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a move toward a more active role on the part of the courts in the area of social policy.

Sharon S. Millians

The Validity of Consequential Damage Disclaimers Following Failure of Essential Purpose of an Exclusive Remedy: S.M. Wilson & Co. v. Smith International, Inc.

S.M. Wilson & Company contracted to construct a mine shaft for the Ayrshire Coal Company. In order to obtain the equipment necessary to drill the tunnel for the shaft, Wilson negotiated with a heavy machinery manufacturer, Smith International, for the purchase of a rock tunnel boring machine.¹ Subsequently, Wilson and Smith International entered into a contract that included four provisions regarding warranties and damages: (1) a limited warranty that the tunnel boring machine would be free from defects in material and workmanship, (2) an exclusive remedy of repair or replacement of defective parts, (3) a disclaimer of all other warranties, and (4) a disclaimer of consequential damages.² The parties further

1. A rock tunnel boring machine is a complicated and expensive piece of equipment. Construction of the machine requires that the parts be manufactured and assembled at the plant, and then disassembled for transportation to and installation at the jobsite. In the course of negotiation Smith International was fully apprised of the details of the Ayrshire project, including the nature of the rock that would be encountered by the tunnel boring machine.

2. The original parties to the contract were McGuire Shaft & Tunnel Corp., a predecessor of S.M. Wilson & Co., and the Calweld Division of Smith International, Inc. Hereinafter, they will be referred to respectively as "Wilson" and "Smith International."

The applicable provisions of the contract are as follows:

WARRANTY:

Calweld warrants the Calweld Machine ("machine") described in the specifications incorporated in this contract to be free from defects in material and workmanship under normal use and service for which it was intended if, but only if, it has been properly installed and operated. Calweld's obligation under this warranty is limited to replacing or repairing, free of charge, . . . any defective part or parts of the machine that were manufactured by Calweld This shall be the limit of Calweld's liability for any breach of warranty.

THIS WARRANTY IS EXPRESSLY IN LIEU OF ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE NOT SET FORTH IN A WRITING SIGNED BY AN AUTHORIZED REPRESENTATIVE OF CALWELD. Calweld shall not be liable for any loss or damage resulting, directly or indirectly, from the use or loss of use of the machine. Without limiting the generality of the foregoing this exclusion from liability embraces the purchaser's expenses for downtime or for making up downtime Calweld neither assumes nor authorizes any person to assume for it any other liability in connection with the sale or use of the Calweld machine, and there are no oral agreements or warranties collateral to or affecting this agreement.

agreed that Smith International would provide a competent tunnel boring specialist to supervise installation at the jobsite by Wilson personnel.³ When the tunnel boring machine was completed and installed at the jobsite, the machine failed to function properly despite Smith International's repeated efforts to repair.⁴ As a result, Wilson fell behind schedule on the Ayrshire project and incurred substantial damages in the form of lost profits, additional labor costs, and additional equipment costs.⁵ After nearing completion of the shaft's construction, Wilson discovered that improper installation of the tunnel boring machine was the cause of the machine's inability to perform properly. Wilson sued Smith International,⁶ stipulating that it suffered only consequential damages as a result of the machine's nonperformance. The district court granted Smith International's motion for summary judgment on grounds that the clause excluding liability for consequential damages was dispositive. Wilson appealed to the Ninth Circuit. *Held, affirmed*: a freely negotiated consequential damages disclaimer survives failure of essential purpose of an exclusive remedy. *S.M. Wilson & Co. v. Smith International, Inc.*, 587 F.2d 1363 (9th Cir. 1978).

I. U.C.C. SECTION 2-719

Subsection 2-719(1)(a) of the Uniform Commercial Code provides that contracting parties may "limit or alter the measure of damages recoverable under this Article" subject to the provisions of subsections 2-719(2) and (3).⁷ The purpose of this provision is to maximize freedom of contract

3. The parties attempted to allocate specifically the costs and risks of shipment and installation:

SHIPPING AND INSTALLATION:

The machine will be delivered to the purchaser F.O.B. Calweld Plant, . . . disassembled if necessary in component units suitable for shipment. Shipment from Calweld Plant . . . to job site will be made at the cost and risk of the Purchaser. Labor and the use of machinery to complete the erection of the machine will be provided by the Purchaser. Calweld is to provide supervision of erection as outlined under "Installation Personnel."

