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RRX Industries, Inc. v. Lab-Con, Inc.: Is the Ninth Circuit's Inconsequential Treatment of Consequential Damages Limitations under U.C.C. 2-719 Unconscionable

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RRX INDUSTRIES, INC. v. LAB-CON, INC.: IS THE NINTH CIRCUIT'S INCONSEQUENTIAL TREATMENT OF CONSEQUENTIAL DAMAGES LIMITATIONS UNDER U.C.C. § 2-719 UNCONSCIONABLE?

I. INTRODUCTION

Article II of the Uniform Commercial Code (UCC) has been described as "one of those rare statutes which has been drafted by a self-conscious jurisprude."¹ The appropriateness of such a description is evident when one examines UCC section 2-719, the Article's provision regarding limitations of remedies.

Section 2-719 of the UCC allows contracting parties the freedom to shape or limit remedies to the parties' particular requirements provided they meet the standards set forth in section 2-719.² Specifically, the provision states:

1. Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,
   (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
   (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.
2. Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.
3. Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of

damages where the loss is commercial is not.³

In *RRX Industries, Inc. v. Lab-Con, Inc.*, the Ninth Circuit held that the limited remedy negotiated between RRX and Lab-Con had failed of its essential purpose⁴ under subsection (2) of section 2-719.⁵ Further, the Ninth Circuit affirmed the district court's award of consequential damages notwithstanding the parties' contractual provision excluding such damages.⁶

This Note examines the failure of limited remedy provisions and the effect that failure has on consequential damages limitations. Specifically, the issue can be phrased as follows: When a limited repair or replace remedy fails of its essential purpose pursuant to section 2-719 of the UCC, what effect, if any, does that failure have on a consequential damages limitation?

At one time, the Ninth Circuit held consequential damages limitations enforceable notwithstanding a failure of a limited remedy, unless the breach of the seller (failure to fulfill the limited remedy) was so total and fundamental as to require that the limitation be expunged from the contract.⁷ Arguably, this meant that when the seller willfully refused to repair or replace the defective goods, causing the limited remedy to fail of its essential purpose, the court could render the consequential damages limitation unenforceable. However, in *RRX*, and other recent decisions, the court of appeals appears to be retreating from its earlier approach in favor of a more stringent approach which invalidates consequential dam-

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3. U.C.C. § 2-719 (1978). The Ninth Circuit applied § 2719 of the California Commercial Code in *RRX Indus., Inc. v. Lab-Con, Inc.* For the purpose of this Note, however, reference will be made to § 2-719 of the Uniform Commercial Code (UCC), except when quoting the Ninth Circuit's *RRX* opinion. The two sections are virtually identical in wording and intent and, in the context of this Note, the minor differences are irrelevant. For the minor differences, see *CAL. COM. CODE* § 2719 (West Supp. 1985).

4. 772 F.2d 543 (9th Cir. 1985).

5. The UCC offers no precise definition of "essential purpose." However, the official comments to § 2-719(2) 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." U.C.C. § 2-719 official comment 1 (1978).

6. *RRX*, 772 F.2d at 547.

7. *Id.* The UCC defines consequential damages as follows:
Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.


8. See *infra* notes 134-39 and accompanying text.
ages limitations *whenever* the limited remedy fails of its essential purpose.

This Note proposes that the Ninth Circuit, as well as all courts, adopt a mid-line approach to this section 2-719 problem. Specifically, this Note suggests that when a seller *willfully* refuses to repair or replace defective goods, thus causing the limited remedy to fail of its essential purpose, courts should render the consequential damages limitation unenforceable. However, if the seller attempts to repair or replace the goods but is *unable* to do so, courts should uphold the consequential damages limitation as valid, notwithstanding the failure of the limited remedy.

II. STATEMENT OF THE CASE

The controversy in *RRX Industries, Inc. v. Lab-Con, Inc.*\(^9\) arose from a computer software contract entered into between Lab-Con, Inc. (Lab-Con) and RRX Industries, Inc. (RRX).\(^10\) Pursuant to the contract, Lab-Con agreed to provide RRX with a computer software system for use in its medical laboratory.\(^11\) Lab-Con also agreed to correct any malfunctions that arose in the system, but limited its overall liability to the contract price.\(^12\) Specifically, the contract provision read as follows:

4. [Lab-Con] warrants that the software shall be free of programming “bugs” for the term of the license, and that [Lab-Con] shall correct any such programming “bugs” (whether discovered by [Lab-Con], User [RRX] or others) at no cost to User. *The liability of [Lab-Con] under this warranty, or under other warranty expressed or implied, shall be limited in amount to $52,300.00, or such lesser sum that shall have actually been paid by User to [Lab-Con] pursuant to Paragraph 5 of this Agreement.*\(^13\)

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9. 772 F.2d 543 (9th Cir. 1985).
10. Lab-Con was a successor corporation to Thomas E. Kelly and Associates (TEKA). TEKA was the original contracting party with RRX; when Lab-Con was formed, TEKA assigned the RRX contract to Lab-Con. *Id.* at 545.
11. *Id.*
12. *Id.*
13. *Id.*

Although § 2-719(b) provides that resort to a limited remedy is optional unless expressly agreed to be exclusive, courts usually do not confront this issue in analyzing § 2-719. As long as the contract provision limits the remedy in some form, courts generally construe the remedy to be exclusive. *See, e.g., Chatlos Sys., Inc. v. National Cash Register Corp.*, 635 F.2d 1081 (3d Cir. 1980). In *Chatlos*, although the contract provision did not state that the remedy was “exclusive,” the court assumed *arguendo* that it satisfied § 2-719(b) because it stated that the seller’s liability was “limited.” *Id.* at 1085. *See also AES Technology Sys., Inc.*
Lab-Con began installing the software system in January, 1981, and completed work in June of that year. Soon after the installation, certain "bugs" or malfunctions appeared in the system. Although Lab-Con attempted to correct the "bugs" by means of telephone patching, these corrections were short lived. In March, 1982, Lab-Con upgraded RRX's system making it compatible with more sophisticated hardware. However, persistent malfunctioning in the system eventually rendered the entire system unreliable.

In September 1982, RRX filed suit alleging breach of contract and fraud against Lab-Con, Inc., as well as Lab-Con's corporate predecessor and founder. Despite the contract provision limiting damages, RRX claimed damages in excess of $500,000.

Following a bench trial, the district court found that Lab-Con had materially breached the contract. The court reasoned that Lab-Con had prevented RRX from receiving the consideration for which it had bargained—namely, "a bug-free, well maintained, complete laboratory software system, that would permit it to reliably and efficiently automate its laboratory."

However, the district court found for Lab-Con on the issue of fraud. In doing so, the court relied on the fact that Lab-Con's loss of two key personnel prevented them from carrying out their contractual obligations. The court concluded that at the time Lab-Con made repre-

v. Coherent Radiation, 583 F.2d 933 (7th Cir. 1978). In AES, although the parties' contract did not contain an express provision excluding consequential damages, the court found such a condition to be implicit in the fact that the repair and replace warranty was expressly exclusive. Id. at 941 n.9.

