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When To Apply The Doctrine Of Failure Of Essential Purpose To An Exclusion Of Consequential Damages: An Objective Approach

Howard Foss*

I. THE PROBLEM
A. The Situation

In a contract for the sale of goods the parties may agree to their own scheme of remedies in preference to the remedies set forth in the Uniform Commercial Code.¹ For example, a hypothetical Buyer agrees by contract that its exclusive remedy in the case of defective goods will be to have its Seller repair the goods and replace defective parts.² Buyer also agrees³ that consequential dam-

¹ The Uniform Commercial Code is hereinafter referred to as the Code or the U.C.C. Code remedies for an aggrieved buyer of goods include, where applicable, cancellation (§ 2-711), cover (§ 2-712), market value damages (§ 2-713), recovery of any purchase price paid(§ 2-711), difference money damages for accepted goods(§ 2-714(2)), consequential and incidental damages (§ 2-715) and/or specific performance (§ 2-716). Code remedies for an aggrieved seller of goods include, where applicable, the right of reclamation against an insolvent buyer (§ 2-702), the right of stoppage (§ 2-705), resale (§ 2-706), market value damages (§ 2-708), an action for the contract price (§ 2-709), incidental damages (§ 2-710), and partial retention of the buyer's payments (§ 2-718(2)(b)).

² Any contractual remedy whereby the seller is to repair defective goods and/or replace defective parts is hereinafter referred to as a "repair and replace remedy."

³ Usually, the contract will expressly provide for an exclusion or limitation of conse-
ages will not be available to Buyer in the event of Seller's breach. Now assume that after Buyer's acceptance the goods are found to be defective, but Seller is unable or unwilling to fix the goods properly, thereby depriving Buyer of the benefit of its bargain and causing Buyer to suffer economic loss in the form of loss of use of the goods and lost profits.

The question to be addressed in the above hypothetical situation is whether the exclusion of consequential damages will be respected in the face of the Seller's failure to repair. Should the Buyer remain bound by the exclusion of consequential damages even though its agreed-upon remedy has not been performed? Although the statutory framework is available for judging the fate of the repair and replace remedy, the applicable Uniform Commercial Code provisions are unclear and conflicting as to the fate of the exclusion of consequential damages.

B. The Statutory Framework

In general, section 2-719 governs contractual modification of consequential damages. However, sometimes the contract does not contain an express exclusion or limitation clause, and the intent to exclude or limit the buyer's consequential damages is inferred from the parties' agreement that a contractual remedy (e.g., a repair and replace remedy) is the sole remedy available to the buyer. Whether an exclusion is implied or express ought not, in the author's opinion, to be decisive as to the issue posed in this article. See infra notes 46 and 47 and accompanying text, and note 150 and accompanying text.

4. Alternatively, the parties might have agreed that consequential damages, or damages of all kinds, could not exceed a certain amount. See, e.g., Computerized Radiological Services, Inc. v. Syntex Corp., 595 F. Supp. 1495 (E.D.N.Y. 1984) (damages limited to amount paid by purchasers).

5. Goods may be accepted by the buyer's words, action or silence. If, after a reasonable opportunity to inspect the goods, the buyer overtly indicates acceptance or fails to reject, the buyer has accepted. U.C.C. §2-606 provides:

§ 2-606. What Constitutes Acceptance of Goods

(1) Acceptance of goods occurs when the buyer
(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
(b) fails to make an effective rejection (subsection (1) of Section 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

6. The repair and replace remedy, or any other limited contractual remedy, is stricken from the contract when it fails of its essential purpose pursuant to U.C.C. §2-719(2). See, e.g., Custom Automated Machinery v. Penda Corp., 537 F. Supp. 77, 83 (N.D. Ill. 1982); see infra note 12.

7. U.C.C. § 2-719 provides:
remedies. The three subsections of section 2-719 seem to tug in different directions when applied to the above hypothetical.

Subsection (1) permits the hypothetical Buyer and Seller to limit or alter the normal measure of damages. Specifically, Buyer’s remedy may be limited, as in the hypothetical, to the repair of non-conforming goods and replacement of defective parts. Such a repair and replace remedy is expressly permitted in subsection (1)(a).

Subsection (3) deals specifically with consequential damages. If consequential loss is commercial, as in the hypothetical, subsection (3) provides that recovery therefor may be limited or excluded altogether unless the limitation or exclusion is unconscionable. Therefore, at least under subsection (3), Buyer would likely be bound by its agreed exclusion of consequential damages so long as such exclusion is conscionable.

The confusion comes when subsection (2) applies. If the Seller fails properly to perform the repair and replace remedy (i.e., he does not timely fix the goods), Seller’s failure invokes subsection (2). Under that subsection whenever an exclusive or limited rem-

§ 2-719. Contractual Modification or Limitation of Remedy
(1) 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.
(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.
(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

8. U.C.C. § 2-719(1) is hereinafter referred to in the text as “subsection (1).” U.C.C. § 2-719(2) is hereinafter referred to in the text as “subsection (2).” U.C.C. § 2-719(3) is hereinafter referred to in the text as “subsection (3).”

9. A contractual remedy complying with U.C.C. § 2-719(1) and limiting or altering remedies otherwise available under the Code is referred to herein as a “limited remedy.”

edy can be said to "fail of its essential purpose" then remedy may be had as otherwise provided in the Code. The exclusive or limited repair and replace remedy will be ignored in favor of the Code's scheme of remedies. However, the impact of such a failure of essential purpose on the exclusion of consequential damages is problematical.

To illustrate the statutory conflict between subsection (2) and subsection (3), assume in the hypothetical that Seller's failure to fix defective goods causes the repair and replace remedy to fail of its essential purpose within the meaning of subsection (2) and that the exclusion of consequential damages is conscionable within the meaning of subsection (3). The application of subsection (2) would cause the repair and replace remedy to be stricken in favor of other remedies provided by the Code. However, the fate of the contractual exclusion of consequential damages is difficult to determine. It could be stricken by operation of subsection (2) and replaced by the Article 2 remedy of consequential damages; on the other hand, it could survive a subsection (2) failure of essential purpose of the repair and replace remedy and be judged under the subsection (3) test of unconscionability.

The question has been stated in terms of the failure of a repair

11. A contractual remedy is deemed to fail of its essential purpose most often because of the seller's inability or refusal to effect the limited remedy within a reasonable time after it is brought to his attention. The usual remedy held to have failed in the case law is the repair and replace remedy. Diverse factors are considered in determining whether such a repair and replace remedy has failed of its essential purpose: the amount of time the buyer is deprived of his goods and the resulting impact on the buyer (e.g., Caterpillar Tractor Co. v. Waterson, 13 Ark. App. 77, 679 S.W.2d 814 (1984)); the amount of time reasonably needed by the seller to effect repairs (e.g., J.A. Jones Constr. Co. v. Dover, 372 A.2d 540 (Del. Super. Ct. 1977)); the bad faith of the seller (e.g., Cundy v. Int'l Trencher Serv., 358 N.W.2d 233 (S.D. 1984)); and the extent of the damage (e.g., Rudd Constr. Equip. Co., Inc. v. Clark Equip. Co., 735 F.2d 974, 977 (6th Cir. 1984); J.A. Jones Constr. Co. v. Dover).

A second, and much less common, situation arises where the latency of a defect prevents the buyer from discovering the defect and utilizing the remedy in accordance with the contract. Here the remedy has been held to fail of its essential purpose because the buyer is unfairly denied any remedy. The classic example of this situation is Wilson Trading Corp. v. David Ferguson, Ltd., 23 N.Y.2d 398, 297 N.Y.S. 2d 108; 244 N.E.2d 685 (1968). See generally Eddy, On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2), 65 CALIF. L. REV. 28 (1977) [hereinafter Eddy].

12. Replacement of the limited remedy by Code remedies is mandated by the language of U.C.C. § 2-719(2) which states that "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." The remedies thereby becoming available to the buyer to replace the limited remedy are described in note 1, supra, subject however to the possible continued applicability of the exclusion of consequential damages.

13. See infra note 37 and accompanying text.
and replace remedy because that kind of limited remedy appears in the hypothetical. More generally, the question is whether an exclusion of consequential damages is stricken by the failure of essential purpose of any accompanying limited remedy. On this issue the cases are in disagreement.  

14. The following cases involve the question of whether the failure of essential purpose of a limited remedy (usually repair and replace) causes an exclusion of consequential damages to be stricken.


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II. Resolution of the Problem

The courts have evolved several approaches to help resolve the question posed above. The approaches are set forth below in isolation, but it should be remembered that they can be and often are combined.

A. Code Construction

A number of courts have analyzed the problem, at least in part, as a matter of statutory construction. Those courts have discussed whether the logic and language of the relevant provisions of the Code require that, upon the failure of essential purpose of a limited remedy, subsection (2) be applied to the exclusion of consequential damages or whether subsection (3) preempts subsection (2) as to such exclusion. Unfortunately, the language of section 2-719, its Official Comments and other relevant Code provisions is rich in contradictory phrases giving credence to both sides of the argument.

