

To Have And Have Not: The Application Of U.C.C. § 2-719 To Clauses Limiting Remedy To Repair Or Replacement And Excluding Liability For Consequential Damages In Commercial Contracts

Joan L. Roth*

In June of 1970, John Schroeder bought a used truck from Fageol Motors, Inc. for use in his auto-hauling business. Before agreeing to buy the truck, Schroeder was assured the original "warranty" would cover the vehicle for another 94,000 miles.¹ The "warranty"² included clauses excluding liability for consequential damages and limiting all remedies to the repair or replacement of defective parts.³ After four months and only 36,000 miles of use, a casting defect caused the truck's engine to explode. Although both Fageol and Cummins Engine Company⁴ repeat-

* Writing Instructor University of Puget Sound School of Law; B.A. Beloit College, 1974; J.D. University of Washington School of Law, 1978.

1. According to Schroeder's brief: "This type of diesel truck would be expected to operate when new for 300,000 to 350,000 miles under normal maintenance without need for overhaul" Brief for Respondent at 5, *Schroeder v. Fageol Motors, Inc.*, 86 Wash. 2d 256, 544 P.2d 20 (1975).

2. The "warranty" was contained in an owner's book given to Schroeder after he signed the order form. "Warranty" is placed in quotation marks to show the term refers to the written document that was referred to in a general manner by both Schroeder and Fageol's salesman as "the warranty." This document actually contained an express warranty, a disclaimer of implied warranties, and remedy limitations as defined later in this article. See text following note 18 *infra*.

3. The pertinent parts of the "warranty" as quoted by the court of appeals, are as follows:

[t]he Seller warrants to the Purchaser that the Cummins Diesel engine (hereinafter called "engine") installed in, and so long as it remains in, the new truck will be free from defects in material, workmanship and title.

The "warranty" further provided that:

If it appears . . . that the engine does not meet the warranty specified above . . . the Seller shall correct or cause another to correct, any defect, at the Seller's option, either by repairing any defective part or by making available, at the Seller's factory or nearest Branch Office or nearest franchised Dealer, a repaired or replacement part

The warranty as to defects is followed by a disclaimer in bold print as follows:

THE FOREGOING WARRANTY IS EXCLUSIVE AND IN LIEU OF ALL OTHER WARRANTIES WHETHER WRITTEN, OR ORAL OR IMPLIED (INCLUDING, BUT NOT LIMITED TO, A WARRANTY OF MERCHANTABILITY OR FITNESS FOR PURPOSE).

Schroeder v. Fageol Motors, Inc., 12 Wash. App. 161, 164, 528 P.2d 992, 994 (1974).

4. Cummins' separate warranty also appeared in Schroeder's owner's book. This

edly attempted to repair the truck, it never again functioned properly.⁵ Schroeder finally sold it and brought suit against Fageol and Cummins for damages, including lost profits,⁶ resulting from breach of warranty and negligence.

The trial court entered judgment in favor of Schroeder and the court of appeals affirmed.⁷ Both courts held that the defendants had breached express warranties to repair the vehicle and that the clause excluding Fageol's liability for consequential damages was ineffective.⁸ The Washington Supreme Court reversed and remanded the case for full hearing on whether the clause excluding consequential damages was unconscionable.⁹

The facts of *Schroeder v. Fageol Motors, Inc.*¹⁰ exemplify a common commercial situation. A product is sold to a commercial buyer under a contract containing "warranty" and "limitation of liability" clauses. These clauses typically 1) disclaim all warranties except an express warranty that the product is free of defects in materials and workmanship and 2) limit remedies exclusively to repair or replacement by the seller of defective parts, often expressly excluding liability of the seller for the buyer's consequential damages. A defect causes the product to break down or to fail to function as promised, and the seller either cannot or does not return the product to a fully-functioning, defect-free condition within a reasonable time. The parties end up in court with the seller claiming the unpaid purchase price, if any, and the buyer claiming damages for breach of warranty. A primary and difficult issue in these cases is whether the buyer can collect consequential damages for lost profits predominantly caused by the seller's failure to repair.

This article will examine the legal questions presented to a court in such a situation, with special reference to the opinion of

warranty, however, did not contain a clause excluding consequential damages.

5. The main problems were severe vibration and engine overheating. See Brief for Respondent, *supra* note 1, at 3.

6. Schroeder claimed \$8,431.45 in repair bills and \$12,160 in lost profits but apparently did not seek compensation for any loss incurred in the resale of the truck. 86 Wash. 2d at 258, 544 P.2d at 22.

7. *Schroeder v. Fageol Motors, Inc.*, 12 Wash. App. 161, 528 P.2d 992 (1974).

8. The lower courts relied on the Washington Supreme Court holding in *Berg v. Stromme*, 79 Wash. 2d 184, 484 P.2d 380 (1971), and *Baker v. Seattle*, 79 Wash. 2d 198, 484 P.2d 405 (1971), discussed at note 17 *infra*. Both courts denied Fageol indemnity against Cummins.

9. *Schroeder v. Fageol Motors, Inc.*, 86 Wash. 2d 256, 263-64, 544 P.2d 20, 25 (1975). The supreme court relied on WASH. REV. CODE §§ 62A.2-719(3), 2-302 (1976), discussed in text accompanying note 28 *infra*, and also upheld the lower courts' denial of indemnity.

10. 86 Wash. 2d 256, 544 P.2d 20 (1975).

the Washington Supreme Court in *Schroeder*. After outlining the subsections of section 2-719¹¹ of the Uniform Commercial Code and suggesting a method for determining to what language in a contract the section should apply, the article discusses the concept of unconscionability that courts must consider under section 2-719(3). It then examines the applicability of section 2-719(2), the "failure of essential purpose" section, to the *Schroeder* facts and argues that its application should result in an award of consequential damages, regardless of the fact that the exclusion of consequential damages is conscionable. The article concludes by suggesting a conceptual approach that may aid courts in solving similar problems.

I. APPLICABLE CODE SECTIONS

As the Washington Supreme Court recognized in *Schroeder*, a court's first task when presented with a *Schroeder*-type situation is to clarify the distinction between warranty disclaimers and remedy limitations and the Code sections applicable to each. The court quoted White and Summers's treatise to make the point:

A disclaimer clause is a device used to exclude or limit the seller's warranties; it attempts to control the seller's liability by reducing the number of situations in which the seller can be in breach. An exclusionary clause, on the other hand, restricts the remedies available to one or both parties once a breach is established.¹²

Both the Washington court and White and Summers used the term "exclusionary clause" instead of "remedy limitation."¹³ The choice is unfortunate for two reasons. First, the term "exclusionary clause" is confusing. The role of warranty disclaimers is to "exclude" implied warranties of merchantability and fitness for a particular use, but by the court's terminology they are "disclaimers" and not "exclusionary clauses." Remedy limitations may not "exclude" anything but only limit the amount recoverable on breach, as in a limitation of recovery to the return of the purchase price. Such a clause, however, is an "exclusionary

11. This section is codified with modification in Washington. See WASH. REV. CODE § 62A.2-719 (1976).

12. 86 Wash. 2d at 259, 544 P.2d at 23 (quoting J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 12-11, at 383-84 (1972) [hereinafter cited as WHITE & SUMMERS]).

13. "Remedy limitation" is derived from the title to section 2-719(2) of the Uniform Commercial Code: "Contractual modification or limitation of remedy." WASH. REV. CODE § 62A.2-719 (1976).

clause" by the court's terminology. Second, using the term "exclusionary clause" may lead to improper application of section 2-719 if a court fails to recognize that a clause limiting remedy to repair or to a return of purchase price is an "exclusionary clause" to which section 2-719 applies.¹⁴ Notwithstanding the court's terminology, this article will use the term "remedy limitation."

The Uniform Commercial Code separates warranty disclaimers and remedy limitations and treats each in a different section: section 2-316¹⁵ covers warranty disclaimers while section 2-719¹⁶ deals with remedy limitations. Courts, however, have had difficulty determining which section to apply to a particular clause and have often confused the two sections.¹⁷ One cause of the confusion is the drafting practice of including remedy limitations in the same paragraph—or even the same sentence—as warranty disclaimers.¹⁸

14. Indeed, the Washington court was so misled. See pt. III of the text.

15. WASH. REV. CODE § 62A.2-316 (1976).

16. *Id.* § 62A.2-719 (1976).