INSTALLATION PERSONNEL:

Calweld will provide one competent tunnel boring machine specialist free of charge, to supervise installation, to demonstrate initial operation, and train customer's operator, for a period of 30 working days.

4. Smith International made repeated attempts to discover the source of the machine's difficulties and provided Wilson with replacement parts upon request. Nevertheless, it was evident that the machine was defective, and Smith International did not claim otherwise.

5. Wilson alleged actual damages totalling \$1,844,599.

6. Wilson alleged eight causes of action: (1) breach of contract for failure to reassemble the machine properly; (2) breach of contract for failure to provide a competent supervisor; (3) breach of an implied warranty of fitness; (4) negligence in design; (5) negligence in construction; (6) negligence in reassembly; (7) negligence in failing to provide a competent reassembly supervisor; and (8) misrepresentation as to the machine's boring rate.

7. U.C.C. § 2-719 provides:

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

(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

without sanctioning the implementation of egregious terms by parties in a strong negotiating posture.⁸ Thus, under subsection 2-719(1)(b) an exclusive remedy must be clearly labeled as such or it is presumed to be cumulative with those provided in article 2.⁹ More importantly, if an exclusive remedy has failed of its essential purpose, under subsection 2-719(2) all other remedies in article 2 become available.¹⁰

Determining when an exclusive remedy fails of its essential purpose¹¹ under subsection 2-719(2)¹² and the effect that failure has on a consequential damages disclaimer under subsection 2-719(3)¹³ frequently troubles the

(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.

8. *See id.* Comment 1.

9. *Id.* Comment 2.

10. *Id.* Comment 1.

11. There are two general fact situations in which exclusive remedies have been held to fail of their essential purpose. The first and most common situation occurs when the party responsible for providing the remedy is either unwilling or unable to do so. The second fact situation occurs when defects in the goods are latent and not discoverable by reasonable inspection upon receipt.

To date only one case has held that the latent-defect situation constitutes a failure of essential purpose. In *Wilson Trading Corp. v. David Ferguson, Ltd.*, 23 N.Y.2d 398, 401, 244 N.E.2d 685, 686, 297 N.Y.S.2d 108, 110 (1968), a contract for the sale of yarn denied the buyer any claim "if made after wearing, knitting, or processing, or more than 10 days after receipt of shipment." The yarn faded in processing and the buyer refused to make further payments. Seller thereafter sued for the price and was granted summary judgment on the ground that the time limitation in the contract barred any claim of breach of warranty. The New York Court of Appeals reversed, holding that the time limitation was an exclusive remedy and that it had failed of its essential purpose. One commentator has severely criticized this decision as a misreading of § 2-719(2) that disrupted a clear allocation of risks. *See Comment, Time Limitations on Warranties: Application and Validity Under the U.C.C.*, 11 B.C. INDUS. & COM. L. REV. 340, 348-49 (1969-1970).

In either fact situation, however, the courts have not explained what factors cause an exclusive remedy to fail of its essential purpose. Rather, they have turned to Comment 1, which states that § 2-719(2) is applicable when circumstances cause an otherwise "fair and reasonable" remedy to "deprive either party of the substantial value of the bargain." In general, any time a seller is unable to conform goods to the provisions of the agreement by exercise of an exclusive remedy of repair or replacement within a reasonable time after discovery of the defects, the courts have held that the buyer has suffered substantial value depreciation. *See Riley v. Ford Motor Co.*, 442 F.2d 670 (5th Cir. 1971); *Moore v. Howard Pontiac-American, Inc.*, 492 S.W.2d 227 (Tenn. Ct. App. 1972). Nevertheless, at least one case has held that an exclusive remedy does not fail of its essential purpose unless the seller acted in bad faith by refusing to honor the exclusive remedy. *Lankford v. Rogers Ford Sales*, 478 S.W.2d 248 (Tex. Civ. App.—El Paso 1972, writ ref'd, n.r.e.).

