Consequential Damages when Exclusive Repair Remedies Fail: Uniform Commercial Code Section 2-719

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CONSEQUENTIAL DAMAGES WHEN EXCLUSIVE REPAIR REMEDIES FAIL:
UNIFORM COMMERCIAL CODE
SECTION 2-719

HENRY MATHER*

I. INTRODUCTION

This Article offers a simple solution to a difficult problem. The problem arises when a seller of goods breaches a warranty, an exclusive repair or replace remedy fails of its essential purpose, and the buyer seeks consequential damages despite a contractual exclusion of such damages. In hypothetical terms, suppose that Seller and Buyer enter into a contract for the sale of goods to be manufactured by Seller and used by Buyer (who is not a consumer) in the ordinary course of its business. The written agreement includes an express warranty of quality and provides that the exclusive remedy for breach of this warranty will be repair or replacement, by Seller and at Seller’s expense, of any portion of the goods that proves to be defective. The written agreement also contains a provision explicitly excluding consequential damages. Seller delivers the goods to Buyer, the war-

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1. The following language would be typical:
   Seller warrants the equipment to be free from defects in material or workmanship for a period of twelve months from the date of delivery. In case of any such defects, Seller will, free of charge, either repair such defects or, at its option, deliver new parts or equipment in place of that found defective. This repair or replacement will be Buyer’s sole and exclusive remedy for breach of warranty and will be the limit of Seller’s liability for any breach of warranty.
   We will assume that Seller has effectively disclaimed all implied warranties and that the express warranty is thus the only warranty that can be breached.

2. The following language would be typical:
   Seller will not be liable for consequential damages of any kind, including, but not limited to, loss of use of the equipment and loss of profits.
warranty is breached, and Seller is given adequate notice of the nature of the breach. Seller is, however, either unwilling or unable to repair or replace the defective goods within a reasonable time. May Buyer recover consequential damages despite the contractual exclusion?

The transaction is governed by Article 2 of the Uniform Commercial Code (the "Code"). Section 2-719(1) of the Code provides that the agreement may limit the buyer's remedies to repair or replacement of nonconforming goods or parts, and if such remedy is expressly agreed to be exclusive, it is the sole remedy. But section 2-719(2) states that when circumstances cause an exclusive remedy to "fail of its essential purpose, remedy may be had as provided in this Act." Because Seller has failed to repair or replace the defective goods within a reasonable time, the exclusive repair or replace remedy has failed of its essential purpose. A buyer's Code remedies for breach of warranty include consequential damages.


5. Id. § 2-719(2). The official comments state that "under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article." Id. § 2-719 comment 1.


The purpose of the exclusive remedy is explained in Beal as follows:

The purpose of an exclusive remedy of replacement or repair of defective parts, whose presence constitutes a breach of an express warranty, is to give the seller an opportunity to make the goods conforming while limiting the risks to which he is subject by excluding direct and consequential damages that might otherwise arise. From the point of view of the buyer the purpose of the exclusive remedy is to give him goods that conform to the contract within a reasonable time after a defective part is discovered.

384 F. Supp. at 426.

7. We will assume that Buyer has accepted the goods and that the time for revocation of acceptance has expired without any revocation. Buyer's statutory remedy for
Our analysis thus far suggests that Buyer may recover consequential damages subject to the usual limitations, such as the requirement that Buyer's consequential loss be foreseeable to Seller. We must, however, consider section 2-719(3) which states: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable." Has our Buyer not agreed to exclude consequential damages? We will assume that the exclusion clause in the agreement is not unconscionable. May we not conclude that Buyer is entitled to any applicable Code remedy for breach of warranty except consequential damages?

In understanding why a problem exists, it is helpful to distinguish the instant hypothetical transaction from two situations that do not present a problem. When the written agreement con-

breach of warranty is thus provided by U.C.C. § 2-714 (1977). See also id. comment 1. Section 2-714(2) specifies the normal measure of damages for breach of warranty: the difference between the value of the goods accepted and the value they would have had if they had been as warranted. Id. § 2-714(2). Subsection (3) states that in a proper case consequential damages under § 2-715 may also be recovered. Id. § 2-714(3). The term "consequential damages" is not defined in the Code. See id. § 1-106 comment 3. Losses caused by a seller's breach of warranty but not measured by the section 2-714(2) difference in value, and not regarded as incidental losses governed by section 2-715(1), are likely to be treated as consequential losses governed by section 2-715(2). Consequential damages typically compensate buyers for personal injury, injury to buyer's property other than the warranted goods, profits lost by buyer in connection with other transactions, and buyer's liability to third parties. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERICAL CODE § 10-4, at 391-93 (2d ed. 1980). Consequential damages usually compensate buyers for losses involving things or transactions beyond the scope of the subject matter of the contract breached by seller.

If a buyer effectively revokes acceptance of the defective goods, the buyer's statutory remedy is governed by § 2-712 or § 2-713. U.C.C. § 2-711(1) (1977). Under either § 2-712(2) or § 2-713(1), a buyer would be entitled to consequential damages. See id. §§ 2-712(2), -713(1).

8. Buyer's consequential damages for economic loss (such as lost profits) are limited to losses "resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know." U.C.C. § 2-715(2)(a) (1977).

9. Id. § 2-719(3). Subsection (3) goes on to state: "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." Id. The problem dealt with in this Article is thus most likely to arise when the buyer is not a consumer.

10. Because our Buyer is a business enterprise and not a consumer, the exclusion of consequential damages is not prima facie unconscionable. See supra note 9. We will assume that Buyer is represented by competent executives and legal counsel, that Buyer is not a victim of unfair surprise and does not suffer from inferior bargaining power, and that there are no other grounds for finding the consequential damages clause unconscionable. For a discussion of unconscionability in contracts between business enterprises, see J. WHITE & R. SUMMERS, supra note 7, § 4-9.
tains a clause excluding consequential damages but does not limit the buyer's remedies to repair or replacement, no problem exists. Assuming the exclusion of consequential damages is not unconscionable, the buyer is not entitled to consequential damages. Section 2-719(3) validates the exclusion of consequential damages, and section 2-719(2) never comes into play because there is no limited or exclusive remedy to fail of its essential purpose. Likewise, when the written agreement provides that repair or replacement is the buyer's exclusive remedy but does not contain an explicit exclusion of consequential damages, no problem exists. If the exclusive repair remedy fails of its essential purpose, section 2-719(2) gives a buyer his Article 2 remedies, including consequential damages. The problem arises when, as in our hypothetical transaction, the exclusive repair remedy fails of its essential purpose and the written agreement expressly provides that the buyer cannot recover consequential damages. In such a case, section 2-719(2) seems to indicate that the buyer can recover consequential damages, while section 2-719(3) suggests that the buyer cannot recover them.