17. See, e.g., *Cyrogenic Equip., Inc. v. Southern Nitrogen, Inc.*, 490 F.2d 696, 698 n.1 (8th Cir. 1974) ("the disclaimer here in issue is a limitation of remedy"); *Checker Taxi Co., Inc. v. Checker Motor Sales Corp.*, 376 F. Supp. 997, 999-1000 (D. Mass. 1974) ("The question of exclusion of implied warranties is a separate question from that of limitation of implied warranties It should further be noted that the Uniform Commercial Code appears not to require conspicuousness as a condition precedent to the limitation of remedies for breach of warranties even though [it] does require conspicuousness as a condition precedent to the exclusion of remedies.") (emphasis added); *Ford Motor Co. v. Tritt*, 244 Ark. 883, 889, 430 S.W. 778, 781 (1968) ("the waiver of the implied warranty of merchantability or fitness certainly does not protect [the dealer] from liability, for to do so would be unconscionable under . . . [§] 2-719(3)") (emphasis added); *K-Lines, Inc. v. Robert Motor Co.*, 273 Or. 242, 246, 541 P.2d 1378, 1381 (1975) ("[T]here has been some confusion about the distinction between disclaimers of warranties and exclusion or limitation of remedies. In our opinion, the two are substantially identical."). The Washington Supreme Court itself confused § 2-316 with § 2-719 and found a remedy limitation invalid because inconspicuous. *Baker v. Seattle*, 79 Wash. 2d 198, 202, 484 P.2d 405, 407 (1971). In *Baker*, a consumer golf cart lessee, under a lease containing a remedy limitation excluding liability for consequential damages, was physically injured when the brakes failed. Because *Baker* involved a lease and not a sale, the Uniform Commercial Code provisions technically did not apply. The court therefore based its decision on public policy grounds, but referred to §§ 2-316 and 2-719(3) as evidence of the policy. The court labeled the limitation clause a "disclaimer" and, failing to distinguish the Code provisions, found the clause unconscionable because inconspicuous. Section 2-316 has a conspicuous requirement but § 2-719 does not.

18. A recent example is *American Elec. Power Co., Inc. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435 (S.D.N.Y. 1976), where the "Guarantee" provided that "Seller shall . . . correct such defects" A further remedy limitation was located in a separate clause labeled "limitation of liability" which excluded liability for consequential damages. *Id.* at 440. For remedy limiting language in the same sentence as the warranty, see *Courtesy Ford Sales, Inc. v. Farrior*, 53 Ala. App. 94, 97-98, 298 So. 2d 26, 28-29 (1974) (Ford Warrants . . . that the Selling Dealer . . . will repair or replace"); *Ford Motor Co.*

In determining which Code section to apply, courts should not be misled by such drafting but should look at the purpose of the language used in each clause. Warranties and warranty disclaimers are concerned with the quality of the products. Language that describes a quality of the product, such as being free of defects, is clearly an express warranty. Language that indicates the product does *not* have certain qualities, such as being merchantable or fit for a particular purpose, is a warranty disclaimer to which section 2-316 applies. In contrast, language which describes what the buyer can or cannot request, or what the seller will or will not do, upon a finding that the machine is lacking a warranted quality, is a remedy limitation to which section 2-719 applies. In *Schroeder*, the Washington Supreme Court correctly found the language in Fageol's warranty that excluded the seller's liability for consequential damages to be an exclusionary clause (remedy limitation) to which section 2-719 applied. However, the court did not apply its own distinction between exclusionary clauses (remedy limitations) and warranty disclaimers to overturn the appellate court's finding¹⁹ that there was a "warranty" to repair or replace defective parts, and thus did not reach the question of whether what was really a remedy limitation to repair or replace had failed of its essential purpose under section 2-719(2).

Section 2-719 contains three subsections governing contractual limitation of remedy. Subsection (1) allows parties to limit remedies such as to a return of purchase price or to repair and replacement of defective parts.²⁰ Such a limited remedy is exclusive only if expressly stated to be so.²¹ Official Comment 1 to

v. Gunn, 123 Ga. App. 550, 551, 181 S.E.2d 694, 696 (1971) ("All warranties shall be fulfilled by the selling dealer . . . replacing . . . or repairing . . ."); *Orange Motors of Coral Gables, Inc. v. Dade County Dairies, Inc.*, 258 So. 2d 319, 320 (Fla. Dist. Ct. App. 1972) ("BMH . . . warrants . . . that it will exchange or repair any part . . .").

19. *Schroeder v. Fageol Motors, Inc.*, 12 Wash. App. 161, 165, 528 P.2d 992, 995 (1974).

20. WASH. REV. CODE § 62A.2-719(1)(a) (1976) states:

(1) Subject to the provisions of subsection (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

21. WASH. REV. CODE § 62A.2-719(1)(b) (1976) states:

(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.

section 2-719 adds that any "reasonable" limitation of remedy should be given effect, but warns that a contract must provide "at least a fair quantum of remedy for breach of obligations or duties outlined in the contract" to avoid being found unconscionable.²² Such a fair quantum of remedy is necessary to insure reasonable protection against breach.²³

Although the language of section 2-719(1) does not specifically say that a fair quantum of remedy must be provided, such a requirement could be read into the section. The reasoning would be that the section only allows parties to "alter" or "limit" remedies, and not avoid them, indicating that some remedy must be left. Courts not wanting to read a fair quantum requirement into section 2-719(1) may employ section 2-302,²⁴ the unconscionability section, to enforce this clear requirement of the Comment. This article will refer to section 2-719(1) as though the fair quantum requirement were enforceable under it.

Section 2-719(2) states that: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Title."²⁵ This subsection enforces the fair quantum requirement in the special situation where a remedy limitation, which appeared reasonable at the time of contracting, failed to provide one party with a fair quantum of remedy after breach due to unexpected circumstances. The test, according to the Official Comment, is whether either party has been deprived "of the substantial value of the bargain."²⁶ If so, the clause "must give way to the general remedy

22. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966). The Comment states in pertinent part:

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 sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed.

23. This can be inferred from the Official Comment's mention of "legal consequence" for breach. See note 22 *supra*.

24. WASH. REV. CODE § 62A.2-302 (1976).

25. This quote constitutes the full text of WASH. REV. CODE § 62A.2-719(2) (1976).

26. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966). The Comment states in pertinent part:

[W]here an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

provisions of the Article.”²⁷

Finally, section 2-719(3), as the Comment states, “recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner.”²⁸ The reference to unconscionability incorporates the general standards for determining unconscionability developed under section 2-302. It also appears to relate to the fair quantum requirement of section 2-719(1) due to the reference to unconscionability in the Comment’s discussion of the fair quantum standard.²⁹

Section 2-302 allows a court, as a matter of law, to find any contract or clause to be unconscionable and either to refuse to enforce the contract or clause or to limit the clause’s application to avoid an unconscionable result.³⁰ The Official Comment provides guidance for determining when contracts or clauses are unconscionable:

The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making

27. *Id.*

28. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 3 (1966). At the time relevant to the *Schroeder* decision, § 62A.2-719 stated:

(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.

Uniform Commercial Code ch. 147, § 2-719, 1965 Wash. Laws, 1st Ex. Sess. 2404-05 (amended 1974). This text was identical to the official U.C.C. version, U.C.C. § 2-719(3) (1972 version). The Comment adds that a clause excluding consequential damages is “merely an allocation of unknown risks.” The 1974 amendments to § 2-719 clarified the different burdens of proof under subsection (3) in cases involving consumer personal injury. See WASH. REV. CODE § 62A.2-719(3) (1976).