Only one case, *Beal v. General Motors Corp.*, 354 F. Supp. 423, 426 (D. Del. 1973), has attempted to explain the purposes underlying an exclusive remedy: an exclusive remedy has the dual purpose of (1) providing the seller with an opportunity to minimize its risk of liability while making the goods conforming, and (2) enabling the buyer to acquire conforming goods within a reasonable time after the defect is discovered. Thus, the majority of cases in the standard § 2-719(2) fact situation accurately reflect those underlying purposes by holding that failure of essential purpose occurs when the seller is unable to repair within a reasonable time after the defect is discovered.

12. U.C.C. § 2-719(2) provides: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."

13. U.C.C. § 2-719(3) provides: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."

courts.¹⁴ To date, few courts have undertaken a separate analysis of the purposes of subsections 2-719(2) and 2-719(3) with a view towards establishing a logical relationship between the two provisions.¹⁵ This failure may be explained partially by the confusion of section 2-719 with other Code sections¹⁶ and the ambiguous nature of section 2-719 itself.¹⁷ Nevertheless, since consequential damages are frequently the only significant amount involved in a commercial suit,¹⁸ a clear understanding of the relationship between an exclusive remedy and a consequential damages disclaimer is important.

Failure of essential purpose of an exclusive remedy does not automatically result in failure of the consequential damages disclaimer.¹⁹ Subsection 2-719(3) tests the validity of a consequential damages disclaimer by its conscionability,²⁰ whereas subsection 2-719(2) tests the validity of an ex-

14. The failure of essential purpose issue naturally precedes the consequential damages issue. *S.M. Wilson & Co.* falls within the standard failure of essential purpose fact situation. See note 11 *supra*. This Note concentrates on the effect that failure of essential purpose has on a consequential damages disclaimer.

15. See generally Anderson, *Failure of Essential Purpose and Essential Failure on Purpose: A Look at Section 2-719 of the Uniform Commercial Code*, 31 Sw. L.J. 759 (1977); Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 CALIF. L. REV. 28 (1977).

16. In particular, § 2-719 may be confused with the warranty disclaimer provision of § 2-316 or the liquidated damages provision of § 2-718. See, e.g., *Farmers Union Grain Terminal Ass'n v. Nelson*, 223 N.W.2d 494 (N.D. 1974). For discussion of the three above-mentioned Code sections, see Anderson, *supra* note 15, at 759-61, and Weintraub, *Disclaimer of Warranties and Limitation of Damages for Breach of Warranty Under the UCC*, 53 TEXAS L. REV. 60 (1974).

17. Some commentators have suggested that the ambiguous nature of art. 2 in general, and the remedy limitation provisions in particular, are necessary consequences of Professor Llewellyn's desire to see the Code evolve in patterns appropriate to different business contexts. Thus Professor Eddy points out: "What section 2-719(2) prescribes is not a rule of law, but a principle in accordance with which the courts shall find the 'immanent law of the transaction.'" Eddy, *supra* note 15, at 92 (citing K. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 122 (1960)). For contrasting viewpoints on Professor Llewellyn's approach to art. 2, compare Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 541-58 (1967), with Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969).

18. Anderson, *supra* note 15, at 774. In *S.M. Wilson & Co.*, for example, no general damages were pleaded although there were almost \$2,000,000 in consequential damages at issue. In comparison, the purchase price of the tunnel boring machine was \$550,000.

19. Pursuant to § 2-719(2) when an exclusive remedy fails of its essential purpose, the buyer may disregard that remedy provision of the agreement and pursue the remedies to which he would have otherwise had recourse. J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 12-10, at 379-82 (1972). Based upon this provision Professors White and Summers conclude that, absent a showing of unconscionability, an independent consequential damages disclaimer will not survive failure of essential purpose of an exclusive remedy. *Id.* § 12-11, at 396. This position is erroneous, however, for it fails to consider that the consequential damages disclaimer is governed by a separate subsection. See notes 12 & 13 *supra* and accompanying text.