II. CONFLICTING COURT DECISIONS

Whether the buyer may recover consequential damages in this situation is one of the most frequently litigated issues arising from the Code. There is, unfortunately, no consensus among the courts on how the issue should be resolved. Differing analytical approaches have produced conflicting decisions. The decisions can be divided into at least five different groups.

A. Five Judicial Approaches

One group of decisions holds that if the exclusive repair remedy fails of its essential purpose, the buyer is automatically entitled to all Code remedies, including consequential damages, even though the written agreement excluded consequential damages.11 These decisions result from a straightforward application

of subsection (2) of section 2-719, with little or no attention paid to subsection (3). In *Soo Line Railroad Co. v. Fruehauf Corp.*, \(^{12}\) for example, the court considered whether the seller should be exonerated from liability for consequential damages because the contract contained a specific bar against such damages. The court’s conclusion that the contract did not effectively bar liability for consequential damages was based in large part on its observation that “the fundamental intent of section 2-719(2) reflects that a remedial limitation’s failure of essential purpose makes available all contractual remedies, including consequential damages authorized pursuant to sections 2-714 and 2-715.”\(^ {13}\) The court did not mention section 2-719(3).

A second line of decisions goes to the other extreme and holds that so long as the clause excluding consequential damages is not unconscionable, the buyer is absolutely precluded from recovering consequential damages.\(^ {14}\) These decisions focus on subsection (3) of section 2-719 and give it an effect that is independent of the failure of the exclusive remedy’s essential purpose. One court observed that subsection (3) is meant to allow freedom in excluding consequential damages unless a consumer is involved and suggested that this freedom would be abridged if subsection (2) were interpreted to make all Code remedies automatically available when the exclusive remedy fails of its essential purpose.\(^ {15}\) The court concluded that subsection (3) rather

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\(^{13}\) *Id. at 1373."


\(^{15}\) *See Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable & Cold Storage Co.*, 709 F.2d 427, 435 (6th Cir. 1983).
than subsection (2) governs the exclusion of consequential damages and the buyer cannot recover consequential damages unless the exclusion clause is unconscionable. Another court opined that if the exclusive remedy fails of its essential purpose, the exclusive remedy clause should be ignored, and other clauses limiting remedies should be judged independently of the stricken exclusive remedy clause; the clause excluding consequential damages should thus be enforced if it is not unconscionable. In other words, if the exclusive remedy fails of its essential purpose, plaintiff buyer is entitled to whatever remedies it would have in the absence of the exclusive remedy clause. Underlying this second group of decisions is an assumption that the parties allocated to the buyer the risk of consequential losses, even in the event that the exclusive remedy fails of its essential purpose.

A third group of decisions makes the buyer's recovery of consequential damages dependent upon the seller's misconduct. If the seller willfully or negligently failed to repair or replace the defective goods, the buyer can recover consequential damages despite the clause excluding consequential damages; the correlative rule (expressed in some opinions, implied in others) is that the buyer cannot recover consequential damages if the seller made a reasonable effort to repair or replace the defective goods. In Adams v. J.I. Case Co., the leading case espousing this view, the court reasoned that the seller cannot repudiate its obligation to repair or replace and also enjoy the benefit of the clause excluding consequential damages. The decisions in this third group seem to regard the recovery of consequential damages as being contrary to the agreement of the parties, but nev-

16. Id. at 434, 435.
18. The assumption is made explicit in Chatlos Sys. v. National Cash Register Corp., 635 F.2d 1081, 1087 (3d Cir. 1980). None of the opinions in this second group discusses the reasons for the assumption or attempts to support it.
21. Id. at 402-03, 261 N.E.2d at 7-8.
ertheless required by equitable or punitive considerations.

In the fourth group of decisions, courts focus upon the con-
tractual intent of the parties rather than the nature of the
seller's conduct. Placement of the exclusive remedy provision
and the exclusion of consequential damages provision in dif-
ferent sections of the written agreement is regarded as virtually
conclusive evidence that the parties intended to allocate to the
buyer the risk of consequential damages, even in the event that
the exclusive repair or replace remedy is ineffectual.\(^{22}\)

In the fifth line of cases, courts purportedly consider all re-
levant circumstances in order to ascertain and carry out the in-
tent of the parties regarding who bears the risk of consequential
damages in the event that the exclusive repair or replace remedy
fails of its essential purpose.\(^{23}\) In these cases, courts eschew the
automatic solutions produced in the first and second groups of
cases and also reject the single-factor analyses employed in the
third and fourth groups of cases. The controlling question is:
Did the parties intend that the buyer bear the risk of conse-
quential damages even if the exclusive remedy is ineffectual? The
problem is thus one of contract interpretation and calls for
consideration of all relevant factors. One court stated this ap-
proach as follows:

We reject the contention that failure of the essential purpose
of the limited remedy automatically means that a damage
award will include consequential damages . . . . An analysis to
determine whether consequential damages are warranted must
carefully examine the individual factual situation including the
type of goods involved, the parties and the precise nature and
purpose of the contract. The purpose of the courts in con-
tractual disputes is not to rewrite contracts by ignoring parties' in-