First, the language of subsection (2) provides that upon the failure of a limited remedy, "remedy may be had as provided in this Act." When a limited remedy (e.g., a repair and replace remedy) fails of its essential purpose, all of the cases agree that subsection (2) requires that the limited remedy be replaced with the remedy scheme provided in Article 2. Some courts have further concluded that subsection (2) also requires that an exclusion of consequential damages must likewise be replaced in order to comply


See supra note 11 and accompanying text.
with the subsection (2) command that "remedy may be had as provided in this Act."\(^{16}\)

Other courts have been troubled with this result because of the specific language of subsection (3). Subsection (3) specifically applies to consequential damages, whereas subsection (2) does not. Therefore, because the particular should govern the general, subsection (3) should govern the fate of the exclusion of consequential damages.\(^{17}\) Under this view subsection (2) only applies to strike the limited remedy and not the exclusion of consequential damages because the exclusion is expressly covered by subsection (3).\(^{18}\) The exclusion should not be affected by a court's conclusion that a separate limited remedy is unenforceable.\(^{19}\) In other words, the two subsections operate discretely.\(^{20}\)

A further indication of separate roles for the two subsections is argued to be discernible from the use of different standards in the two subsections. Subsection (3) uses an unconscionability standard, whereas subsection (2) uses the different "failure of essential purpose" standard. Use of different standards in the two subsections is said to indicate that they operate not only differently, but also separately.\(^{21}\)

Both sides of the argument find justification for their positions in the Official Comments to section 2-719. Comment 1 provides that the buyer must get at least "minimum adequate remedies"\(^{22}\)

\(^{16}\) See, e.g., R.W. Murray Co. v. Shatterproof Glass Corp., 758 F.2d 266, 272 n.7 (8th Cir. 1985); Hartzell v. Justus Co., 693 F.2d 770, 774 (8th Cir. 1982); Volkswagen of Am., Inc. v. Harrell, 431 So.2d 156, 164 (Ala. 1983); Hibbs v. Jeep Corp., 666 S.W.2d 792, 797 (Mo. Ct. App. 1984); see also J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 12-10, at 469-70 (2d ed. 1980); Eddy, supra note 11, at 84.

\(^{17}\) Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable and Cold Storage Co., 709 F.2d 427, 435 (6th Cir. 1983).


\(^{19}\) AMF Inc. v. Computer Automation, Inc., 573 F. Supp. 924, 928 (S.D. Ohio 1983). As to whether the limited remedy and the exclusion are separate or dependent, see infra notes 46-61 and accompanying text.


\(^{22}\) Official Comment 1 to §2-719 provides in its entirety:

1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect. However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for
and a court could conclude that a buyer does not get those minimum adequate remedies if, when its seller does not properly repair, the buyer gets no compensation for consequential damages. Similarly, the provision of Comment 1 that there must be "at least a fair quantum of remedy for the breach of the obligations or duties outlined in the contract" indicates that a buyer with significant consequential damages should not be bound by an exclusion of consequential damages when the limited remedy fails, lest the buyer not get his fair quantum of remedy. On the other hand, a court could reach a contrary result by relying on the provision of Comment 1 that the "parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect."  

In holding that an exclusion of consequential damages is stricken by a subsection (2) failure of essential purpose of the limited remedy, other courts have relied on the language of Comment 1 that "under subsection (2), where an apparently fair and reasonable clause because of the 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." Without consequential damages, this provision is arguably violated because the buyer does not get the "substantial value of the bargain." 

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Another argument is based on interpreting the foregoing language of Comment 1 to mean that subsection (2) applies after the passage of time to determine whether a post-contractual change of circumstances has rendered the exclusion of consequential damages oppressive. On the other hand, because the subsection (3) unconscionability of an exclusion of consequential damages is determined at the time of the agreement, there is no scrutiny under subsection (3) of the exclusion's effect after the passage of time. Therefore, the argument is that when a failure of the limited remedy occurs during the course of performance of the contract (e.g., by reason of the seller's failure to repair the goods), subsection (2) must then be applicable to the exclusion because subsection (2) is the only device available to take into account the effect on the exclusion of a post-formation event such as failure of the seller to repair goods. Of course, whether such a gap in coverage was intended by the drafters remains to be determined. None of the Comments specifically address that question.

The above language from the Comments indicating that subsection (2) applies to an exclusion of consequential damages is at least partially balanced by the fact that the only specific reference to exclusions of consequential damages contained in the Comments invokes subsection (3) without mentioning subsection (2). Comment 3 provides that "subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner." This language from Comment 3 supports the argument that with not detract from the substantial value of the bargain because, where the limit has been negotiated, it is the bargain.

27. Milgard Tempering, Inc. v. Selas Corp. of Am., 761 F.2d 553, 556 (9th Cir. 1985)(quoting Comment 1); Fiorito Bros v. Fruehauf Corp., 747 F.2d 1309, 1315 (9th Cir. 1984)(quoting Comment 1).
29. Assuming that subsection (2) is held applicable to the limited remedy during performance, but not applicable to the exclusion of consequential damages during performance, then a failure of essential purpose would result in striking the limited remedy, but not the exclusion clause, and would also result in the buyer's recovery of direct damages under §2-714(2) but not consequential damages, unless the exclusion of consequential damages is unconscionable.
30. Official Comment 3 to U.C.C. §2-719 provides:
   Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in Section 2-316.
respect to an exclusion of consequential damages there is a separate and discrete role for subsection (3) and its unconscionability standard.

Reference is sometimes made to the language of other Code sections for resolution of the issue. Courts arguing for the application of subsection (2) to an exclusion of consequential damages can cite the admonition in section 1-106\(^3\) that Code remedies are to be liberally administered "to the end that the aggrieved party may be put in as good a position as if the other party had fully performed."\(^2\) For example, the only way to get our hypothetical aggrieved Buyer into the position where performance would have put it is to give it consequential damages for its lost profits. Achieving this goal requires that subsection (2) prevail over subsection (3). The contrary view would cite section 1-102(3)\(^3\) and the "general UCC philosophy"\(^3\) of freedom of contract. The argument is that the spirit of freedom of contract requires that subsection (2) should not be used to strike the exclusion of consequential damages without a clearer indication in the statutory language that a conscionable exclusion of consequential damages agreed upon by buyer and a seller should be stricken.\(^3\)

A further resort to other Code sections must be made in choosing the remedies available under the subsection (2) provision that "remedy may be had as provided in this Act." Not surprisingly, the

31. U.C.C. §1-106 provides in its entirety:
§ 1-106. Remedies To Be Liberally Administered
(1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.
(2) Any right or obligation declared by this Act is enforceable by action unless the provision declaring it specifies a different and limited effect.
33. U.C.C. §1-102(3), which embodies a spirit of freedom of contract, provides:
The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.
34. See Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable and Cold Storage Co., 709 F.2d 427, 435 (6th Cir. 1983).
courts have disagreed both as to which sections become available upon the failure of a limited remedy and as to the meaning of those sections when applied to an exclusion of consequential damages.

Where goods have been accepted, as has typically been the case when a limited remedy fails, the relevant part of the Code remedy scheme most often used by the courts has been section 2-714. Direct damages are available under section 2-714(2), and section 2-714(3) provides that in a "proper case" consequential damages may be recovered pursuant to section 2-715(2). The argument is that because subsection (2) grants to the buyer the remedies "as provided in this Act," such remedies must include sections 2-714(3) and 2-715(2) and therefore consequential damages. In particular, because section 2-714(3) is a remedy "as provided in this Act," consequential damages must be available in a proper case de-
spite a contractual exclusion thereof. Given the quoted language of subsection (2), the argument is that there is no reason to limit a buyer's recovery to direct damages under 2-714(2) when section 2-714(3), a remedy provided in the Code, also permits consequential damages. Along the same lines, another court has said that since consequential damages under section 2-715(2)(a) is a remedy provided in the Code, consequential damages must then be available when there has been a failure of essential purpose under subsection (2).

The problem with the section 2-714 argument is that consequential damages are only available under section 2-714(3) in a "proper case." It does not further analysis for the court to conclude that the failure of essential purpose of a limited remedy is a section 2-714(3) "proper case" for consequential damages on the ground that it becomes such a proper case because subsection (2) has invalidated the exclusion of consequential damages. After all, it is equally plausible for a court to conclude that when a limited remedy fails of its essential purpose only direct damages are available under section 2-714(2), and that a "proper case" for consequential damages under section 2-714(3) is not established without a finding that the exclusion is unconscionable under subsection (3).

It could also be argued that because subsection (3) is a Code remedy "as provided in this Act", then even if subsection (2) is held applicable to an exclusion of consequential damages upon a failure of a limited remedy, the only effect of subsection (2) on the exclusion is to reintroduce subsection (3) as the applicable remedy provided in the Code. Therefore, subsection (3) would still apply to the exclusion of consequential damages. If the waiver is conscionable, then it would survive the test of subsection (3) and there would be no "proper case" for consequential damages under sec-

42. Volkswagen of Am., Inc. v. Harrell, 431 So.2d 156, 164 (Ala. 1983); but see AES Technology Sys. v. Coherent Radiation, 583 F.2d 933, 940 (7th Cir. 1978)(recognizing that surrounding facts determine what is a "proper case").
45. Eddy, supra note 11, at 87.
tion 2-714(3). Such an effective exclusion of consequential damages would also preclude the buyer's resort to consequential damages under section 2-715(2)(a).

B. Independence of Exclusion from Limited Remedy

Another way to approach the problem is to focus on the contractual terms and to ask whether an exclusion of consequential damages should be treated as independent from the limited remedy. If independent, the survival of the exclusion does not necessarily depend on the validity of the limited remedy. Where the exclusion and the limited remedy are independent, then subsection (3) could be used separately to determine the validity of the exclusion, even if subsection (2) applies to strike the limited remedy. On the other hand, where the exclusion and limited remedy are characterized as dependent, then it would follow that the fate of the exclusion would depend on the validity of the limited remedy. A subsection (2) failure of essential purpose of the limited remedy would more likely invalidate the exclusion of consequential damages.

Determining whether the exclusion and the limited remedy are independent or dependent has involved some creative interpretation. For example, sometimes parties have not expressly stated an exclusion of consequential damages in their contract and the exclusion is found to arise implicitly from a contract clause limiting the buyer's remedies generally. Thus, a clause stating that a buyer's sole remedy shall be the repair and replace remedy means by implication that the buyer cannot recover consequential damages. This would seem a likely situation for finding the exclusion to be dependent upon the limited remedy. Where the exclusion must be so gleaned from the limited remedy, its fate would seem more clearly tied to that limited remedy, because once the limited remedy is stricken there is no longer the same basis to infer an exclusion of consequential damages. In fact, in most of the cases where an express exclusion is not apparent, it has been held that the exclusion fails upon a failure of essential purpose of the limited remedy.46 However, the only case to have explicitly considered the question held that such an implied limit on consequential damages

survived the failure of the limited remedy and that it made no difference that the exclusion was not express.\textsuperscript{47}

Where there is an express exclusion of consequential damages the issue of independence is even murkier. When the exclusion of consequential damages is expressly stated, and therefore does not depend on the limited remedy for its very existence, it is easier to say as a matter of logic that the two might be independent. Thus, a court can state that an express exclusion is a "separate and distinct"\textsuperscript{48} provision and is therefore entitled to separate consideration under the unconscionability test of section 2-719(3).\textsuperscript{49} However, another court can just as easily conclude that an express exclusion is not separable from the obligation to repair and replace,\textsuperscript{50} or that the two are "integral and interdependent."\textsuperscript{51} Or a court might try to have it both ways.\textsuperscript{52} Such results are not useful without informing us of the factors that must be considered in determining whether an express exclusion is separate from the repair and replace remedy.