20. See note 13 *supra*. Section 2-302 sets forth the effect of an unconscionable contract or clause on the determination of the rights of the parties:

- (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 so 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

clusive remedy according to whether it fulfills its essential purpose.²¹ The distinction between the two tests is significant. Unconscionability is determined according to the circumstances existing at the time of the making of the contract, whereas the failure of a remedy's essential purpose is determined by circumstances relating to performance of the contract.²² At the time a contract is entered into, a buyer generally assumes that consequential damages will be avoided by the seller's prompt fulfillment of the exclusive remedy. If the seller fails to effect the exclusive remedy, however, the buyer might encounter consequential damages that were not foreseeable when he assented to the exclusion of consequential damages. This result clearly is not unconscionable when the seller's performance did not cause the consequential damages in question or where the buyer freely and unconditionally accepted the risk of consequential damages.²³

Accordingly, an exclusion of consequential damages should be unenforceable upon failure of essential purpose of an exclusive remedy only in those cases where the seller's refusal or inability to perfect the exclusive remedy directly caused consequential damages that the buyer did not agree to assume.²⁴ Only in this instance does the failure of essential purpose of the exclusive remedy render enforcement of the consequential damages disclaimer unconscionable.

Unfortunately, cases dealing with the issue of the independent validity of a consequential damages disclaimer have not applied this analysis. Some jurisdictions have made the mistake noted earlier²⁵ by refusing to view the continuing validity of a consequential damages disclaimer as an

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.

Although the section does not define unconscionability, Comment 1 states:

The basic test is whether, in the 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 of the contract*. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. 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.

(Emphasis added; citation omitted). See generally Ellinghaus, *supra* note 17, at 763-65; Leff, *supra* note 17, at 489.

21. As noted earlier, the courts have relied on Comment 1 in applying § 2-719(2). See note 11 *supra*. Thus, the test actually used by the courts in determining the validity of an exclusive remedy is whether the buyer has retained the substantial value of the bargain. *Id.*

22. "It is important to note that the language of the subsection 'is not concerned with arrangements oppressive at their inception, but rather with the application of an agreement to novel circumstances not contemplated by the parties.'" Anderson, *supra* note 15, at 763-64 (quoting 1 REPORT OF THE NEW YORK LAW REVIEW COMMISSION FOR 1955, at 584) (footnote omitted).

23. Anderson, *supra* note 15, at 776.

24. *Id.* Professor Eddy indicates that in a consumer context enforcement of a consequential damages disclaimer may be per se unconscionable after the exclusive remedy fails of its essential purpose. This suggestion is premised on the fact that a consumer ordinarily will expect the exclusive remedy to be fulfilled and that the exclusion of consequential damages will be effective only when the exclusive remedy also is effective. Eddy, *supra* note 15, at 91.

25. See note 19 *supra* and accompanying text.

issue separate from failure of essential purpose of an exclusive remedy.²⁶ Other jurisdictions more correctly apply the separate standards under subsections 2-719(2) and 2-719(3),²⁷ but misidentify the factors that should cause a consequential damages disclaimer to fail in light of failure of essential purpose of an exclusive remedy.

Most commonly this mistake is manifested by focusing attention on whether the seller made a good faith effort to fulfill the exclusive remedy.²⁸ For example, in *Adams v. J.I. Case Co.*²⁹ the seller took fifteen months to effect a limited repair warranty pursuant to the sale of a tractor, thereby causing the buyer to lose 810 work hours. In holding that the consequential damages disclaimer could no longer stand, the court apparently reasoned that, in light of the seller's willful refusal to repair, it would be unconscionable to deny the buyer consequential damages.³⁰ The court did not discuss the causal connection between failure of the exclusive remedy's essential purpose and the consequential damages,³¹ nor was there any discussion of the bargaining context and allocation of risk for consequential damages.³² Thus, although the exclusion of consequential damages may