\(^{23}\) See Milgard Tempering, Inc. v. Selas Corp. of Am., 761 F.2d 553, 556-57 (9th
Cir. 1985); Waters v. Massey-Ferguson, Inc., 775 F.2d 587, 591-92 (4th Cir. 1985) (farmer
buyer); Fiorito Bros. v. Fruhauf Corp., 747 F.2d 1309, 1314-15 (9th Cir. 1984); AES
Technology Sys. v. Coherent Radiation, 583 F.2d 933, 941 (7th Cir. 1978); S.M. Wilson &
Co. v. Smith Int'l, Inc., 587 F.2d 1383, 1375-76 (9th Cir. 1978); Agristor Credit Corp. v.
Schmidlin, 601 F. Supp. 1307, 1315 (D. Or. 1985) (farmer buyer); Clark v. International
Harvester Co., 99 Idaho 326, 343-44, 581 P.2d 784, 801-02 (1978) (farmer buyer); Cayuga
(1983).
tent; rather, it is to interpret the existing contract as fairly as possible when all events did not occur as planned.24

According to another court, "Judging each case and each contract on its own merits will better allow courts to give effect to the parties' intentions regarding risk allocation and will lead less frequently to unjust results."25

Waters v. Massey-Ferguson, Inc.26 provides guidance in pursuing this case-by-case approach. In Waters the court examined the contract from three different interpretive perspectives. First, it looked at the language used in the text of the written agreement. Next, it considered the creative context of the contract to determine which party drafted the written terms in question. Finally, the court looked at the commercial context, asking two questions: What kind of goods were sold? Would it be reasonable to assume that they could be repaired if defective?27

B. Evaluation of the Five Approaches

Our survey of five groups of decisions reveals five quite different approaches to our problem. Of these five approaches, four can be summarily rejected.

The first approach, which holds that when the exclusive remedy fails of its essential purpose, the buyer is automatically entitled to consequential damages, should be rejected because it overlooks the possibility that the buyer agreed to exclude consequential damages even in the event that the exclusive remedy

24. AES Technology Sys. v. Coherent Radiation, 583 F.2d 933, 941 (7th Cir. 1978) (citations omitted).
25. Fiorito Bros., Inc. v. Fruehauf Corp., 747 F.2d 1309, 1314-15 (9th Cir. 1984).
26. 775 F.2d 587 (4th Cir. 1985). Judge Wilkinson's opinion in Waters is one of the few well-reasoned opinions dealing with our problem.
27. Id. at 591-92. The court found that examination of the contract from each of the three perspectives led to the conclusion that the exclusion of consequential damages was not intended to apply to losses resulting from the seller's failure to fix the goods within a reasonable time and that buyer's consequential losses resulting from the failure of the exclusive remedy are thus recoverable. Id. In other cases, courts using the case-by-case interpretive approach have found that the risk of consequential damages was allocated to the buyer, even in the event that the exclusive remedy fails of its essential purpose. See S.M. Wilson & Co., 587 F.2d at 1375-76; AES Technology Sys., 583 F.2d at 937, 941; Cayuga Harvester, 95 A.D.2d at 14-15, 465 N.Y.S.2d at 613-14.

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fails. In *R.W. Murray, Co. v. Shatterproof Glass Corp.*, 28 for example, the court followed the first approach and held that the buyer was automatically entitled to consequential damages, despite the following written provision: "In no event will we [the seller] be liable for special, incidental or consequential damages . . . ." 29 The words "in no event" can easily be interpreted to mean that a buyer cannot recover consequential damages, no matter what happens (or does not happen), i.e., that the buyer cannot recover consequential damages even if the defective goods are never repaired or replaced. The *Murray* court never even considered this plausible interpretation of the contract. 30 The first approach unfortunately leaves the court no opportunity to interpret the contract and carry out the intent of the parties. Such an opportunity is beneficial and is not foreclosed by the language in Code section 2-719(2); the words "remedy may be had as provided in this Act" can reasonably be interpreted to refer to all other Article 2 provisions dealing with remedies for breach of warranty, including provisions like section 2-719(3), which permit contractual limitations on remedies.

The second approach, holding that the buyer is automatically precluded from recovering any consequential damages so long as the exclusion clause is not unconscionable, should be rejected because it overlooks the possibility that the exclusion of consequential damages was not intended to apply if the exclusive remedy fails of its essential purpose. Courts taking this second approach merely assume, without engaging in any serious contract interpretation, that the agreement allocates to the buyer the risk of consequential damages in the event that the seller fails to repair or replace the defective goods. The clause excluding consequential damages is assumed to have an effect independent of the exclusive remedy clause and the extent to

28. 758 F.2d 266 (8th Cir. 1985).
29. *Id.* at 269.
30. The court was applying what it believed to be Missouri law, and its interpretation of Missouri law was based in large part on Givan v. Mack Truck, Inc., 569 S.W.2d 243 (Mo. Ct. App. 1978). *See Murray*, 758 F.2d at 272. *Givan*, however, involved a written agreement which apparently did not contain any clause explicitly excluding consequential damages. *See* 569 S.W.2d at 245-46.

For criticism of judicial failure to consider plausible interpretations of the contract and try to give effect to the intent of the parties, see *Note, The Enforceability of Contractual Clauses Excluding Sellers from Liability for Consequential Damages Under Section 2-719 of the Uniform Commercial Code*, 58 WASH. U.L.Q. 317, 332-33 (1980).
which the exclusive remedy is carried out. We will soon see, however, that buyers may reasonably believe that the exclusion of consequential damages is intended to apply only if the defects are corrected. Assuming that the written agreement does not expressly exclude consequential damages in the event that the seller fails to correct the defects, a question of what the parties agreed to in this regard remains open. The question calls for some analysis and should not simply be assumed away.