14. RRX, 772 F.2d at 545.
15. Id.
16. Id. Telephone patching is a method of computer software correction done over the telephone. In this case, Thomas E. Kelly issued instructions over the telephone to an RRX employee who entered the information into RRX's computer system. Id. at 545 n.1.
17. Id. at 545.
18. Id. RRX, however, continued to use the system throughout the end of 1981 and into the spring of 1982. Brief for Appellants, supra note 13, at 3.
19. Lab-Con filed a counterclaim alleging breach of contract and fraud. However, the district court found that RRX did not breach its contract by failing to make its final payment on the purchase price because Lab-Con's previous breach excused RRX's performance. Further, the court found that RRX had made no fraudulent representations. Findings of Fact and Conclusions of Law at 10-11, RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. 1985).
21. See supra note 13 and accompanying text.
23. Findings of Fact and Conclusions of Law, supra note 19, at 3-6.
24. Id. at 8.
25. Id. at 9.
26. Id.
sentations to RRX the company could not have anticipated the departure of these employees. Further, the district court held that at the time the agreement was consummated, the representations made were within Lab-Con's capacity to execute. The court reasoned, however, that Lab-Con's loss of key personnel after entering into the contract left the company understaffed and deficient in cash flow, thus resulting in the breach.

As a remedy for Lab-Con's breach, the district court rescinded the contract and awarded RRX $40,866.66, the sum paid by RRX to Lab-Con for the system. Further, the court refused to enforce the contract provision limiting damages, finding the limited remedies to have failed of their essential purpose. The court concluded that "since defendants were either unwilling or unable to provide a system that worked as represented, or to fix the 'bugs' in the software, these limited remedies failed of their essential purpose, and plaintiff is entitled to recover all of its damages." Hence, the court awarded consequential damages to plaintiff totalling $7,456.39.

The Ninth Circuit Court of Appeals affirmed the district court's ruling in its entirety. Judge Norris, while concurring in the majority's finding of a breach of contract, dissented in the majority's award of consequential damages.

III. REASONING OF THE COURT

A. The Majority Opinion

On appeal, Lab-Con challenged the district court's award of consequential damages to RRX. The district court had utilized the Califor-
nia Commercial Code (Code) in awarding consequential damages.\(^3\) The Ninth Circuit stated that reliance on the Code was proper only if the computer system could be considered a "good" rather than a service.\(^3\) In making this determination, the appellate court stated that it must "look to the essence of the agreement" to determine whether the contract involved the sale of goods or services.\(^3\) The court concluded that the contract between RRX and Lab-Con predominantly involved the sale of goods—the computer software system.\(^3\) The court stated that the employee training, repair services and system upgrading were incidental to the sale of the system and thus did not defeat the characterization of the system as a "good."\(^4\)

inconsistent that a fact finder would not credit it." \(^{\text{Id.}}\) Further, the court of appeals found corroborative testimony by other witnesses that supported the district court's findings. \(^{\text{Id.}}\)

Second, the defendants argued that because Kelly was not found to have acted in bad faith, the district court's determination that Kelly was the alter ego of TEKA was erroneous. \(^{\text{Id.}}\) at 546. The Ninth Circuit disagreed with appellants' argument, holding that under California law a finding of bad faith is not a prerequisite to the application of the alter ego doctrine. \(^{\text{Id.}}\) Further, the court stated that the record supported the district court's application of the alter ego doctrine because the requisite unity of interest and ownership existed in Kelly's exertion of total control over TEKA. \(^{\text{Id.}}\) at 545-46. The defendants also argued that it was erroneous for the district court to hold that TEKA was undercapitalized because TEKA had $8,000 in its corporate account. \(^{\text{Id.}}\) at 546. However, the Ninth Circuit found that that fact alone was not sufficient to defeat a finding of undercapitalization. \(^{\text{Id.}}\) Thus, the court concluded that the district court did not err by imposing liability on Kelly. \(^{\text{Id.}}\)

Third, defendants argued that the district court erred in imposing liability on Lab-Con since TEKA was the original contracting party. The Ninth Circuit disagreed, stating that following TEKA's transfer of all its software and licenses to Lab-Con for no consideration, "TEKA was simply an empty shell, which the district court properly disregarded." \(^{\text{Id.}}\)

Finally, defendants argued that the district court's finding of breach of contract was erroneous because RRX had also breached the contract by failing to pay the remaining payments for the computer. \(^{\text{Id.}}\) According to the court of appeals, however, that contention clearly lacked merit. \(^{\text{Id.}}\) It reasoned that Lab-Con contracted to timely install an operational software system, repair malfunctions and train RRX employees. Because the record reflected that (1) the software never functioned as intended, (2) Lab-Con failed to repair the malfunctions in the system, and (3) Lab-Con did not sufficiently train RRX employees, the appellate court concluded that the evidence supported the district court's finding of a breach of contract. Moreover, the Ninth Circuit held that the district court properly found that RRX did not breach the contract by failing to make its final payment because Lab-Con's breach excused RRX's performance. \(^{\text{Id.}}\)

36. \(^{\text{Id.}}\) at 546-47.

37. \(^{\text{Id.}}\) at 546. Article 2 of the UCC and Division 2 of the California Commercial Code (Code) cover the sale of goods. The UCC and the Code define goods as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action . . . ." U.C.C. § 2-105 (1978); CAL. COM. CODE § 2105 (West 1964).

38. \(^{\text{RRX, 772 F.2d at 546. See, e.g., Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572, 580 n.6 (7th Cir. 1976).}}\)

39. \(^{\text{RRX, 772 F.2d at 546. See also Chatlos Sys., Inc. v. National Cash Register Corp., 635 F.2d 1081 (3d Cir.}}\)

40. \(^{\text{Id. See also Chatlos Sys., Inc. v. National Cash Register Corp., 635 F.2d 1081 (3d Cir.}}\)
Section 2-719(2) of the UCC states that "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." Interpreting this provision to mean that all remedies may be had (including consequential damages), the district court awarded RRX consequential damages in the amount of $7,456.39. Lab-Con argued that this award was improper because the contract limited damages to the amount paid under the contract. However, the Ninth Circuit, quoting the district court, disagreed: "since the defendants were either unwilling or unable to provide a system that worked as represented, or to fix the "bugs" in the software, these limited remedies failed of their essential purpose . . . ."

Moreover, the court of appeals reasoned that the district court's award of consequential damages was consistent with its earlier decisions. In *S.M. Wilson & Co. v. Smith International, Inc.*, the Ninth Circuit held that the failure of a limited repair remedy does not require a court to allow the recovery of consequential damages unless the breach is so total and fundamental as to require that the consequential damages limitation be expunged from the contract. In *RRX*, the Ninth Circuit stated that the district court "properly found the default of the seller so total and fundamental that its consequential damages limitation was expunged from the contract."