26. See *Beal v. General Motors Corp.*, 354 F. Supp. 423 (D. Del. 1973) (negligent failure to effect exclusive remedy of repairs or replacement in the sale of a truck held to make available all remedies under the Code despite presence of a consequential damages disclaimer); *Reynolds v. Preferred Mut. Ins. Co.*, 11 U.C.C. Rep. Serv. 701 (Mass. App. Div. 1972) (inability to effect exclusive remedy of repair in a contract for sale and installation of gutters held to make available all Code remedies despite a consequential damages disclaimer). Professor Anderson points out that *Beal* and *Reynolds* might turn upon the fact that in neither case was there a separate, consequential damages disclaimer nor explicit mention of the word consequential. Rather, the contracts merely limited the seller's liability to repair or replacement of defective parts. Anderson, *supra* note 15, at 783-87.

27. See notes 20 & 21 *supra* and accompanying text.

28. See *Koehring Co. v. A.P.I., Inc.*, 369 F. Supp. 882 (E.D. Mich. 1974); *Jones & McKnight Corp. v. Birdsboro Corp.*, 320 F. Supp. 39 (N.D. Ill. 1970); *Adams v. J.I. Case Co.*, 125 Ill. App. 2d 388, 261 N.E.2d 1 (1970).

29. 125 Ill. App. 2d 388, 261 N.E.2d 1 (1970).

30. The court in *Adams* stated that:

[The] plaintiff could not have made his bargain and purchase with knowledge that defendants would be unreasonable, . . . willfully dilatory or careless and negligent in making good their warranty in the event of its breach. . . . It should be obvious that they cannot at once repudiate their obligation under their warranty and assert its provisions beneficial to them.

261 N.E.2d at 7-8. Most of the court's discussion was not this straightforward. Rather than simply stating that enforcement of the consequential damages disclaimer would be unconscionable, the court stated that the seller's dilatory conduct constituted a breach of an implied warranty of prompt repairs. *Id.* at 8. Breach of this implied warranty availed the buyer of all other remedies provided by the Code despite the presence of a disclaimer of all other warranties, express or implied. *Id.* at 6.

31. For a discussion of the relevance of a nexus between failure of the essential purpose of the exclusive remedy and occurrence of consequential damages, see notes 24 & 25 *supra* and accompanying text.

32. Although no cases have discussed causal relationships in this context, there are cases that have focused on the allocation of risk in determining whether a consequential damages disclaimer has continuing validity after the essential purpose of an exclusive remedy fails. Nevertheless, in *Jones & McKnight Corp. v. Birdsboro Corp.*, 320 F. Supp. 39, 43 (N.D. Ill. 1970), a case involving parties of substantially equal bargaining power in a commercial transaction, the court quoted from *Adams* in holding that the consequential damages disclaimer could not stand in light of the seller's refusal to effect the exclusive remedy. Moreover, in *Koehring Co. v. A.P.I., Inc.*, 369 F. Supp. 882 (E.D. Mich. 1974), the court falsely

have been unconscionable in *Adams*, the court's discussion does not reveal the necessary facts.³³

Only one case to date, *American Electric Power Co. v. Westinghouse Electric Corp.*,³⁴ has sustained a consequential damages disclaimer despite a seller's refusal to perform an exclusive remedy. The product involved in that case was a turbine generator described by the court as a "highly complex, sophisticated, and in some ways experimental" piece of machinery.³⁵ After the turbine generator proved defective, the buyer brought suit alleging that the seller willfully refused to effect the limited repair warranty and therefore that the consequential damages disclaimer was no longer enforceable. The court agreed that the exclusive remedy had failed of its essential purpose, but it refused to grant consequential damages on grounds that the contract was fully negotiated and the "agreed-upon allocation of commercial risk should not be disturbed."³⁶

II. S.M. WILSON & CO. V. SMITH INTERNATIONAL, INC.

Against this background the Ninth Circuit decided *S.M. Wilson & Co. v. Smith International, Inc.*, thereby taking one more step towards judicial understanding of the relationship between subsections 2-719(2) and 2-719(3).³⁷ After disposing of Wilson's contention that there was an express

indicated that allocation of risks and a nexus between the failure of the essential purpose of the exclusive remedy and occurrence of consequential damages are irrelevant by stating that buyers "might not be entitled to additional remedies if they fail to prove that plaintiff [seller] failed to repair and such failure was willfully dilatory." *Id.* at 891.

