* may be applied to the sequencing of sections 2-719(1)–(3) to signal special treatment of consequential damages as separate from the reach of section 2-719(2). Section 2-719(3) reasserts a specific aspect of section 2-719(1), but states the premise more emphatically. Nowhere else in the Code is any remedy limited or excluded by name, and only section 2-719(3) specifically uses language of extinguishment when referring to the limitation of a remedy. Further indication of special treatment is that section 2-719(3) provides for the exclusion of consequential damages but for a single proviso: unconscionability. The statute does *not* read that consequential damages can be limited “unless unconscionable *or a limited remedy fails of its essential purpose*.” The universe of exceptions under the Code to the ability of parties to exclude or limit consequential damages is provided by the provision itself. The separate and distinct treatment of the exclusion of consequential damages, juxtaposed with the general limitation of remedies (which notably includes consequential damages), strongly favors an interpretation of section 2-719 that permits the exclusion of consequential damages even when other limited or substituted remedies fail of their essential purpose.

Next, we examine how, under other jurisprudence examining the construction of conflicting statutes, section 2-719(3) must remain untouched by any circumstance that resurrects remedies as provided under section 2-719(2). The Fourth Circuit has affirmed the following principle of statutory interpretation as articulated by the Virginia Supreme Court: In construing conflicting statutes, if one section addresses a subject in a general way and the other section speaks to part of the same subject in a more specific manner, the more specific provision prevails.¹⁹

Section 2-719(1) provides in its own language that it is subject to 2-719(2). Thus, where a remedy is limited under section 2-719(1), and the remedy fails of its essential purpose, the contractual limitation must fall to the

19. Beard Plumbing and Heating, Inc. v. Thompson Plastics, Inc., 152 F.3d 313, 320 (4th Cir. 1998) (citing *Dodson v. Potomac Mack Sales & Serv., Inc.*, 400 S.E.2d 178, 181 (Va. 1991)).

statutory right to an alternative remedy provided by the law of sales under section 2-719(2). This simply follows the maxim that a contract is only enforceable insofar as it is legally supportable. Section 2-719(3), however, does not contain language subjecting it to section 2-719(2). Therefore, principles of statutory construction determine whether it survives the broader scope of section 2-719(2). Applying the principle expressed by the Virginia Supreme Court, section 2-719(3) survives because it addresses the same issues as sections 2-719(1) and (2), but in a more specific manner.

Another canon of statutory construction instructs interpreters of a statute “to give effect, if possible, to every clause and word of a statute.”²⁰ The only way to lend meaningful effect to section 2-719(3), in light of section 2-719(1), is to determine that section 2-719(3) is not overridden by section 2-719(2). This is because section 2-719(1) does everything that section 2-719(3) does *unless* section 2-719(3) permits the exclusion of consequential damages to survive when other remedies are resurrected under section 2-719(2). To put it simply, section 2-719(3) only restates more specifically and emphatically that which was already expressly permitted by the limitation and/or substitution of remedies (including consequential damages) provided under section 2-719(1). An unconscionable agreement is unenforceable to begin with, so the second clause of section 2-719(3) does no independent work. The only way to give meaningful effect to the exclusion of consequential damages under section 2-719(3) is, therefore, to determine that section 2-719(2) does not destroy a contract provision that lawfully limits or excludes consequential damages if substituted remedies provided under section 2-719(1) fail of their essential purpose.

Finally, when we apply the rule of contract law that rejects the notion of rewriting contracts, we come to the conclusion that section 2-719(3) should survive any conflict with section 2-719(2). The Third Circuit has ruled clearly on this principle: “Sympathy aside, it is axiomatic that a court may not rewrite the clear provisions of a contract to make it more reasonable or to protect a party against an unwelcome result.”²¹ A noted contract law expert puts it this way:

20. *United States v. Menasche*, 348 U.S. 528, 538–39 (1955) (quoting *Inhabitants of Montclair Twp. v. Ramsdell*, 107 U.S. 147, 152 (1883)).

21. *Brisbin v. Superior Valve Co.*, 398 F.3d 279, 290 (3d Cir. 2005); *see also* *United States v. Joseph A. Holpuch Co.*, 328 U.S. 234, 240 (1946) (declaring that allowing claims to proceed in contravention of the terms of a contract would be unacceptable because it would “rewrite the contract”).

Classical contract law . . . is premised upon the notion of bargained for exchange. The sanctity of the exchange is reflected in the fact that contract law highly values the keeping of one's contractual promises. This is evident from the fact that most breaches of contract entitle the promisee to a contractual remedy. The philosophical grounding for such recourse is the rationale of freedom of contract. It is the belief that equality of consideration is not an appropriate issue for the courts to address.²²

Even where contracts are found to be unconscionable, it is not an accepted practice for a court to make substantive adjustments to remedy a breach; rather the contract, or the unconscionable provision, is rendered unenforceable.²³

The effect of reinserting consequential damages into a contract that jettisoned them is to rewrite a fundamental term of the contract, particularly in light of the disproportionate value that often accompanies consequential damages relative to the value of the goods sold under the contract itself. Inserting the basic statutory damages provided by the UCC under section 2-714(2) (i.e., the difference in market value between what was received and what was paid for) is much closer to the original design of the parties and their agreement to limit available remedies. In light of the centrality of freedom of contract and the hallowed status granted to the bargain that parties make at the time of agreement, the statute should be construed so as to give effect to the original intent of the parties as closely as possible and in such a manner as to provide maximum certainty.

Thus, powerful arguments support a determination that if a buyer waives consequential damages for breach of warranty or breach of contract (or both) in a sales contract, the buyer cannot reinstate them as a remedy when the agreed upon remedy fails. First we noted that after applying principles of statutory construction to the conflict with section 2-719(2), section 2-719(3) emerges unscathed. Moreover, we see that only section 2-719(3) provides that any damages are excludable "unless unconscionable," thus signaling what appears to be specific treatment of consequential damages and providing the

22. Larry A. DiMatteo, *Equity's Modification of Contract: An Analysis of the Twentieth Century's Equitable Reformation of Contract Law*, 33 NEW ENG. L. REV. 265, 267 (1999).

23. See U.C.C. § 2-302(1).

sole grounds for their reinstatement under the Code. Finally, under principles of contract law, where the limited remedy fails of its essential purpose, the remedies claimed under section 2-719(2) should match the original intent of the parties as closely as possible. A reinstatement of consequential damages serves to expand, not substitute, any limited remedy for which the parties bargained.

The Commissioners themselves have debated how consequential damages fit into the remedies made available under section 2-719(2) if a limited remedy fails.²⁴ After years of proposed amendments and amendments to the amendments, a 7-1 vote jettisoned all changes to the Code with respect to this issue.²⁵ Thus the Commissioners left the courts with the duty to interpret the naked statute. As Part II explains, the courts have employed considerably varied reasoning when evaluating the conflict between sections 2-719(2) and (3).

II. JUDICIAL INTERPRETATION OF THE LIMITATION OF REMEDIES

For a party to claim a right to a remedy not in the contract, the contractual remedy must fail of its essential purpose, effectively leaving the injured party without the remedy for which it bargained.²⁶ To fail of its essential purpose, a remedy must fail to provide the value to the buyer that the buyer relied upon when it agreed to limit the remedies it would seek from the seller in the event of seller's breach of its obligations under the sales contract.

A proper understanding of the essential purpose of any contractual clause ultimately springs from the basis of the bargain that represented the parties' legitimate expectations at the time of contracting. Thus, to determine whether a remedy has failed of its essential purpose, the bargain itself must be probed to root out the original intent of the parties. It is essential to discover what the buyer negotiated when it agreed to limit its remedies. In light of this proposition, an unusual phenomenon occurs after section 2-719(2) is invoked and a remedy is found to have failed of its essential purpose. At this point, most courts abandon all inquiry into the essential purpose of the bargain actually struck and subvert the expectations of the parties as expressed in the

24. See *infra* Part III(C).

25. See *infra* Appendix B.

26. See U.C.C. § 2-719(2).

contract. This Article provides a way of construing the contracts to more closely fit the basis of the bargain.

Of course, if the seller is aware that failed remedies will trigger an onslaught of consequential damages even if the buyer waived its right to them, then the parties have achieved their bargain. However, it is quixotic to believe sophisticated sellers who bargain to limit the available remedies in the first place also agree to pay consequential damages for a breach of warranty when the limited remedy falls short of the mark. Subpart (A) explores how the courts have defined “essential purpose” under section 2-719(2). Subpart (B) discusses the reasoning courts use to impose consequential damages as a remedy for breach of contract when the original remedy fails of its essential purpose.