29. See note 22 *supra*.

30. WASH. REV. CODE § 62A.2-302 (1976) states:

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

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

Following subsection (2), the Washington Supreme Court in *Schroeder* appropriately remanded the case for a full hearing on unconscionability. 86 Wash. 2d at 263, 544 P.2d at 24.

of the contract. . . . The principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power.³¹

A determination of unconscionability is made in light of circumstances at the time of contracting.³²

II. UNCONSCIONABILITY

A. *The Interrelation of Substantive and Procedural Unconscionability*

Commentators have concluded that in most cases a contract clause should not be found unconscionable unless it is both procedurally and substantively deficient.³³ Only contractual provisions that are overly harsh, that is, substantively unconscionable, must be accorded adequate procedural safeguards against surprise and oppression. The unconscionability doctrine is not meant to bar *any* surprise, but only *unfair* surprise and oppression.³⁴ Surprise is unfair only when it involves a harsh unexpected clause. Similarly, a party is not oppressed when forced to accept a neutral clause. Oppression arises when the party has no meaningful choice about a harsh clause he would prefer excluded from the

31. WASH. REV. CODE ANN. § 62A.2-302, Official Comment 1 (1966).

Section 2-302 allows courts to overtly make the public policy decision that they had previously made covertly, with the exact limits of application to be developed through case law. One commentator explained:

[T]he unconscionability doctrine can improve the stability of contracts. It seems that courts have always regulated contracts for unfairness. But prior cases created problems because of the surreptitious manner of decision, the misused technical devices, and the uncertainty produced by their use. Under the Code, courts will not have to use surreptitious devices in such cases. Because the courts can use overt, instead of covert methods, some of the uncertainties should be eliminated. Opinions may now state the reasons that actually influenced decision, and the attorney's ability to predict how a court will decide future similar cases should increase. Increased predictability should also increase the stability of contracts.

Spanogle, *Analyzing Unconscionability Problems*, 117 U. PENN. L. REV. 931, 936 (1969) (footnotes omitted). Schroeder provided the Washington court the opportunity to define the limits of unconscionability doctrine in Washington.

32. This time reference should be contrasted with that in § 2-719(2) which specifies that a determination that a limited remedy has failed of its essential purpose is to be made in light of circumstances as they developed after the time of contracting. See text following note 71 *infra*.

33. See Leff, *Unconscionability and the Code, the Emperor's New Clause*, 115 U. PENN. L. REV. 485, 488 (1967); Spanogle, *supra* note 31, at 932. At least one district court agrees with the commentators. *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264, 268 (E.D. Mich. 1977).

34. See pt. III of the text for a discussion of the applicability of § 2-719(2) to such clauses due to circumstances after the time of contracting.

contract. If such a harsh clause is, however, included in the contract in a procedurally conscionable manner, the clause should not usually be found unconscionable.

In some cases, a court may find a clause so one-sided that no procedural safeguards will save it. Such a clause is then stricken as being unconscionable on a substantive basis alone. The Official Comment to section 2-719 may be found to describe one type of such overly-harsh clause—one that attempts to so limit remedies that a fair quantum of remedy is not provided.³⁵ Section 2-719(3) clarifies that clauses excluding consequential damages may be included in sales contracts and therefore are not so one-sided as to be unconscionable on a substantive basis alone. However, section 2-719(3) also indicates that such clauses are harsh enough to require scrutiny for procedural unconscionability.

The Washington Supreme Court in *Schroeder* correctly recognized that it was dealing with a question of procedural, not substantive, unconscionability by explaining the distinction between the two:

Substantive unconscionability involves those cases where a clause or term in the contract is alleged to be one-sided or overly harsh, while procedural unconscionability relates to impropriety during the process of forming a contract.³⁶

The court defined that impropriety alternatively as a “lack of meaningful choice” or “unfair surprise” and discussed four aspects of the circumstances surrounding contract formation that courts should consider in determining if procedural unconscionability exists.

B. *The Washington Court's Analysis in Schroeder*

The Washington court saw the essential concept behind procedural unconscionability relating to clauses excluding consequential damages to be lack of notice: “The code specifically

35. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966). Whether a court should, absent some indication of legislative intent in the Code and comments, find a clause unconscionable on substantive grounds alone is questionable, because such action is essentially legislative in that it bars all use of such clauses. The Code properly gives courts the task of establishing rules of fairness in the formation of contracts via § 2-302. However, a decision that a certain clause should never be included in a contract is a policy decision more appropriately made by a legislature after a comprehensive consideration of the potential effect on commercial transactions. The fact that the legislature acted to bar certain clauses may show an intent not to bar others.

36. 86 Wash. 2d at 260, 544 P.2d at 23.

provides for consequential damages and an individual should be able to rely on their existence in the absence of being informed to the contrary, either directly, or constructively through prior course of dealings or usage of trade."³⁷ In determining whether such notice was present, the Washington court directed the lower court to consider all the surrounding circumstances including the conspicuousness of the clause, the negotiations that took place, any relevant usage of trade, and any prior course of dealing. The court indicated that the presence of either a trade usage of including the questioned clause or a prior course of dealing between the parties involving use of such a clause by itself would support a finding of conscionability,³⁸ but that evidence of either negotiations or conspicuousness alone would not be conclusive.³⁹

The *Schroeder* opinion leaves unclear the role "conspicuousness" plays under the direct or constructive notice test. Although conspicuousness is required to disclaim implied warranties under section 2-316,⁴⁰ it is not required under section 2-719 to limit remedies.⁴¹ Accordingly, *Schroeder* does not suggest that such a conspicuousness requirement should be read into section 2-719. The fact that a clause excluding consequential damages is inconspicuous does not make it automatically unconscionable. On the other hand, the court appears unwilling to make the policy decision that a buyer should be found to have notice of all conspicuous clauses in its contract. The fact that the clause is conspicuous is "not conclusive" of conscionability.⁴² Some other aspects of the circumstances that confer notice also must be present. However, if the clause is negotiated, the buyer has notice. If there is a trade usage or a prior course of dealing concerning

37. *Id.* at 262, 544 P.2d at 24.

38. The court stated that:

The presence of either of these elements . . . would support a finding of conscionability in spite of a lack of "negotiations" or the "inconspicuous" appearance of the clause.

Id. at 261, 544 P.2d at 23-24.

39. *Id.* at 260, 544 P.2d at 23.

40. WASH. REV. CODE § 62A.2-316(2) (1976).

41. In *Schroeder*, the court of appeals supported its conclusion that Fageol's remedy limitation was invalid by citing alternatively the lack of negotiations required by *Berg v. Stromme*, 79 Wash. 2d 184, 484 P.2d 380 (1971), and the lack of conspicuousness required by *Baker v. Seattle*, 79 Wash. 2d 198, 484 P.2d 405 (1971). But *Baker* had incorrectly cited the conspicuousness requirement of § 2-316 in determining the validity of what was really a remedy limitation. Although the supreme court in *Schroeder* correctly found that § 2-719, and not § 2-316, governed cases involving remedy limitations, it continued to discuss conspicuousness as a relevant consideration.

42. 86 Wash. 2d at 260, 544 P.2d at 23.

inclusion of the clause, the *Schroeder* opinion states that the presence of either alone is proof of notice. Therefore, it is difficult to see what evidence of conspicuousness would add if one of the other three aspects mentioned in *Schroeder*, or some other form of actual notice, must be present for the clause to be conscionable. Such reasoning may be why two courts have declared that conspicuousness is irrelevant in determining the unconscionability of a clause excluding consequential damages under section 2-719(3).⁴³

There is one situation, however, where conspicuousness may play a role. Where the contract as a whole has been negotiated, but not the specific clause excluding consequential damages, a court may be willing to impute notice of the clause to the buyer only if the clause was conspicuous. This may be the situation the court had in mind when it stated that evidence of "negotiations" alone would also be "not conclusive," because surely evidence that the particular clause was negotiated would be sufficient to meet the notice test.