33. Professor Anderson suggests that the courts in *Adams* and in *Birdsboro* may simply have been trying to couch their decisions in the strongest terms by stressing the egregious nature of the seller's conduct. This could explain the failure to discuss allocation of risks or causal connections; it does not, however, explain the dictum in *Koehring*, see note 32 *supra*, suggesting that buyers must prove willful refusal to honor the exclusive remedy before the consequential damages disclaimer will fail. Anderson, *supra* note 15, at 779-80.

34. 418 F. Supp. 435 (S.D.N.Y. 1976).

35. *Id.* at 458.

36. *Id.* Other commercial cases have recognized that an exclusive remedy is totally separate from a consequential damages disclaimer. These cases did not, however, involve allegations of willful refusal to effect the exclusive remedy. See *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572 (D.D.C. 1974), *rev'd and remanded*, 527 F.2d 853 (D.C. Cir. 1975); *U.S. Fibres, Inc. v. Proctor & Schwartz, Inc.*, 358 F. Supp. 449 (E.D. Mich. 1972), *aff'd*, 509 F.2d 1043 (6th Cir. 1975); *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300 (S.D.N.Y. 1970), *aff'd on other grounds*, 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971). Professors Anderson and Eddy disagree over the correctness of the decisions in this line of commercial cases. Professor Eddy indicates that failure of the essential purpose of an exclusive remedy should have no bearing on the validity of a consequential damages disclaimer in cases in which the parties have fully and freely allocated the risk of such damages. Eddy, *supra* note 15, at 90-91. Professor Anderson, by contrast, states that these decisions are correct only if breach of the exclusive remedy was not the proximate cause of the consequential damages. Nevertheless, Professor Anderson notes that causation may be irrelevant to a determination of conscionability in experimental goods cases such as *American Elec. Power Co.* This assertion is based on the premise that in purchasing complex and experimental goods subject to a consequential damages disclaimer the buyer implicitly accepts the risk of damages stemming from the experimental nature of the goods. With regard to the purchase of standard products, however, a buyer assumes that consequential damages will be averted by fulfilling the exclusive remedy. Anderson, *supra* note 15, at 780-81.

37. Professor Eddy emphasizes that an understanding of the relationship between §§ 2-

warranty of proper installation separate and distinct from the limited warranty of materials and workmanship,³⁸ the court directed its attention to whether the exclusive remedy of repair or replacement had failed of its essential purpose.³⁹ A relatively easy decision in the affirmative⁴⁰ raised the more difficult issue as to what effect this failure would have on the consequential damages disclaimer.⁴¹

Wilson argued that under the line of cases beginning with *Adams v. J.I. Case Co.*⁴² failure of the essential purpose of the exclusive remedy eliminates any limitations on liability and reinstates all remedies provided by the Code.⁴³ Smith International, by contrast, argued that continuing validity of the consequential damages disclaimer depends upon the contractual allocation of risks.⁴⁴ Smith International distinguished *Adams*⁴⁵ as arising in a consumer context and involving sellers who willfully refused to repair.⁴⁶ The Ninth Circuit was persuaded by this distinction and turned to the commercial cases, beginning with *County Asphalt, Inc. v. Lewis*

719(2) and 2-719(3) involves three steps. The first step was taken in the line of commercial cases recognizing that an exclusive remedy is separate from a consequential damages disclaimer. See note 36 *supra*. The second step will be reached when courts recognize that the issues in §§ 2-719(2) and 2-719(3) are disparate and that a single rule applicable to both subsections is not necessary. The third step will be reached when courts begin analyzing the conscionability of consequential damages disclaimers independently on a case-by-case basis. Eddy, *supra* note 15, at 92.