The majority in *RRX* also relied on two recent Ninth Circuit cases, *Milgard Tempering, Inc. v. Selas Corp. of America* and *Fiorito Bros. v.*
Fruehauf Corp.,\(^5\) in upholding the award of consequential damages.\(^6\) The gist of these two cases, and Wilson, is that each case must be judged on its own facts, enabling courts to give effect to the parties' intentions regarding risk allocation.\(^7\) The RRX court went on to state that the facts in RRX justified the district court's ruling, including its award of consequential damages.\(^8\)

**B. The Dissent**

Although Judge Norris concurred with the majority's holding that Lab-Con breached its contract, he dissented as to the award of consequential and incidental damages.\(^9\) He began his dissent by analyzing the provision of the contract which discussed the obligations and potential liabilities of the parties.\(^10\) Judge Norris stated that he saw no legitimate reason to ignore the bargain struck by the parties.\(^11\) Under the terms of the contract, Lab-Con agreed to repair any malfunctions that arose in the system, but the parties agreed that Lab-Con's liability for consequential damages for failure to correct the bugs would not exceed the contract price.\(^12\)

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50. 747 F.2d 1309 (9th Cir. 1984).
51. RRX, 772 F.2d at 547. In Milgard, the Ninth Circuit held that a consequential damages limitation did not justify summary judgment for the seller when the limited repair and replace remedy had failed of its essential purpose. Milgard, 761 F.2d at 557. The court remanded the case to the district court for an examination of the facts and circumstances surrounding the breach. Id. In Fiorito, the court held that a dump truck body manufacturer's limited repair or replace remedy failed of its essential purpose rendering the consequential damages limitation unenforceable. The Ninth Circuit stated that the best way of approaching § 2-719 cases is to undertake a case-by-case analysis, with each case and contract judged on its own merits. This way, the court reasoned, courts would be better able to "give effect to the parties' intentions regarding risk allocation and will lead less frequently to unjust results." Fiorito, 747 F.2d at 1314-15.
52. RRX, 772 F.2d at 547.
53. Id. The majority's entire discussion relating to the validity of the consequential damages limitation consisted of six brief paragraphs, covering three-quarters of a page, while the dissent's opinion covered five pages. This fact is noted for two reasons. First, it explains why this Note's analysis of the majority's reasoning is much shorter than the analysis of the dissent's reasoning. Second, it emphasizes the majority's shortshrifted treatment of the § 2-719 issue in RRX.
54. RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 547-48 (9th Cir. 1985) (Norris, J., concurring in part and dissenting in part). The majority did not distinguish between consequential and incidental damages, but referred only to consequential damages. For the purpose of this Note, the distinction between the two terms is irrelevant and thus this Note will refer only to consequential damages. See UCC § 2-715 for the distinction.
55. RRX, 772 F.2d at 548 (Norris, J., concurring in part and dissenting in part); see supra note 13 and accompanying text.
56. RRX, 772 F.2d at 548 (Norris, J., concurring in part and dissenting in part).
57. Id. (Norris, J., concurring in part and dissenting in part).
Judge Norris asserted that RRX agreed to bear the risk of a possible breach which resulted in consequential damages:

Lab-Con and RRX were both sophisticated commercial enterprises bargaining at arms length. The limitation on consequential damages, viewed ex ante, seems to be a reasonable accommodation of interests. There is no suggestion that Lab-Con acted in bad faith in failing to repair the "bugs." The district court found that Lab-Con's failure to make repairs was not deliberate but resulted from the loss of two key [Lab-Con] employees. There is no suggestion that the contract was unconscionable in any respect. Therefore, there is simply no good reason for the court to intrude on the bargaining process by shifting to Lab-Con the risk of RRX's loss in excess of the contract price.

Judge Norris noted that section 2719 of the California Commercial Code allows parties to contract for alternative remedies in lieu of the Code or to limit the amount of damages, or to do both, as did RRX and Lab-Con in their contract. Judge Norris agreed with the majority's finding that the repair remedy failed of its essential purpose because Lab-Con was incapable of keeping the computer system free of "bugs." However, he then went on to conclude that a finding that the repair remedy failed of its essential purpose should not automatically render the consequential damages limitation unenforceable.

58. Although the UCC does not define "bad faith," it does define "good faith." In the case of a merchant, the UCC defines "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103 (1978). Presumably, anything not done in "good faith" would constitute "bad faith."

59. "Unconscionability" has been defined as absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965). The official comment to UCC § 2-302 (entitled "Unconscionable Contract or Clause") states that "[t]he principle [of unconscionability] is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power." U.C.C. § 2-302 official comment 1 (1978).

60. RRX, 772 F.2d at 548 (Norris, J., concurring in part and dissenting in part) (footnotes added) (citations omitted).

61. See supra note 3 and accompanying text.

62. RRX, 772 F.2d at 548-49 (Norris, J., concurring in part and dissenting in part).

63. Id. at 549 (Norris, J., concurring in part and dissenting in part).

64. Id. (Norris, J., concurring in part and dissenting in part). Even the case relied upon by the majority expounds this view. In S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363 (9th Cir. 1978), the court stated that "[t]he failure of the limited repair warranty to achieve its essential purpose makes available . . . the remedies as may be had as provided in this code." [But] [t]his does not mean . . . that the bar to recovery of consequential damages should be eliminated." Id. at 1375. For a full discussion of Wilson, see infra notes 136-42 and accompa-
According to Judge Norris, the majority ignored the fundamental goal of section 2719, which is to allow parties the freedom to limit or alter their remedies and to allocate business risks as appropriate. The majority erroneously assumed that a buyer could resort to all remedies in the Code once a contract failed of its essential purpose under section 2719(2). Judge Norris relied on the comments to section 2719 to support his conclusion:

[I]t is 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 must be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract.

Judge Norris concluded that "[c]onsequential damages go beyond 'minimum adequate remedies.'"

Judge Norris also noted that a contract price may vary depending on which party assumes the risk of consequential damages. If a seller and a buyer negotiate a contract whereby the buyer obtains a lower contract price in return for a limitation on the seller's potential consequential damages liability, is not the buyer receiving a windfall when a court

65. *RRX*, 772 F.2d at 549 (Norris, J., concurring in part and dissenting in part).

66. Id. (Norris, J., concurring in part and dissenting in part).

67. Id. (Norris, J., concurring in part and dissenting in part) (quoting U.C.C. § 2-719 official comment 1 (1978)).

68. *RRX*, 772 F.2d at 549 (Norris, J., concurring in part and dissenting in part). Minimum adequate remedies, in this case, would have been damages measured as the difference between the value of the goods as warranted and the value of what was received, without the award of consequential damages. See generally U.C.C. § 2-713 (1978).

69. *RRX*, 772 F.2d at 550 (Norris, J., concurring in part and dissenting in part). Judge Norris offered the following hypothetical to support his proposition:

Assume, for example, that a Fortune 500 company offers a contract to a small company, such as Lab-Con. Although the contract could be profitable for the small company, the prospect of liability for the large company's lost profits or good will that might result from an interruption in operations caused by faulty software could be staggering. The stakes could be far too high for a small software company. Being much larger, and capable of diversifying its risk, the large company should be free to bargain for a lower price in exchange for its agreement to limit the seller's consequential damages.

Id. (Norris, J., concurring in part and dissenting in part) (footnote omitted). Judge Norris stated that this principle should be applied even when there is no significant difference in the size of the buyer and seller. Id. at 550 n.4.
ignores the damages limitation? The buyer gets more than he or she bargained for while the seller suffers a double loss, receiving less than market price for the goods and paying full damages.