The third approach makes the buyer's recovery of consequential damages dependent upon the seller's willful or careless failure to repair or replace defective goods. This approach should be rejected because a seller's good faith effort, or lack thereof, is irrelevant to the questions of what the Code requires and what the parties agreed to. Not even a deliberate breach of the seller's obligation to repair or replace should give the buyer remedies to which he is not otherwise entitled. Awarding the buyer consequential damages he agreed to give up, merely because the seller's failure to correct defects was willful or negligent, is punitive in nature, and the Code expresses a policy against punitive remedies. 31

When the seller does make reasonable but unsuccessful efforts to correct the defects, his good faith effort should not diminish the remedies to which the buyer is entitled under the Code or by way of contractual agreement. Contractual liability is, in a sense, strict liability, and reasonable efforts to perform contractual obligations generally do not provide the breaching party with a defense or reduce his liability. In particular, section 2-719(2) states that the normal Code remedies may be resorted to when "circumstances cause an exclusive or limited remedy to fail of its essential purpose." 32 The statutory language seems to envision any circumstances. As one court noted:

[Subsection (2)] does not specifically require the plaintiff to prove negligent or willfully dilatory conduct. Rather, the section is to apply whenever an exclusive remedy, which may have appeared fair and reasonable at the inception of the contract, as a result of later circumstances operates to deprive a party of

31. See U.C.C. § 1-106(1) & comment 1 (1977) (punitive damages are not compensatory and may be imposed only as specifically provided in the Code or other rule of law). Article 2 of the Code does not specifically provide for punitive damages. 32. Id. § 2-719(2).
a substantial benefit of the bargain. Such circumstances may or
cannot be the result of dilatory or negligent conduct. 33

The fourth approach focuses on the location of the exclusive
remedy clause and the exclusion of consequential damages
clause; if these clauses are contained in separate sections of the
written agreement, the exclusion of consequential damages is
deemed to have an effect independent of the failure of the exclu-
sive remedy, and consequential damages are denied. This ap-
proach should be rejected because the location of the two clauses
is not conclusive evidence of the parties’ intent as to whether the
buyer is to bear the risk of consequential damages in the event
that the exclusive repair or replace remedy is ineffectual. In
most sales contracts, the seller’s obligation to deliver the goods
and the buyer’s obligation to pay for the goods are specified in
separate sections of the written agreement. It is undoubtedly im-
plied, however, that the buyer does not have to pay for the
goods if they are never delivered; no one could reasonably claim
that the buyer’s obligation to pay is independent of the seller’s
performance of his delivery obligation.

We are thus left with the fifth approach, an interpretive one
in which the court considers all relevant circumstances in an ef-
fort to ascertain the intent of the parties regarding whether the
buyer can recover consequential damages if the exclusive repair
remedy fails of its essential purpose. Of the various approaches
taken by the courts, this seems the most sensible. Assuming that
the court’s task is to effectuate the agreement of the parties, all
relevant circumstances should be considered in ascertaining
what that agreement is. 34 We will soon see, however, that discov-
ering the agreement intended by the parties is easier said than
done. As Arthur Corbin noted, “In reading each other’s words,

(citations omitted).
34. See U.C.C. § 1-201(3) (1977) (“agreement” means the bargain of the parties as
found in their language or by implication from other circumstances); RESTATEMENT (SE-
COND) OF CONTRACTS § 202(1) (1979) (words and other conduct are interpreted in the light
of all the circumstances); 3 A. CORBIN, CORBIN ON CONTRACTS § 536, at 28 (1960) (in order
to give meaning to the words of a contract, it is necessary to consider extrinsic evidence
of the surrounding circumstances); E. FARNsworth, CONTRACTS § 7.10, at 492 (1982) (the
overarching principle of contract interpretation is that the court is free to look at all the
relevant circumstances).
men certainly see through a glass darkly.”

III. PROBLEMS IN INTERPRETATION

In ascertaining the intent of the parties, a good way to begin is to ask what expectations were probably aroused in the parties by the written language. We are not interested in just any expectations, of course; we are interested only in expectations that would be reasonable in light of the surrounding circumstances. In our hypothetical case involving Buyer and Seller, a judge might ask what reasonable expectations would be aroused by the written terms concerning remedies for breach of the express warranty. When the parties signed the agreement, did they expect that Buyer would be entitled to recover consequential damages in the event that Seller fails to repair or replace defective goods?

A. Ascertaining the Intent of the Parties: Reasonable Expectations of Buyer and Seller

Almost as soon as our judge poses the question, she will recognize the likelihood that neither party had any conscious expectation as to what would happen in the event that Seller fails to repair or replace defective goods. It is quite likely that both parties assumed that any defects could and would be corrected, and thus did not think about what might happen if defects are not corrected. This is especially likely if the goods are of a kind that normally can be repaired or else replaced with substitute goods conforming to the warranty.

If the parties did have any expectations (conscious or tacit) about the damages that Buyer can recover in the event that the exclusive remedy fails, it is quite possible that they did not have the same expectations. Seller could have reasonably attached one meaning to the written terms regarding remedies, and Buyer could have reasonably attached a very different meaning to those same terms.

35. 3 A. Corbin, supra note 34, § 535, at 16.
36. See E. Farnsworth, supra note 34, § 7.7, at 478.
37. This hypothetical assumes that the written agreement contains the language set forth in notes 1 and 2, supra.
We can imagine Seller's president giving the following account of the meaning he attached to the remedy language:

The agreement states that Seller will not be liable for consequential damages of any kind. This means that Seller will not be liable for consequential damages no matter what happens—or does not happen. In other words, it means that Seller will not be liable for consequential damages, even if we fail to repair or replace defective goods. The exclusion of consequential damages is not expressly conditioned on the exclusive remedy being effective; therefore, I assumed that the exclusion is not conditional. We knew that Buyer was going to use the goods in its business, and we did not want to be liable for lost profits and other consequential damages that could far exceed the purchase price we were to receive.\(^\text{38}\) Our intent, therefore, was to give Buyer the risk of consequential damages, even if there was a breach of warranty and we were unable to correct the defects. We fully expected that we would be able to correct any defects, but we were aware of the possibility that we would not be able because of circumstances we had not anticipated. We believed that shifting the risk of all consequential damages onto Buyer was justified because Buyer could estimate its potential consequential losses better than we could and could thus insure against them more efficiently. This allocation of risk was also reflected in the purchase price. If we had agreed to be liable for consequential damages in the event that we were unable to correct any breach of warranty by repair or replacement, we would have charged a higher price for our goods.

This is certainly a reasonable interpretation of the written language and a plausible explanation of Seller's intentions and expectations.