By including negotiations as an aspect to be considered in determining unconscionability, the Washington court merged the pre-Code rule of *Berg v. Stromme*⁴⁴ with the statutory test for unconscionability, clearing up any ambiguity about the post-Code validity of the *Berg* rule. In *Berg*, the court had held that a disclaimer of warranty in a contract for the sale of an automobile to a consumer must state with particularity the items not warranted and must be expressly negotiated.⁴⁵ The Washington Legislature added the requirement of particularity to section 2-316(4) in 1974.⁴⁶ In *Schroeder*, the court also made negotiation a Code requirement under section 2-302 which places a requirement of conscionability on all clauses in all contracts. Negotiation also has been mentioned as a factor tending to prove the conscionability of a clause excluding consequential damages by courts of other

43. *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364, 381 (E.D. Mich. 1977); *Boone Valley Coop. Processing Ass'n v. French Oil Mill Mach. Co.*, 383 F. Supp. 606, 612 (N.D. Iowa 1974). Few courts have even mentioned conspicuousness. Two cases mentioned bold headings. See *Royal Indem. Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 520, 525 (S.D.N.Y. 1974); *Wille v. Southwestern Bell Tel. Co.*, 219 Kan. 755, 764, 549 P.2d 903, 910 (1976). One case held that an inconspicuous written limitation was unenforceable, but on rehearing the court said the real problem was that the language was unclear. *Gramling v. Baltz*, 253 Ark. 352, 362-63, 485 S.W.2d 183, 189-90 (1972). One case did find that a clause limiting remedies must be conspicuous. *Avenell v. Westinghouse Elec. Corp.*, 41 Ohio App. 2d 150, 154-55, 324 N.E.2d 583, 587 (1974).

44. 79 Wash. 2d 184, 484 P.2d 380 (1971).

45. *Id.* at 196, 484 P.2d at 386.

46. WASH. REV. CODE § 62A.2-316(4) (1976).

jurisdictions⁴⁷ and would give either direct notice of the inclusion of such a clause, if the particular clause was negotiated, or at least constructive notice, if the contract in general was negotiated. In this second instance, however, the court may also require that the clause be conspicuous before it will impute notice.⁴⁸

Although "conspicuousness" and "negotiations" are aspects to consider in all cases, the other two factors mentioned in *Schroeder*—usage of trade and course of dealing—are additional aspects to be considered especially in commercial settings.⁴⁹ The court directs that where "it is a recognized practice within the trade to exclude consequential damages"⁵⁰ such a clause should be found conscionable, on the basis of constructive notice. This is in agreement with the Code. Section 2-204(2) defines a usage of trade as:

any 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.⁵¹

Trade usages can give meaning to contract terms or even can constitute terms themselves.⁵² It is not necessary for both parties to be consciously aware of a trade usage for it to be binding.⁵³ If it is a trade usage to include clauses excluding consequential damages in contracts, then anyone dealing in the trade has constructive notice of the presence of the clause. Hence, the consideration of trade usages clearly fits the *Schroeder* direct or constructive notice concept. Courts of other jurisdictions also presume that contracts containing such clauses are conscionable if their inclusion is a "custom" or "common practice" in a particular

47. See, e.g., *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572, 579 (D.D.C. 1974), *rev'd mem.*, 527 F.2d 853 (D.C. Cir. 1975); *Royal Indem. Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 520 (S.D.N.Y. 1974).

48. *Berg*, dealing with a consumer situation, required negotiation of the particular clause in question. However, courts of other jurisdictions, dealing with commercial contracts, have looked at negotiations concerning the contract as a whole as indicating the conscionable inclusion of all clauses in the contract. The *Schroeder* opinion did not clarify the degree of negotiation necessary to meet its test. It may be appropriate to hold that commercial buyers have constructive notice of all terms of a contract that has been negotiated as a whole but that consumer buyers only have notice of those clauses that are conspicuous or are actually negotiated. Future judicial interpretations will be necessary to clarify this point.

49. 86 Wash. 2d at 260, 544 P.2d at 23.

50. *Id.* at 260-61, 544 P.2d at 23.

51. WASH. REV. CODE § 62A.2-204(2) (1976).

52. See *Id.* § 62A.2-316(3)(c) (1976).

53. WHITE & SUMMERS, *supra* note 12, § 3-3 at 84.

industry.⁵⁴ By using the Code terminology, the *Schroeder* opinion moves toward clarity and uniformity.⁵⁵

Similarly, *Schroeder* uses Code terminology in discussing the fourth aspect to be considered—prior course of dealing. The lower court is directed to determine whether the parties “through prior contracts had established a consistently adhered to policy of excluding consequential damages.”⁵⁶ This accords with section 1-205 of the Code which states:

A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.⁵⁷

Courts of other jurisdictions have considered the inclusion of clauses excluding consequential damages in previous contracts between the same parties as evidence of conscionability.⁵⁸ Under the *Schroeder* test, knowledge that a remedy limitation was in-

54. See *Dow Corning Corp. v. Capitol Aviation, Inc.*, 411 F.2d 622, 626 (7th Cir. 1969); *Architectural Aluminum Corp. v. Macarr, Inc.*, 70 Misc. 2d 495, 500, 333 N.Y.S.2d 818, 823 (Sup. Ct. 1972); *Eimco Corp. v. Joseph Lombardi & Sons*, 193 Pa. Super. Ct. 1, 7, 162 A.2d 263, 266 (1970). The Third Circuit recently applied trade usage in a similar manner stating: “That a party is bound by a trade usage of which he ‘should be aware’ implies that a limitation of damages may be imposed even if the parties did not explicitly and expressly negotiate it.” *Postape Assocs. v. Eastman Kodak Co.*, 537 F.2d 751, 756 (3rd Cir. 1976).

55. Clauses excluding consequential damages have rarely been found unconscionable in a commercial setting. *United States Fibres, Inc. v. Proctor & Schwartz, Inc.*, 509 F.2d 1043, 1048 (6th Cir. 1975). *Accord*, *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364, 381 (E.D. Mich. 1977). See *Speidel, Products Liability, Economic Loss and the U.C.C.*, 40 TENN. L. REV. 309, 327 (1973). But see *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264 (E.D. Mich. 1976). The usual exceptions are the cases involving indemnity for consumer injury liability. See, e.g., *Majors v. Kalo Laboratories, Inc.*, 407 F. Supp. 20 (M.D. Ala. 1975); *Ford Motor Co. v. Tritt*, 244 Ark. 883, 890-90A, 430 S.W.2d 778, 782 (1968); *Sarfati v. M.A. Hittner & Sons, Inc.*, 35 App. Div. 2d 1004, 1005, 318 N.Y.S.2d 352, 354 (1970), *aff’d*, 28 N.Y.2d 808, 270 N.E.2d 729, 321 N.Y.S.2d 912 (1971). This fact has led some courts to imply that because a transaction is commercial, there can be no unconscionability. See, e.g., *Westfield Chem. Corp. v. Burrough’s Corp.*, 21 U.C.C. REP. SERV. 1293, 1296 (Mass. Super. Ct. 1977). However, the Code states these clauses are only prima facie conscionable in commercial settings. By explaining that trade usage gives constructive notice, the Washington court in *Schroeder* clarifies why such clauses are usually conscionable in commercial settings.

56. 86 Wash. 2d at 260, 544 P.2d at 23.

57. WASH. REV. CODE § 62A.1-205(1) (1976).

58. See *Boone Valley Coop. Proc. Ass’n v. French Oil Mill Mach. Co.*, 383 F. Supp. 606, 612 (N.D. Iowa 1974); *Raybond Elec., Inc. v. Glen-Mar Door Mfg. Co.*, 22 Ariz. App. 409, 415, 528 P.2d 160, 166 (1974); *Kansas City Struct. Steel Co. v. L.G. Barcus & Sons, Inc.*, 217 Kan. 88, 95, 535 P.2d 419, 424 (1975); *Architectural Aluminum Corp. v. Macarr, Inc.*, 70 Misc. 2d 495, 500, 333 N.Y.S.2d 818, 823 (Sup. Ct. 1972).

cluded in previous contracts gives constructive notice of its inclusion in a later contract.⁵⁹

C. Oppression

In considering whether a clause excluding liability for consequential damages is unconscionable, courts in other jurisdictions also mention other aspects of the circumstances surrounding a transaction, including the relative bargaining power between the parties, the absence of an adhesion contract, or the fact that one party was not an "unwilling purchaser over-reached."⁶⁰ Each of these aspects concerns what Official Comment 1 to section 2-302 and commentators on unconscionability term "oppression."⁶¹ The Washington court in *Schroeder* did not mention any of these aspects nor did it mention "oppression" in its consideration of unconscionability even though it did define procedural unconscionability alternatively as "lack of meaningful choice" and as