Norris stated that California law recognizes this business reality and cited *Delta Airlines, Inc. v. Douglas Aircraft Co.*\(^7\) to support his premise.\(^1\) In *Delta Airlines* the court upheld an airplane manufacturer's exculpatory clause\(^2\) against the airline's claim for damages and reasoned as follows:

Under the contract before us, Delta . . . bears that risk [of economic loss] in return for a purchase price acceptable to it; had the clause been removed, the risk would have fallen on Douglas . . . but in return for an increased price deemed adequate by it to compensate for the risk assumed. We can see no reason why Delta, having determined, as a matter of business judgment, that the price fixed justified assuming the risk of loss, should now be allowed to shift the risk so assumed to Douglas, which had neither agreed to assume it nor been compensated for such assumption.\(^3\)

Judge Norris argued that, in a particular transaction, a limitation on consequential damages might be necessary to create a bargain and that

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70. 238 Cal. App. 2d 95, 47 Cal. Rptr. 518 (1965).
71. *RRX*, 772 F.2d at 550 (Norris, J., concurring in part and dissenting in part).
72. The exculpatory clause read, in pertinent part, as follows:

> The extent of Seller's liability under this warranty as to defects in material or workmanship, and defects arising from the selection of material or the process of manufacture, is limited to the repair of such defects in the aircraft or to the repair or replacement . . . of any accessory, equipment or part which is defective in any such respects.

*Delta Airlines*, 238 Cal. App. 2d at 98, 47 Cal. Rptr. at 520.
73. *Id.* at 104-05, 47 Cal. Rptr. at 524 (footnote omitted). The *Delta* court emphasized the equality of bargaining power between the plaintiff, Delta Airlines, and the defendant, Douglas Aircraft.

It is clear from the record that Delta, one of the major airlines of the nation, with the aid of a staff of experienced executives and attorneys, had negotiated a contract with terms individual to Douglas. There is not, nor can there be, any doubt that Delta knew that the exculpatory clause was in the contract, and that it voluntarily agreed to it. It is suggested that the contract took on an element of a "contract of adhesion" in that the clause was part of Douglas' standard form. But the clause clearly was open to negotiation, and Delta was free to seek another airplane from another manufacturer on terms which . . . would not have included such a clause.

*Id.* at 102-03, 47 Cal. Rptr. at 523 (footnote omitted).

In *RRX*, both parties contributed to the formation of the contract. Lab-Con provided a standard form which RRX added to by amendment and with additional documents. Findings of Fact and Conclusions of Law, *supra* note 19, at 2. Thus, it appears that had RRX been dissatisfied with the terms of the contract, specifically the limitation on damages provision, it could have renegotiated or amended the contract to suit its business needs.
such a limitation becomes a part of the value of the bargain.\textsuperscript{74} To support his proposition Judge Norris resorted again to the official comments of section 2-719: "[U]nder subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the \textit{substantial value of the bargain}, it must give way to the general remedy provisions of this Article."\textsuperscript{75} A limitation on consequential damages, Judge Norris reasoned, does no violence to the "\textit{substantial value of the bargain}," unlike a limitation on damages for the difference between the value of what was received and what was expected.\textsuperscript{76}

Judge Norris further noted that subsection (3) of section 2719\textsuperscript{77} governs the limitations of consequential damages.\textsuperscript{78} Subsection (3) allows parties to limit or exclude consequential damages unless the limitation or exclusion is unconscionable.\textsuperscript{79} Because neither RRX nor the majority suggested that the limitation on consequential damages was unconscionable, Judge Norris implicitly asserted that the provision should be allowed to stand with full force and effect.\textsuperscript{80}

Quoting official comment 1 to UCC section 2-719, which states that "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

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\item\textsuperscript{74} RRX, 772 F.2d at 550 (Norris, J., concurring in part and dissenting in part).
\item\textsuperscript{75} Id. (Norris, J., concurring in part and dissenting in part) (emphasis added) (citing U.C.C. § 2-719 official comment 1 (1978); Cal. Com. Code § 2719 comment 2 (West 1964)).
\item\textsuperscript{76} RRX, 772 F.2d at 550 (Norris, J., concurring in part and dissenting in part).
\item\textsuperscript{77} Section 2719(3) of the California Commercial Code reads as follows:
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 invalid unless it is proved that the limitation is not unconscionable. Limitation of consequential damages where the loss is commercial is valid unless it is proved that the limitation is unconscionable.
\textsuperscript{\textsuperscript{\textsuperscript{CAL. COM. CODE § 2719(3)}} (West Supp. 1985). For a definition of unconscionability, see \textit{supra} note 59.}
\item\textsuperscript{78} RRX, 772 F.2d at 550-51 (Norris, J., concurring in part and dissenting in part). Judge Norris argued that statutory construction compels the conclusion that subsection (3) of § 2-719 governs consequential damages. If subsection (3) did not have specific language regarding the issue of consequential damages, the general language of subsection (2) would determine the validity of consequential damage provisions. However, Judge Norris reasoned that the priority of specific over general provisions is a basic principle of statutory construction, and thus subsection (3) controls the validity of consequential damages limitations or exclusions. \textit{Id.} at 551 n.5. \textit{See}, e.g., Monte Vista Lodge v. Guardian Life Ins. Co. of America, 384 F.2d 126, 129 (9th Cir. 1967), \textit{cert. denied}, 390 U.S. 950 (1968); Karrell v. United States, 181 F.2d 981 (9th Cir.), \textit{cert. denied}, 340 U.S. 891 (1950).
\item\textsuperscript{79} Cal. Com. Code § 2719(3) (West Supp. 1985).
\item\textsuperscript{80} RRX, 772 F.2d at 551 & n.6 (Norris, J., concurring in part and dissenting in part).
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stricken clause had never existed," Judge Norris asserted that the "negative implication is that the drafters of § 2-719 did not envision any basis for invalidating limitations on consequential damages other than unconscionability." Judge Norris went on to quote the California version of section 2-719, which specifies that the "[l]imitation of consequential damages where the loss is commercial is valid unless it is proved that the limitation is unconscionable." Judge Norris next questioned the majority’s reliance on S.M. Wilson & Co. v. Smith International, Inc., a 1978 Ninth Circuit decision which applied California law to a breach of contract case. Norris stated that he could not reconcile Wilson with the facts in RRX. In Wilson, the court enforced a limitation on damages provision, notwithstanding the failure of the repair remedy. The Wilson court held that "[t]he failure of the limited repair warranty to achieve its essential purpose makes available . . . the remedies as ‘may be had as provided in the code.’ [But] [t]his does not mean . . . that the bar to recovery of consequential damages should be eliminated." In so holding, the Wilson court stated that it was heavily influenced by the characteristics of the contract between the parties. The court reasoned that the parties were of relatively equal bargaining power and had allocated risks of loss to fit their business needs. The risk of consequential damages was assigned to the buyer, Wilson. When the complex machine proved defective, the seller, Smith, did not ignore its obligation to repair, but simply was unable to do so. The court concluded that under this particular factual setting the seller should not have to absorb the risk of loss which had been clearly assigned to the buyer. The contract was freely negotiated and the court was not going to engage in "so-
cially expensive risk shifting.” The court further reasoned that the seller’s breach was “not so total and fundamental as to require that its consequential damage limitation be expunged from the contract.”