Other aspects of the parties' contract supply an inference as to whether the exclusion is separate from or dependent on the limited remedy. For example, two courts found the exclusion to be separate from the limited remedy at least in part because the exclusion clause was located in a separate part of the contract from the limited remedy clause.\textsuperscript{53} Another court looked to the wording of the clauses and their purposes so revealed to see if the clauses were interrelated.\textsuperscript{54} They were not.\textsuperscript{55} However, an examination of the four corners of the contract is likely to ground a decision on a fortuitous detail of drafting; therefore, more factors must be

\textsuperscript{47} AES Technology Sys. v. Coherent Radiation, 583 F.2d 933, 941 n.9 (7th Cir. 1978).
\textsuperscript{48} Office Supply Co. v. Basic/Four Corp., 538 F. Supp. 776, 788 (E.D. Wis. 1982).
\textsuperscript{49} Id.
\textsuperscript{52} Koehring Co. v. A.P.I., Inc., 369 F. Supp. 882, 890 (E.D. Mich. 1974). ("The County Asphalt holding has merit as the consequential damages clause was separate and independent from the repair and replacement clause. On the other hand, the Seventh Circuit cases [holding exclusion not separate] are attractive since the buyer, when it entered into the contract, did not anticipate that the sole remedy available to it would be rendered a nullity, thus causing additional damages.").
\textsuperscript{55} Id.
Some courts have looked to the "larger context" of the exclusion and limited remedy to see how the parties must have viewed the independence or dependence of the terms in light of the parties' deal. Thus, in *Kearney & Trecker Corp. v. Master Engraving Co.*, a contractual provision excluding consequential damages in connection with the sale of a tooling machine was held to be "mutually dependent" with a failed repair and replace remedy, because from the buyer's perspective the allocation of risk created by the exclusion did not extend to consequential loss occasioned by the complete failure of the repair and replace remedy. On the other hand, in *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, the exclusion was found to be separate from and not interrelated with the limited remedy. It was reasoned that the seller would not have entered into the deal without assurance that its failure to repair and replace would not subject it to consequential damages, since the risk of overwhelming consequential damages was sufficiently great from his perspective.

An approach that goes beyond conclusory statements is essential. It leads to an understanding that before affixing labels like independent, separate or dependent one must consider the circumstances of the bargain. From this perspective one can hopefully determine the parties' view of the matter. How the parties' intent can be determined will be discussed later in this article.

C. Seller's Bad Faith

In the case of a limited repair and replace remedy, another approach to the problem is to use the seller's bad faith in effecting repair as a reason for invalidating an exclusion of consequential damages. Thus when the failure of essential purpose of a repair and replace remedy is due to the seller's bad faith in effecting repair, an exclusion of consequential damages would automatically

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56. *Id.* at 14, 465 N.Y.S.2d at 613.
58. *Id.* at 379, 511 A.2d at 1228.
59. *Id.* at 381, 511 A.2d at 1229.
61. *Id.* at 14, 465 N.Y.S.2d at 613. The mere fact that consequential loss could be large does not really indicate who should bear it. When faced with the possibility of ruinous consequential loss, both Buyer and Seller would want to avoid it. *See infra* notes 116-120 and accompanying text.
fail along with the repair and replace remedy.

One justification for this position is that the buyer needs protection from this type of conduct. The buyer is particularly vulnerable to the seller's bad faith once the buyer has given up all rights to consequential damages. The buyer expects to avoid consequential damages through the device of the repair and replace remedy. If the seller then creates consequential damages by willfully failing to perform the expected repair and replace remedy, the buyer ought not to be bound by the exclusion.\textsuperscript{2}

A second and closely related justification for focusing on the seller's bad faith is to punish the seller for his behavior. A seller ought not to be allowed deliberately to welch on his repair duty under the contract and at the same time to look to the contract for relief from consequential damages.\textsuperscript{3} The goal is to prevent the bad faith seller from maneuvering his buyer into an unfair position during the repair process. One court characterized such conduct on the part of a seller as an "impermissible" attempt "to choose which sections of the warranty to be bound by."\textsuperscript{4} Another court thought it "untenable" to permit the defendant to "shelter itself" behind one remedy provision while repudiating its obligations under another remedy provision.\textsuperscript{5}

An example of this reasoning is found in \textit{Fiorito Bros. v. Fruehauf Corp.},\textsuperscript{6} where plaintiff purchased truck bodies from defendant for the purpose of hauling wet cement. When the bodies bulged and bowed and their hydraulic hoists failed, plaintiff demanded repairs under the parties' repair and replace remedy.\textsuperscript{7} Defendant refused, denying that the bodies were covered under warranty.\textsuperscript{8} Later, defendant claimed that it had lived up to its obligation and that plaintiff had misused the bodies.\textsuperscript{9} No repairs

\textsuperscript{2} Fiorito Bros v. Fruehauf Corp., 747 F.2d 1309, 1315 (9th Cir. 1984).


\textsuperscript{5} "This Court would be in an untenable position if it allowed the defendant to shelter itself behind one segment of the warranty when it has allegedly repudiated and ignored its very limited obligations under another segment of the same warranty, which alleged . . . repudiation has caused the very need for relief which the defendant is attempting to avoid." Jones & McKnight Corp. v. Birdboro Corp., 320 F. Supp. 39, 43-44 (N.D. Ill. 1970).

\textsuperscript{6} Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309 (9th Cir. 1984).

\textsuperscript{7} \textit{Id.} at 1311.

\textsuperscript{8} \textit{Id.} at 1311, 1313.

\textsuperscript{9} \textit{Id.} at 1313.
were ever attempted. The Ninth Circuit held that the repair and replace remedy had failed of its essential purpose and that the parties' contractual exclusion of consequential damages was likewise invalidated by the seller's bad faith. The court agreed with the district court that:

*It cannot be maintained that it was the parties' intention that Defendant be enabled to avoid all consequential liability for breach by first agreeing to an alternative remedy provision designed to avoid consequential harms, and then scuttling that alternative remedy through its recalcitrance in honoring the agreement.*

A continuum of descending seller culpability in connection with repair may be stated as follows:

1. Seller's repudiation as shown by seller's willful failure to repair;
2. Seller's repudiation based on an honest mistake; and
3. Seller's so-called repudiation arguably shown by careless, negligent or insignificant repair.

A seller's repudiation consisting of willful failure to perform its obligation to repair or replace has consistently resulted in a holding that a consequent failure of essential purpose of a repair and replace remedy also invalidates an exclusion of consequential damages. It is an easy case to decide under the bad faith approach because both of the above rationales apply. The buyer needs protection and the seller ought not to be allowed to manipulate the buyer. Thus, in *Hibbs v. Jeep Corp.*, defendant had contracted for a repair and replace remedy and an exclusion of consequential damages, but later denied any duty to repair buyer's vehicle. The court held that the exclusion of consequential damages could survive only if Jeep had chosen to perform its duty to repair and replace.

A difficult question arises in the next position on the continuum, *i.e.*, when the seller repudiates for an honestly believed but incorrect reason. For example, if the seller honestly but mistakenly asserts that there is no defect to be repaired, or that the mileage on

70. *Id.* at 1315 (italics in original).
73. *Id.* at 796.
74. In *Hibbs v. Jeep Corp.*, defendant asserted that it had no duty to repair the Jeep.
the vehicle has been altered," the repudiation based on such good faith might be treated differently from a calculated repudiation. Of course, even in the situation of a good faith failure to repair, the repair and replace remedy still fails of its essential purpose, and so must be stricken. The question is whether the removal of the bad faith element from the seller's repudiation prevents the repudiation from destroying the exclusion of consequential damages. When the seller repudiates in good faith, albeit mistakenly, the rationale concerning the buyer's need for protection still applies, but the rationale disfavoring seller manipulation in the repair process does not apply. Therefore, even if one accepts the bad faith approach, the result should be that good faith repudiation does not by itself cause the exclusion of consequential damages to fail even though such repudiation does cause the repair and replace remedy to fail.

In the third position on the continuum, seller's conduct is less egregious than willful failure to repair. Bad faith is not immediately apparent. Yet it has been held that when seller carelessly or negligently complies with his duty to repair, this conduct constitutes a sufficient repudiation to invoke the bad faith approach. Another court stated that a seller's failure to have "substantially performed" meant the same thing as seller's bad faith. If these cases merely hold that seller's bad faith may be inferred from its negligent or careless efforts to repair, or from its failure to effect substantial repair, then they are unobjectionable. If they hold that such botched efforts at repair by seller automatically constitute a bad faith repudiation, so that a subsection (2) failure of essential purpose due to seller's poor job of repair will inevitably invalidate because there was no defect in the vehicle. This belief was found erroneous, but the court did not address whether defendant honestly held its belief. Id. at 796.

75. In Ehlers v. Chrysler Motor Corp., defendant asserted that it was excused from performing its repair obligation because plaintiff had tampered with the vehicle's speedometer. The Supreme Court of South Dakota, assuming for purposes of a motion for directed verdict that Chrysler was wrong in this assertion, did not hold on the effect of an honest mistake by Chrysler. Ehlers v. Chrysler Motor Corp., 88 S.D. 612, 617-18, 226 N.W.2d 157, 158, 160 (1975).


an exclusion of consequential damages, then they are objectionable. Negligent or careless efforts at repairs or failures to effect substantial repair do not automatically mean that the seller is manipulating the buyer; and such manipulation by the seller would seem an important element of the bad faith approach. Indeed, most cases dealing with botched seller repairs have apparently distinguished them from the situation of seller bad faith and have refused to invalidate an exclusion of consequential damages on the grounds of the seller’s bad faith.  