A. Failure of Essential Purpose

The UCC provides additional remedies for a buyer when the seller’s remedy fails because the basic value of the bargain is frustrated when the remedy the buyer relied upon (e.g., a promise to repair or replace nonconforming goods) fails to provide the value promised by the seller in the event of a breach of warranty. Therefore, the analysis of essential purpose appropriately begins with the basis of the bargain and whether in the absence of a statutory remedy the buyer would be deprived of what it obtained by right in the agreement. The Sixth Circuit interpreted Ohio Revised Code section 1302.93(B), which is identical to UCC section 2-719(2), from the standpoint of the benefit bestowed by the agreed-upon remedy:

[A]ll of the remedies prescribed in Chapters 1301 [general provisions of commercial law] and 1302 [the law of sales] become available if an “exclusive or limited” remedy provided by contract fails of its essential purpose- *i.e.*, if circumstances cause the injured party to be deprived of the remedy’s benefits.²⁷

27. *Non Wovens Tech., S.P.A. v. Thompson*, 67 F. App’x 895, 899 (6th Cir. 2003). The Ohio Revised Code reads, “Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in Chapters 1301., 1302., 1303., 1304., 1305., 1307., 1308., 1309., and 1310. of the Revised Code.” OHIO REV. CODE ANN. § 1302.93 (2010); *see also* *Jacada, Ltd. v. Int’l Mktg. Strategies, Inc.*, 401 F.3d 701, 712 (6th Cir. 2005) (upholding the non-enforcement of a limited liability provision, finding that such non-enforcement “draws its essence from the agreement”).

The Fifth Circuit also defined essential purpose in value terms: “[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.”²⁸ The Seventh Circuit perhaps stated the mechanics of section 2-719(2) most clearly:

Minimally, the failure of essential purpose provision presupposes the existence of a breach of contract, which in turn triggers the limited remedies. It is when these remedies are ineffectual or the seller fails to live up to the remedy’s provisions, thereby depriving the buyer of the benefits of the bargain, that remedies fail of their essential purposes. . . . [T]he UCC merely seeks to provide a buyer with the substance for which it bargained²⁹

The Eighth Circuit has stated, “[T]he purpose of an exclusive remedy of repair or replacement from a buyer’s viewpoint is to give him goods which conform to the contract within a reasonable time after a defect is discovered.”³⁰ Thus, the pervasive understanding of section 2-719(2) is that alternative remedies are justified when the contracted-for remedy does not provide the buyer with the value for which it bargained.

If the sales contract itself disclaims a warranty, courts will not permit a buyer to use section 2-719(2) to reinstate remedies with respect to such waived warranty under a failed essential purpose theory. Section 2-719(2) only operates insofar as affirmative warranties (and their respective remedies) were made. In a case before the Second Circuit, a buyer attempted to have remedies provided by the Code restored after agreeing to waive all warranties.³¹ In that case, TIA, a telephone service reseller, entered into a series of agreements for the purchase of AT&T long-distance services and equipment.³² TIA intended to use the services and equipment in a unified

28. *Riley v. Ford Motor Co.*, 442 F.2d 670, 673 (5th Cir. 1971).

29. *Sunny Indus. v. Rockwell Int’l Corp.*, No. 98-2824, 1999 U.S. App. LEXIS 7001, at *29–30 (7th Cir. April 12, 1999) (citations omitted).

30. *Arabian Agric. Servs. Co. v. Chief Indus. Inc.*, 309 F.3d 479, 486 (8th Cir. 2002) (quoting *John Deere Co. v. Hand*, 319 N.W.2d 434, 437 (Neb. 1982)).

31. *Telecom Int’l Am., Ltd. v. AT&T Corp.*, 280 F.3d 175, 181, 188 (2d Cir. 2001).

32. *Id.* at 181.

system, but the various agreements disclaimed any warranties by AT&T as to performance of such a system and proclaimed each agreement to be a separate, wholly-integrated contract.³³ The equipment agreements also capped AT&T's liability for defective equipment at \$100,000 and barred recovery of consequential damages.³⁴

AT&T's equipment failed and could not be repaired. TIA claimed that under the circumstances the limited damages failed of their essential purpose as an adequate remedy.³⁵ After all, the only remedy for equipment failure in the contract was payment of \$100,000 in liquidated damages. Nonetheless, the Second Circuit concluded,

We . . . see nothing in the contractual agreements that suggests anything but a rational, informed allocation of the risks of equipment failure, system failure, or opportunistic behavior. Essentially . . . the parties agreed to swallow their own out-of-pocket and consequential losses if Diamond Net failed. . . . [T]here was no "essential purpose" left unremedied by the equipment agreements.³⁶

Thus, courts scrutinize the original contract and circumstances of performance to determine what the warranties are and what their essential purpose is. *Telecom International American* makes clear that the essential purpose of the remedy does not fail simply because the buyer is dissatisfied with, or not made whole by, the remedy. Rather, the essential purpose is unfulfilled only when the obligation the seller agreed to perform as a result of the breach is unsatisfied. In *Telecom International American*, the court held the parties to the deal they had made, even though the contractual remedy was of low value in light of the lost profits suffered by the buyer.³⁷

Was the \$100,000 adequate remuneration? It failed to bring the buyer into a position it would have been in if the goods had performed as advertised, and in this way it was inadequate as a "remedy" in the traditional sense provided by section 2-714(2). But the payment essentially fulfilled *both parties' expectations* under the contract in the event of a breach. Legally, it was

33. *Id.*

34. *Id.*

35. *Id.* at 194.

36. *Id.* at 189–90, 194.

37. The lost profits that TIA was suing for totaled in the tens of millions of dollars. *See id.* at 189.

adequate. UCC section 2-316(1) requires that “words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other” Thus, as long as a seller’s behavior complies with the ultimate warranty promised, and such limitation is not unconscionable, the courts will not use section 2-719(2) to renegotiate the warranties actually provided in the contract. This is a compelling reason for sellers to provide liquidated damages clauses should a remedy fail of its essential purpose. In this manner the seller and buyer agree on the value of a failed limited remedy.

One of the central arguments of this Article is that even where the parties lack liquidated damages or a backup remedy, courts should limit substituted remedies under section 2-719(2) to providing the buyer no more than the value essentially bargained for in the remedy that failed by not reinstating consequential damages for breach of warranty if the parties agreed to exclude them. As discussed in the next Subpart, when a remedial promise fails of its essential purpose, most U.S. courts of appeals abandon their adherence to fulfilling the original intent of the parties (i.e., an examination of the value of the essential purpose of the remedial promise that failed). Despite employing an objective, straightforward, and contract-centric approach when determining the essential purposes of remedies in the contract, most courts are willing to abandon the role as interpreters of contract once they find that a remedy has failed of its essential purpose. Not only does this have the potential to frustrate the expectations of the parties as set forth under contract, this Article argues such substitution is potentially illegal if it misapplies section 2-719(2) of the Code.

Most U.S. courts of appeals permit a buyer to pick its remedy (including consequential damages) without regard to any limitations that inhere in the contract if the essential purpose of the remedy provided by contract fails.³⁸

38. The state supreme courts have the ultimate responsibility to interpret the state code, and the U.S. courts of appeals do so only to the extent that they must predict how a particular state supreme court would interpret the code. The following circuits have held or acknowledged that consequential damages are available where a remedy fails of its essential purpose:

In the Third Circuit, see *Ragen Corp. v. Kearney & Trecker Corp.*, 912 F.2d 619, 624–25 (3d Cir. 1990), applying the law of Wisconsin:

[W]here the limited remedy fails of its essential purpose it will be disregarded and under UCC § 2-719, the buyer can proceed to any remedies available under the UCC [W]e conclude that the Wisconsin Supreme Court would hold that because Ragen’s exclusive limited remedy failed in its essential purpose, it can recover consequential damages under

the UCC, notwithstanding that consequential damages may be excluded under its contract with K & T.

But see *Chatlos Sys., Inc. v. Nat'l Cash Register Corp.*, 635 F.2d 1081, 1086 (3d Cir. 1980), interpreting New Jersey law:

The limited remedy of repair and a consequential damages exclusion are two discrete ways of attempting to limit recovery for breach of warranty. 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.

In the Fourth Circuit, see *Figgie Int'l, Inc. v. Destileria Serralles, Inc.*, 190 F.3d 252, 257 (4th Cir. 1999), which holds that South Carolina law “provides that the general remedies of the UCC will apply, notwithstanding an agreed-upon exclusive remedy, if the circumstances cause [the remedy] . . . to fail of its essential purpose.”

In the Fifth Circuit, see *Miss. Chem. Corp. v. Dresser-Rand Co.*, 287 F.3d 359, 366 (5th Cir. 2002), which holds that under Mississippi law, if the repair or replacement remedy fails its essential purpose, then the buyer may seek any alternative remedy provided in the Code.

In the Sixth Circuit, see *Non Wovens Tech., S.P.A. v. Thompson*, 67 F. App'x 895, 899 (6th Cir. 2003), which states that “[u]nder Ohio Rev. Code Ann. § 1302.93(B), all of the remedies prescribed in Chapters 1301 and 1302 become available if an exclusive or limited remedy provided by contract fails of its essential purpose” But see *U.S. Fibres, Inc. v. Proctor & Schwartz, Inc.*, 358 F. Supp. 449, 465 (E.D. Mich. 1972), *aff'd*, 509 F.2d 1043 (6th Cir. 1975), which holds that “limitations of liability under Pennsylvania law are valid and enforceable.”