Judge Norris asserted that Wilson is “clear authority” for the proposition that a failure of a repair remedy does not render a limitation on consequential damages automatically invalid. Because the limitation in Wilson was not found to be unconscionable and no one claimed unconscionability in RRX, Judge Norris was unable to reconcile the majority’s position in RRX with the court’s prior holding in Wilson. Judge Norris stated that the majority’s entire attempt to distinguish Wilson consisted of an extremely ambiguous paragraph from which he could decipher no distinguishing legal principle.

Nor could Judge Norris understand the majority’s “expansive reading of subsection (2) [of 2-719] that allows RRX to receive more than the value of its bargain in the absence of a determination that the contract limitation was unconscionable.” According to Judge Norris, the RRX majority creates more confusion than help for parties attempting to utilize provisions limiting consequential damages: “The opinion provides no basis for predicting with confidence when a bargained-for cap on consequential damages will be judicially enforced.”

Judge Norris concluded by stating that the majority’s broad interpretation of subsection (2) of section 2-719 undermines parties’ freedom to bargain and offers no “moorings” for negotiating risk allocation in regard to consequential damages.

IV. Analysis

Subsection 2-719(1)(a) of the UCC allows parties to “limit or alter the measure of damages recoverable under this Article” subject to the

88. Id.
89. RRX, 772 F.2d at 551 (Norris, J., concurring in part and dissenting in part).
90. Id. (Norris, J., concurring in part and dissenting in part).
91. The paragraph to which Judge Norris referred simply provided as follows:
   The district court’s award of consequential damages is consistent with S.M. Wilson. The court concluded that “since the defendants were either unwilling or unable to provide a system that worked as represented, or to fix the ‘bugs’ in the software, these limited remedies failed of their essential purpose. . . .” (emphasis added). This is a finding that both limited remedies failed of their essential purpose. The trial judge did not state that because the repair remedy failed, the limitation of damages provisions should not be enforced.
   Id. at 552 (Norris, J., concurring in part and dissenting in part).
92. Id. (Norris, J., concurring in part and dissenting in part).
93. Id. (Norris, J., concurring in part and dissenting in part).
94. Id. (Norris, J., concurring in part and dissenting in part).
95. Id. (Norris, J., concurring in part and dissenting in part).
limitations contained in subsections (2) and (3) of that section. The purpose of this provision is to provide parties the freedom to shape their remedies without allowing egregious and unfair terms by parties who have an upper hand in the bargaining process. If a limited or exclusive remedy fails of its essential purpose, then pursuant to section 2-719(2) the aggrieved party may resort to the remedies that are provided for in the UCC.

A. Failure of Essential Purpose

There is no definitive rule which enables courts to determine when a limited remedy has failed of its essential purpose. Rather, courts utilize a case-by-case approach, especially since the facts relating to a particular "failure" are unique in every case.

1. Seller's unintentional inability to repair

A common failure of a limited remedy occurs when a seller unintentionally fails to comply with the limited remedy. S.M. Wilson & Co. v. Smith International, Inc. clearly illustrates this type of failure. In Wilson, the seller of a tunnel boring machine limited its liability to replacing or repairing, free of charge, any defective part of the machine. When several machine parts proved defective the seller attempted to repair/replace them but was unable to do so. As a result, the buyer lost a substantial benefit of his bargain—a working machine, free from defect. Thus, the court held that the seller's inability to cure the defects indicated that the limited remedy had failed of its essential purpose. Many limited remedies involve sellers agreeing to repair or replace the goods involved and many "failures" of those limited remedies involve

96. See supra note 3 and accompanying text.
97. Official comment 1 to section 2-719 reads:
[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.
98. The most common type of failure of a limited or exclusive remedy occurs when the party responsible for providing the remedy is either unable or unwilling to perform its obligations. See infra notes 100-06 and accompanying text.
100. 587 F.2d 1363 (9th Cir. 1978).
101. Id. at 1366-68.
102. Id. at 1375.
sellers’ *unintentional* inability to do so.\(^{103}\)

2. Seller’s willful refusal to repair

Failures of limited remedies also occur when a seller *willfully* refuses to comply with the limited remedy. For example, in *Fiorito Bros. v. Fruehauf Corp.*,\(^{104}\) the court found that Fruehauf, the seller, “arbitrarily” declined to make necessary repairs of dump truck bodies improperly manufactured and “arbitrarily and unreasonably declined to live up to its contractual promises.”\(^{105}\) Thus, the court held that the limited repair remedy failed of its essential purpose.\(^{106}\)

The distinction between the seller’s unintentional inability to repair and the seller’s willful refusal to repair is extremely important. As will be discussed below,\(^{107}\) this distinction could resolve many difficulties that courts presently confront in applying section 2-719. Specifically, if courts would focus more on the particular characteristics of the failure, i.e., willful versus unintentional, it could help the courts decide what effect that failure should have on a consequential damages limitation or exclusion. However, courts generally focus more on the fact that there has been a failure, rather than on the *particular characteristics* of that failure. Unfortunately, this focus has lead to a barrage of differing opinions concerning section 2-719.\(^{108}\)

**B. The Effect of a Failure of a Limited Remedy on a Consequential Damages Limitation and the Courts’ Two Extreme Approaches**

1. Failure of a limited remedy automatically renders a consequential damages limitation unenforceable

Generally, courts have followed two extremely different approaches in addressing the problem of a limited remedy failure and its effect on a consequential damages limitation. One approach suggests that once a limited or exclusive remedy has failed of its essential purpose, the aggrieved party (usually the buyer) may resort to *all* of the remedies for breach offered by the UCC\(^{109}\) without regard to the other limitations.

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\(^{103}\) See, e.g., Milgard Tempering, Inc. v. Selas Corp. of America, 761 F.2d 553 (9th Cir. 1985); Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable & Cold Storage Co., 709 F.2d 427 (6th Cir. 1983).

\(^{104}\) 747 F.2d 1309 (9th Cir. 1984).

\(^{105}\) Id. at 1313.

\(^{106}\) Id.

\(^{107}\) See infra notes 160-67 and accompanying text.

\(^{108}\) See infra note 110 and accompanying text & note 121 and accompanying text.

\(^{109}\) Buyer’s remedies can be found in UCC §§ 2-711, 2-712, 2-713, 2-714, 2-715 and 2-716.
contained in the contract. This reasoning can arguably be supported by a literal reading of section 2-719(2). According to subsection (2), when an exclusive or limited remedy fails of its essential purpose, the aggrieved party may seek remedies as are provided for in the UCC.

This literal approach to section 2-719 was taken by the Eighth Circuit in *Soo Line Railroad v. Fruehauf Corp.* There, the court stated 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." Further, the *Fruehauf* court reasoned that since a buyer does not anticipate (when entering into a contract) that a limited or sole remedy will fail, thereby causing consequential damages, all damages should be recoverable.