D. Adequacy and Fairness of Remedy Without Consequential Damages

This approach examines the consequences to the buyer if consequential damages are excluded or limited. Although it seems result-oriented, this approach has support in the Uniform Commercial Code.

As discussed earlier, Comment 1 to 2-719 provides that a contractual remedy scheme must provide "minimum adequate remedies" for breach and that the parties are bound to a "fair quantum of remedy for breach." In the earlier case of the hypothetical Buyer, if Buyer has been the victim of a failure of essential purpose of the repair and replace remedy, but Buyer would receive a minimum adequate and fair remedy without consequential damages, then the agreed exclusion of consequential damages could be upheld consistently with these requirements of Comment 1. On the other hand, if the repair and replace remedy fails of its essential purpose, and Buyer would not receive a minimum adequate and fair remedy without an award of consequential damages, then the exclusion of consequential damages would violate the above requirements of Comment 1.

Such an approach demands an inquiry into the nature of the remedy available to the buyer without consequential damages and an evaluation of the adequacy and fairness of such remedy. The former is easy; the latter is difficult.

In the cases the remedy to be evaluated for adequacy and fair-


80. See supra text accompanying notes 22-25 and accompanying text.

81. See supra note 22 for text of Comment 1.
ness if consequential damages are excluded has been either an alternative contractual remedy (i.e., a limited remedy which comes into play upon the failure of another limited remedy) or direct, non-consequential damages available under the Code. The alternative contractual remedy has typically been a limited monetary remedy occurring with a repair and replace remedy. The direct Code damages in the cases have typically been difference money damages under section 2-714(2) or, less frequently, a remedy under section 2-711.

As the following cases illustrate, the difficult aspect of applying this approach is to determine whether, upon the failure of a limited remedy, the remaining remedy is adequate and fair without an


83. See supra note 36.

84. UCC § 2-711 provides:

§ 2-711. Buyer’s Remedies in General; Buyer’s Security Interest in Rejected Goods
(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid
(a) “cover” and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or
(b) recover damages for non-delivery as provided in this Article (Section 2-713).
(2) Where the seller fails to deliver or repudiates the buyer may also
(a) if the goods have been identified recover them as provided in this Article (Section 2-5-2); or
(b) in a proper case obtain specific performance or replevy the goods as provided in this Article (Section 2-716).
(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

In the case where goods have been accepted (and where the buyer has retained the goods long enough for the seller to try to repair, the buyer will likely be deemed to have accepted), the buyer must revoke acceptance pursuant to UCC § 2-608 in order to use the buyer’s remedies under UCC § 2-711. In Computerized Radiological Services v. Syntex Corp., 595 F. Supp. 1495 (E.D.N.Y. 1984), the buyer was held to have properly revoked acceptance pursuant to UCC § 2-608 and was therefore entitled to recover all money paid pursuant to UCC § 2-711. However, because the court respected the exclusion of consequential damages, notwithstanding the failure of the limited remedy of repair and replace, the buyer could not recover consequential damages.
award of consequential damages.

*Computerized Radiological Services v. Syntex Corp.*[^85] is a case where a court uses an alternative contractual remedy to help determine whether the failure of a repair and replace remedy invalidates an exclusion of consequential damages. The contract limited defendant seller's liability to a repair and replace remedy and further provided that in no event would liability exceed the amount paid by the purchaser.[^86] Consequential damages were expressly excluded.[^87] The district court held that in the event of a failure of essential purpose of the repair and replace remedy, the exclusion of consequential damages survived because even without consequential damages the buyer still got the benefit of the limited monetary remedy.[^88] Such remedy was deemed adequate, although the reasons for this are not clear.

On the other hand, in *RRX Indus., Inc. v. Lab-Con, Inc.*[^89] an alternative contractual remedy limiting damages to the amount paid was held to have failed of its essential purpose along with a repair and replace remedy. The seller's breach in failing to make software operational was deemed so "total and fundamental"[^90] that the contractual monetary remedy did not provide an adequate alternative remedy to the buyer. Therefore both contractual remedies were stricken and consequential damages were recoverable.[^91] Unfortunately no guidelines were given for judging the adequacy of the alternative contractual remedy.

*Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*[^92] is a case where the adequacy of the Code remedy of direct damages was a factor in upholding an exclusion of consequential damages where a repair and replace remedy failed of its essential purpose. In determining whether the exclusion of consequential damages left the buyer a "fair quantum of remedy," the court determined it to be "material"[^93] and "significant"[^94] that, regardless of the contrary ruling on

[^86]: Id. at 1509.
[^87]: Id.
[^88]: Id. at 1510.
[^89]: RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. 1985).
[^90]: Id. at 547.
[^91]: Id.
[^93]: Id. at 13, 465 N.Y.S.2d at 613.
[^94]: Id.
the survivability of the consequential damages exclusion, the plaintiff would still be permitted to recover damages under section 2-714(2) of the Uniform Commercial Code.\footnote{Id. at 14, 465 N.Y.S.2d at 613.} Again, no guidance was given in this case as to why such damages are considered adequate.

A contrary result is found in \textit{Kelynack v. Yamaha Motor Corp.}\footnote{Kelynack v. Yamaha Motor Corp., 152 Mich. App. 105, 394 N.W.2d 17 (1986).} The repair and replace remedy in a motorcycle contract had failed of its essential purpose because of the seller's failure to effect timely repair. The seller sought to interpose a contractual exclusion of consequential damages against the buyer's claim for attorney's fees. The court noted that under the circumstances of the case, where the bulk of plaintiff's damages were consequential, a recovery without consequential damages constituted "no remedy at all."\footnote{Id. at 115-16, 394 N.W.2d at 21-22.}

The obvious difficulty with this line of cases is that there are no guidelines for determining when an alternative remedy is adequate and fair, and when it is not. Most courts have not articulated any standards. Two courts have given rudimentary guidance by looking to the amount of consequential harm that will be uncompensated in order to determine when an alternative remedy is adequate and fair.\footnote{Earl M. Jorgensen Co. v. Mark Constr., Inc., 56 Haw. 466, 480, 540 P.2d 978, 987 (1975); Oldham's Farm Sausage Co. v. Salco, Inc., 633 S.W.2d 177, 182-83 (Mo. Ct. App. 1982).} Similarly, another court thought that the enforceability of an exclusion clause depended on the extent to which the seller breached.\footnote{Milgard Tempering, Inc. v. Selas Corp. of Am., 761 F.2d 553, 557 (9th Cir. 1985).} Presumably, the greater the amount of uncompensated consequential injury, the more likely the remedy without consequential damages will be considered inadequate and unfair.\footnote{But see Hightower v. General Motors Corp., 175 Ga. App. 112, 332 S.E.2d 336 (1985), where the court determined that all of plaintiff's damages would be uncompensated if the exclusion were enforced, yet held that the failure of the repair and replace remedy did not invalidate the exclusion and that the exclusion must be shown to be unconscionable to be invalidated.} A related approach is to compare uncompensated harm (if consequential damages are excluded) with the total harm suffered, as apparently was done in the \textit{Yamaha Motor} case. The greater the ratio between such uncompensated harm and total harm, the more likely the remedy without consequential damages should be found inadequate and unfair.

However, dollar amounts and comparisons cannot fully and ac-
Curiously determine the adequacy and fairness of a remedy without an award of consequential damages. The more likely way to resolve the question of the fairness of the remedy is to ask whether it is fair and reasonable to make the buyer bear the risk of uncompensated consequential damages. This inquiry requires a much fuller look at the surrounding circumstances.

E. Interpreting Exclusionary Language

Yet another approach to the problem is to interpret the language of the exclusion in order to clarify the effect, scope and validity of the exclusion when the limited remedy fails.

Extrinsic evidence should be admissible to interpret the exclusion. After all, there is a necessary ambiguity in the meaning of the exclusion when the limited remedy fails. The ambiguity is whether the exclusion continues in such event to be applicable. For example, in *AMF, Inc. v. Computer Automation, Inc.*

It was held that parol evidence could be introduced as to the meaning and interrelationship of an exclusion and a repair and replace remedy upon a failure of the latter when the meaning and relationship were arguably ambiguous on the face of the contract. The court also indicated that in a jurisdiction with a relatively liberal parol evidence rule, such evidence could be admitted even if such an ambiguity did not exist on the face of the contract. It appears that the court recognized the ambiguity lurking within an exclusion of consequential damages whenever a companion limited remedy fails. The use of parol or extrinsic evidence would provide a method for resolving that lurking ambiguity.

The use of extrinsic evidence to interpret the meaning of an exclusion was demonstrated in *Waters v. Massey-Ferguson, Inc.* Despite exclusionary language providing in part that "in no event shall the owner be entitled to recover for incidental, special or consequential damages," the court interpreted the exclusion to mean that the buyer could recover for consequential damages.

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102. 573 F.Supp. at 929.
103. *Id.*
105. *Id.* at 592.
caused by the seller's failure to repair a tractor pursuant to the repair and replace remedy.\textsuperscript{106} What seems a strained interpretation makes sense in light of the extrinsic evidence. The court considered the language itself,\textsuperscript{107} the creative context,\textsuperscript{108} and the commercial context\textsuperscript{109} and concluded that the parties contemplated that repair of the tractor was a certainty. Therefore, the exclusion could not have been intended to exclude consequential damages arising from an event as unexpected as a failure to repair the tractor.

The language interpretation approach used in Waters seems calculated to avoid the issue of whether the failure of a limited remedy invalidates an exclusion of consequential damages. To the contrary, however, the Waters approach simply rephrases the issue in terms of the reasonably intended meaning of the exclusion language upon a failure of the limited remedy. The question still being answered is whether the exclusion survives the failure, and the Waters court gives us a useful insight into how to answer this question. The court looked at the entire context of the deal. From the context comes the objective meaning of the language and an objectively intended result regarding the continued validity of the exclusion upon a failure of the limited remedy. The same inquiry concerning the complete context should be made when the issue is phrased in terms of whether the exclusion survives the failure. It is the complete context of the deal that offers the best guidance for resolving the issue.

