

## CONTRACTING OUT OF ARTICLE 2: MINIMIZING THE OBLIGATION OF PERFORMANCE & LIABILITY FOR BREACH

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### I. INTRODUCTION

The U.S. Census Bureau reports that in 2005, 1.67 trillion dollars in goods were imported to the United States and 904 billion dollars in goods were exported.<sup>1</sup> These statistics corroborate the reported expansion of goods and services exported in 2005 by 226,000 small businesses.<sup>2</sup> Approximately seventy-five percent of all goods traded in 2005 were shipped to or from fifteen top countries.<sup>3</sup> Of this seventy-five percent, fifty-two percent were destined for or originated from countries that are signatories to the U.N. Convention on Contracts for the International Sale of Goods. Unless otherwise agreed, the U.N. Convention on Contracts for the International Sale of Goods governed these transactions.<sup>4</sup> A seller confronted with an expanding global market may desire to define its business risk and increase efficiency by using the same standard terms in both its domestic and international contracts.

This article addresses the seller's ability to opt-out of the

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1. U.S. CENSUS BUREAU, FOREIGN TRADE STATISTICS, TOP TRADING PARTNERS—TOTAL TRADE, EXPORTS, IMPORTS, <http://www.census.gov/foreign-trade/statistics/highlights/top/top0512.html> (last visited Sept. 3, 2006).

2. Renuka Rayasam, *Hemmed in No Longer, This Firm Sews Up a Global Brand*, U.S. NEWS & WORLD REPORT, July 31, 2006, at 50.

3. U.S. CENSUS BUREAU, *supra* note 1.

4. *See* United Nations Convention on Contracts for the International Sale of Goods, art. 1, Apr. 11, 1980, 1489 U.N.T.S. 60 [hereinafter CISG].

Uniform Commercial Code<sup>5</sup> in domestic transactions. Indeed, the goal of this article is to ascertain the extent to which a seller may “push the envelope” in minimizing: (1) its obligation of performance, (2) the buyer’s right to complain regarding the quality of the seller’s performance, and (3) the seller’s responsibility for failing to perform as obligated. This article is not an endorsement of such conduct but rather an exercise to define the parameters imposed by the UCC.

First, this article addresses the extent to which parties may freely contract out of Article 2. Second, it identifies the methods available for minimizing a seller’s obligation of performance, a buyer’s right to complain regarding the quality of a seller’s performance, and a seller’s responsibility for failing to perform. Finally, this article assesses, as part of the discussion, whether UCC norms and policing tools constrain a seller to meet minimum UCC standards.

## II. FREEDOM OF CONTRACTING

UCC section 1-302 of Revised Article 1 propounds a broad public policy of freedom of contracting between parties to transactions subject to the UCC.<sup>6</sup> Indeed, Official Comment 2 to this section suggests that parties may opt-out of the UCC. In pertinent part, it provides:

An agreement that varies the effect of provisions of the Uniform Commercial Code may do so by stating the rules that will govern in lieu of the provisions varied. Alternatively, the parties may vary the effect of such provisions by stating their relationship will be governed by recognized bodies of rules or principles applicable to commercial transactions. Such bodies of rules or principles may include, for example, those that are promulgated by intergovernmental authorities such as UNCITRAL or Unidroit (*see, e.g.,* Unidroit Principles of International Commercial Contracts), or non-legal codes such as trade codes.<sup>7</sup>

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5. The focus of this article, unless otherwise indicated, is unamended Article 2 of the Uniform Commercial Code (UCC or Code). The unamended article will be cited as U.C.C. § 2-xxx (2000); the amended version of Article 2 will be cited as U.C.C. § 2-xxx (2003). Revised Article 1 will be cited as U.C.C. § 1-xxx (2001).

6. *See* U.C.C. § 1-302 (2001).

7. *Id.* § 1-302 cmt. 2.