We can also imagine Buyer's president giving the following account of the meaning he attached to the written terms regarding remedies:

I thought the remedy language meant that if there is a breach of warranty, Seller would repair or replace defective goods and, so long as Seller does this, Buyer will have no other

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\(^{38}\) One judicial opinion suggested that it defies reason to suppose that the seller in that case could have intended to assume the risk that its failure to repair or replace defective parts despite good faith efforts would subject it to liability for consequential damages many times the value of the goods sold. Cayuga Harvester, Inc. v. Allis-Chalmers Corp., 95 A.D.2d 5, 14, 465 N.Y.S.2d 606, 613 (1983).
remedy and, in particular, will not be able to recover consequential damages. Our waiver of consequential damages assumed that Seller would keep its promise to repair or replace and was conditioned on that promise being kept. In effect, we were saying to Seller, "If you breach the warranty and repair or replace defects, we will not ask for consequential damages." As our legal counsel explained it to us, we were giving up our normal Code remedies in exchange for a repair remedy not granted in the Code. It was a *quid pro quo*, and we did not expect the exclusion of consequential damages to be effective if Seller failed to keep its side of the bargain. We thought we were merely waiving our right to compensation for consequential losses occurring while the defects are being repaired. We did not anticipate that we would suffer any other consequential losses because we assumed that Seller would correct any defects within a reasonable time. I do not think it is unreasonable to suppose that Seller agreed to retain the risk of consequential damages in the event that the defects are never corrected. I realize that such damages might far exceed the

39. In *Waters* the court found that the written "language reveals an unequivocal assumption that Massey-Ferguson [the seller] will be able to correct any mechanical problem in the tractor . . . . the contract nowhere suggests—much less provides for—the possibility that repair may be impossible . . . . The premise of certain repair informs the reading of the entire contract." *Waters* v. Massey-Ferguson, Inc., 775 F.2d 587, 591 (4th Cir. 1985). In *Clark* the court declared:

These various elements of the 'New Equipment Warranty'—the express warranty, the limited repair or replacement remedy, the disclaimer of other warranties, and the exclusion of liability for consequential damages—are all integral parts of the provision, reciprocal to one another, and together they represent the agreed allocation of risk between the parties. Under these circumstances a seller who fails to comply with its obligations under the warranty, such as its repair or replacement duties, cannot receive the benefit of the other provisions, which in part at least were premised on the assumption that the seller would fulfill its obligations. The failure of the limited remedy in this case would materially alter the balance of risk set by the parties in the agreement. In such situation we conclude that the other limitations and exclusions on the seller's warranties and liability must also be disregarded and that the general provisions of the UCC should govern the rights of the parties.


40. See Special Project, *Article Two Warranties in Commercial Transactions*, 64 CORNELL L. REv. 30, 239 (1978) (normally, buyer has bargained away his right to consequential damages in reliance on seller's promise to repair or replace; when seller fails to meet the obligation, the exclusion of consequential damages should collapse).

41. In *Soo Line R.R. v. Fruehauf Corp.*, 547 F.2d 1365 (8th Cir. 1977), the court suggested that "a buyer when entering into a contract does not anticipate that the sole remedy available will be rendered a nullity, thus causing additional damages." *Id.* at 1373.
purchase price we paid, but Seller may have been confident of its ability to repair or replace and may have calculated that the risk of consequential loss was so small that it was advantageous for Seller to bear that risk rather than shift the risk to us in exchange for a lower purchase price. For the foregoing reasons, we interpret the written agreement as excluding consequential damages only in the event that the exclusive repair remedy works as it is supposed to.

This would seem to be a reasonable interpretation from Buyer's point of view.

Therefore, there appear to be two different ways in which the contract terms can be reasonably interpreted. A seller could reasonably expect that consequential damages would be excluded, even if the exclusive remedy fails of its essential purpose. A buyer could reasonably assume that the exclusion of consequential damages does not apply when the exclusive remedy fails of its essential purpose. Unfortunately, many judges who thought they had ascertained the intent of the parties did not see that both interpretations are reasonable.

It thus appears likely that at the time of contract formation, Buyer and Seller either did not have any intentions regarding the recovery of consequential damages in the event that the exclusive remedy fails, or had different, but reasonable, intentions. Therefore, it would be useless for our judge to search for "the intention of the parties." There is no such thing because no

42. Buyer's president has a good point. Presumably, what concerns a seller is its "expected liability," which is a function of the probability of liability as well as the extent of liability. For example, when there is a 1% probability of $100,000 liability, the expected liability is .01 x $100,000, or $1000. If the seller is confident of its ability to repair or replace defects, or confident that a small portion of customers will even have breach of warranty claims, it may calculate that the expected consequential damages liability resulting from failure of the repair or replace remedy is so small that it would be cheaper to bear the risk than to shift the risk to the buyer in exchange for a lower contract price.

It may be cheaper for the seller to bear the risk even when the seller's product is still in the experimental stage and the risk that seller will be unable to correct defects is relatively great. It may be more expensive for the buyer to assess the risk of non-repair and consequential loss and insure against that risk, than it would be for the seller, in which case the buyer may demand a price reduction exceeding the seller's cost of bearing the risk itself. In this situation, the seller might well agree to bear the risk of consequential losses resulting from failure of the exclusive remedy.


43. One commentator notes that the court carries out the intentions of the parties
one intention is shared by both parties.\textsuperscript{44} In most cases involving similar contract terms,\textsuperscript{45} the interpretive approach (the fifth approach examined in part II of this Article) fails. In the absence of any clearly expressed provision concerning consequential damages in the event that the repair or replace remedy fails of its essential purpose, trying to ascertain the agreement intended by the parties is a futile exercise. Not only is there no express agreement, there is not even a tacit agreement. Tacit agreements depend upon usages of trade, other customary ways of doing business, or obvious mutually beneficial strategies. In most cases involving the failure of an exclusive repair remedy, no such usage, custom, or strategy appears.

\textbf{B. Supplemental Principles of Construction}

When our judge abandons all hope of ascertaining the intention of the parties, she may consider some of the traditional principles of construction that courts employ to give legal effect to contractual language when no meaning common to both parties can be found.\textsuperscript{46} These principles sometimes help a judge
choose between two different reasonable interpretations advanced by the litigants.