\textbf{F. Objective Allocation of Risk}

The best approach to analyzing the fate of an exclusion of consequential damages upon a failure of a limited remedy is to determine objectively an intended allocation of the risk of consequential loss when the limited remedy does not work as planned. This approach requires one to find and consult the objective indicia of the parties' intent among all the facts and circumstances surrounding the transaction and, based on such indicia, to impute an intended result to the parties. By considering the facts and circumstances in which an exclusion or limitation of consequential damages arises, one is most likely to reach the fairest allocation of risk of conse-

\textsuperscript{106} Id.
\textsuperscript{107} The language revealed an unequivocal assumption that the seller would successfully repair. \textit{Id.}
\textsuperscript{108} The seller drafted the language and therefore any ambiguity was to be resolved against it. \textit{Id.}
\textsuperscript{109} The commercial understanding is that tractors can and will be repaired. \textit{Id.}
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sequential loss and therefore the fairest result to the original question of the fate of the exclusion upon a failure of the limited remedy.

Although the courts have not always been clear as to the relationship between the factual circumstances and the parties’ intended allocation of consequential loss, many courts have recognized that each case should be determined based on its own facts and circumstances,\textsuperscript{110} and many courts have recognized the decisive nature of the parties’ intended allocation of risk of consequential loss.\textsuperscript{111} Because the facts and circumstances vary from case to case, and because the parties’ objective intent regarding allocation of the risk likewise varies, a rule that the exclusion always fails or always survives is not possible under this approach.\textsuperscript{112} Indeed, courts basing their decisions on the parties’ intended allocation of risk sometimes have held that the exclusion survives,\textsuperscript{113} and sometimes have held that it fails.\textsuperscript{114} Because the surrounding facts and circumstances are determinative, a decision by summary judgment, demurrer or motion to dismiss is inappropriate.\textsuperscript{115}

In utilizing the objective approach one must realize that there is always an objective argument in favor of each side because both sides can be said to have wished to avoid bearing consequential


\textsuperscript{112} S.M. Wilson & Co. v. Smith Int’l, Inc., 587 F.2d 1363, 1375-76 (9th Cir. 1978).


loss. For example, courts favoring the buyer's position have imputed to the buyer an intent to avoid consequential damages altogether through operation of the repair and replace remedy. When the seller does not repair within a reasonable time, the exclusion is said to fail lest this intended allocation be upset. A variation on this buyer's argument is to find an intent that the consequential loss being excluded was to be only such loss as occurred during a successful repair process, but not consequential loss occasioned by a complete failure of repair. On the other hand, courts favoring the seller's position have imputed to the seller an intent to avoid consequential damages when the limited remedy fails. If consequential loss was foreseeable at the time of the agreement, then the argument is that the seller's objective intent was to avoid such loss. Indeed, the deal would not be made unless the seller could effectively limit ruinous liability for consequential loss.

Both characterizations of intent are partially valid, but without more they cancel each other. Both buyer and seller will always have obvious reasons for wanting to allocate the risk of consequential loss to the other. Simply choosing and announcing one of the above characterizations of their intent does not further the analysis. There must be objective reasons for elevating one party's intent over the other's. Therefore, the chief inquiry under the objective approach is to find the facts and circumstances that permit choosing one position over the other.

An example of facts and circumstances which led a court to conclude that the allocation of risk of consequential loss was intended to be on the buyer is S.M. Wilson & Co. v. Smith Int'l, Inc. In this case the seller could not repair a tunnel boring machine, causing the repair and replace remedy to fail. Nevertheless, the exclusion clause was held to survive because the court determined that the buyer had been allocated the risk of consequential loss when

117. Waters v. Massey-Ferguson, Inc., 775 F.2d 587, 591 (4th Cir. 1985); Kearney & Trecker Corp. v. Master Engraving Co., Inc., 211 N.J. Super. 376, 381, 511 A.2d 1227, 1229 (1986); see also Eddy, supra note 11, at 88-89.
119. See the dissenting opinion in RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 550 (9th Cir. 1985) (Norris, J., dissenting).
the machine could not be repaired. The crucial factors were that the parties were of relatively equal bargaining power, they had negotiated an exclusion clause freely, the boring machine had been designed for the buyer's purposes, and the seller made repeated good faith efforts to repair.\textsuperscript{121} These facts allow us to construct a scenario whereby the parties foresaw the possibility of the seller's inability to repair an item which it had no experience in repairing, bargained fairly to put the risk of consequential loss from such failure on the buyer, and then saw the possibility of consequential loss from such failure become a reality. In such circumstances, it seems fair that the risk of consequential loss should remain on the buyer.

The facts and circumstances to be considered will be as varied as the transactions involved. Generally, anything that could fairly and reasonably help to impute the parties' intent is relevant. One court has summarized the inquiry to include the type of goods involved, the parties, and the nature and purpose of the contract.\textsuperscript{122}

The objective approach incorporates some of the previously discussed approaches. Courts using the objective approach have considered the good or bad faith of the seller,\textsuperscript{123} and the adequacy of the remedy without consequential damages,\textsuperscript{124} and have explored the same factual context used in interpreting the exclusionary language.\textsuperscript{125} On the other hand, the objective approach is a refutation of the Code construction approach. The Code construction approach is based on the assumption that the same result always applies, whereas the objective approach is premised on the possibility of differing results on different facts. The objective approach in a sense utilizes the severability analysis because we are concerned with discovering whether the parties intended the remedy and exclusion as severable or as dependent parts of an intended risk allocation. However, before affixing the label "severable" or "dependent," it is first necessary to make a factual inquiry to determine objectively the proper allocation of risk. Then, consistent with that objective allocation, one can affix the label. The next section of this

\begin{itemize}
  \item \textsuperscript{121} Id. at 1375.
  \item \textsuperscript{122} AES Technology Sys. v. Coherent Radiation, 583 F.2d 933, 941 (7th Cir. 1978).
  \item \textsuperscript{123} See, e.g., 587 F.2d at 1375.
  \item \textsuperscript{125} In Waters v. Massey-Ferguson, Inc., see supra note 104, the court interpreted language by considering the commercial context, see supra note 78, of the deal. In essence, the approach in Waters is to interpret language by divining the parties' objective intent on the issue of allocation of risk of consequential loss.
\end{itemize}
article discusses the various facts and circumstances which can be used under the objective approach to determine the proper allocation of risk. Finally, the substantive import of combinations of and interrelationships among such facts will be considered.

III. APPLYING THE OBJECTIVE APPROACH

The difficulty in determining the parties’ intent often occurs because, although contract language might seemingly allocate the risk of consequential loss from all sources generally to the buyer, it is unclear after the fact whether consequential loss caused particularly by failure of the limited remedy was intended to be so allocated. Under the objective theory certain facts can help determine whether the parties intended such risk to be on the buyer, as seemingly provided in the contract, or whether the situation as it occurred was beyond the risk allocated to the buyer and must instead be allocated to the seller. Facts indicating the parties’ objective intent regarding this question are discussed below.

A. The Relevant Facts

Seller Conduct. If the failure of essential purpose is caused by the seller’s willful, bad faith refusal to perform the limited remedy, the risk of consequential loss therefrom is almost certainly beyond what a reasonable buyer would have agreed to bear. Therefore, under the objective approach such risk is allocated to the seller, and the exclusion fails.

If the seller performs the limited remedy incompetently, carelessly or without substantial results, or refuses to perform because of the seller’s honest mistake (e.g., concerning buyer's eligibility,) under the objective theory consequential loss therefrom is likely allocated to the seller because the parties probably did not expect loss from such conduct when they contractually allocated consequential loss to the buyer. However, such situations are in-

126. See infra note 146 for a sample of general language purporting to assign all consequential loss to the buyer.

127. See, e.g., Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309 (9th Cir. 1984) in which the seller of truck bodies for hauling wet cement refused to repair them. Although it might have been argued in Fiorito that the parties might reasonably have doubted the seller’s ability to repair truck bodies subject to such heavy-duty use, and that the parties therefore intended to take away from the seller the risk of consequential loss from such failure, reasonable parties would not have allocated to the buyer the risk of seller’s bad faith refusal to perform. See supra text accompanying notes 19-24 for discussion of seller’s bad faith.

128. See supra notes 77-79 and accompanying text.

129. See supra notes 74-75.
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conclusive, unlike the situation of a bad faith refusal to perform, because it is possible to imagine situations, even though they may be exceptional, where consequential loss from such seller conduct could reasonably be allocated to the buyer. For example, in the case of a repair and replace remedy, if the course of negotiations discloses that the parties knew that the seller was sufficiently unskilled in such repairs so that it was foreseeable that the seller might not successfully repair, and the price was adjusted downward to compensate the buyer for this foreseen possibility, then reasonable parties in such circumstances might have determined to allocate consequential loss from incompetent repair to the buyer. From this example it can be seen that other facts must be considered to determine the probable intent of the parties in allocating the risk of consequential loss caused by a seller’s carelessness, incompetence or mistake in effecting repair.

If the seller repairs carefully, competently and in good faith but without success, 130 this is neutral under the objective theory. Without further facts, it is not apparent that reasonable people would allocate consequential loss from this conduct to one side rather than the other. However, if a seller’s good faith, competent efforts do not result in successful repair, this might indicate that the goods are not repairable. As discussed later, 131 if it were known or foreseeable at the time of contracting that the goods were of a type not likely repairable, then another factual inquiry is raised under the objective theory.