Similarly, the court in *Jones & McKnight Corp. v. Birdsboro Corp.* reasoned that even though the seller properly limited its liability to repair or replace, the buyer was also entitled to expect that the seller would not repudiate its warranty to repair. Further, the *Birdsboro* court noted that it was the specific breach of the warranty to repair that caused the buyer the bulk of its damages. In allowing consequential damages, the court reasoned that a seller should not be allowed "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 . . . ."

The approach of these courts is to treat the limited or exclusive remedy and the consequential damages provision as being so inextricably intertwined that the failure of one automatically leads to the failure of the other. Whether this is the approach intended by the drafters of section 2-719 is highly debatable, especially since the drafters provided a separ-
rate and specific subsection allowing for the limitation or exclusion of consequential damages.  

2. A consequential damages limitation is always enforceable unless found to be unconscionable

The other approach to this section 2-719 issue can be found in a second line of decisions which holds that a limited remedy is independent of the provision excluding or limiting consequential damages and that a failure of the limited remedy does not automatically destroy the other contractual provisions, such as a limitation on consequential damages. This line of reasoning depends on a liberal reading of section 2-719, such as that offered by the court in County Asphalt, Inc. v. Lewis Welding & Engineering Corp.;

Plaintiff would have UCC 2-719 read in such a fashion as to result in all limitations whatsoever being stricken in any event in which an exclusive remedy should fail of its essential purpose. A better reading is that the exclusive remedy clause should be ignored; other clauses limiting remedies in less drastic manners and on different theories would be left to stand or fall independently of the stricken clause. Since the clause excluding consequential damages has been held not unconscionable, and is not otherwise offensive, it will be applied.

This liberal view has also been adopted by several other circuits. For example, in Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable & Cold Storage Co., the Sixth Circuit held that unless a limitation on consequential damages is found to be unconscionable, it will be enforceable notwithstanding a failure of a limited remedy. The court based its decision on two grounds. First, it stated that subsection (3) of section 2-719 governed the issue of limitations on consequential damages:

[I]t should . . . be noted that, absent the specific language of subsection (3), the general language of subsection (2) would . . .

120. See U.C.C. § 2-719(3) (1978).
123. Id. at 1309.
124. 709 F.2d 427 (6th Cir. 1983).
125. Id. at 434-36.
cover the issue of consequential damages. Since it is a basic principle of statutory construction that the particular governs over the general, we believe that the section 2-719 drafters intended subsection (3) to deal with the issue of consequential damages.\footnote{126} Second, the court concluded that the content of subsections (2) and (3) were substantially different.\footnote{127} Subsection (2) applies to the failure of the essential purpose of limited remedies and subsection (3) allows limitations on consequential damages absent unconscionability.\footnote{128} The court noted that one of the purposes of subsection (3) was to allow merchants to allocate business risks, a purpose which is concomitant with the general UCC philosophy of contractual freedom in commercial transactions. Hence, the court reasoned that to read subsection (2) so expansively as to govern limitations on consequential damages would abridge this freedom provided for in the UCC, and in section 2-719 specifically.\footnote{129}

A similar viewpoint is also held by the Third Circuit. In Chatlos Systems, Inc. v. National Cash Register Corp.,\footnote{130} the court stated that in deciding the effect which a failure of a limited remedy has on a consequential damages limitation, "the better reasoned approach is to treat the consequential damage disclaimer as an independent provision, valid unless unconscionable."\footnote{131} The court reasoned that a limited remedy provision and a consequential damages limitation are two discrete ways of limiting recovery in the event of a breach.\footnote{132} Further, the Third Circuit noted that the UCC tests each by a different standard: The limited remedy provision is enforceable unless it fails of its essential purpose while the consequential damages limitation is valid unless found unconscionable.\footnote{133}

The foregoing decisions suggest that in S.M. Wilson & Co. v. Smith International, Inc.,\footnote{134} the Ninth Circuit also aligned itself with this more liberal approach. Both the Sixth and Third Circuits, in stating that the better approach to the section 2-719 problem was to allow a consequential damages limitation to stand unless found unconscionable, cited the

\begin{footnotes}
\item[126] Id. at 435 (footnote omitted).
\item[127] Id.
\item[128] Id.
\item[129] Id.
\item[130] 635 F.2d 1081 (3d Cir. 1980).
\item[131] Id. at 1086 (footnote omitted).
\item[132] Id.
\item[133] Id.
\item[134] 587 F.2d 1363 (9th Cir. 1978).
\end{footnotes}
Ninth Circuit's Wilson opinion.\textsuperscript{135}

In Wilson, the Ninth Circuit found that the limited repair warranty had failed of its essential purpose when the seller was unable to cure substantial defects that existed in the goods.\textsuperscript{136} The court held that although section 2-719 states that when there has been a failure of essential purpose, remedies "may be had as provided in this Code," it does not follow that a bar to recovery of consequential damages should also be eliminated.\textsuperscript{137}

C. The Ninth Circuit's 1978 Wilson Decision: Arguably a Mid-Line Approach to the Section 2-719 Problem

Although at first glance it appears that Wilson is in concert with the more liberal approach outlined above, when more carefully examined, the decision arguably falls somewhere between the two extreme positions. However, it is obvious from the Ninth Circuit's recent decisions\textsuperscript{138} that the court is either unaware of the ramifications of its Wilson decision or is simply retreating from that decision without acknowledging or recognizing such retreat.

The Wilson court, in holding that the failure of the limited remedy did not require permitting the recovery of consequential damages, relied on the characteristics of the contract in reaching its conclusion.

Parties of relatively equal bargaining power negotiated an allocation of their risks of loss. Consequential damages were assigned to the buyer, Wilson. The machine was a complex piece of equipment designed for the buyer's purposes. The seller Smith did not ignore his obligation to repair; he simply was unable to perform it. This is not enough to require that the seller absorb losses the buyer plainly agreed to bear. Risk shifting is socially expensive and should not be undertaken in the absence of a good reason. An even better reason is required when to so shift is contrary to a contract freely negotiated. The default of the seller is not so total and fundamental as to require that its consequential damage limitation be expunged from the contract.\textsuperscript{139}

\textsuperscript{135} See Lewis Refrigeration, 709 F.2d at 434 & n.10; Chatlos, 635 F.2d at 1086 n.3.
\textsuperscript{136} Wilson, 587 F.2d at 1375.
\textsuperscript{137} Id. For a more detailed discussion of Wilson, see infra notes 138-44 and accompanying text.
\textsuperscript{138} RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. 1985); Milgard Tempering, Inc. v. Selas Corp. of America, 761 F.2d 553 (9th Cir. 1985); Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309 (9th Cir. 1984).
\textsuperscript{139} Wilson, 587 F.2d at 1375.
1. A "total and fundamental" breach: the additional element of willfulness

An analytical examination of the Ninth Circuit's opinion in Wilson reveals more than the words appear to convey. Specifically, this Note suggests that the Wilson court added an element of willfulness to its test for determining when a limitation on consequential damages should be allowed to stand in the face of a failure of a limited remedy. Although the court did not expressly require willfulness, it stated that when a seller's breach is "so total and fundamental" the consequential damage limitation shall be expunged from the contract. However, the court did not define what it meant by "total and fundamental." Taken literally, it is arguable that total and fundamental means the same thing as failure of essential purpose. Thus, "total" in essence means "failure" and "fundamental" in essence means "essential." But, the court obviously meant something more by its use of the language because the court held the consequential damages limitation enforceable, notwithstanding the failure of the limited remedy. If "total and fundamental" did not have a meaning independent from that of "failure of essential purpose" then the limitation would have been invalidated, and recovery of consequential damages allowed.