In the Seventh Circuit, see *Sunny Indus. v. Rockwell Int'l Corp.*, No. 98-2824, 1999 U.S. App. LEXIS 7001 (7th Cir. Apr. 12, 1999), and see *infra* Part II(B) for further discussion.

In the Eighth Circuit, see *Arabian Agric. Servs. Co. v. Chief Indus., Inc.*, 309 F.3d 479, 486 (8th Cir. 2002), which holds that when an exclusive remedy fails of its essential purpose, the aggrieved buyer may invoke any remedies available under the Nebraska Uniform Commercial Code.

In the Ninth Circuit, see *S. M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363, 1375 (9th Cir. 1978), which holds under California law that whether a bar to consequential damages should be eliminated in the context of a failure of essential purpose depends upon whether the default of the seller was “so total and fundamental as to require that its consequential damage limitation be expunged from the contract.” But see *Milgard Tempering, Inc. v. Selas Corp. of Am.*, 902 F.2d 703, 709 (9th Cir. 1990), which holds under Washington law that the only question is whether the failure to remedy as promised caused a loss which was not part of the bargained-for allocation of risk, and stating that “[t]his court has found nothing magical about the phrase ‘total and fundamental default’ in relation to U.C.C. 2-719(2).”

In the Tenth Circuit, see *Webco Indus., Inc. v. Thermatool Corp.*, 278 F.3d 1120, 1131 n.6 (10th Cir. 2002) (citing *Kelynack v. Yamaha Motor Corp., USA*, 394 N.W.2d 17 (Mich. Ct. App. 1986)), which applies Michigan law which:

The irony is that to the extent courts provide a remedy that bestows on the buyer a greater benefit than it bargained for, they also instigate a breach of the bargain struck by the parties. Courts only uphold the original intent of the parties insofar as their rulings permit new remedies that neither provide an additional benefit to the buyer nor fall short of the benefit to which the buyer is entitled. However, most U.S. courts of appeals abandon discussion of the parties' intent underlying the bargain behind a failed remedy after they determine a seller failed to perform. As discussed below, the courts either provide consequential damages outright or move to a quasi-unconscionability analysis that depends on the facts of the particular case. When courts reinstate party-excluded consequential damages they never do so in light of the value bargained for under the original contract. While this is acceptable under section 2-719(2) if consequential damages are indeed "provided" within the meaning of that section, this Article argues that consequential damages are *not* provided within the meaning of section 2-719(2) if the parties have excluded them. As we have seen, principles of statutory construction support the proposition that section 2-719(2) does not contemplate supplanting parties' manifested intent, but rather fulfilling it if the agreed-upon remedy fails of its essential purpose. This requires courts to provide a substitute remedy that approximates the benefit contracted for by the buyer.

Under all circumstances, the courts should interfere with the original contract as little as possible, and that means using remedies to effectuate the original intent of the parties as embodied in the contract. Ironically, the very courts that make consequential damages a permissible remedy after parties have waived them proclaim this principle!³⁹ While apparently genuine in their conviction, by reinstating consequential damages the courts in fact undermine the intent that the parties specifically manifested in the contract. The

acknowledged the conflicting opinions on this issue and agreed "with those jurisdictions which have held that the failure of an exclusive remedy provision contained in a warranty renders the limitation of damages inoperable. . . . [T]he repair and replace remedy and the exclusion of consequential damages are integral and interdependent parts of the warranty . . ."

39. For example, see *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933, 941 (7th Cir. 1978), which holds 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 precise nature and purpose of the contract. The purpose of the courts in contractual disputes is not to rewrite contracts by ignoring parties' intent; rather, it is to interpret the existing contract as fairly as possible when all events did not occur as planned.

remainder of this Part explains how the courts came to understand reinstatement of consequential damages as a means to fulfill party intent rather than to undermine it.

The essential purpose of the limited remedy should remain at the heart of the analysis when a court grants a statutory remedy not agreed to by the parties in order to satisfy a breach of warranty. Courts should adhere to this principle in the absence of unconscionability. Where courts breathe life into party-excluded consequential damages, they expressly frustrate freedom of contract, especially where, as is often the case, the result colossally misbalances the original benefit structure of the contract. The next Subpart deals with how the majority of the U.S. courts of appeals have come to reinstate consequential damages for breach of warranty in failed remedy situations. These courts are referred to hereinafter as “pro-damages courts.”

B. Essential Consequential Damages?

The difficult concept to grasp at this stage in the discussion is the rationale for the switch in the pro-damages courts’ focus. Courts necessarily dwell heavily on party intent in their opinions when analyzing whether or not a limited remedy has failed of its essential purpose. Yet after determining that the essential purpose of a remedy has not been met, pro-damages courts begin to consider available remedies under the UCC, but *without considering a remedy that meets as closely as possible the purpose of the original remedy*. This abandons party intent. These courts either award consequential damages outright, or they conduct a quasi-unconscionability test that compares the relative bargaining power of the parties to determine whether consequential damages should be available to the buyer because the buyer experienced a loss for which it did not bargain.⁴⁰ We see the quasi-unconscionability test outlined in *S. M. Wilson & Co. v. Smith International, Inc.*, where the Ninth Circuit set forth the reasons for which the failure of a limited remedy under California’s implementation of section 2-719(2) should not automatically result in the elimination of a bar on consequential damages:

40. See, e.g., *Chatlos Sys., Inc. v. Nat’l Cash Register Corp.*, 635 F.2d 1081, 1086 (3d Cir. 1980) (“Several cases have held that when a limited remedy fails of its purpose, an exclusion of consequential damages also falls”); *Milgard Tempering, Inc. v. Selas Corp. of Am.*, 902 F.2d 703, 709 (9th Cir. 1990) (“The task . . . was to . . . determine whether [the party’s] default caused a loss which was not part of the bargained-for allocation of risk.”).

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 the 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.⁴¹

The implication of the ruling is that if the parties had unequal bargaining power, or the default of the seller radically upset the basis of the bargain, the buyer could claim consequential damages even though it had assumed their risk in the agreement. A similar analysis is illustrated in *Sunny Industries, Inc. v. Rockwell International Corporation*.⁴²

In *Sunny Industries* the buyer, Sunny Industries (“Sunny”), needed a press capable of printing a large volume of material according to the stringent specifications of *TV Guide*. To satisfy this demand, Sunny entered into a sales agreement for a new printing press with Rockwell International Corporation (“Rockwell”), a reputable manufacturer of industrial printers.⁴³ The contract contained a warranty provision stating that the press would meet all specifications. It also contained an “exclusion of damages” provision, which provided that Rockwell would not be liable for consequential damages.⁴⁴ In addition, the parties agreed to the following exclusive remedy:

Seller's sole responsibility and liability and Purchaser's exclusive remedy under this agreement shall be limited to the repair or replacement at Seller's option, of part or parts, not so conforming to the warranty; or replacement with other Machinery conforming to the Specifications, of [sic] within a

41. 587 F.2d 1363, 1375 (9th Cir. 1978) (emphasis added).

42. No. 98-2824, 1999 U.S. App. LEXIS 7001 (7th Cir. Apr. 12, 1999).

43. *Id.* at *4.

44. *Id.* at *5.

reasonable period of time, if Seller is unable to replace the Machinery with other Machinery conforming to the warranties and Specifications contained herein, Seller shall remove the Machinery at Seller's expense and return moneys paid to Seller thereon, without interest, and rescind the Agreement and return to Purchaser the promissory note.⁴⁵

The remedy limitation provided for repair and replacement of the press within a reasonable time or the agreement would be rescinded and the purchase price (of approximately \$18 million) returned.⁴⁶ The machinery was custom-designed, and the delivery was extended twice.⁴⁷ Despite the delays, the buyer made payments for progress.⁴⁸ The final product was delivered in July 1995, but soon proved unable to print to specifications. Sunny lost more than \$500,000 in value-added revenue per month as a result of the deficiencies.⁴⁹ From July through October 1995, Rockwell sent engineers to fix the problems, but they were unsuccessful.⁵⁰ In February 1996, Rockwell engineers said they had located the problem and would redesign accordingly.⁵¹ Sunny agreed to an amendment to the sales contract granting Rockwell more time to bring the equipment to specification.⁵²

With losses mounting and threats from *TV Guide* to send the work elsewhere, Sunny obtained a sixteen-year-old Toshiba press in September 1996. Sunny refused to make any payments on the promissory notes held by Rockwell until the problem was fixed; however, Sunny did make periodic interest payments on the notes through August 2006.⁵³ In the fall of 2006, a Sunny representative sent a letter to Rockwell demanding that Rockwell “bring the press up to specifications, or I will have to ask you to remove the equipment.”⁵⁴

45. *Id.* at *19.

46. *Id.* at *5–6.