Another relevant type of conduct is the seller’s breach of contract (as opposed to the seller’s failure to perform the limited remedy). If the breach was not reasonably contemplated by the parties when they agreed to the exclusion, then consequential loss stemming from such breach is arguably not within the losses allocated to the buyer under the exclusion clause. For example, in the situation where the parties agreed to an exclusion of consequential damages and a repair and replace remedy and the seller subsequently refused to deliver the goods at all, it would be a fair as-

130. In most of the cases there is no mention of seller bad faith of incompetence or mistake. Rather than seller’ negligence, most seem to involve seller’s inability to repair in a timely fashion. See, e.g., Chatlos Sys., Inc. v. NCR Corp., 635 F.2d 1081 (3d Cir. 1980) (consequential loss allocated to buyer where seller’s repeated attempts to repair were ineffective); Kelnyack v. Yamaha Motor Corp., 152 Mich. App. 105, 394 N.W.2d 17 (1986) (consequential loss allocated to seller where seller effected repair, but late).

131. See infra text accompanying notes 133-145 for a discussion of the effect under the objective approach of the foreseeability of non-repair and the parties’ expectation of repair.
assumption that the parties foresaw the possibility of defective goods (hence the repair and replace remedy) but not the possibility that no goods would be delivered at all (whereupon the repair and replace remedy makes no sense). An argument could be made that the objective intent was for the buyer to bear consequential loss only from expected sources and not from a source so unexpected as to nullify the limited remedy.  

Foreseeability of Non-Repair; Expectation of Repair. In the case of a repair and replace remedy, if reasonable parties would have foreseen the likelihood of the seller's failure to repair, and they nevertheless entered a contract with an exclusion or limitation of consequential damages that makes no exception for such failure, then it is arguable under the objective theory that they intended to allocate the risk of consequential loss to the buyer in accordance with the generality of the exclusion. Conversely, if the parties' reasonable expectation was that the goods would surely be repaired, so that failure of the repair remedy was not reasonably anticipated, then the exclusion clause was arguably not intended to cover loss from such a surprise source. Therefore, under the objective theory, the intent imputed to the parties is to allocate the risk of loss from such an unanticipated failure of the repair and replace remedy (even one marked by the seller's good faith and competent efforts) to the seller.

The foregoing reasoning turns on the parties' reasonable expectations of repair and non-repair, and objective facts can indicate such expectations. For example, if the goods are of the type with an established repair market and a so-called "after market" of replacement parts, then objectively the parties must have expected repair under a repair and replace remedy to be a certainty. The best example of this situation is the automobile market, where buyer and seller can observe an ongoing repair industry with the technology and material to effect successful repair and a long history of doing so. When the parties agree to an exclusion or limita-

132. In this example of non-delivery, the buyer cannot be said to have accepted the goods, and therefore U.C.C. § 2-714 is not the appropriate damages section. Rather, the buyer would resort to U.C.C. § 2-711. The effect might be to ease the buyer's lot slightly because the buyer seeking consequential damages would not then have to contend with the "proper case" language of U.C.C. § 2-714(3).

tion of consequential damages, it is on the assumption that the repair and replace remedy will assuredly be successful. If the repair so reasonably expected is not forthcoming, the objective theory indicates that the parties' intent is not to bind the buyer to an exclusion clause that anticipated repair. Rather, the parties' imputed intent is that in this unexpected situation, the burden of consequential loss will be on the seller. This result is consistent with the results of the cases, where it is usually held that failure of the repair and replace remedy causes the exclusion to fail in the case of automobiles, trucks, tractors, motorcycles, mobile homes, vans, and recreational vehicles.

On the other hand, facts can indicate that the parties questioned the certainty of repair. For example, if goods are experimental, or specially designed based on a newly introduced technology, or specially designed


138. In the following cases involving mobile homes, the exclusion was invalidated by a failure of the repair and replace remedy: Jacobs v. Rosemount Dodge-Winnebago S., 310 N.W.2d 71 (Minn. 1981); Lidstrand v. Silvercrest Indus., 28 Wash. App. 359, 623 P.2d 710 (1981).


142. As new generations of computer components are introduced, they raise the possibility that the parties are uncertain of the prospects for repair. Although not analyzed in
for the buyer,' there may be no established market or procedure to repair such goods and no history of successful repair associated with such goods. The parties therefore may have had a reasonable basis for doubt as to the seller's ability to repair such goods. Similarly, if the goods whose repairability is established are to be put to novel uses, and therefore incur novel injuries, or are put to heavier-than-normal use, there also may be a foreseeable problem with repairing them. In addition, where goods are of a type that are so complicated as to be predictably partly non-functional at all times, even though operational, the parties could reasonably be said to have foreseen the potential uncertainty as to repair. Under the objective theory, all of these situations of conscious doubt create an indication that the parties intended the exclusion clause to apply when the repair remedy fails.

The Contract. The terms of the exclusion can indicate the parties' intent. In the cases, the exclusion has typically been general in its terms and does not specifically answer the question of whether the exclusion is intended to apply when the limited remedy fails. Such general language is neutral under the objective theory because it leaves open the central question of intent in the special situation of the failure of the limited remedy, which must then be


144. See Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309 (9th Cir. 1984) and supra note 127.

145. In American Elec. Power Co. v. Westinghouse Elec. Corp., 418 F. Supp. at 458, the court reasoned that the parties foresaw that a turbine generator is too complicated to characterize as fully repaired or not repaired at all, the operation of such a generator spanning "too large a spectrum for such simple characterizations," and so the parties contracted for a limitation on consequential damages for that very reason. The district court upheld the exclusion clause.

146. The language of exclusion clauses appearing in the cases has not been drafted to answer specifically the question of whether the exclusion is intended to apply upon a failure of essential purpose of the limited remedy. Instead, exclusion language is typically general, seemingly applicable to all situations. Typical is the following exclusion clause from Kearney & Trecker Corp. v. Master Engraving Co., 211 N.J. Super. 376, 379, 511 A.2d 1227, 1228 (1986): "UNDER NO CIRCUMSTANCES WILL SELLER BE LIABLE FOR ANY INCIDENTAL OR CONSEQUENTIAL DAMAGES OR FOR ANY OTHER LOSS, DAMAGE OR EXPENSE OF ANY KIND, INCLUDING LOSS OF PROFITS." But see U.S. Fibres, Inc. v. Proctor & Schwartz, Inc., 358 F. Supp. 449, 456 (E.D. Mich. 1972) (providing that if seller is unable to repair, then it shall refund purchase price in full satisfaction of all liability).
answered from the surrounding circumstances. On the other hand, if the language of the exclusion expressly purports to allocate the risk of consequential loss to the buyer upon a failure of the limited remedy, then the seller's position is greatly enhanced, at least where the contract was negotiated fully and freely by sophisticates, but much less so where the contract was a printed form and the terms not bargained.

A slight indication of the parties' objective intent might be found from the location of the exclusion. If the exclusion is in a different part of the contract from the limited remedy, it is at least possible to impute an intent that the two clauses operate separately. Conversely, where there is no express exclusion at all, and the exclusion of consequential damages must be inferred from the language of the limited remedy, it is possible to impute an intent that the exclusion and remedy operate in tandem. However, intent determined from the location or presence or absence of the exclusion seems highly unreliable, because such factors ignore the parties' situation, from which intent can be found reliably, and emphasize drafting technique, which might not indicate the parties' intent at all. In the case of a form contract in particular, there is virtually no likelihood that the drafting reflects the parties' intent to allocate risk in the situation at hand.

Characteristics of Negotiations. Facts implying the parties' intent can be found in their negotiations. Helpful to the seller's position is the type of negotiation where the contract is bargained as fully and freely as desired by sophisticated individuals and drafted specifically for that particular deal. In this situation the parties would be expected to understand the meaning of the exclusion clause and would be more likely to foresee any possibility of non-repair than if the buyer lacked sophistication. Therefore, this type of negotiation indicates, although not conclusively, that we should

147. A simple modification (as italicized) of the Kearney & Trecker exclusion language, supra note 146, would address the problem: "Under no circumstances, not even a failure of essential purpose of the limited remedy hereunder, will seller be liable for any incidental or consequential damages or for any other loss, damage or expense of any kind, including loss of profits, the risk thereof in all such events having been allocated to buyer."

148. See supra text accompanying notes 151-154.

149. See supra note 53 and accompanying text.

150. See supra notes 46-47 and accompanying text; see also supra note 3.

not disturb the generality of the exclusion clause\(^{152}\) and should leave the risk of consequential loss on the buyer.

Somewhat less persuasive for the seller’s position, but still indicative of an intent that buyer bear the risk of consequential loss from failure of the limited remedy, is the situation where the parties are sophisticated business people who negotiated as fully as desired but used a standard form agreement prepared by the seller.\(^{153}\) Here the intent to allocate the risk to the buyer is less clear because of the form. Still, such intent is indicated somewhat because the buyer had an opportunity to negotiate and, arguably, should have appreciated the risk, but did not object. Similarly, when the buyer is not sophisticated with respect to the goods, then even where the deal is negotiated fully and freely the objective intent to allocate risk to the buyer is debatable because the buyer’s lack of sophistication with respect to the goods prevents us from ascribing to the buyer any foresight that the repair remedy might fail. Finally, in the situation where the buyer is not allowed to negotiate at all, being handed a boilerplate contract prepared by the seller, such a non-negotiation lends no credence to the imputation to the buyer of an intent to bear the allocation of consequential loss upon a failure of the limited remedy.\(^{154}\)

**Trade Usage.** The existence of a trade usage concerning allocation of consequential loss would be relevant to determining intent,\(^{155}\) but trade usage can only operate against a party so situated as to “justify an expectation” that it will be observed.\(^{156}\) Thus, a

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152. See infra note 146 and accompanying text.
153. See, e.g., Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309, 1310-11 (9th Cir. 1984) (exclusion in sales order form; some negotiations indicated); Tareyton Elec. Composition, Inc. v. Eltra Corp., 21 UCC Rep. Serv. (Callaghan) 1064, 1066 (M.D.N.C. 1977) (exclusion contained in seller’s standard printed from contract; parties negotiated both before and after the execution of the form contract).
154. See, e.g., AES Technology Sys. v. Coherent Radiation, 583 F.2d 933, 938 (7th Cir. 1978) (form contract; no apparent negotiations over terms); Cayuga Harvester, Inc. v. Allis-Chalmers Corp., 95 A.D.2d 5, 7, 465 N.Y.S.2d 606, 609 (1983) (exclusion contained in seller’s purchase order; no negotiations apparent); see also the automobile cases cited supra note 134.
156. The term “usage of trade” is defined in UCC § 1-205(2) as:

[A]ny practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

Under this definition, the two parties do not have to know the trade usage. What is required
buyer obviously lacking access to the norms of the industry might not be bound to that industry's usage, whereas a member of the industry much more likely would be. If a trade usage normally allocates a risk of consequential loss to the seller, and a repair and replace remedy fails due to seller's good faith inability to repair, the trade usage would be a factor indicating that the parties' intent was for the consequential loss to be allocated to the seller even though the seller tried to repair.