One principle is that the language in question should be construed against the drafter. In other words, in deciding between a reasonable meaning favoring the party who chose the language and a reasonable meaning favoring the other party, the court should prefer the meaning of the other party. This is sometimes an appropriate principle to apply, especially when one party is a consumer who has no influence on the contract terms and only a limited understanding of the legal significance of those terms. In cases such as our hypothetical transaction, however, both parties are commercial enterprises, most likely represented by executives experienced in contract bargaining and by lawyers who understand the legal significance of contractual language. Assuming that the parties had relatively equal bargaining power, the contractual language concerning warranties and remedies is likely to be a joint product incorporating some suggestions of seller’s counsel and some suggestions of buyer’s counsel. In such cases, it is not realistic to identify either party as the drafter. Even if the language was supplied by one party, the court should not automatically prefer the meaning advanced by the other. That other party had an opportunity to require clarification of the drafter’s language and must share the blame for the ambiguity concerning consequential damages. One must conclude that in many cases the principle of construing contractual language against the drafter does not provide an adequate solution to our problem.

Another principle of construction prescribes that contractual terms be given a meaning that results in a reasonable and

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[T]he first task of a court in contract interpretation is determining from the agreement itself and the surrounding circumstances what the intent of the parties was. If, after examining all these sources of information, it is still not possible to determine the intent of the parties, courts can rely on rules of law which purport to determine what, in certain circumstances the parties intended, when, in fact, no one really knows what was intended or that the parties even thought about the matter.

Southern Bell Tel. & Tel. Co. v. Florida E. Coast Ry., 399 F.2d 854, 856 (5th Cir. 1968).

47. See Restatement (Second) of Contracts § 206 (1979); E. Farnsworth, supra note 34, § 7.11, at 499.

48. For an example of a commercial contract in which both parties played active roles in drafting contract language, see Lincoln Pulp & Paper Co. v. Dravo Corp., 436 F. Supp. 262, 265-68 (D. Me. 1977).
fair bargain. It is difficult to see how this principle could help our judge. We are assuming that Buyer and Seller are commercial enterprises and that the clause excluding consequential damages is not unconscionable. Seller's interpretation of that clause does not seem unfair; it merely shifts to Buyer the risk of all consequential damages. This is frequently done in commercial contracts when the buyer is the better risk-bearer. If the written agreement had excluded consequential damages and failed to provide an exclusive remedy, Buyer could not recover any consequential damages, and no one would argue that that was unfair. Nor does Buyer's interpretation of the exclusion clause seem unfair to Seller. It is not unfair to ask Seller to compensate for losses resulting from breach of Seller's obligation to correct defects in the goods. Our problem is not one of fairness or unfairness; Buyer and Seller were morally free to allocate the risk of consequential damages in any manner they desired. Unfortunately, they left it unclear how that risk was allocated and thereby committed the venial sin of ambiguity.

According to yet another principle of construction, a contract term should be given a meaning that makes it significant and effective, rather than superfluous or redundant. In Buyer's interpretation, the exclusion of consequential damages clause seems to be a redundant particularization of the exclusive remedy clause; the exclusive remedy clause already states that repair or replacement is the only remedy for breach of warranty, and Buyer interprets the exclusion of consequential damages clause as a mere reminder that consequential damages is one of the remedies waived in reliance on the exclusive repair remedy. In Seller's interpretation, on the other hand, the exclusion of consequential damages clause has a very significant effect. It means that Buyer cannot recover consequential damages, no matter what happens, including Seller's failure to correct defects. Unlike the meaning Buyer advocates, this is a meaning that cannot be derived from other provisions in the written agreement. Any sane judge would not, however, adopt Seller's interpretation merely because it makes the consequential damages clause logically significant rather than redundant. Written

49. See Restatement (Second) of Contracts § 203(a) & comment c (1979); E. Farnsworth, supra note 34, § 7.11, at 498.
50. See Restatement (Second) of Contracts § 203(a) & comment b (1979).
agreements often contain emphatic reminders, clarifying examples, and other language that might be regarded as redundant. Buyer may reasonably have assumed that the consequential damages clause was an emphatic reminder, in which case it would be repetitive but not superfluous.

We must conclude that in most cases involving failure of the exclusive repair remedy, courts will not be able to ascertain the intent of the parties concerning consequential damages or resolve the issue through traditional principles of construction. Yet the contract must be given legal effect one way or the other; the court must decide either that the buyer is entitled to consequential damages or that it is not.

IV. A Proposed Presumption

The problem can best be solved by the following presumption: In the absence of an explicit or clear indication to the contrary, it should be presumed that the buyer agreed to exclude consequential damages only on the condition that defects are corrected by repair or replacement within a reasonable time.

51. Assuming contract terms similar to those set forth supra notes 1 & 2.

52. A similar approach is proposed in Special Project, supra note 40, at 239 n.884, which suggests that it should be presumed the parties did not intend to exclude consequential damages flowing from a failure of essential purpose. This presumption is rebuttable, however: "The seller should be allowed to demonstrate a contrary intent". Id. The presumption proposed in this Article, on the other hand, is conclusive once it is deemed applicable. It comes into play in the absence of an explicit or clearly implied agreement that consequential damages will be excluded even if the exclusive remedy fails of its essential purpose. The presumption should be conclusive because consequential damages should be denied only when it is unmistakably clear that both parties agreed to their exclusion. See infra text accompanying notes 59 & 60.

When the seller is the sole drafter of the limitation of remedy language, my proposed presumption yields the same result as that produced by the principle of construing language against the drafter. When the limitation of remedy language is the joint product of the seller's and the buyer's suggestions, neither party can be identified as the drafter, and my proposed presumption resolves an issue that cannot be resolved by the principle of construing language against the drafter. In the unlikely event that the buyer is the sole drafter of the limitation of remedy language, my proposed presumption and the principle of construing language against the drafter produce different results. My proposed presumption is supported by the policy of limiting remedies only when it is unmistakably clear that both parties agreed to the limitation. This important policy outweighs the principle of construing language against the drafter, a principle which has little weight when the parties have roughly equal bargaining power. Assuming the parties had roughly equal bargaining power, one may therefore suppose that the seller had am-
There are good reasons for the proposed presumption. Sometimes the best way to "solve" a problem is to prevent it from occurring. Our problem is one of ambiguity. One way to prevent this ambiguity is to impose upon one party the burden of ensuring that the contract language clearly specifies which party is to bear the risk of consequential damages in the event the exclusive repair remedy fails of its essential purpose. This gives one party in each transaction a strong incentive to insist on language that is unambiguous; he knows that any ambiguity will be resolved against him.