47. *Id.* at *6.

48. *Id.*

49. *Id.* at *8.

50. *Id.*

51. *Id.* at *12.

52. *Id.* at *12–13 (“[B]ased on Rockwell’s promise that repairs would be made, Sunny signed another amendment to the sales agreement, which stated that Sunny “shall automatically, without further action, be deemed to have effected irrevocable final acceptance of the machinery on June 30, 1996.”).

53. *Id.* at *13.

54. *Id.* at *14.

In March 1997, Goss Graphics, the successor to Rockwell's liabilities after it purchased Rockwell, informed Sunny that it would no longer service the printer.⁵⁵ Sunny sued for breach of contract and for alternative remedies under the UCC, including consequential damages, alleging that none of the remedies provided in the contract could satisfy their essential purpose.⁵⁶ In determining what remedies were available under the contract, the Seventh Circuit wrote,

Because Rockwell was the only party with experienced engineers and a knowledge of the capabilities of its machinery, only Rockwell could determine when it was unable to replace the non-performing machinery with conforming machinery. Certainly Rockwell would not entrust Sunny with the obligation to rescind whenever Sunny believed that Rockwell could not correct defects in the press.⁵⁷

Conspicuously absent from the court's analysis is any examination of the reasonable time period requirement that was written into the remedy provision in the contract. Sunny should have been able to seek rescission when efforts to repair failed after a reasonable time had passed. Nevertheless, the court determined that Rockwell should have offered to rescind the agreement, and the remedy failed because "Rockwell did not adequately repair or replace the press, or rescind the contract."⁵⁸ Furthermore, the court found that it was "impracticable" for Sunny to seek to enforce rescission as an adequate remedy, holding that where a remedy is impracticable it fails of its essential purpose even if it is available.⁵⁹

After making these findings of law, the court moved directly into a discussion of the essential purpose doctrine, beginning with the reasons for the doctrine. The court first asserted what the doctrine is not: "[I]t does not mean that an exclusive remedy has failed 'of its essential purpose' whenever a

55. *Id.* at *17.

56. *Id.*

57. *Id.* at *23.

58. *Id.* at *27.

59. *Id.* at *20 n.5 (citing *Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable & Cold Storage Co.*, 709 F.2d 427, 431–32 (6th Cir. 1983) ("Because Sunny needed the press in order to meet its obligations to TV Guide, rescission quickly became, or may have always been, impracticable.")).

contracting party loses money because a limited remedy provision prevents him from being fully reimbursed for the damages caused by the other party's breach."⁶⁰ The court then summed up the purpose of the doctrine in what is now familiar language: "It is when these remedies are ineffectual or the seller fails to live up to the remedy's provisions, thereby depriving the buyer of the benefits of the bargain, that remedies fail of their essential purposes."⁶¹ The court reiterated, "[T]he UCC merely seeks to provide a buyer with the substance for which it bargained . . ."⁶²

The court proceeded to outline the purposes of the repair and replace remedy: "From the buyer's perspective, the essential purpose of the repair or replace remedy is to 'provide goods that conform to the contract for sale and do so at an appropriate time.'"⁶³ As for the rescission remedy, its essential purpose "is to place the parties in the same position they would have been in had the contract not been executed."⁶⁴ The court determined that, under the circumstances, Sunny had been left without a fulfillment of the essential purpose of either of these remedies.⁶⁵ The court remanded the case to the district court to determine what type of remedy should be applied. Consequential damages, it noted, are available on a case-by-case basis if "the failure of the remedy caused a loss which was not part of the bargained-for allocation of risk."⁶⁶

The character of this order yields a troubling logic. In analyzing the essential purpose of the limited remedy, the court already determined that it had failed, precisely because the buyer had not received what it bargained for. Therefore, contrary to the court's assertion that the case-by-case approach "neither automatically grant[s] nor denie[s] consequential damages,"⁶⁷ if the essential purpose of a remedy fails because of the incurrence of a loss that was not part of the parties' bargain, and consequential damages may then be

60. *Id.* at *29 (quoting *J.D. Pavlak, Ltd. v. William Davies Co.*, 351 N.E.2d 243, 246 (Ill. App. Ct. 1976)).

61. *Id.* at *30 (citing *Waukesha Foundry v. Indus. Eng'g, Inc.*, 91 F.3d 1002, 1010 (7th Cir. 1996)).

62. *Id.*

63. *Id.* at *31 (quoting *Chatlos Sys., Inc. v. Nat'l Cash Register Corp.*, 635 F.2d 1081, 1085 (3d Cir. 1980)).

64. *Id.* at *31–32 (citing *Resolution Trust Corp. v. Fed. Sav. & Loan Ins. Corp.*, 25 F.3d 1493, 1504 (10th Cir. 1994)); *see also* *Cotter v. Parrish*, 520 N.E.2d 1172, 1176 (Ill. App. Ct. 1988).

65. *Sunny Indus.*, 1999 U.S. App. LEXIS 7001, at *32–33.

66. *Id.* at *39 (quoting *Milgard Tempering, Inc. v. Selas Corp. of Am.*, 902 F.2d 703, 709 (9th Cir. 1990)).

67. *Id.* at *38.

reinstated if the failed remedy caused a loss that was not part of the bargained-for allocation of risk, consequential damages may be reinstated in every case.

Perhaps in an attempt to clarify the opinion, the court added another wrinkle to the remand by indicating that the analysis turned on *bargaining power* as opposed to *the bargain itself*: “The case-by-case approach . . . allows some measure of certainty in that parties of relatively equal bargaining power can allocate all of the risks that may accompany a breach of warranty, and prevents the court from upsetting that allocation upon a breach of contractual duties.”⁶⁸ The court hastily cautioned that such bargaining power was only one element of many in the analysis of the restoration of consequential damages: “[I]his court placed special emphasis on the relative bargaining power of each party. But that is merely one of many elements that could be considered in determining whether the failure of the remedy ‘caused a loss which was not part of the bargained-for allocation of risk.’”⁶⁹ Thus, the heart of the question is whether there existed a loss that was not part of the bargained-for exchange. Unequal bargaining power may be evidence of such loss. As the court articulated:

[W]here the limited warranty fails to provide the benefits that the buyer expected (i.e., to repair or replace the defective parts) and the parties are clearly on unequal terms with respect to relative bargaining power, the case-by-case approach . . . enables the courts to . . . determine whether consequential damages are warranted, rather than automatically exposing the seller to liability for consequential damages despite an otherwise valid disclaimer.⁷⁰

Therefore, the court established what can be deemed an effective quasi-unconscionability test that investigates whether unequal bargaining power existed during the formation of the contract. Section 2-719(3) already forbids the limitation of consequential damages if they are unconscionable, but the court is not willing to walk down that road and conduct a full blown unconscionability test, because the limitation is, apart from unequal

68. *Id.* at *38 (quoting *Smith v. Navistar Int’l Transp. Corp.*, 957 F.2d 1439, 1444 (7th Cir. 1992)).

69. *Id.* at *39 (quoting *Milgard Tempering*, 902 F.2d at 709).

70. *Id.* at *38–39 (quoting *Smith*, 957 F.2d at 1444).

bargaining power, “otherwise valid.”⁷¹ The order to the district court at this point appears quite muddled. If the limitation of consequential damages is valid, provided the parties have equal bargaining power, is not the question of whether the parties had equal bargaining power the essential fact-finding mission that the Seventh Circuit charged the district court with determining? Yet in apparent double-speak, the court ruled that the heart of the analysis is whether a party experienced a loss which was never part of the bargain.

Indubitably, the contract remedy fails to provide the bargained value if the remedy fails to meet its essential purpose. Does this essentially mean that for courts adopting the Seventh Circuit approach expressed in *Sunny Industries*, if unequal bargaining power is established, consequential damages are automatically available, contrary to the assertions of the court? Is unequal bargaining power alone a just cause to provide an injured party with much more than it bargained for, even where the contract clause is lawful (i.e., conscionable)? One point is clear: in asserting these tests, the Seventh Circuit dropped any further discussion of the value of the essential purpose of the contractual remedy that failed. In so doing, it deviated from the very heart of its own propounded test (i.e., the existence of a loss not bargained for).

It is difficult to see how the U.S. courts of appeals adopted these tests from the standpoint of the Code. In fact, the Seventh Circuit shunned any statutory analysis of its own, and this is a popular trend in this area of law. Judge Lowell A. Reed, for example, argued the following concerning his fellow Pennsylvania judges who had interpreted the Pennsylvania UCC-styled statute to reinstate consequential damages only if their waiver was unconscionable:

I disagree with the logic and the conclusions of these courts. First of all, the conclusion flies in the face of the language of the Pennsylvania Commercial Code, which states, “Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this title.” That means that when an exclusive remedy fails, a buyer may seek the entire range of remedies available under the UCC.⁷²

71. *Id.*

72. *Caudill Seed & Warehouse Co. v. Prophet 21, Inc.*, 123 F. Supp. 2d 826, 831–32 (E.D. Pa. 2000) (citing 13 PA. CONS. STAT. § 2719).