**Nature of the Deal.** The type of deal can sometimes indicate an intent to allocate consequential loss from a failure of repair. For example, where the seller sells a small component in a large project being undertaken by the buyer, or a small component in a larger product to be sold by the buyer, reasonable parties would not, without more facts, expect the seller to underwrite the entire project or the profitability of the buyer's resale business. Such a deal indicates an objective intent for the buyer to bear the risk of consequential loss from a failure of the limited remedy, but such indication could be offset by other facts (e.g., in the case of a repair and replace remedy, goods of a type that engender an expectation of repair). Not every deal in which the buyer has a profit motive indicates an intent for the buyer to bear the risk of consequential loss, but where the seller is a small cog in a larger effort there is some indication of intent to allocate to the buyer the risk with respect to the larger whole.

A related, perhaps less compelling, situation involves a distributor selling goods to a wholesaler of those goods, or a manufacturer selling to a distributor. In such a case the disappointed buyer's consequential damages are likely lost profits from his busi-
ness. Yet the seller’s whole purpose in contracting for an exclusion clause may have been to avoid guaranteeing his buyer’s profitability. Such a deal also ought to be closely scrutinized as to whether reasonable parties would expect a seller to take the risk of lost profits upon a failure to repair.

**Adequacy of Remedy Without Consequential Damages.** The fact that consequential loss is severe, and that the buyer would suffer a great loss if not allowed consequential damages, usually should be neutral under the objective approach. Without knowing more facts, there is no reason to expect that the parties would allocate a severe loss to the seller rather than to the buyer.\(^\text{162}\) Both want to avoid it.

It is circular to include within the objective theory the factor of whether buyer has an adequate and fair remedy without consequential damages.\(^\text{163}\) Such a factor is arguably relevant under the objective theory in that, if the parties foresaw that the buyer would be adequately and fairly protected without the right to recover consequential damages upon a failure of essential purpose, such foresight indicates the parties’ intent to allocate consequential loss to the buyer. Conversely, if the parties’ foresaw that the buyer would not be adequately protected without consequential damages, they might have intended to allocate consequential loss to the seller. However, one cannot know if the buyer is adequately protected without consequential damages until a court tells us whether the remedy without consequential damages is adequate and fair, and the court can best determine such adequacy and fairness by determining, based on the circumstances, a fair and reasonable allocation of the risk and by imputing that to the parties. In a sense, when a conclusion is reached under the objective theory as to a reasonably imputed allocation of risk, then it is time to decide whether the remedy without consequential damages is adequate and fair.

**Consumer/Commercial Buyer.** The mere fact that a buyer is a consumer or business entity does not dictate an intent regarding allocation of consequential loss upon a failure of the limited remedy.\(^\text{164}\) However, other factors which are important to the objective

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162. See supra notes 116-120 and accompanying text.

163. Official Comment 1 requires “minimum adequate remedies” and a “fair quantum of remedy.” See supra notes 80-100 and accompanying text.

164. However, where the buyer is a consumer and suffers injury to the person, UCC § 2-719(3) establishes a presumption of unconscionability in any disclaimer of the remedy for such personal injury.
theory may be present coincidental with a commercial or consumer buyer. For example, if the buyer is a consumer, this may indicate that the goods being purchased are likely to be of a type which carry with them a strong expectation of repair. Furthermore, a consumer buyer might not be bound to the trade usage of an industry to which he does not belong. A consumer buyer is also more likely to be involved in non-negotiations featuring boilerplate remedies clauses. Conversely, the presence of a commercial buyer may indicate a greater likelihood of goods where the confidence level in repair is low. A commercial buyer is also more likely to be bound by trade usage and to have engaged in extensive negotiations on an equal footing with the seller. Finally, the presence of a commercial buyer might indicate that the buyer has the financial wherewithal to bear the risk of consequential damages, and under the objective theory that would be one factor indicating the parties' intent to put the risk on the buyer. What matters for the objective theory in each of these examples is not that the buyer is a business entity or a consumer, but rather the related circumstances allowing the imputation of intent.

B. Examples

The following are illustrations of how the objective approach could be applied in specific situations.

Situation #1: A dealer sells a new automobile to a consumer. Although the price is negotiated, there is no bargaining over the limited repair and replace remedy or the exclusion clause, which are both contained in the seller's printed form contract. The exclusion clause contains general language making it applicable in all situations without specifying any particular situation. When defects arise in the car, the seller is unable to repair them in a timely fashion despite seller's good faith efforts, causing the limited remedy to fail of its essential purpose. The holding should be that the exclusion is stricken by the failure of essential purpose because the risk of consequential loss in this situation is objectively intended to be allocated to the seller.

The holding should be that the exclusion is stricken by the failure of essential purpose because the risk of consequential loss in this situation is objectively intended to be allocated to the seller. Because the parties must have expected that the seller would cer-

165. See supra notes 156-57 and accompanying text.
166. Id.
tainly be able to repair a new automobile, the objective theory indicates an intent that the exclusion was premised on the seller's expected successful repair. Absent that repair, the exclusion is not objectively intended to bind the buyer. The buyer cannot be said to have assumed the risk of consequential loss when his reasonably anticipated shield from such loss (i.e., the repair and replace remedy) fails. The other factors in this situation are neutral in the circumstances. General terms that are contained in a printed form, and do not seem bargainable to the buyer, do not illuminate the intent of reasonable parties. Although the seller acted in good faith, this does not indicate an intent to shift the risk to the buyer when the buyer's reasonable expectations are upset.

Situation #2: Same as Situation #1 except that the printed language of the exclusion clause expressly states that consequential loss is excluded in the event of the seller's good faith failure to repair.

The holding should be that the exclusion is stricken because the objective intent was that the seller bear consequential loss. This is a closer case than Situation #1 because of the contract language addressing the failure to repair. Still, because that language is contained in a printed form, in circumstances not likely conducive to understanding or bargaining with respect to that language, it does not give as strong an indication of the parties' intent as does their reasonable expectation that an automobile will certainly be repaired. Again, the seller's good faith does not indicate an intent to allocate loss to the buyer.

Situation #3: A dealer sells a tractor to a large agribusiness concern for crop planting. Although the price is negotiated, there is no bargaining over the limited repair and replace remedy and a general exclusion clause, which terms are contained in the seller's printed form. Seller is unable in good faith to effect timely repair, resulting in a large crop loss to the buyer from an unsuccessful planting.168

The holding should be that the exclusion is stricken. The objective understanding is that a tractor can be repaired in a timely fashion, and as in the previous situations the contractual allocation of consequential loss to the buyer was implicitly premised on such timely repair. The seller would argue that the buyer is presumably sophisticated enough to negotiate for an exclusion more favorable to it, and because it did not, it must be bound by the exclusion.

This argument should not prevail, however, because the buyer could not reasonably anticipate a loss from the seller's failure of repair and so had no reason to negotiate about it. The seller might also argue that it would not reasonably have intended to bear a foreseeable large loss from a large producer's failed crop. This argument is not persuasive because the buyer would no more reasonably have intended to bear such loss and because, given the expectation of repair, neither side reasonably contemplated such loss at all.

Situation #4: Seller agrees to design, produce and install special air pollution equipment for buyer's plant. It is understood by both sides that the equipment is based on a new technology. Both sides are represented by counsel in extensive negotiations over all aspects of the deal, including remedies. The contract agreed upon contains a general exclusion clause and a limited repair and replace remedy. When defects in the equipment arise, the seller is unable to repair after good faith efforts to do so. The seller's failure to repair the equipment causes an expensive shut down.

Based on the hypothesis that reasonable parties would harbor doubt as to the repairability of such specially designed equipment, the holding should be that the exclusion survives the failure of the repair and replace remedy and that such consequential loss therefore is allocated to the buyer. There is no reason to ignore the generality of application of the exclusion clause where the buyer could foresee the difficulty of repair and especially where, armed with such foresight in on-point negotiations with advice of counsel, the buyer failed to negotiate a different result if the repair remedy failed. The buyer would still be entitled to his remedy under section 2-714(2), and that would adequately compensate the buyer in light of what it knew and failed to do.

Situation #5: Same as Situation #4 except that the buyer is not represented by counsel, does not negotiate concerning the exclusion clause, and the deal is documented on the seller's standard form.

The holding should be that the exclusion survives the failure of the repair remedy. This is a closer case than Situation #4 because the exclusion was not negotiated and is boilerplate instead. The buyer could argue that it never understood the impact of the exclusion language when applied to the situation where the limited remedy failed. Still the same result ought to apply as in Situation

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169. This situation was inspired by Lincoln Pulp & Paper Co. v. Dravo Corp., 436 F. Supp. 262 (D. Me. 1977).
170. See supra note 36 for the text of U.C.C. § 2-714(2).
#4. Again, where reasonable parties would harbor doubt as to the repairability of an item, there is no reason to ignore the general applicability of an exclusion clause when the goods subsequently cannot be repaired in good faith. The lack of negotiations between the parties is not decisive because a reasonable buyer with reasonable foresight and reasonable general sophistication would be expected to negotiate concerning what it can foresee, or if not, accept the consequences of not negotiating.

Situation #6: Same as Situation #4 except that seller in bad faith refuses to repair.