Why put the burden on the seller, as the proposed presumption does, rather than the buyer? There are practical reasons for so doing. The seller already has the burden of carefully drafting an implied warranty disclaimer that complies with Code section 2-316. The seller already has the burden of clearly expressing an agreement that the repair or replace remedy is the sole and exclusive remedy for breach of warranty. The additional burden of ensuring clarity in the consequential damages clause is therefore not an onerous one for the seller to bear, and it seems convenient to assign to one party the major responsibility for the clarity and coherence of all provisions limiting remedies for breach of warranty.

There are also policy reasons for placing the burden on the seller and resolving ambiguity in the buyer's favor. The general goal of the Code provisions dealing with remedies for breach is to afford plaintiffs fully compensatory expectancy damages. When a buyer suffers consequential loss because of seller's breach, full compensation requires consequential damages. The Code provides for consequential damages as a normal remedy for buyers, subject to limitations prescribed in Code section 2-715(2)(a). The Code also permits contractual limitations of remedies, limitations which exclude one or more of the normal

\[\text{ple opportunity to require clarification of any ambiguous language drafted by the buyer.}\]


54. See id. § 2-719(1)(b) & comment 2.

55. These are damages designed to put the plaintiff in the position he would be in had the breach not occurred. See id. § 1-106(1).

56. See supra notes 7 & 8 and authority cited therein. Although U.C.C. § 1-106(1) states that consequential damages may be recovered only as specifically provided, the U.C.C. sections cited in notes 7 and 8 specifically provide for consequential damages.
Code remedies and thus give the victim of the breach something other than compensatory expectancy damages. Such limitations, however, are not favored in the Code.\textsuperscript{57} The Code contains provisions restricting the right to substitute limited remedies for the normal Code remedies, and also provides that certain limitations of remedies will be enforced only when expressed in clear and unmistakable language.\textsuperscript{58} One might well conclude that the general policy of the Code is to prescribe fully compensatory remedies and enforce contractual deviations from these prescribed remedies only when it is unmistakably clear that both parties agreed to the deviation.\textsuperscript{59}

In our hypothetical case, the meaning of the clause excluding consequential damages is not clear. The parties obviously agreed to exclude consequential damages in the event that Seller

\footnotesize{\textsuperscript{57} E.g., Chemetron Corp. v. McLouth Steel Corp., 381 F. Supp. 245, 250 (N.D. Ill. 1974), aff'd, 522 F.2d 469 (7th Cir. 1975); Jacobs v. Rosemount Dodge-Winnebago S., 310 N.W.2d 71, 78 (Minn. 1981); Goddard v. General Motors Corp., 60 Ohio St. 2d 41, 44, 396 N.E.2d 761, 764 (1979); Schroeder v. Fageol Motors, Inc., 86 Wash. 2d 256, 261, 544 P.2d 20, 24 (1975); Murray v. Holiday Rambler, Inc., 83 Wis. 2d 406, 418, 265 N.W.2d 513, 520 (1978).

\textsuperscript{58} See U.C.C. § 2-718(1) & comment 1 (1977) (restricting liquidation of damages); id. § 2-719(1)(b) & comment 2 (giving effect to exclusive remedy clause only if clearly expressed); id. § 2-719(2) (making normal Code remedies available when exclusive remedy fails of its essential purpose); id. § 2-719(3) (giving effect to exclusion of consequential damages only if exclusion is conscionable); cf. id. § 2-316(2) (requiring that disclaimers of implied warranties be conspicuous); id. § 2-720 (requiring clear expression of any renunciation of remedies for antecedent breach in event of cancellation or rescission of contract). For judicial suggestions that contractual limitations of remedies must be in clear and unmistakable language, see Cryogenic Equip., Inc. v. Southern Nitrogen, Inc., 490 F.2d 696, 698 (8th Cir. 1974); Gramling v. Baltz, 253 Ark. 361, 362-63, 485 S.W.2d 183, 189-90 (1972).

\textsuperscript{59} To be sure, one can also find in the U.C.C. a policy respecting the freedom of the parties to fashion their own remedies. See U.C.C. § 2-718 comment 1 (1977) (upholding liquidated damages clauses when the liquidated amount is reasonable); id. § 2-719 comment 1 (parties are left free to shape their remedies, and reasonable agreements limiting remedies are to be given effect). The best way to reconcile the freedom of contract policy with the policy favoring the normal compensatory Code remedies is to enforce contractual limitations of remedies, but only when they are expressed in clear and unmistakable language. A party should be free to contract away his statutory rights, but we should require clear and convincing evidence before concluding that he has done so.

This disposes of any argument that the seller's interpretation of the consequential damages clause should prevail if it is \textit{more reasonable}, in view of all the circumstances, than buyer's contrary interpretation. So long as the buyer's interpretation is reasonable, there is no mutual assent to the exclusion of consequential damages when the exclusive remedy fails, see supra pt. III, and buyer's interpretation should prevail simply because buyer has not clearly and unmistakably waived his statutory right to those consequential damages.
performs its obligation to repair or replace defects, but Buyer could reasonably have expected to recover consequential damages in the event that the defects are not corrected, despite Seller's contrary understanding. Under the proposed presumption, the court would find that Buyer agreed to exclude consequential damages only on the condition that the exclusive remedy does not fail, and the court would conclude that Buyer is entitled to consequential damages because the exclusive remedy did fail. The presumption serves the Code policy by excluding consequential damages only to the extent that both parties clearly agreed to exclude them.60

V. THE LIMITED SCOPE OF RECOVERY

In our hypothetical case, the proposed presumption results in the court holding that Buyer is entitled to consequential damages because the exclusive repair remedy failed. Buyer should not, however, recover all consequential losses caused by Seller's breach of warranty. In addition to the usual foreseeability requirement, two additional limitations should restrict the scope of recovery.