In allowing the limitation to stand, the Ninth Circuit in Wilson reasoned that the "default of the seller [was] not so total and fundamental as to require that its consequential damage limitation be expunged from the contract." The determining factor in the court's conclusion appears to have been that the seller did not willfully and arbitrarily refuse to repair the goods. "The seller Smith did not ignore his obligation to repair; he simply was unable to perform it. This is not enough to require that the seller absorb losses the buyer plainly agreed to bear." This additional factor of willfulness can be seen in a recent Ninth Circuit case. In Fiorito Bros. v. Fruehauf Corp., the court, in holding the consequential damages limitation unenforceable, stated that the seller, Fruehauf, arbitrarily declined to make the necessary repairs of its improperly manufactured goods and unreasonably refused to live up to its contractual promises. The Fiorito court went on to emphasize the

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140. Id.
141. Id.
142. Id. The Wilson court was also influenced by the fact that the parties had relatively equal bargaining power. However, this factor arguably goes to the notion of conscionability versus unconscionability—had the court found coercion or oppressiveness in the bargaining process, it would have invalidated the limitation based on unconscionability.
143. 747 F.2d 1309 (9th Cir. 1984).
144. Id. at 1313.
distinguishing factors between *Wilson* and the case at hand: "In *Wilson*, the court found that the . . . seller 'did not ignore his obligation to repair; he was simply unable to perform it.' . . . [That] factor is [not] present here."\(^{145}\)

2. *RRX Industries, Inc. v. Lab-Con, Inc.*: a retreat from *Wilson*

In *RRX*, the Ninth Circuit continued its use of the words “total and fundamental.” However, the willfulness element suddenly disappeared. The *RRX* court did not overrule *Wilson* but in fact relied on *Wilson* as its principal authority.\(^{146}\) The Ninth Circuit stated that the district court “properly found the default of the seller so total and fundamental that its consequential damages limitation was expunged from the contract.”\(^{147}\) Curiously, however, the district court never made such a finding.\(^{148}\) Nowhere in the district court’s Findings of Fact and Conclusions of Law was anything stated about the seller’s breach being so total and fundamental that the limitation should be expunged from the contract.\(^{149}\) Further, the Ninth Circuit offered no reasoning of its own for such a conclusion, nor did it refer to the district court’s ruling for support.\(^{150}\)

The *RRX* court also ignored the reasoning employed in *Wilson*. The *Wilson* court was heavily influenced by the fact that the seller did not willfully refuse to repair, but rather that he was unable to do so.\(^{151}\) Similarly, in *RRX*, the seller, Lab-Con, did not arbitrarily refuse to repair, but instead was simply unable to do so. The district court acknowledged this in its Findings of Fact and Conclusions of Law:

The loss of two key personnel prevented defendants from carrying out their obligations. At the time the representations were made, these two people were with the defendant company. Defendant could not anticipate that these two people would be leaving the defendant company. At the time of the consummation of the agreement, the representations made were within the capacity of the company to carry out. Thus, the company’s failure to fulfill the contract was caused by the loss of key personnel after the contract was made. As a result, defendant

\(^{145}\) *Id.* at 1314.
\(^{146}\) 772 F.2d 543, 547 (9th Cir. 1985). *See supra* notes 45-48 and accompanying text.
\(^{147}\) *RRX*, 772 F.2d at 547.
\(^{148}\) Findings of Fact and Conclusions of Law, *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985).
\(^{149}\) *Id.*
\(^{150}\) *RRX*, 772 F.2d at 547.
\(^{151}\) *See supra* note 139 and accompanying text.
company was understaffed and deficient in cash flow.\textsuperscript{152} However, in \textit{RRX}, the Ninth Circuit apparently ignored the individual facts before it, as well as the precedent of \textit{Wilson}, in favor of reliance on conclusionary reasoning. Had the Ninth Circuit examined the facts in \textit{RRX} more closely, it would have seen, as Judge Norris did,\textsuperscript{153} that they were curiously similar to the facts in \textit{Wilson}.

In \textit{RRX}, the Ninth Circuit relied on two other recent Ninth Circuit cases, \textit{Milgard Tempering, Inc. v. Selas Corp. of America}\textsuperscript{154} and \textit{Fiorito Bros. v. Fruehauf Corp.},\textsuperscript{155} in affirming the district court's decision.\textsuperscript{156} However, the \textit{RRX} court failed to recognize the fact that \textit{Fiorito} involved a seller who arbitrarily and intentionally \textit{refused} to repair the defective goods, not a seller who was \textit{unable} to do so.\textsuperscript{157} Further, in \textit{Milgard} the court merely reversed a summary judgment granted to the seller. The court remanded the case to the district court for a more detailed examination of the circumstances surrounding the breach so as to enable the court to properly determine the validity of the consequential damages limitation.\textsuperscript{158} Although the Ninth Circuit stated in \textit{RRX} that these cases, as well as \textit{Wilson}, stand for the principle that "[e]ach case must stand on its own facts,"\textsuperscript{159} the court either failed to examine the facts in \textit{RRX} or it failed to give any substantive reasoning for its decision.

The Ninth Circuit appears to be retreating from its earlier decision in \textit{Wilson}. Although it stated that a case-by-case approach should be utilized in determining the validity of consequential damages limitations, the Ninth Circuit is apparently opting for the more literal and stringent approach when dealing with such cases: a failure of essential purpose leads to the invalidity of a limitation on consequential damages. However, if this is not true, and a case-by-case approach is still the standard to apply, such an approach surely was not evident from the majority's vague decision in \textit{RRX}.

If the Ninth Circuit is not retreating from its \textit{Wilson} decision, then it should explicitly define what is meant by the language "total and fundamental." In so doing, the Ninth Circuit would provide other courts and the contracting public with some guidelines regarding the circum-

\textsuperscript{152} Findings of Fact and Conclusions of Law, \textit{supra} note 19, at 9-10.
\textsuperscript{153} \textit{RRX}, 772 F.2d at 551 (Norris, J., concurring in part and dissenting in part).
\textsuperscript{154} 761 F.2d 553 (9th Cir. 1985).
\textsuperscript{155} 747 F.2d 1309 (9th Cir. 1984).
\textsuperscript{156} \textit{RRX}, 772 F.2d at 547.
\textsuperscript{157} \textit{Fiorito}, 747 F.2d at 1313.
\textsuperscript{158} \textit{Milgard}, 761 F.2d at 357-58.
\textsuperscript{159} \textit{RRX}, 772 F.2d at 547 (quoting S.M. Wilson & Co. v. Smith Int'l, 587 F.2d 1363, 1376 (9th Cir. 1978)).
stances which will constitute a total and fundamental breach and precisely what it is that will invalidate a consequential damages limitation.