59. *Schroeder's* concept of direct or constructive notice also should encompass findings of conscionability based on actual knowledge of the limiting clause through other means. See *Earl M. Jorgensen Co. v. Mark Constr., Inc.*, 56 Haw. 466, 469-70, 540 P.2d 978, 981-82 (1975) (buyer used quotation form containing clause in preparing purchase order); *Kansas City Struct. Steel Co. v. L.G. Barcus & Sons, Inc.*, 217 Kan. 88, 95, 535 P.2d 419, 424 (1975) (clause inserted in purchase order by buyer himself); *K-Lines, Inc. v. Roberts Motor Co.*, 273 Or. 242, 252, 541 P.2d 1378, 1384 (1975) (signed statement by buyer that warranty had been explained). Even though the direct or constructive notice test establishes what will support a finding of conscionability, as opposed to unconscionability, the burden of proof is on the party asserting unconscionability. The *Schroeder* court reasoned: "Since exclusionary clauses in purely commercial transactions are prima facie conscionable, the burden of establishing that a clause is unconscionable lies upon the party attacking it." 86 Wash. 2d at 262-63, 544 P.2d at 25. The court did not, however, explain what must be shown to meet that burden in the first instance. It is unclear whether the attacking party must prove the nonexistence of a trade usage or course of dealing or only allege lack of direct notice. The latter seems the more reasonable approach with the burden then shifting to the other party, usually the seller, to come forward with evidence of a trade usage or a course of dealing or negotiations.

60. See, e.g., *Cyrogenic Equip., Inc. v. Southern Nitrogen, Inc.*, 490 F.2d 696, 699 (8th Cir. 1974) (bargaining power); *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364, 381 (E.D. Mich. 1977) (bargaining power); *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572, 579 (D.D.C. 1974) (bargaining power and unwilling purchaser over-reached), *rev'd mem.*, 527 F.2d 853 (D.C. Cir. 1975); *Boone Valley Coop. Ass'n v. French Oil Mill Mach. Co.*, 383 F. Supp. 606, 612 (N.D. Iowa 1974) (bargaining power); *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300, 1308 (S.D.N.Y. 1970) (bargaining power and adhesion contract), *aff'd*, 444 F.2d 372 (2d Cir., *cert. denied*, 404 U.S. 939 (1971)); *Earl M. Jorgensen Co. v. Mark Constr., Inc.*, 56 Haw. 466, 475, 540 P.2d 978, 985 (1975) (unwilling purchaser over-reached); *K & C, Inc. v. Westinghouse Elec. Corp.*, 437 Pa. 303, 308, 263 A.2d 390, 393 (1970) (adhesion contract).

61. WASH. REV. CODE ANN. § 62A.2-302, Official Comment 1 (1966); Leff, *supra* note 33, at 499; Spanogle, *supra* note 31, at 944.

“unfair surprise.”⁶² Although the court’s concept of direct or constructive notice gives protection against unfair surprise, “lack of meaningful choice” includes both the idea of not knowing and the idea of knowing but being powerless to avoid: the idea of oppression.

Such powerlessness, however, may be viewed simply as evidence of inferior bargaining power, supposedly irrelevant to a determination of unconscionability under the comment to section 2-302 which states that the unconscionability doctrine is “not [one] of disturbance of allocation of risks because of superior bargaining power.”⁶³ The contradiction between this statement and the comment’s reference to oppression can be resolved by reading the statement to mean that *mere* disparity of bargaining power is not proof of unconscionability.⁶⁴ The clause must be substantively harsh and achieved through deception or refusal to bargain. As one commentator explained:

There are at least two distinctions between “oppression” and “allocation of risks because of superior bargaining power.” One distinction is the difference between a factual condition (the presence of unequal bargaining power) and conduct (non-bargaining). . . . The second distinction is the difference between reasonable and unreasonable (harsh) resultant contract terms.⁶⁵

Another way to resolve the contradiction is to read the statement to mean that the *terms* of the choices presented, which will be dictated by the party with the greater bargaining power, will not be upset if the buyer has a choice and the terms have a commercially reasonable basis.

Evidence of an inability to bargain as an indication of oppression should, therefore, be relevant to a determination of the unconscionability of a clause excluding consequential damages under section 2-719(3). A tension arises, however, if both trade usage, as an aspect negating surprise, and ability to bargain, as an aspect negating oppression, are considered in determining the conscionability of an exclusionary clause. Dicta in opinions mentioning oppression suggest that evidence must be shown that the buyer attempted both to alter the unwanted clause in the contract at issue and to obtain a contract without the clause from other sellers of similar products without success.⁶⁶ However, when

62. 86 Wash. 2d at 260, 544 P.2d at 23.

63. WASH. REV. CODE ANN. § 62A.2-302, Official Comment 1 (1966).

64. Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757, 766-67 (1969).

65. Spanogle, *supra* note 31, at 944 (footnotes omitted).

66. See, e.g., *Royal Indem. Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 520, 525

a buyer knows it is a trade usage in an industry to include a particular clause in sales contracts, it is not commercially feasible to require the buyer to bargain and shop around in a hopeless quest for a contract without such a clause. Recognizing this, one court has directed inquiry at a hearing on unconscionability to "whether it was possible to purchase the [product] at all unless the exculpatory clauses were placed in the agreement."⁶⁷

The Washington court's inclusion of trade usage but not oppression as an aspect of circumstances to be considered in determining the unconscionability of a clause excluding consequential damages leaves it unclear whether evidence of oppression can be used to prove such unconscionability in Washington and, if so, whether the buyer must show he actually attempted to bargain and to contract with others without success. The policy issues here are concededly difficult. At the very least, the court should not apply the trade usage test so liberally that a buyer truly functioning under a gross inequality of bargaining power, like the service station lessee in *Johnson v. Mobil Oil Corp.*,⁶⁸ will be unable to prove that inclusion of the clause excluding consequential damages was unconscionable.⁶⁹ This may be what the Washington court meant when it said that presence of a trade usage would support a finding of conscionability "unless the trade practice as related to the plaintiff was clearly unreasonable."⁷⁰ Although it might appear good policy to allow a buyer who actively, but unsuccessfully, sought a contract without a clause excluding consequential damages to rebut the prima facie conscionability of the clause, this would in a sense be making a seller liable for the consequential loss of only its more enterprising buyers while upholding identical risk allocations for other buyers. Sellers would be encouraged either to refuse to deal with any buyer that wants to bargain about the clause, or to bargain by so escalating the price for a contract without the clause that the buyer inevitably chooses to accept the contract with the clause included. To allow evidence of no available alternative to rebut the prima facie

(S.D.N.Y. 1974).

67. *Monsanto Co. v. Alden Leeds, Inc.*, 130 N.J. Super. 245, 262, 326 A.2d 90, 99 (1974).

68. 415 F. Supp. 264 (E.D. Mich. 1976).

69. *Keystone Aeronautics Corp. v. R.J. Enstrom Corp.*, 499 F.2d 146 (3rd Cir. 1974), discusses the policy behind freedom of contract in commercial situations where "the buyer and seller are both business entities, in a position where there may be effective and fair bargaining." *Id.* at 149 (emphasis added). The emphasized words indicate that a finding of equal bargaining power is a condition to the applicability of this policy.

70. 86 Wash. 2d at 261, 544 P.2d at 23-24 (footnote omitted).

conscionability of such clauses would make the clause unconscionable wherever it is a trade usage, directly opposite of what the Washington court stated in *Schroeder*.

III. FAILURE OF ESSENTIAL PURPOSE.

A. *Applicability to Schroeder Fact Situation*

Neither the court nor counsel in *Schroeder* considered the applicability of section 2-719(2), which provides that:

Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in the Title.⁷¹

Whereas unconscionability is to be determined at the time of contracting, this subsection applies to circumstances that develop after the time of the contracting. Official Comment 1 to section 2-719 stresses that this subsection can nullify a remedy limitation, "apparently fair and reasonable" at the time of contracting, when "because of circumstances" the clause "fails in its purpose or operates to deprive either party of the substantial value of the bargain."⁷²

Courts of other jurisdictions have most often applied section 2-719(2) in situations where the exclusive remedy involved repair or replacement of defective parts and the product was so defective that it could not be or was not repaired or replaced within a reasonable time.⁷³ These courts have looked at the purpose of the

71. WASH. REV. CODE § 62A.2-719(2) (1976).

72. *Id.* § 62A.2-719(2), Official Comment 1 (1966).