38. See note 2 *supra*. For a discussion of the relationship between "workmanship" and "installation," see notes 57 & 58 *infra* and accompanying text.

39. 587 F.2d at 1374.

40. The court quoted from Professor Eddy's article in deciding that the exclusive remedy had failed of its essential purpose:

This rosy picture of the limited repair warranty, however, rests upon at least three assumptions: that the warrantor will diligently make repairs, that such repairs will indeed "cure" the defects, and that consequential loss in the interim will be negligible. So long as these assumptions hold true, the limited remedy appears to operate fairly But when one of these assumptions proves false in a particular case, the purchaser may find that the substantial benefit of the bargain has been lost.

Id. at 1375 (quoting Eddy, *supra* note 15, at 63). The essential purpose of the exclusive remedy in *S.M. Wilson & Co.* failed on both the second and third assumptions enunciated by Professor Eddy.

41. *Id.*

42. For a discussion of this line of cases, see notes 28-31 *supra* and accompanying text. Also cited favorably by Wilson were *Kohlenberger, Inc. v. Tyson's Food, Inc.*, 510 S.W.2d 555 (Ark. 1974); *Orr Chevrolet, Inc. v. Courtney*, 488 S.W.2d 883 (Tex. Civ. App.—Texarkana 1972, no writ); and *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157 (S.D. 1975).

43. Wilson failed to recognize that the dispositive issue was conscionability. Although the commercial setting may have caused it to shy away from arguing that enforcement of the consequential damages disclaimer would be unconscionable, it could have argued unconscionability on the ground that failure of the essential purpose of the exclusive remedy caused the consequential damages that both parties thought the exclusive remedy would prevent when they entered into the contract. See notes 24 & 25 *supra* and accompanying text.

44. Smith International's argument appears to be a restatement of Professor Eddy's argument that failure of the essential purpose of an exclusive remedy is irrelevant to the conscionability of a consequential damages disclaimer in cases where the parties fully negotiated the contract and had relatively equal bargaining powers. See note 36 *supra*.

45. See also notes 28-31 & 42 *supra*.

46. Unfortunately, Smith International muddied the waters of an otherwise cogent argument by stressing the importance of its good faith effort to repair. While this clearly puts

Welding & Engineering Corp.,⁴⁷ as proper authority.⁴⁸ The remainder of the court's discussion of section 2-719 analyzed the bargaining context of the transaction.⁴⁹ Ultimately, three factors combined in persuading the court to sustain the exclusion of consequential damages: (1) the fact that both parties enjoyed relatively equal bargaining power and freely negotiated the risk of loss,⁵⁰ (2) the complex nature of the tunnel boring machine,⁵¹ and (3) Smith International's repeated efforts to repair.⁵² The court concluded its discussion of section 2-719 by warning that its decision was based upon the facts "and is not intended to establish that a consequential damages bar always survives a failure of the limited repair remedy to serve its essential purpose."⁵³

Judge Enright, dissenting, stated that the dispositive issue regarding the exclusion of consequential damages was whether the parties intended the exclusive remedy and consequential damages disclaimer to shift the risk of damages resulting from improper installation to Wilson.⁵⁴ He concluded that they did not so intend, stating that the contractual obligation to provide a competent tunnel boring specialist to supervise installation was a condition precedent to the exclusive remedy, and therefore the conse-

the seller in a more favorable posture, it does not bear logical relevance to the validity of the consequential damages disclaimer. See notes 32 & 33 *supra* and accompanying text.

47. 323 F. Supp. 1300 (S.D.N.Y. 1970), *aff'd on other grounds*, 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971); see note 36 *supra*.

48. Although the appellee's brief did not mention *American Elec. Power Co.*, that is the strongest case in support of Smith International and is distinguishable only in that the consequential damages in *American Elec. Power Co.* may implicitly have been attributed to the experimental nature of the goods.