Judge Reed failed to address the separate provision of the Pennsylvania Commercial Code tracking section 2-719(3) and providing for the limitation of consequential damages unless they are unconscionable. He succeeded merely in repeating a proposition as a conclusion.

The majority of U.S. courts of appeals either expressly provide consequential damages, comparable to Judge Reed, or, similar to that articulated in *Sunny Industries*, take a more measured quasi-unconscionability analysis that investigates relative bargaining power and/or loss of a contracted-for benefit. Pro-damages courts that do not take a case-by-case quasi-unconscionability approach simply argue, “when an exclusive remedy fails of its essential purpose, the aggrieved buyer may ‘invoke any remedies available under the Uniform Commercial Code,’ including ‘provable consequential damages, even though specifically excluded by the written warranty.’”⁷³ Without engaging the conflict that exists in the statute, these courts topple party expectations embodied in the agreement at the time of contracting and substitute their own judgment for that of the parties.

As illustrated by the Seventh Circuit’s opinion in *Sunny Industries*, pro-damages courts have gone so far as to reinstate contract-barred consequential damages even when the seller and buyer negotiated a backup remedy (e.g., refund of the purchase price) in anticipation that other remedial promises might fail of their essential purpose. The Seventh Circuit did not rule out consequential damages in *Sunny Industries* even though the parties had agreed that if the repair or replace warranty failed, rescission of the contract would be an adequate remedy.⁷⁴ Without explanation, the Tenth Circuit blended a backup limited remedy into the primary repair warranty in *Webo Industries v. Thermatool Corporation*:

We are not convinced that, with respect to the issue of failure of essential purpose, a warranty limiting remedies to repair or replacement is materially distinguishable from one limiting remedies to repair or refund of the purchase price. Accordingly we are persuaded that whether the seller is obligated to repair or replace, or repair and refund, Michigan

73. *Arabian Agric. Servs. Co. v. Chief Indus., Inc.*, 309 F.3d 479, 486 (8th Cir. 2002) (quoting *John Deere Co. v. Hand*, 319 N.W.2d 434, 437 (Neb. 1982)); *see also* *Ragen Corp. v. Kearney & Trecker Corp.*, 912 F.2d 619, 624–25 (3d Cir. 1990).

74. *See supra* text accompanying notes 45 and 59.

law requires the seller do so within a reasonable time under the nature and circumstances of the case.⁷⁵

In *Weeco Industries* the jury found that the seller had failed to make every effort to correct the machine's problems, causing its repair warranty to fail of its essential purpose.⁷⁶ The seller had also offered a refund warranty, but because the seller had not offered to refund the purchase price within a reasonable time (notwithstanding the fact that the buyer never claimed the refund remedy that it had bargained for), the Tenth Circuit ruled that the buyer was entitled to consequential damages.⁷⁷

Pro-damages courts that permit the injured party to claim consequential damages do so in the name of equity. Claiming to “eschew wooden analysis” (i.e., predictability and certainty of outcome), the Ninth Circuit merely asserted, as justification for reinstating consequential damages, that a buyer would never pay to “participate in a science experiment.”⁷⁸ The Seventh Circuit averred similarly in *Sunny Industries*, “[A] purchaser hardly would have agreed to limit the seller's liability for consequential damages if it had known that the seller would scuttle the only remedies allowed under the contract.”⁷⁹

It is surprising that sophisticated judges use this reasoning when the entire purpose of waiving consequential damages is precisely to allocate the risk of loss that results when foreseen or unforeseen circumstances intervene and frustrate the ability of a party to perform as promised. The argument that the buyer never would have gone through with a deal that would leave it without a remedy but with severe consequential damages can be applied equally to the seller. Query whether a seller would agree to design and install a machine that would cost it millions to build and service, never satisfactorily complete, lose good-will and reputation, and all the while secure the buyer against consequential damages! Under these circumstances, hindsight is 20/20 for both parties, and that is why the risk of loss is allocated in the contract before the “science experiment” begins.

This Article argues that consequential damages should not be available when a remedy fails of its essential purpose and the buyer waived them in the contract, unless the waiver was unconscionable. All other remedies are

75. 278 F.3d 1120, 1131 (10th Cir. 2002).

76. *Id.* at 1130.

77. *Id.* at 1130–31.

78. *Milgard Tempering, Inc. v. Selas Corp. of Am.*, 902 F.2d 703, 709 (9th Cir. 1990).

79. *Sunny Indus., Inc. v. Rockwell Int'l Corp.*, No. 98-2824, 1999 U.S. App. LEXIS 7001, at *37 (7th Cir. Apr. 12, 1999).

available by virtue of the interaction of sections 2-719(1) and (2). If a buyer waives consequential damages in a contract for breach of warranty and an agreed remedy offered by the seller fails of its essential purpose, the buyer indeed receives a loss that was not bargained for. However, if consequential damages arising from the breach of warranty prior to the failure of the limited remedy are awarded to the buyer, (barring unconscionability) the buyer receives a gain that it did not bargain for. *After* a remedy fails of its essential purpose, further losses occur as a result of breach of contract (due to the failure of the promised limited remedy) and should be awarded accordingly, unless waived by the original bargain, provided such waiver is not unconscionable. Here we must distinguish between the damages for the breach of warranty and the damages for the breach of the remedial promise. If the parties have waived consequential damages for breach of warranty and breach of the remedial promise, then consequential damages should not be available under any circumstances. If consequential damages were waived only with respect to breach of warranty, then under standard contract theory they should be made available for the period of time *after* the seller fails to cure the breach of warranty (i.e., only for the breach of contract that occurs *after* the agreed limited remedy fails of its essential purpose).

In the absence of unconscionability, a reinstatement of consequential damages under any other circumstances destroys the allocation of risk that the parties bargained for and destroys the principle of freedom of contract that lies at the heart of U.S. commercial law. The Second Circuit has embraced this position.⁸⁰ The Third Circuit has both embraced this position as well as rejected it, interpreting identical language under the laws of two separate state jurisdictions with directly opposite results.⁸¹

In reality, the jurisprudence is inconsistent and confusing, leaving judges incapable of applying a standard test that upholds the spirit of the law. In

80. See *McNally Wellman Co. v. N.Y. State Elec. & Gas Corp.*, 63 F.3d 1188, 1195–97 (2d Cir. 1995) (“[A] limitation on incidental or consequential damages remains valid even if an exclusive remedy fails.”).

81. See *Caudill Seed & Warehouse Co. v. Prophet 21, Inc.*, 123 F. Supp. 2d 826, 830–31 (E.D. Pa. 2000) (comparing *Chatlos Sys., Inc. v. Nat’l Cash Register Corp.*, 635 F.2d 1081, 1086 (3d Cir. 1980)) (“The limited remedy of repair and a consequential damages exclusion are two discrete ways of attempting to limit recovery for breach of warranty The former survives unless it fails of its essential purpose, while the latter is valid unless it is unconscionable.”) with *Ragen Corp. v. Kearney & Trecker Corp.*, 912 F.2d 619, 625 (3d Cir. 1990) (holding that where an exclusive remedy fails in its essential purpose, the buyer can proceed to any remedy available under the UCC, including consequential damages, even if excluded by contract)).

Caudill Seed & Warehouse, for example, Judge Reed concluded that because the Third Circuit had interpreted identical language in two different states within its jurisdiction in a conflicting manner, “there is no controlling legal authority to direct me in my consideration of the law.”⁸² The result is uncertainty and division even among courts *applying the law of the same state*. Thus, even though Judge Reed determined that the U.S. district courts within the Third Circuit (including other U.S. district courts in Pennsylvania) generally favored the *Chatlos* approach of enforcing damage disclaimers even when the exclusive remedy is found to have failed of its essential purpose, he declined to follow their precedent.⁸³

Similarly, we see that the Ninth Circuit, when applying Washington State’s implementation of section 2-719(2), which is substantially identical to the California provision that it ruled on in *Wilson*, retreated from its quasi-unconscionability analysis outlined in *Wilson* even though the issue was one of first impression for Washington.⁸⁴ In *Milgard*, the Ninth Circuit acknowledged that the Washington courts had not addressed the issue of whether failure of a limited repair remedy may serve to invalidate a consequential damages exclusion.⁸⁵ Instead of affirming its own logic as expressed in *Wilson*, however, the Ninth Circuit simply ruled that the seller’s inability to repair the goods sold “caused [the buyer] losses not part of the bargained-for allocation of risk. Therefore, the cap on consequential damages is unenforceable.”⁸⁶

Courts need to speak with one voice on this issue to restore certainty to the process of bargaining for remedies. Part III discusses such an approach.

82. *Id.* at 831.