73. *Accord*, WHITE & SUMMERS, *supra* note 12, § 12-10 at 382; Boyson & Borling, *Substantial Non-Conformity and the Exclusive Remedies Clause*, 1 OHIO N.L. REV. 451, 454-55 (1974); Weintraub, *Disclaimers of Warranties and Limitation of Damages for Breach of Warranty Under the U.C.C.*, 53 TEX. L. REV. 60, 78 (1974). See AES Tech. Sys., Inc. v. Coherent Radiation, 583 F.2d 933, 939 (7th Cir. 1978); Soo Line R.R. v. Fruehauf Corp., 547 F.2d 1365, 1371 n.7 (8th Cir. 1977); Fargo Mach. & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364, 382 (E.D. Mich. 1977); Kohlenberger, Inc. v. Tyson's Foods, Inc., 256 Ark. 584, 600, 510 S.W.2d 555, 566 (1974); J.A. Jones Constr. Co. v. City of Dover, 372 A.2d 540, 551 (Del. Super. Ct. 1977); Clark v. International Harvester Co., 99 Idaho 326, —, 581 P.2d 784, 798 (1978).

A few courts have stated the buyer must prove that the seller was willfully dilatory in repairing. Koehring Co. v. A.P.I., Inc., 369 F. Supp. 882 (E.D. Mich. 1974); Potomac Elec. Power Co. v. Westinghouse Elec. Corp., 385 F. Supp. 572 (D.D.C. 1974), *rev'd mem.*, 527 F.2d 853 (D.C. Cir. 1975); United States Fibres, Inc. v. Proctor & Schwartz, Inc., 358 F. Supp. 449 (E.D. Mich. 1972), *aff'd*, 509 F.2d 1043 (6th Cir. 1975). This is a minority position that has no support in the Code which refers to "circumstances" causing a remedy to fail with no reference to fault. See, e.g., WASH. REV. CODE § 62A.2-719(2) (1976).

On the other hand, some courts have suggested that an exclusive remedy to repair or replace can fail when, although repaired, the item is constantly in need of repair or was

remedy limitation in deciding that failure of the seller to repair or replace the product within a reasonable time should be the determining factor in applying section 2-719(2) in these situations. As one court explained:

The purpose of an exclusive remedy of replacement or repair of defective parts, whose presence constitute a breach of an express warranty, is to give the seller an opportunity to make the goods conforming while limiting the risks to which he is subject by excluding direct and consequential damages. 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.⁷⁴

When the goods are not conforming after a reasonable period of time has elapsed, the remedy fails. Another way of deciding when to apply subsection (2) is, as the Comment directs, by looking at the value of the bargain. The value of the bargain to the buyer is to have a perfectly working machine after allowing the seller a reasonable "debugging" period. If the machine remains non-conforming after a reasonable period of time has elapsed, the buyer is deprived of the substantial⁷⁵ value of the bargain and the remedy has failed. Clearly *Schroeder* presented an ideal case for application of section 2-719(2).

The applicability of section 2-719(2) in *Schroeder* was masked by the lower court's reasoning that a "contractual agreement" or "warranty" to repair or replace had been breached.⁷⁶

so defective when delivered as to constitute a failure of consideration. *V-M Corp. v. Bernard Distrib. Co.*, 447 F.2d 864, 869 (7th Cir. 1971); *Conte v. Dwan Lincoln-Mercury, Inc.*, 20 U.C.C. REP. SERV. 899 (Conn. 1976).

Finally, a limited remedy to repair or replace has been held to fail where the defect was latent, discoverable only after the material was used in manufacturing. *Neville Chem. Co. v. Union Carbide Corp.*, 294 F. Supp. 649 (W.D. Pa. 1968), *aff'd in part, vacated in part on other grounds*, 422 F.2d 1205 (3rd Cir.), *cert. denied*, 400 U.S. 826 (1970); *Earl M. Jorgensen Co. v. Mark Constr., Inc.*, 56 Haw. 466, 540 P.2d 978 (1975). For a good discussion of the applicability of § 2-719(2) to situations where there is a latent defect, see Eddy, *On the "Essential" Purpose of Limited Remedies: The Metaphysics of U.C.C. Section 2-719(2)*, 65 CALIF. L. REV. 28 (1977).

74. *Beal v. General Motors Corp.*, 354 F. Supp. 423, 426 (D. Del. 1973).

75. When the item warranted is complex or experimental machinery, complete repair may be impossible to determine or achieve. In such a case, the remedy fails only if the value of the buyer's bargain has been substantially lessened. In *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572, 579 (D.D.C. 1974), *rev'd mem.*, 527 F.2d 853 (D.C. Cir. 1975), the repaired generator consumed more fuel than warranted. The court held alternatively that Westinghouse had not been willfully dilatory in repairs and that Potomac had not lost the substantial value of its bargain since the unit was operable and the increased full cost was not excessive.

76. 12 Wash. App. at 166, 528 P.2d at 995.

Viewing the "repair or replace" clause as a "warranty" hindered consideration of it as a limited remedy which failed. The Washington Supreme Court failed to apply the definitions in its own distinction between warranty disclaimers and remedy limitations to correct the lower court's reasoning.⁷⁷ The only "warranty" in the case was that the truck would be free of defects in materials and workmanship.⁷⁸ This warranty was breached, calling into play the *limitation of remedy* to repair or replacement of defective parts. Because the trial court found that the truck was never satisfactorily repaired after a considerable length of time, this remedy failed of its essential purpose.

B. Consequential Damages

Courts in different jurisdictions have split regarding whether a separate clause barring consequential damages should remain valid after the exclusive remedy provided by a contract has failed of its essential purpose. Section 2-719(2) states in unequivocal terms that when an exclusive remedy fails, "remedy may be had as provided in this Title."⁷⁹ The comment also states that a remedy that fails "must give way to the general remedy provisions of this Article."⁸⁰ Those general remedy provisions include consequential damages. Accordingly, most courts have held that failure of the limited remedy causes the clause excluding consequential damages to fail also.⁸¹ Only one court has denied recovery of

77. The Washington courts are not alone in this mislabeling of clauses. Even White and Summers allow that a seller can limit his "warranties" to repair and replacement. WHITE & SUMMERS, *supra* note 12, § 12-8 at 376. As White and Summers note, a case is likely to be resolved differently when a repair or replacement clause is seen as a warranty than when it is viewed as a remedy limitation. *Schroeder* is an example. See pt. IV of the text. See also *Southwest Forest Indus., Inc. v. Westinghouse Elec. Corp.*, 422 F.2d 1013 (9th Cir.), *cert. denied*, 400 U.S. 902 (1970). In *Southwest* a negligent repair claim was held barred by Westinghouse's valid exclusion of liability for negligence. An argument that "negligence" referred to in the limitation was negligence in only original manufacture and that where the exclusive remedy to repair was performed negligently it failed of its essential purpose, might have lead the court to a result more favorable to the plaintiff. Boyson and Borling state that: "Where the refusal to repair is viewed as a breach of warranty, it should not alter the conclusion that the limited remedy has failed of its essential purpose." Boyson & Borling, *supra* note 73, at 454 n.20.

78. See note 3 *supra*.

79. WASH. REV. CODE § 62A.2-719(2) (1976).

80. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966).

81. *Soo Line R.R. v. Fruehauf Corp.*, 547 F.2d 1365 (8th Cir. 1977); *Riley v. Ford Motor Co.*, 442 F.2d 670 (5th Cir. 1971); *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364 (E.D. Mich. 1977); *Koehring Co. v. A.P.I., Inc.*, 369 F. Supp. 882 (E.D. Mich. 1974); *Beal v. General Motors Corp.*, 354 F. Supp. 423 (D. Del. 1973); *Jones & McKnight Corp. v. Birdsboro Corp.*, 320 F. Supp. 39 (N.D. Ill. 1970); *Clark v. Interna-*

consequential damages, on the theory that the clause excluding consequential damages is separate from the remedy limitation and therefore still binding.⁸² This line of reasoning, however, fails to view the contract as a whole and does not give full effect to the Code comments.