The holding should be that the exclusion is stricken. Reasonable parties cannot be deemed to have allocated the loss from such seller conduct to the buyer for two reasons. First, the parties must have expected the seller to attempt repair in good faith (or they need not have bothered to include the repair and replace remedy at all) and premised the exclusion clause on good faith efforts by the seller. Absent such good faith, the exclusion is not objectively intended to bind the buyer. Second, it is simply not reasonable for the parties to allocate a loss from one party's bad faith conduct to the innocent victim. Even though the parties had doubt as to the repairability of the equipment, a factor that normally indicates the exclusion should survive, in this case they objectively did not expect a failure of repair caused by the seller's bad faith when they formed the premises of the exclusion clause.

It might also be argued that the buyer, being sophisticated and well represented in negotiations, could have protected itself by negotiating an exception to the exclusion clause for the seller's bad faith failure to perform. However, the buyer should not be required to negotiate concerning what cannot reasonably be expected.

Situation #7: The seller supplies standard refrigerator motors to the buyer for inclusion in refrigerators manufactured by the buyer. Some terms are bargained, but there are no negotiations concerning the repair and replace remedy or the exclusion, both of which are contained in the seller's purchase order form. When defects arise in the motors, many of which are already installed in refrigerators sold by buyer, the seller is unable to repair in timely fashion. Buyer's loss from this failure of the repair remedy includes an expensive recall of refrigerators, lost production, and lost sales.171

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The exclusion should survive the failure of the repair remedy. There are two chief objective factors in this situation and they pull in opposite directions. The parties reasonably expected that repair could be effected on standard motors. This strongly indicates an intent, upon a failure of repair, to disregard the exclusion and allocate consequential loss from the failure to the seller. However, it is difficult to imagine that reasonable parties, knowing the scope of the buyer's business, would expect a component supplier to underwrite it. Therefore, the better result here would be to attribute to the parties an intent that the buyer must bear the consequential loss in accordance with the exclusion. The buyer will nevertheless recover damages for the diminution in value of the motors caused by their defects.\textsuperscript{172}

\textit{Situation \#8:} The seller agrees to supply the computer hardware and program the software to create an inventory control and accounting system for the buyer. Terms are contained in the seller's printed form contract. A limited remedy of repair (an undertaking to work the "bugs" out of the system) is stated to be the sole and exclusive\textsuperscript{173} remedy available to buyer, but there is no express exclusion of consequential damages. Subsequently, the seller cannot debug the program despite repeated good faith efforts.\textsuperscript{174}

The exclusion should survive. Again, objective factors in this situation indicate different results. There is a conscious doubt factor in that, given the difficulty of customized programming and the difficulty of effecting bug-free programs, reasonable parties would have anticipated the possibility of a failure to repair. When they nevertheless entered into a contract which, by making the limited remedy exclusive, seems to assign consequential loss to the buyer, they must have intended the loss from a failure to repair to be allocated to the buyer. The counter-argument is that the parties

\textsuperscript{172} Where the buyer has accepted goods, he may still recover for breach of warranty the difference at the time and place of acceptance between the value of the goods with their defects and the value of the goods as warranted. U.C.C. § 2-714(2). \textit{See supra} note 36 for the text of U.C.C. § 2-714.

\textsuperscript{173} Under U.C.C. § 2-719(1)(b), the buyer may resort to other Code remedies, notwithstanding the buyer's agreement to a contractual remedy, unless the contractual remedy is stated to be exclusive. U.C.C. § 2-719(1)(b) provides:

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

\textbf{(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.}

\textsuperscript{174} This situation is based on Chatlos Sys., Inc. v. NCR Corp., 635 F.2d 1081 (3d Cir. 1980) and AMF, Inc. v. Computer Automation, Inc., 573 F. Supp. 924 (S.D. Ohio 1983).
cannot reasonably be said to have allocated consequential loss to the buyer because their contract does not expressly address the issue of consequential damages. There is only an implication of an exclusion of consequential damages. This counter-argument should fail. An accident of drafting should not be held determinative of the parties' intent, especially where the terms are contained in a form contract. Furthermore, there is a sufficient objective indication of intent to allocate risk of consequential loss to the buyer when one combines the implied intent to exclude consequential damages implicit in the exclusivity of the repair remedy together with a reasonable doubt concerning the efficacy of the limited remedy.

Situation #9: Same as Situation #8 with the additional fact that nearly all of the buyer's losses are consequential.

The exclusion should survive the failure of the limited remedy. The buyer would argue that because his losses are nearly all consequential, he would not, if consequential loss is allocated to him, receive the minimally adequate and fair remedy to which he is entitled. However, the buyer's remedy for direct damages, even though accounting for only a small part of his loss, is adequate and fair if it is reasonable to think that the buyer took the risk of a partial recovery; and it is reasonable so to conclude where the buyer, expecting the possibility of non-repair, enters into a contract implying that consequential damages are excluded. Under such circumstances the limited remedy is fair if not full.

Situation #10. Buyer purchases rolls of film for use in his job as a photographer. Each package of film displays language which limits the buyer's remedy for defective film to a replacement roll of film. Consequential damages are expressly excluded. Although the buyer had previously purchased many rolls of film, he had never read the limited remedy or the exclusion clause. The buyer loses the income from the job when one of the rolls is defective.

The threshold question here is whether the limited remedy and

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175. See text accompanying notes 159-162 for discussion regarding the limited relevance under the objective theory of an inquiry into the adequacy of a remedy.

176. Although in most of the cases the parties have agreed to a repair and replace remedy, the principles discussed in this article apply as well to other kinds of limited remedies. Examples of other kinds of limited remedies may be found in R.W. Murray Co. v. Shatterproof Glass Corp., 758 F.2d 266 (8th Cir. 1985) (replacement of goods); V-M Corp. v. Bernard Distrib. Co., 447 F.2d 864 (7th Cir. 1971) (refund of purchase price); Belfont Sales Corp. v. Gruen Indus., 112 A.D.2d 96, 491 N.Y.S.2d 652 (1985) (purchase price credited to buyer's account with seller).
exclusion clause become part of the contract at all. In conformity with the objective approach, the limited remedy and exclusion would be part of the contract if the buyer reasonably ought to have noticed the language on the package. On the other hand, if the setting is such that a buyer ought not to have understood the contractual import of the printing on the package, then maybe the limited remedy and exclusion do not become part of the contract. For purposes of further analysis, let us assume that the limited remedy and exclusion are part of the contract because an experienced buyer should have known about the language on the package and its import. Further, one must assume that the limited remedy fails of its essential purpose.

To determine whether the exclusion survives under the objective theory one must reconstruct what reasonable parties, and in this case a reasonable buyer in particular, could be expected to foresee. Here, the buyer had sophistication regarding photography and should have known that a roll of film is sometimes defective. (Add to this that the buyer could have protected himself by taking extra photographs on another roll.) By hypothesis, the buyer should have known of the contract language. Thus, the buyer should have known that he was taking a risk of consequential loss of exactly the type that occurred. Therefore, the objective theory indicates that the exclusion should survive.

It might be argued in response that because the limited remedy is restricted to the replacement of a roll of film, and because the value of that remedy is so small in comparison to the buyer's consequential loss, that the buyer cannot receive the required fair and adequate remedy without recovering consequential damages. However, if a reasonable interpretation of the circumstances indicates that the buyer is deemed to have taken the risk of an uncompensated consequential loss, then the remedy is fair and adequate to the buyer.

177. See generally cases and material collected in E. Farnsworth & W. Young, Cases and Materials on Contracts 453-57 (3d ed. 1980).
178. Id.
179. Although it is beyond the scope of this article to determine when a limited remedy fails of its essential purpose, one could argue that where a photographer with knowledge that a roll of film is sometimes defective fails to take extra shots on a second roll, the limited remedy of replacing the defective roll ought not to fail of its essential purpose. The remedy would have been effective if the photographer had protected himself.
180. It is assumed that the buyer should have known of the limited remedy and the exclusion. This assumption is the basis for determining these terms to be part of the parties’ agreement.
Situation #11. Buyer purchases goods. The repairability of this type of goods is doubtful. However, neither the buyer nor the seller subjectively knows that the repairability of the goods is in doubt. Both subjectively expect repair to happen. Their contract contains both a repair and replace remedy and an exclusion of consequential damages. When the seller is unable to repair the goods, the buyer suffers consequential damages.

The exclusion should be stricken. The parties in this case actually expected repair. Their expectations were upset when repair did not occur; therefore, their contractual allocation of risk, based on the assumption of repair, should not be followed. These facts are an exception to the usual operation of the objective approach. Under the objective approach as previously examined, one would first determine that because of the type of goods the parties must have doubted the likelihood of repair, and from that premise one would impute to the parties the intent that the buyer bear the risk from an expected failure in accordance with the contract. However, because the parties in this case actually expected repair and not failure, the most accurate way to gauge their intended allocation of such risk must proceed from the premise that repair was expected. The result is therefore to deem the risk to be allocated to the seller, contrary to the contract, when the seller fails to repair as expected.

IV. Conclusion

The problem of whether an exclusion of consequential damages fails upon the failure of an accompanying limited remedy is best resolved by a consideration of the objective facts and circumstances. The result will vary depending on such facts and circumstances. Any approach leading to an unvarying result should be avoided. Flexibility is the best way to achieve fairness.

The suggested objective approach is the fairest because it considers the surrounding circumstances with a view toward constructing for the parties a reasonable intent concerning the risk of consequential loss when a limited remedy fails. The analysis is similar to an unanticipated event analysis, perhaps most commonly typified by the Code’s treatment of commercial impracticability.181 Thus, the objective theory may be summarized as a pro-

181. U.C.C. § 2-625, dealing with commercial impracticability in the event that presupposed conditions subsequently fail to apply, provides in relevant part:

§ 2-615. Excuse by Failure of Presupposed Conditions

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:
cess whereby reasonable assumptions and intentions are imputed to the parties based on the facts and circumstances at the time of the contract, and a reasonable allocation of risk is determined in light of the effect of subsequent events on those assumptions and intentions.

(a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.