83. *Id.* (citing but declining to follow *Northeastern Power Co. v. Balcke-Durr, Inc.*, No. 97-4836, 1999 U.S. Dist. LEXIS 13437, at *54–55 (E.D. Pa. Aug. 23, 1999); *Otobai, Inc. v. Auto Tell Servs., Inc.*, No. 93-2855, 1994 U.S. Dist. LEXIS 7592, at *33 (E.D. Pa. June 1, 1994); *Middletown Concrete Prods., Inc. v. Black Clawson Co.*, 802 F. Supp. 1135, 1150–54 (D. Del. 1992); *Jim Dan, Inc. v. O. M. Scott & Sons Co.*, 785 F. Supp. 1196, 1199–1200 (W.D. Pa. 1992)).

84. *Milgard Tempering, Inc. v. Selas Corp. of Am.*, 902 F.2d 703, 707–10 (9th Cir. 1990) (citing *S. M. Wilson & Co. v. Smith Int’l, Inc.*, 587 F.2d 1363 (9th Cir. 1978)); *see also supra* text accompanying note 41.

85. *Id.* at 708.

86. *Id.* at 709.

III. A BETTER REASONED APPROACH

The final part of the Article presents an approach that all courts could take to resolve the conflict between sections 2-719(2) and (3). It is the approach that principles of statutory construction justify most clearly, party expectations at the time of contract call for most vividly, and as this Part discusses, other relevant provisions in the UCC and the Commissioner's handling of sections 2-719(2) and (3) overlap with most compellingly.

A. Unconscionability and breach of remedial promise alone can give rise to consequential damages if the parties excluded consequential damages for breach of warranty.

The Third Circuit embraced a bright-line distinction between the tests for applying extra-contractual remedies under sections 2-719(2) and (3) in *Chatlos*.⁸⁷ The court stated, "The limited remedy of repair and a consequential damages exclusion are two discrete ways of attempting to limit recovery for breach of warranty. The Code, moreover, tests each by a different standard."⁸⁸

The section 2-719(2) limitation survives unless it fails of its essential purpose, while the section 2-719(3) limitation is valid unless it is unconscionable. The distinction is supported by the analysis in Part I of this Article. This distinction provides a model for the rest of the country. But this model is incomplete. Both the Second Circuit in *McNally Wellman*, as well as the Third Circuit in *Chatlos*, refused to provide consequential damages for the breach of contract that occurred when the remedies failed of their essential purpose.⁸⁹ Consequential damages are available for any breach by the seller (unless excluded).⁹⁰ This would include breach of warranty, remedial promise, or failure to perform a promise under the contract unless waived by the parties.

This Article argues that no consequential damages should be awarded as a substitute for the failure of a limited remedy if the parties agreed to waive them with respect to a breach of warranty, but they should be awarded for the

87. *Chatlos Sys., Inc. v. Nat'l Cash Register Corp.*, 635 F.2d 1081, 1086 (3d Cir. 1980).

88. *Id.*

89. *McNally Wellman Co. v. N.Y. State Elec. & Gas Corp.*, 63 F.3d 1188, 1196-97 (2d Cir. 1995); *Chatlos Sys.*, 635 F.2d at 1087.

90. *See* U.C.C. § 2-715(2).

breach of contract that arises when the remedial promise fails of its essential purpose (unless they were also waived for breach of contract). In other words, if consequential damages are not excluded for breach of contract, then consequential damages should be available to the buyer for losses incurred after the point in time that the limited remedies promised under the contract fail of their essential purpose. Such damages would not include losses incurred by the buyer during the remedial period, provided that the seller was carrying out his obligations under the agreement in good faith.

The question then arises, when does the seller's breach actually occur? The answer is when the seller's remedial promise finally fails to provide the value for which the buyer contracted. There is a powerful argument that the seller is not in breach until the final attempt to repair or replace fails. If the seller promises a standard repair or replace remedy and attempts to repair and replace on multiple occasions but fails each time until finally succeeding on the last attempt, then the remedy has succeeded in its essential purpose. The buyer could only claim a breach of contract if it could prove that it bargained for a fix on one of the earlier occasions and that the remedy failed. However, such an attempt would probably prove futile, as the purpose of a repair and replace remedy is generally accepted to give the seller *time* to provide a cure.⁹¹ It is only when the performance fails (by the excessive passage of time without conforming results) that the seller is in breach of contract. At that time, consequential damages should become available (unless the parties agreed to exclude them for breach of contract or provided another backup remedy, such as a refund, or liquidated damages). Any recovery for consequential damages while repair and replace efforts were being made in good faith serves only to punish the party in breach. In the absence of bad faith (read unconscionability), this is inappropriate.

All consequential damages available for breach of contract due to a failed remedial promise under this Article's proposal, therefore, are forward-looking from the point the remedy fails. Moreover, as argued in detail in Part III Subpart B, if a repair and replace warranty serves as a warranty explicitly extending to the future performance of goods, then under no circumstances should consequential damages for breach of such warranty be available before the repair and replace warranty ultimately fails. Section 2-719(2) provides all other remedies to meet the essential purpose of the remedy that failed.

In no case is there justification for the courts to rewrite the contract in a manner that drastically upsets the original intent of the parties, as most U.S.

91. See *supra* text accompanying notes 30, 63, 75, and 76.

courts of appeal have done.⁹² This proposal does not leave a remediless buyer without a cause of action. It simply requires that any remedy claimed will approximate the original remedy bargained for (i.e., through rescission or a refund in the difference between the market value of the product received and what was paid for it). Any actionable loss in addition to this can only result from a separate breach of contract, because up until the last point at which the remedy failed, all losses were allocated to fall with the success or failure of efforts to repair and replace within a reasonable time. Such agreements are not unconscionable and are therefore enforceable.

The final part of the Article presents two arguments in support of the approach outlined above. The first argument provides a way for sellers to argue in pro-damages courts that even if the court determines consequential damages are available under section 2-719(2), the law limits them to the period *after the performance on the remedial promise failed*. The second argument looks at the proposed revisions by the National Conference of Commissioners on Uniform State Laws to UCC section 2-719. The Commissioners considered amending section 2-719 to provide for consequential damages when a remedy fails of its essential purpose but decided not to do so. They also considered amending section 2-719 to deny consequential damages when a remedy fails of its essential purpose but decided not to do that either. The Commissioners did, however, provide for an important amendment to section 2-725, which addresses when a cause of action accrues for breaches of a sales contract.

As of the publishing of this Article, no state has adopted the modified language relating to the accrual of a breach of warranty claim under amended section 2-725. As will be discussed, the manner in which section 2-725 was amended dictates when a cause of action for breach of a remedial promise (as opposed to a breach of warranty) begins and should have the same effect on the availability of consequential damages that this Article argues is lawful (i.e., to limit them to the breach of contract that occurs when the remedial promise fails of its essential purpose).

92. See *supra* note 38.

B. A limited remedy in the form of a promise to repair and replace may be a warranty explicitly extending to future performance of goods.

This Subpart addresses how sellers who offer limited repair and replace remedies could argue from the Code in a manner consistent with the proposal set forth in Part III Subpart A. They would argue that they made an explicit promise of future performance within the meaning of section 2-725(2) as currently encoded by the state legislatures (i.e., in its pre-amended form) by virtue of the application of section 2-719(2). Section 2-725(2), as currently enacted by the states that adopt Article 2 of the Code, generally reads as follows:

A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, *except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.*⁹³

93. N.Y. U.C.C. LAW § 2-725 (McKinney 2002) (emphasis added); *see also* ALA. CODE § 7-2-725 (2009); ALASKA STAT. § 45.02.725 (2010); ARIZ. REV. STAT. ANN. § 47-2725 (2010); ARK. CODE ANN. § 4-2-725 (2010); CAL. COM. CODE § 2725 (2010); COLO. REV. STAT. ANN. § 4-2-725 (West 2010); CONN. GEN. STAT. ANN. § 42a-2-725 (West 2009); DEL. CODE ANN. tit. 6, § 2-725 (2010); GA. CODE ANN. § 11-2-725 (West 2009); HAW. REV. STAT. § 490:2-725 (2009); IDAHO CODE ANN. § 28-2-725 (2010); IND. CODE ANN. § 26-1-2-725 (West 2010); IOWA CODE ANN. § 554.2725 (West 2010); KAN. STAT. ANN. § 84-2-725 (2009); KY. REV. STAT. ANN. § 355.2-725 (West 2010); ME. REV. STAT. ANN. tit. 11, § 2-725 (2009); MD. CODE ANN., COM. LAW § 2-725 (West 2009); MASS. GEN. LAWS ANN. ch. 106, § 2-725 (West 2010); MICH. COMP. LAWS ANN. § 440.2725 (West 2010); MINN. STAT. ANN. § 336.2-725 (West 2009); MISS. CODE ANN. § 75-2-725 (West 2009); MO. ANN. STAT. § 400.2-725 (West 2010); MONT. CODE ANN. § 30-2-725 (2009); NEB. REV. STAT. ANN. § 2-725 (West 2009); NEV. REV. STAT. § 104.2725 (2009); N.H. REV. STAT. ANN. § 382-A:2-725 (2010); N.J. STAT. ANN. 12A:2-725 (West 2010); N. M. STAT. ANN. § 55-2-725 (West 2010); N.C. GEN. STAT. ANN. § 25-2-725 (West 2009); N.D. CENT. CODE § 41-02-104 (2009); OKLA. STAT. ANN. tit. 12A, § 2-725 (West 2009); OR. REV. STAT. ANN. § 72.7250 (West 2009); 13 PA. CONS. STAT. ANN. § 2725 (West 2010); S.C. CODE ANN. § 36-2-725 (2009); S.D. CODIFIED LAWS § 57A-2-725 (2009); TENN. CODE ANN. § 47-2-725 (West 2010); UTAH CODE ANN. § 70A-2-725 (West 2009); VT. STAT. ANN. tit. 9A, § 2-725 (2009); VA. CODE ANN. § 8.2-725 (West 2009); WASH. REV. CODE ANN. § 62A.2-725 (West 2010); W. VA. CODE ANN., § 46-2-725 (West 2010); WIS. STAT. ANN. § 402.725 (West 2010); WYO. STAT. ANN. § 34.1-2-725 (2010).