A separate clause excluding consequential damages is surplusage when the *exclusive* remedy provided for is repair or replacement of defective parts. The addition of the second, redundant clause does not change the *quid pro quo* of the total contract. The buyer paid the purchase price to get a machine that would

tional Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); *Adams v. J.I. Case Co.*, 125 Ill. App. 2d 388, 261 N.E.2d 1 (1970).

82. The court is the Southern District of New York. See *American Elec. Power Co., Inc. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435 (S.D.N.Y. 1976); *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372 (2nd Cir.), *cert. denied*, 404 U.S. 939 (1971). In both cases direct and incidental damages were allowed. In *American Electric*, the court granted the defendant partial summary judgment, stating that even if the remedy failed of its essential purpose, the clause excluding consequential damages was still binding. The court gave three reasons. First, the clauses limiting remedies and excluding consequential damages were independent. However, other courts have not found placement of the clauses to be a determinative factor. See, e.g., *J.A. Jones Constr. Co. v. City of Dover*, 372 A.2d 540, 551 (Del. Super. Ct. 1977). A contract should be read as a whole and the mere placement of clauses in two separate sentences or under separate headings does not alter the *quid pro quo* of the contract.

Second, the *American Electric* case referred to the fact that the item involved was a "highly complex, sophisticated and in some ways experimental piece of equipment," and went on to reason:

Moreover, compliance with a warranty to repair or replace must depend on the type of machinery in issue. In the case of a multi-million dollar turbine-generator, we are not dealing with a piece of equipment that either works or does not, or is fully repaired or not at all.

418 F. Supp. at 458 (footnote omitted). The problem with this reasoning is that it addresses the issue of whether the limited remedy has failed and not the issue of whether consequential damages are available if the remedy does fail. Because the equipment is complex, the limited remedy will only fail if the buyer is deprived of the substantial value of his bargain. See note 75 *supra*. Certainly if the remedy does not fail no consequential damages should be awarded.

Finally, the court stated that the contract involved in *American Electric* provided for a minimum adequate remedy distinct from the warranty to repair, because it stated that the seller's liability in no case would exceed the price of the equipment. However, the contract did not allow the buyer to rescind and collect that purchase price. It is hard to see how the contract provided the buyer with an adequate remedy.

See also *AES Tech. Syss., Inc. v. Coherent Radiation*, 583 F.2d 933 (7th Cir. 1978). The Seventh Circuit stated dictum that appears to agree with the above cases. 583 F.2d at 941. However, the case did not involve a claim for lost profits and the holding on the facts was that damages for past salaries were improperly allowed because AES had failed to mitigate such damages as required by § 2-715(2) of the Uniform Commercial Code. Even when a limited remedy has failed of its essential purpose, consequential damages must be properly proved under § 2-715 before they can be awarded. See WASH. REV. CODE § 62A.2-715 (1976).

function as warranted, and agreed to forego collecting consequential damages in return for free prompt repair or replacement of defective parts. When the seller does not live up to its part of the bargain, the buyer should not be bound by the contract.⁸³

An analysis of risk allocation emphasizes this point. Official Comment 3 to section 2-719 states that the exclusion of consequential damages is "merely an allocation of unknown or undetermined risks."⁸⁴ In the *Schroeder*-type situation, the buyer has assumed the risk of consequential damages and the seller has accepted the risk of the cost of making repairs, replacing the part, or even replacing the whole machine. The buyer's risk, however, is a closed-ended one. The buyer has agreed to forego consequential damages only because the seller has promised to repair and arguably only during the reasonable time it takes the seller to repair. When the seller fails to repair or replace within a reasonable time, the buyer loses the substantial value of his bargain because he then must bear more consequential damages than he bargained for.⁸⁵ Because it would be difficult to partition the final consequential damages into an amount attributable to a reasonable delay, which the buyer should bear, and an amount attributable to an unreasonable delay, which the seller should bear, the Code indicates that the total loss should be borne by the seller.⁸⁶

83. See *Jones & McKnight Corp. v. Birdsboro Corp.*, 320 F. Supp. 39 (N.D. Ill. 1970), where the court stated:

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.

Id. at 43-44.

84. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966).

85. See *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364 (E.D. Mich. 1977), where the court stated:

At the outset then, it is necessary to distinguish and segregate those defects which merely required that work be performed and those legally significant defects which . . . remained uncured after reasonable opportunity to correct them . . . Fargo does not contend that it was entitled to a perfect machine, nor that the installation and break-in period should have been completely service free.

Id. at 370. See also *Soo Line R.R. v. Fruehauf Corp.*, 547 F.2d 1365, 1373 (8th Cir. 1977); *Koehring Co. v. A.P.I., Inc.*, 369 F. Supp. 882, 890 (E.D. Mich. 1974) ("[T]he 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.").

86. Section 2-719(2) states that remedy may be had as provided in other sections of the Code, indicating that those sections will apply as though the remedy limitation never existed. WASH. REV. CODE § 62A.2-719(2) (1976).

After all, the seller contracted to be in the active position and always had the option of limiting liability by securing a replacement for the buyer within a reasonable time.⁸⁷

If a clause limiting remedies to repair or replacement of parts and excluding consequential damages were to be interpreted as excluding consequential damages, whether or not the seller successfully repaired or replaced the defective product, the contract would be in violation of section 2-719(1), or unconscionable, because a fair quantum of remedy would not be available to the buyer. A seller can exclude liability for consequential damages only if a fair quantum, or a minimum adequate remedy, is otherwise provided.⁸⁸ Although the Code and comments do not define what a fair quantum of remedy is, inferentially a remedy limitation provides a fair quantum only if it provides the buyer some method of limiting consequential loss due to the seller's original breach. Section 2-719(1) lists two limited remedies that would be minimally adequate: repair or replacement of nonconforming parts, or repayment of purchase price.⁸⁹ Additionally, section 2-719(3) suggests that a limitation which allowed resource to all Code remedies except consequential damages would also be adequate.⁹⁰ Each of these suggested remedies provides the buyer some method of limiting consequential loss. For example, when a seller excludes liability for consequential damages but does not otherwise limit available remedies, the buyer, upon breach, can revoke acceptance and cover to mitigate consequential loss, later suing for direct and incidental damages. Similarly, if a seller breaches after providing an exclusive remedy of repayment of purchase price, the buyer can return the machine and use the returned value to purchase another machine to minimize consequential loss.

When a seller limits remedy exclusively to repair or replacement of defective parts, the buyer's consequential loss is limited either by the seller's prompt repair or replacement of the product

87. Litigation usually will not arise until it is clear the product is irreparable, and the seller has clearly refused to replace it. In a suit by a buyer after repair, a judge could reason that the buyer's willingness to wait for repair estops his claim of unreasonable delay. On the other hand, it is unlikely a buyer will risk the costs of litigation when a finding that the delay was not unreasonable remains possible. "Reasonable" repair delays will be kept within the short end of the "reasonable" spectrum more by the desire for commercial goodwill than by the threat of litigation.

88. WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966).

89. WASH. REV. CODE § 62A.2-719(1)(a) (1976).

90. *Id.* § 62A.2-713(3). Unless this were true, consequential damages could never be excluded. Section 2-719(3) clearly states they can be.

or by an award of consequential damages under section 2-719(2) if the seller fails to put the product in warranted condition in a reasonable time. If consequential damages are not allowed under section 2-719(2), an exclusive remedy of repair or replacement does not provide a fair quantum of remedy. If the product is irreparably defective and the seller does not or cannot replace it, the buyer is left with mounting consequential losses, caused by the seller's original breach, and no right under the contract to do anything except wait futilely for the seller to honor the warranty. For his part, the seller will have little incentive to act where repair is difficult because his liability on inaction will be no greater than the cost of securing the replacement product. A limited remedy to repair or replace meets the fair quantum requirement only if section 2-719(2) is interpreted to insure that consequential damages will be awarded when the limited remedy fails to provide a means of limiting such damages.

Under the Code, the seller who wants safely to bar all liability for the buyer's consequential damages must give the buyer more of a remedy than repair or replacement of defective parts by the seller. That remedy places on the seller the risk that the machine will be unrepairable with no replacements available. The seller assumes this risk when he restricts the buyer's remedies so that the buyer has no right to minimize consequential losses. In other words, the seller bears the risk that circumstances beyond the seller's control may cause the remedy to fail of its essential purpose. To avoid liability for consequential damages, the seller must provide the buyer a remedy that will allow the buyer to limit his consequential loss and which is within the seller's control. The seller may, for example, provide for repair or replacement or rescission and return of the purchase price at the buyer's option, thus allowing the buyer to act to limit his consequential loss.