The first limitation is imposed by the agreement of the parties. Seller promised to remedy any breach of warranty by repairing or replacing defective parts. The written agreement did

60. If the buyer agrees to bear the risk of consequential damages, no matter what happens, the seller should insist on language such as the following: "Seller will not be liable for consequential damages even if Seller fails to repair or replace defective equipment or the exclusive remedy in any way fails of its essential purpose." Such language avoids ambiguity and makes it clear that the buyer is waiving all consequential damages for breach of warranty; the proposed presumption would therefore not come into play.

A buyer who does not want to exclude consequential damages in the event that defects are not corrected should insist on language such as the following: "Provided that Seller performs its obligations under the exclusive repair or replacement remedy within a reasonable time not to exceed ______ after notification of breach of warranty, Seller will not be liable for consequential damages." Language such as this makes the proposed presumption unnecessary.

A difficult problem arises when the contract provides that "In no event will Seller be liable for consequential damages." This seems to indicate that the buyer has agreed to exclude consequential damages even if the exclusive remedy fails of its essential purpose. The buyer can argue, however, that it means "So long as defects are corrected by repair or replacement, Seller will not be liable for consequential damages arising in any situation or circumstances." My somewhat tentative view is that the meaning of the language is not clear and unmistakable and that the proposed presumption should therefore be applied.
not specify the period of time within which the repair or replacement must be accomplished, and thus, under Code section 2-309(1), Seller is given a reasonable time. Under both Seller's and Buyer's interpretations of the agreement, Seller is not liable for consequential damages or other money damages if Seller meets its obligation to repair or replace defective parts. An obvious purpose of the exclusive repair remedy is to give Seller a reasonable time in which to correct defects, during which time Seller will be free of liability. Buyer clearly intended to waive consequential damages for losses occurring during that reasonable time period. We thus arrive at the first limitation on Buyer's recovery of consequential damages: Buyer cannot recover for consequential losses that would have occurred even if defects had been corrected within a reasonable time.

When does the reasonable time period expire? A reasonable time for correction of defects should not be deemed to expire until Buyer notifies Seller that Seller has had long enough. So long as this notification is not premature, the time of notification can be used as the termination of Seller's reasonable time for correcting defects. In deciding that the notification was not premature, the finder of fact need not fix the precise time period during which any notification would have been premature; it need only determine that the time of actual notification lies outside that period, whatever it may be. If the finder of fact de-

61. "The time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time." U.C.C. § 2-309(1) (1977). In Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978), the court correctly noted that if the contract does not state the time for performance of the repair or replacement obligation, the seller is obligated to repair or replace defective parts within a reasonable time pursuant to § 2-309(1). Id. at 340, 581 P.2d at 798.

62. See Waters v. Massey-Ferguson, Inc., 775 F.2d 587, 591-92 (4th Cir. 1985) (exclusion of consequential damages should be interpreted as referring to damages incurred during a reasonable time for repair); Special Project, supra note 40, at 239 (buyer should recover only those consequential damages flowing from the limited remedy's failure and should not recover consequential damages arising during the seller's reasonable time for correction of defects). Unfortunately, most courts awarding consequential damages have failed to mention the limitation.

63. See U.C.C. § 2-309 comment 5 (1977), which states in part:

The obligation of good faith under this Act requires reasonable notification before a contract may be treated as breached because a reasonable time for delivery or demand has expired . . . .

When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance.
cides that the notification was premature, it will have to consider the relevant circumstances of the case in fixing Seller’s reasonable time for correcting defects.

The second limitation on Buyer’s recovery of consequential damages is imposed by Code section 2-715(2)(a): Buyer cannot recover for losses that Buyer could reasonably have prevented by cover or other attempts to mitigate damages. Once Buyer notifies Seller that a reasonable time for correction of defects has expired, Buyer should no longer rely on Seller and should immediately begin attempts to obtain substitute goods from another supplier. Any delay on Buyer’s part should result in the denial of consequential damages for losses that could have been avoided by timely cover.

The combined effect of the first and second limitations can be illustrated by figure 1, in which T1 represents the time of delivery of the goods; T2 represents the date on which Seller is notified of the breach of warranty; T3 represents the date on which Seller is notified that a reasonable time for repair or replacement has expired, assuming that this notice is not premature; and T4 represents the latest date for timely cover by Buyer, assuming cover is possible.

![Figure 1](https://scholarcommons.sc.edu/sclr/vol38/iss4/3)

Consequential losses that would have occurred, even if the defects had been corrected by time T3, can be regarded as losses arising during period A, the period terminating when Seller’s reasonable time for repair or replacement expires. Under the first limitation, Seller should not be held liable for these losses. Consequential losses that would have been avoided had Buyer

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64. Id. § 2-715(2)(a).
covered no later than time T4 can be regarded as losses arising during period C, the period during which any cover is tardy. Under the second limitation, Seller should not be held liable for these losses. Buyer should recover consequential damages only for losses that were caused by Seller's failure to correct defects within a reasonable time and that could not have been avoided by Buyer's timely cover: losses arising during period B.65 If Buyer has purchased goods of a kind readily available in the marketplace, period B will be brief, and Buyer will be left with a very narrow window of recovery. In many cases, the proposed presumption gives buyers a hollow victory.

VI. CONCLUSION

A problem arises under Code section 2-719 when an exclusive repair remedy fails of its essential purpose and the written agreement contains a clause excluding consequential damages. Due largely to their failure to see that differing but reasonable interpretations of the agreement are possible, courts have produced conflicting and unsatisfactory resolutions of the problem. The solution proposed in this Article is fairly simple: In the absence of a clear indication to the contrary, it should be presumed that the buyer agreed to exclude consequential damages only on the condition that defects in the goods are corrected within a reasonable time; the buyer should thus be allowed to recover consequential damages, but only for losses that were caused by the seller's failure to correct defects within a reasonable time and that could not have been avoided by the buyer's timely cover or other reasonable efforts to mitigate damages. Buyers should expect neither more nor less from judges who must see through a glass darkly, but are not blind.