Most courts hold that a promise to repair and replace, by itself, is merely a remedy—a promise that the seller will mend any malfunctioning part for a given period of time—and not a warranty that the goods themselves will conform.⁹⁴ The consequence is that any right of action under section 2-725(2) (as currently enacted by the states) for breach of *warranty* occurs at the time delivery of the good is tendered. As discussed above, the breach of contract to perform a *remedy* as promised arises at the point in time the remedy fails of its essential purpose.

Sellers could argue that section 2-719(2) converts what would otherwise be a remedial promise, or a non-performance guarantee, into an extended warranty, or a performance guarantee. Such a result would cause a date-shift in the accrual of a claim for breach of warranty under the Code (in its pre-amended and currently-enacted form) with the result of limiting the damages for any such breach to the time frame after which the explicit warranty (i.e., remedial promise) fails of its essential purpose.

The overwhelming weight of authority supports a finding that a seller must explicitly warrant a product for a defined period of time in order for the buyer to establish a future performance warranty.⁹⁵ This Article argues that, in effect, the operation of section 2-719(2) guarantees the future performance of the goods sold as long as a repair and replace remedial promise remains in effect. This argument calls for viewing the remedial promise as a future performance warranty because it is, by virtue of section 2-719(2), inseparable from a guarantee that the seller who makes such a remedial promise must bring the goods into conforming condition for the duration of the repair and replace warranty or provide the buyer with other relief under the Code.

The existence of section 2-719(2) in effect *explicitly* incorporates Code-provided remedies into the basis of the bargain as remedies provided by the seller if the essential purpose of contract-provided remedies fails. In essence, this guarantees the future performance of the product because, as discussed above, the essential purpose of the repair and replacement warranty is to offer

94. *See, e.g.*, *Tittle v. Steel City Oldsmobile GMC Truck, Inc.*, 544 So. 2d 883, 889–91 (Ala. 1989); *Cosman v. Ford Motor Co.*, 674 N.E.2d 61, 66–68 (Ill. App. Ct. 1996). *But see* *Nationwide Ins. Co. v. Gen. Motors Corp.*, 625 A.2d 1172, 1176–78 (Pa. 1993).

95. *See, e.g.*, *R.W. Murray Co. v. Shatterproof Glass Corp.*, 697 F.2d 818, 823 (8th Cir. 1983) (applying Missouri law); *Stumler v. Ferry-Morse Seed Co.*, 644 F.2d 667, 671–72 (7th Cir. 1981) (applying Indiana law); *Standard Alliance Indus., Inc. v. Black Clawson Co.*, 587 F.2d 813, 820–21 (6th Cir. 1978) (applying Ohio law); *Spring Motors Distribs., Inc. v. Ford Motor Co.*, 465 A.2d 530, 543–33 (N.J. Super. Ct. App. Div. 1983), *rev'd on other grounds*, 98 N.J. 555, 489 A.2d 660 (1985).

the seller time to bring the product into a state of satisfactory performance.⁹⁶ If the operation of section 2-719(2) is seen as incorporated into the contract as an explicit promise of future performance, this changes the date of the breach of warranty under section 2-725(2) to occur when “*breach is or should have been discovered.*”⁹⁷ The breach would be the failure of the remedial promise to accomplish its essential purpose.

Under such an extended performance warranty, the cause of action for breach of warranty would only accrue when the repairs fail to bring the goods into conformity. This Article has explained that courts look at the continued condition of the goods as the basis for whether a remedial promise fails. If the seller cannot bring nonconforming goods into conformity through an agreed-upon remedy, the buyer has access to other remedies as provided in the Code. The Seventh Circuit held this to be the essential purpose of a repair and replace warranty.⁹⁸ Additionally, the Eighth Circuit recently held, “the purpose of an exclusive remedy of repair or replacement from a buyer’s viewpoint is to give him goods which conform to the contract within a reasonable time after a defect is discovered.”⁹⁹ This argument is paralleled where backup remedies or liquidated damages are provided in addition to the repair and replace warranty. The liquidated damages can only be invoked if there is an underlying deficiency in the performance of the goods and such deficiency cannot be remedied.

This argument could be a way for a seller battling in a pro-damages court to argue that contract-excluded consequential damages, even if reinstated under section 2-719(2), should not be awarded prior to the failure of the limited remedy. Because “a cause of action accrues when the breach occurs,” and the breach of extended warranty only occurs when the final effort to repair or replace fails, consequential damages should only be actionable under this approach—even in pro-damages courts—after the point at which the remedy failed.¹⁰⁰

Interestingly, the recent revision of the Code is consistent with the result this argument produces. The most recent amendments to section 2-725(2)

96. See *supra* text accompanying note 91.

97. U.C.C. § 2-725(2) (2002) (emphasis added).

98. See *supra* note 63 and accompanying text (“From the buyer’s perspective, the essential purpose of the repair or replace remedy is to ‘provide goods that conform to the contract for sale and do so at an appropriate time.’”).

99. *Arabian Agric. Servs. Co. v. Chief Indus., Inc.*, 309 F.3d 479, 486 (8th Cir. 2002) (quoting *John Deere Co. v. Hand*, 319 N.W.2d 434, 437 (Neb. 1982)).

100. See U.C.C. § 2-725(2).

state that if a warranty in the form of a remedial promise is breached (i.e., the remedy fails of its essential purpose), a buyer's right of action for breach of warranty accrues only "when the remedial promise is not performed when performance is due."¹⁰¹ If states adopt newly revised Article 2, there will be no need for the argument propounded above. This is so because the new version pegs the date of the accrual of a cause of action for breach of a remedial warranty to the same date as that arising under a breach of a warranty that explicitly guarantees the future performance of the goods. At this point in time, however, no state has adopted the revised version of section 2-725(2).¹⁰²

C. Providing a "Fair Quantum of Remedy"

Comment 1 to section 2-719 states, "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."¹⁰³ Many pro-damages courts have relied upon this Comment to justify the reinstatement of party-waived consequential damages when a remedy fails of its essential purpose.¹⁰⁴ Comment 1 continues:

Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive

101. U.C.C. § 2-725(2) (2003). Revised Article 2 (2003) introduced the term "remedial promise" to the Uniform Commercial Code. The Code defines the term as "a promise made by the seller to repair or replace goods or to refund all or part of the price of goods upon the happening of a specified event." U.C.C. § 2-103(1)(n).

102. *See supra* note 93.

103. U.C.C. § 2-719 cmt. 1.

104. *See, e.g.,* Ragen Corp. v. Kearney & Trecker Corp., 912 F.2d 619, 625 (3d Cir. 1990) (citing Comment 1 in holding that when a remedy fails of its essential purpose consequential damages are available notwithstanding their exclusion in the contract).

either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.¹⁰⁵

This Comment appears to support the result espoused by the pro-damages courts, but the Second Circuit limited its import to unconscionable contract provisions, ruling that the buyer's effort to reinstate consequential damages after they had been waived "misapplies this commentary," and reaffirming that the allocation of risk with respect to consequential damages had been determined properly in the sales contract.¹⁰⁶

The Commissioners, however, fell into the same pitfall in Comment 1 that many of the pro-damages courts have fallen into. Their assertion does not interpret or add insight to the manner in which sections 2-719(2) and (3) interact. Comment 1 merely restates section 2-719(2) in broader terms than the statute itself reads. The Commissioners do not even hint at the quasi-unconscionability test employed by some courts that limits the availability of consequential damages to cases where the buyer had no real bargaining power vis-à-vis the seller.¹⁰⁷

It is apparent that the Commissioners at some point came to understand the conflict between sections 2-719(2) and (3), because between March 1998 and March 2000 several proposed amendments to section 2-719 were offered in various forms to address the conflict. In March 1998 the Drafting Committee to Revise Uniform Commercial Code Article 2 Sales made proposals to the American Law Institute and the National Conference of Commissioners of Uniform State Laws.¹⁰⁸ Although the ideas in the draft cannot be attributed to the Commissioners,¹⁰⁹ they are a source of scholarly insight and reveal the fact that a genuine conflict exists between sections 2-719(2) and (3), a fact that Comment 1 does not acknowledge.