In *Marr Enterprises, Inc. v. Lewis Refrigeration Co.*,⁹¹ the Ninth Circuit, applying Washington law, held that a remedy to repair or replace did not fail of its essential purpose when the contract provided that if the seller did not replace parts within a reasonable time the buyer could then rescind the contract and the sole remedy would be a return of the purchase price paid. In *Marr*, the buyer sued instead of returning the machine for the purchase price and therefore no question of what was a reasonable time arose. Buyers and sellers, however, may differ in their defini-

91. 556 F.2d 951 (9th Cir. 1977).

tions of "reasonable time." To avoid the risk of litigating this issue, the parties should spell out time limits in the contract. The contract could include, in addition to the usual remedy limitation, the following clause:

If seller has not replaced the machine in warranted condition within thirty days of notification of any defect, the buyer, as his sole remedy, may at any time thereafter, upon two weeks advance notice to the seller and if the seller does not place the machine in warranted condition within those two weeks, rescind the contract and receive a refund of the purchase price paid.

Under such a contract both parties would know precisely the risks involved and their obligations. Further, the seller will not be held liable for consequential damages unless it refuses to refund the price upon proper demand.⁹²

IV. AN ANALYTIC APPROACH

If the Washington courts had applied section 2-719(2) to the facts of *Schroeder*, where after repeated attempts the truck was never satisfactorily repaired, they probably would have found that the exclusive remedy to repair or replace defective parts had failed of its essential purpose and would have awarded Schroeder consequential damages to the extent such were properly proved. Therefore, the result in this case would have been different had the "repair or replacement" clause been properly interpreted as a remedy limitation, rather than a warranty, and section 2-719(2) been applied. A strict application of the definitions in the *Schroeder* court's distinction between remedy limitations, which the court terms "exclusionary clauses," and warranty disclaimers could eliminate the risk of such differing results. The following analytical approach is suggested.

1. *Warranty disclaimer or remedy limitation.* When confronted with "warranty" language in a contract, a court should first decide whether the words used describe the quality of the goods, either stating or "reducing the number of situations in which the seller can be in breach," or describe the "remedies

92. Even this clause may not protect the buyer in the case of latent defects or "lemons." The latent defect analysis, however, has only been applied where the material sold is to be used in the manufacture of another product. See note 73 *supra*. If the machine sold is a "lemon" which is constantly in need of repair despite the fact that each repair is completed promptly, this clause could be applied under the theory that the machine is never placed in *fully-functional* condition and the buyer had the right after thirty days and two weeks notice, to rescind and receive the purchase price.

available to one or both parties once a breach is established.”⁹³ Words that describe qualities create a warranty or disclaimer, while words that describe remedies create a remedy limitation. “Repair” and “replacement” are remedies, not qualities. For example, if a contract gives an express warranty and then states that the seller warrants to repair or replace parts in lieu of all other warranties,⁹⁴ a court should interpret such a clause as an attempt to disclaim all other warranties, by the “in lieu of” language, and to limit remedies exclusively to repair or replacement.⁹⁵ The requirements of section 2-316 should then be applied to the attempted disclaimer and those of section 2-719 to the remedy limitation. If the seller warrants that a product will be free of defects and limits remedies exclusively to the seller’s repairing or replacing parts for one year, the court should interpret this to mean that the machine is warranted for only one year, that the effect of any implied warranties after one year is being disclaimed, and that remedy is limited to repair or replacement. This interpretation is based on the fact that, under the Code, a seller cannot disclaim all remedy for any warranty but no remedy, as in the example after one year, the court must either find the contract to be unconscionable or interpret the time limit to mean that there is no warranty after one year, rather than just no remedy. A disclaimer of implied warranties, even after one year, must still meet the requirements of section 2-316.

2. *Section 2-719(1)—substantive unconscionability.* After properly identifying the effect of contractual language concerning warranties and remedies, a court must determine whether there has been a breach, either of an express warranty or of an unsuccessfully disclaimed implied warranty, which would call into play any remedy limitation. If a breach is found, the first question the court must decide concerning the remedy limitation is whether it

93. *Schroeder v. Fageol Motors, Inc.*, 86 Wash. 2d 256, 259, 544 P.2d 20, 23 (1975) (quoting from *WHITE & SUMMERS*, *supra* note 12, § 12-11, at 383-84).

94. Other phrases, such as that seller “shall repair” or “agrees to repair” or that seller has an “obligation limited to repair” or “liability to repair,” should be similarly scrutinized.

95. Section 2-719(2) performs a function similar to, but from a different conceptual approach than, the pre-Code common law rule stated in 46 AM. JUR. *Sales* § 732 (1943): seller does not have an unlimited time for the performance of the obligation to repair and replace parts. The buyer of an automobile is not bound to permit the seller to tinker . . . indefinitely.

Accord, 77 C.J.S. *Sales* § 340 (1952).

96. See WASH. REV. CODE ANN. § 62A.2-719, Official Comment 1 (1966).

complies with section 2-719(1). Section 2-719(1) requires that the limitation state that the remedy provided is exclusive, if it is to be so, and Official Comment 1 adds that at least a fair quantum of remedy must be provided. If the remedy limitation does not provide a fair quantum of remedy, the court may either find the clause invalid under section 2-719(1) or find it unconscionable under section 2-302 on a substantive basis alone.⁹⁷

3. *Section 2-719(2)—failure of essential purpose.* If an exclusive remedy has been properly provided, the court must next determine whether that remedy has failed of its essential purpose under section 2-719(2). When the exclusive remedy is the repair or replacement of defective parts and the seller does not correct the defects within a reasonable time, as in *Schroeder*, a court should find that the remedy failed of its essential purpose. All Code remedies should then be available to the buyer, including consequential damages for lost profits where appropriate.⁹⁸

4. *Section 2-719(3)—procedural unconscionability.* Where an exclusive remedy is found not to have failed or where no exclusive remedy is provided, if the contract excludes liability for consequential damages, such exclusion must be scrutinized for procedural conscionability under section 2-719(3).⁹⁹ In Washington, as the *Schroeder* opinion pronounced, the essential question is whether the buyer had notice. Courts should consider conspicuousness, negotiations, trade usages, and course of dealing to determine whether notice was given. Evidence of oppression caused by inability to bargain may also be relevant.

V. CONCLUSION

Schroeder v. Fageol Motors, Inc. provided the Washington Supreme Court an opportunity to clarify the often confused distinction between warranty disclaimers and remedy limitations under the Uniform Commercial Code and to clarify the law applicable to remedy limitations—Code section 2-719. The court set out four aspects of the circumstances surrounding a transaction—conspicuousness, negotiations, trade usage, and course of

97. See text accompanying note 22 *supra*.

98. Any claim of consequential damages for lost profits still must meet the requirements of WASH. REV. CODE § 62A.2-715(2) (1976).

99. One court has explicitly recognized the dual test that § 2-719 places on clauses excluding liability for consequential damages, stating that "[u]nder § 2-719 . . . it appears . . . that, unless unconscionable or causing a limited remedy to fail of its essential purpose, this limitation on damages is effective." *Fargo Mach. & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp. 364, 381 (E.D. Mich. 1977).

dealing—under a “notice” concept to guide the lower court on remand in the full hearing on unconscionability required under sections 2-719(3) and 2-302. However, the court did not direct the lower court to consider aspects of the circumstances showing “oppression” leaving unclear the role evidence of oppression should play in determining unconscionability of clauses excluding liability for consequential damages in Washington.

The Washington court also did not consider the applicability of section 2-719(2)—the “failure of essential purpose” section—to the case. The facts of *Schroeder* present the type of situation in which many courts have used section 2-719(2), and application of this subsection probably would have resulted in an award of consequential damages to Schroeder. A more thorough application of the court’s own distinction between warranty disclaimers and remedy limitations, despite misleading contractual language, may aid future courts in proper application of the important Code section 2-719.