If the court of appeals is retreating from its *Wilson* decision and intends to return to the section 2-719 "literal approach," then it should clearly state such an intent. Article II of the UCC was written to inform parties of their contractual obligations and rights, and to create some degree of certainty in the area of contract law. The court’s chameleon-like approach to section 2-719 is certainly not helpful to contracting parties who attempt to follow the UCC. This is not to suggest that laws or interpretation of laws should remain static. However, this Note suggests that courts stop tapdancing around the issue of what effect the failure of a limited remedy provision has on consequential damages limitations and attempt to squarely face the issue. Contract law is based on rewarding the expectations of parties. Unfortunately, after *RRX*, the only certainty the contracting public can expect is uncertainty and inconsistency in decisions regarding section 2-719.

D. *A Mid-Line Approach Should be Adopted by Courts in Determining the Effect of a Failure of a Limited Remedy on a Consequential Damages Limitation*

The vagueness that has plagued section 2-719 is more harmful than both the literal approach, which invalidates all consequential damages limitations when there has been a failure of a limited remedy, and the liberal approach, which consistently allows the limitation to stand absent unconscionability. For that reason a mid-line approach, briefly discussed above and seemingly used at one time by the Ninth Circuit, would lead to the most equitable result in section 2-719 cases.

Rather than adhere to one of the two extreme approaches, a more workable approach would find courts focusing on the nature of the limited remedy’s failure in determining what to do with a limitation on consequential damages. For example, if the failure of a limited remedy is caused by the seller willfully and intentionally refusing to repair or replace the goods, then the buyer should be able to recover all damages, including consequential. However, if the limited remedy fails despite good faith efforts by the seller to repair or replace the goods, then the limitation on consequential damages should be allowed to stand. The buyer, in this situation, is not left empty handed as he or she can still recover ordinary damages under section 2-714(2).\textsuperscript{160}

This mid-line approach rewards the expectations of all parties in-

\textsuperscript{160} U.C.C. § 2-714(2) (1978).
volved in the transaction. On the one hand, the parties, in limiting con-
sequential damages, have anticipated the possibility of a breach and
allocated the risks to meet their business needs. On the other hand,
the buyer expected the seller to fulfill the limited remedy obligation of
repairing or replacing the goods. Thus, when a seller willfully refuses to
repair or replace the goods the buyer loses the benefit of the bargain. The
seller's arbitrary refusal was not part of the bargain and was not expected
or anticipated by the buyer; hence, consequential damages should be al-
lowed. In discussing "willful" failures to repair, Professor Eddy stated:
"where the bulk of consequential damages flow directly from the failure
to repair and accrue during the period of wrongful refusal, what 'incentive' . . . exists to compel compliance with the remedy, unless conse-
quential damages are awarded?" 

However, the consequential damages limitation should be enforcea-
able if the seller attempted to repair but was unable to do so. Under this
scenario, the seller tried, but was unable to fulfill its contractual obliga-
tions. Nevertheless, the buyer is not left without a remedy. The limited
remedy having failed of its essential purpose will allow the buyer to re-
cover ordinary damages as provided for by section 2-714(2). Specifically,
the buyer may recover the difference between the value of what he or she
should have received and the value of what he or she got. These damages
will compensate the buyer for his or her loss of the bargain. Moreover,
the UCC requires only that "at least minimum adequate remedies be
available." Arguably, the section 2-714(2) remedy meets this require-
ment. Further, "the apparent 'inequity' presented when defendant's re-

It is extremely important to note that in this area of section 2-719,
most cases which have held consequential damages limitations unen-
forceable involved a situation where the seller willfully refused to repair
or replace the goods. Conversely, most cases in which consequential

161. Although it is not stated in any of the opinions, the economics of a transaction suggest
that in return for a limitation on consequential damages, the buyer likely received some form
of compensation, either a lower contract price or more goods and services. See supra note 69
and accompanying text.

162. If there has been coercion by one party or if unequal bargaining exists between the
parties, the limitation will face the test of unconscionability by the trier of fact. See U.C.C.
§ 2-719(3) (1978).


165. Eddy, supra note 163, at 88.

166. See Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309 (9th Cir. 1984); Soo Line R.R. v.
damages limitations were upheld have involved a seller who attempted to repair or replace, but was simply unable to do so.\textsuperscript{167} Although these decisions occasionally mention the elements of willfulness versus unintentional inability, courts have failed to recognize that it is the distinction between these two elements which is truly the distinguishing factor in determining the validity of a consequential damages limitation.

V. CONCLUSION

Under the UCC, which postulates freedom of contract as one of its principal goals, there is much to be said for a position that leaves undisturbed to the greatest extent possible the allocation of business risks made by the parties. The reluctance of some courts to allow consequential damages limitations to stand once it is found that the limited remedy provision fails of its essential purpose does not contradict this position. Rather, it seems predicated on the difficulty of fashioning appropriate relief for the aggrieved party.

For this reason the adoption of a mid-line approach by the Ninth Circuit, as well as all courts, would create some degree of certainty in an area which is now deluged with ambiguous, confusing and contradictory decisions. Courts have already taken the first step toward clarity in the section 2-719 area by recognizing that the issue of whether a limited remedy has failed of its essential purpose is distinct from the issue of enforceability of a limitation on consequential damages.\textsuperscript{168} Since that time, however, courts have not further clarified what effect the failure of a limited remedy has on consequential damages limitations.

The two extreme positions now taken by the courts\textsuperscript{169} are simply not necessary in light of this equitable mid-line approach. Each case will still be determined on its individual facts, yet the real and much simpler issue to be resolved by the trier of fact will be whether the seller \textit{willfully} refused to repair or replace the goods or whether the seller attempted to repair or replace but was simply \textit{unable} to do so. Once that determina-

\textsuperscript{167} See Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable & Cold Storage Co., 709 F.2d 427 (6th Cir. 1983); Chatlos Sys., Inc. v. National Cash Register Corp., 635 F.2d 1081 (3d Cir. 1980); AES Technology Sys., Inc. v. Coherent Radiation, 583 F.2d 933 (7th Cir. 1978); S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363 (9th Cir. 1978); County Asphalt, Inc. v. Lewis Welding & Eng'g Corp., 444 F.2d 372 (2d Cir. 1971); V-M Corp. v. Bernhard Distrib. Co., 447 F.2d 864 (7th Cir. 1971).

\textsuperscript{168} Eddy, supra note 163, at 92.  
\textsuperscript{169} See supra notes 110-33 and accompanying text.
tion is made, the court's decision regarding the validity of the consequential damages limitation will easily and necessarily follow. A willful refusal to repair or replace should automatically render the limitation on consequential damages unenforceable and all UCC remedies would then be available, including consequential damages. If the failure to repair results instead from the seller's unintentional inability to do so, then the consequential damages limitation should be enforceable. The buyer is entitled to section 2-714(2) damages, but the buyer is not entitled to consequential damages as those have been properly excluded as provided by the UCC.170

In conclusion, it is important to note that even if a consequential damages limitation is held enforceable under the above approach, it will still be subject to the test of unconscionability. Accordingly, though a court may find the limitation valid because the breach of the seller was not willful, the consequential damages limitation may nevertheless fail to pass muster under subsection (3) of section 2-719.

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