105. U.C.C. § 2-719 cmt. 1.

106. See *McNally Wellman Co. v. N.Y. State Elec. & Gas Corp.*, 63 F.3d 1188, 1197 (2d Cir. 1995).

107. See *supra* text accompanying note 41.

108. See *infra* Appendix A; Nat'l Conference of Comm'rs on Unif. State Laws, Revision of Uniform Commercial Code Article 2 – Sales, 147–49 (March 1, 1998) [hereinafter 1998 U.C.C. Draft], available at <http://www.law.upenn.edu/bll/ulc/ucc2/ucc2298.htm>.

109. "The ideas and conclusions set forth in this draft . . . do not necessarily reflect the views of the Conference and its Commissioners, the Institute and its Members, and the Drafting Committee and its Members and Reporters. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal." 1998 U.C.C. Draft *supra* note 108, at 1.

Appendices A and B to this Article contain the revisions discussed in this subpart. The amendments reveal the deep conflict in the Code with which the Commissioners wrestled. One proposed provision would have made a limitation on consequential damages per se unconscionable if an exclusive remedy failed to provide “a minimum adequate remedy for breach of the obligations in the contract.”¹¹⁰ This proposal was rejected, as illustrated by the March 2000 revisions.¹¹¹

To summarize, the proposed changes to the Code in their final form, before the March 2000 convention struck them, codified the Third Circuit’s decision in *Chatlos* by enforcing all limitations on consequential damages in a commercial sales contract unless such limitation was determined to be unconscionable.¹¹² Other general remedies would still be available. It is to these remedies that an injured buyer in a failed remedy situation should turn to provide the quantum of relief the parties bargained for. Arguably, the 2003 amendments to section 2-725 support the *Chatlos* prohibition of a restoration of consequential damages for breach of warranty if the parties expressly limited such warranty to a remedial promise, because the cause of action for such breach only accrues when the remedial promise fails. This Article argues further that if the parties waived consequential damages for breach of the remedial promise in addition to breach of any warranty regarding the condition of the goods, then they cannot be reinstated unless such waiver was unconscionable.

CONCLUSION

Certainty is vital to the healthy performance of a market economy. When sophisticated parties allocate risk, and such allocation of risk is not unconscionable, if courts disrupt the allocation, uncertainty enters the bargaining situation. This only increases the transaction costs of future negotiations.

This Article has proposed a path that follows party intent and recognized principles of statutory interpretation. The proposal neither dismisses

110. See *infra* Appendix A, Alternative C [for subsection 2]; 1998 U.C.C. Draft *supra* note 108, at 147–49.

111. See *infra* Appendix B; Nat’l Conference of Comm’rs on Unif. State Laws, Revision of Uniform Commercial Code Article 2 – Sales, 119–20 (March 1, 2000) [hereinafter 2000 U.C.C. Draft], available at <http://www.law.upenn.edu/bll/ulc/ucc2/ucc2300.htm>.

112. See *infra* Appendix B; 2000 U.C.C. Draft, *supra* note 111, at 119–20; *Chatlos Sys., Inc. v. Nat’l Cash Register Corp.*, 635 F.2d 1081, 1086 (3d Cir. 1980).

alternative remedies available when an exclusive remedy fails of its essential purpose, nor does it invade the contract to reinstate consequential damages under those circumstances. Rather, this Article argues that the breach of warranty and breach of remedial promise (within the jurisprudence of the state codes as currently enacted) are two distinct causes of action. This Article further argues that when a remedy fails of its essential purpose, parties may resort to all remedies available for a breach of warranty under section 2-719(2), excluding consequential damages if they were excluded for breach of warranty and breach of remedial promise in the contract. Only this approach matches the substituted relief with the bargained for relief to provide the adequate quantum of relief called for by the Commissioners in Comment 1.

Justice Marshall asserted in one of the most significant opinions ever handed down from the Highest Court, “It is a settled and invariable principle, that every right, when withheld, must have a remedy, and every injury its proper redress.”¹¹³ The UCC provides such redress when limited remedies fail of their essential purpose and would otherwise cause a loss without the bargained-for remedy. When the courts, in their effort to provide an adequate remedy, abandon the essential purpose of the remedy that failed, and tip the scales against the seller by providing the buyer consequential damages, the redress no longer serves the injury, and it ceases to be proper.

This Article does not argue against substituting other remedies in the Code for remedies that fail of their essential purpose; rather, it seeks a remedy that always and only has as its focus the essential purpose of the freely bargained remedy. This Article has provided multiple examples demonstrating that the U.S. courts of appeals fully comprehend the essential purpose of the repair and replace remedy: to bring the goods into conformity with the expectations of the buyer within a reasonable period of time. When the agreed remedy fails to do this, the buyer suffers a loss it did not bargain for. However, it makes no sense to subsequently assign the seller a loss it did not bargain for either. A return to the heart of the bargain would restore confidence that contractual intent will remain the focus of judicial attention, thereby upholding the time-honored principle of freedom of contract, protecting the sanctity of the bargained exchange, and ensuring the stability of American commercial law.

113. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 147 (1803).

APPENDIX A

March 1, 1998 Draft:

(a) Subject to Section 2-809 and subsections (b) and (c), the following rules apply:

(1) An agreement may add to or substitute for the remedies available under this article and may limit or alter the measure of damages recoverable for breach of contract such as by limiting the buyer's remedies to return of the goods and repayment by the seller of the price or to repair and replacement of nonconforming goods or parts by the seller.

Alternative A [for section 2]

(2) An agreed remedy under paragraph (1) may not be applied to deprive the aggrieved party of a minimum adequate remedy under the circumstances.

Alternative B

(2) An exclusive agreed remedy must be a minimum adequate remedy for breach of the obligations in the contract.

Alternative C

(2) An exclusive agreed remedy that is not a minimum adequate remedy for breach of the obligations in the contract is unconscionable.

End of Alternatives

(3) Resort to an agreed remedy under paragraph (1) is optional. However, if the parties expressly agree that the agreed remedy is exclusive, it is the sole remedy.

Alternative A [for subsection (b)]

(b) [Subject to subsection (a)(2)], if, because of a breach of contract or other circumstances, an exclusive, agreed remedy fails substantially to achieve the intended purpose of the parties, [if circumstances cause an exclusive or limited remedy to fail of its essential purpose] the following rules apply:

(1) In a contract other than a consumer contract, the aggrieved party may pursue all remedies available under this article. However, an agreement expressly providing that incidental or consequential damages, including those resulting from the failure to provide the limited remedy, are excluded is enforceable to the extent permitted under subsection (c).

(2) In a consumer contract, an aggrieved party may reject the goods or revoke acceptance and, to the extent of the failure, may pursue all remedies available under this article including the right to recover

consequential or incidental damages, despite any term purporting to exclude or limit such remedies.

Alternative B [for subsection (b)]

(b) If circumstances cause an exclusive or limited remedy to fail of its essential purpose, an aggrieved party may resort to all remedies for breach provided under this article. An exclusion of incidental and consequential damages that is otherwise enforceable under subsection (c) is not effective to preclude recovery of consequential and incidental damages that arise from the failure of the exclusive or limited remedy.

Alternative C [for subsection (b)]

(b) If circumstances cause an exclusive or limited remedy to fail of its essential purpose, an aggrieved party may resort to all remedies for breach provided under this article. An exclusion of consequential or incidental damages otherwise enforceable under subsection (c) is enforceable only if the breaching party demonstrates that the aggrieved party agreed to assume the risk of the consequential or incidental damages in the event the exclusive or limited remedy was not provided.

(c) Subject to subsection (b)(1), consequential damages may be limited or excluded by agreement unless the limitation or exclusion is unconscionable. Limitation of the consequential damages for injury to person in the case of a consumer contract is presumed to be unconscionable, but limitation of such damages where the loss is commercial is not.

END.

Edits made in 1998 are revealed in the March 1999 draft. This draft appears in Appendix B, as edited in March 2000. The March 2000 conference undid all the revisions, leaving section 2-719 unchanged in Revised Article 2 (2003).

APPENDIX B

March 1, 2000 Draft. Revealing the final edits from March 1999, which were here rejected.

2) 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.

(b) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose ~~in a contract other than a consumer contract~~, remedy may be had as provided in this Act. ~~However, an agreement expressly providing that consequential damages are excluded is enforceable to the extent permitted under subsection (d).~~

~~(e) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose in a consumer contract, remedy may be had as provided in this Act including the right to recover consequential damages notwithstanding any term purporting to exclude or limit such damages.~~

~~(d)c~~ Subject to subsection ~~(e)~~ ~~e~~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.

[Reporter's Note - The section returns to the language of original 2-719 per 7-1 committee vote.]