49. 587 F.2d at 1375-76.

50. See notes 24, 25 & 36 *supra* and accompanying text.

51. The importance attributed to the complex nature of the machinery is unclear. The court states only that "[t]he machine was a complex piece of equipment designed for the buyer's purposes." 587 F.2d at 1375. Nevertheless, the tunnel boring machine was not an experimental good such as that involved in *American Elec. Power Co.* Thus, the consequential damages could not have been caused by defects attributable to qualities for which neither party could have reasonable expectations as opposed to defects that both parties expected to be cured by the exclusive remedy. See note 36 *supra*. Perhaps the court reasoned that in the sale of complex machinery, the buyer should reasonably foresee that unrepairable defects will be discovered, and therefore it would not be unconscionable to retain the consequential damages disclaimer. This rationale is persuasive only if the defects responsible for the consequential damages could not be cured within a reasonable time. In *S.M. Wilson & Co.*, however, repair clearly was a viable remedy for the defective tunnel boring machine. (All that was necessary to correct the machine's operation was reversal of the thrust rollers and one of its 10 Staffa motors. 587 F.2d at 1368.) Consequently, the court appears to be stressing the complex nature of the machinery not as a causation factor, but rather to clarify the bargaining context.

52. The court indicated that if Smith International had refused to repair, then the consequential damages disclaimer would fail: "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." 587 F.2d at 1375. This dictum is a step back from *American Electric Power Co.*, which recognized that the seller's good faith effort at repair is not decisive of the validity of a consequential damages disclaimer. See notes 34-36 *supra* and accompanying text.

53. 587 F.2d at 1375-76.

54. Wilson argued that there was an express warranty of proper installation, the fulfillment of which was a condition precedent to validity of the exclusive remedy and consequential damages disclaimer. See note 6 *supra*.

quential damages disclaimer never became effective.⁵⁵

This rationale was based on the conditional clause in the warranty providing that the workmanship and materials warranty was to be effective "if, but only if" the machine has been properly installed and operated.⁵⁶ The majority, on the other hand, reasoned that the conditional clause was inserted to protect Smith from liability attributable to faulty assembly or operation when Wilson personnel were not under Smith's supervision.⁵⁷ In essence, Judge Enright disagreed with the majority's position that a "workmanship and materials" warranty encompasses installation.⁵⁸ Thus, according to Judge Enright, when an exclusive remedy is attached to a "workmanship and materials" warranty, any obligation regarding installation must be fulfilled before the exclusive remedy or limitations on liability come into effect.⁵⁹

III. CONCLUSION

In *S.M. Wilson & Co.*, the Ninth Circuit faced the issue of the continuing validity of a consequential damages disclaimer in light of failure of essential purpose of an exclusive remedy. Case law prior to *S.M. Wilson & Co.* was confused at best; some cases held that the consequential damages disclaimer automatically failed with the failure of the essential purpose of the exclusive remedy, while other cases focused on the seller's conduct. *S.M. Wilson & Co.* looked to the seller's efforts at fulfilling the exclusive remedy. This case, however, marks the first time that a circuit court has joined *American Electric Power Co.* in recognizing the separability of subsections 2-719(2) and 2-719(3) by focusing on the contractual allocation of risks and conscionability in the total bargaining context. Moreover, *S.M. Wilson & Co.* is a more direct statement of the relationship between subsections 2-719(2) and 2-719(3) than *American Electric Power Co.*, which may be distinguished on the basis of the experimental nature of the goods involved. The next step to an understanding of section 2-719 will be a recognition that unconscionability is present only in those cases where failure of the essential purpose of the exclusive remedy is the direct cause of the consequential damages beyond those that the buyer agreed to assume.

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55. 587 F.2d at 1377; see note 2 *supra*.

56. See note 2 *supra*.

57. 587 F.2d at 1371.

58. The majority's position is based on the argument that since assembly at the factory clearly is "workmanship," so should installation at the jobsite be included within the meaning of workmanship. *Id.* at 1372.

59. *Id.* at 1377.