Thus, under Revised Article 1, parties to a transaction within the scope of Article 2 may opt-out of Article 2's "variable" provisions but remain subject to its mandatory provisions.<sup>8</sup> Hence, the broad policy of freedom of contracting in the Code is not an absolute one.

This right to vary the effect or consequences of the Code's standards is "subject to specific exceptions," some expressed, some implied.<sup>9</sup> Sections of the Code may be construed as mandatory and not subject to variance because a provision expressly prohibits variance; construction of the language suggests that the section is mandatory rather than discretionary; or some general public policy supports a conclusion that a provision is a mandatory one.<sup>10</sup> This right to vary terms is fraught with complexities if the limits suggested by section 1-302, Comment 2 are pursued.

Consider a seller whose burgeoning sales increasingly involve trade with international parties. The seller may desire the efficiency of having the same terms in both its domestic and international

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8. *Id.* § 1-302.

9. *Id.* § 1-302 cmt. 1.

10. The following provisions should be construed as mandatory. 1) *Statute of Frauds—UCC § 2-201 Formal Requirements; Statute of Frauds.* See *infra* notes 16–17 and accompanying text. 2) *The Parol Evidence Rule—UCC § 2-202 Final Written Expression in a Record: Parol or Extrinsic Evidence.* See *infra* notes 18–22 and accompanying text. 3) *UCC § 2-302 Unconscionable Contract or Clause.* Section 2-302 provides a substantive tool designed to encourage uniformity in policing bargains to prevent oppression and unfair surprise; parties may not, by agreement, negate the applicability of the provision. 4) *UCC § 2-318 Third Party Beneficiaries of Warranties Express or Implied.* Each of the statutory alternatives that extend the rights of express and implied warranties to third parties expressly prohibits the exclusion or limitation of a seller's liability to third parties for warranties made by the seller to its buyer. 5) *UCC § 2-603 Merchant Buyer's Duties as to Rightfully Rejected Goods.* Here, the language of the section is mandatory rather than discretionary and the duty to follow the seller's instructions or to resell when none are given is imposed as a matter of good faith and commercial necessity. 6) *Duty to Mitigate Damages—UCC § 2-715 (2)(a).* The section restates a general public policy of a buyer's duty to mitigate damages. See U.C.C. § 2-715 cmt. 2 (2000); U.C.C. §§ 1-103, 1-106 cmt. 1, 1-305 cmt. 1 (2001) (common law duty to mitigate damages); see also U.C.C. § 2-803(b) (Draft, March 1999) (mitigation requirements bar aggrieved parties to transactions from recovering the portion of losses resulting from breach of contracts that could have been avoided by "reasonable measures under the circumstances"). 7) *UCC § 2-718 Liquidation or Limitation of Damages; Deposits.* Agreements liquidating damages must be reasonable. 8) *UCC § 2-719 Contractual Modification or Limitation of Remedy.* An agreement must provide a "fair quantum" of a remedy and the limitation of consequential damages cannot be unconscionable. 9) *UCC § 2-725 Statute of Limitations in Contracts for Sale.* The statutory provision defining a default rule for the statute of limitations expressly limits variation to not less than one year and not more than four years.

In addition to these mandatory sections, several sections are partially mandatory in character. See, e.g., U.C.C. §§ 2-403(2), 2-607(1), (4) (2000).

deals.<sup>11</sup> With this goal in mind, consider an attempt by the seller in a transaction with a domestic buyer to opt-out of Article 2 and select the UNIDROIT Principles of International Commercial Contracts<sup>12</sup> to govern their relationship as suggested by Comment 2 to Revised UCC section 1-302. The UNIDROIT Principles contain neither a statute of frauds<sup>13</sup> nor a parol evidence rule.<sup>14</sup> Yet, the parties remain subject to UCC sections 2-201 and 2-202. This result is effectuated by the strong public policy rationale for both rules, rather than an express prohibition in either statutory provision.<sup>15</sup>

The general public policy goals of preventing perjury and fraud while promoting certainty, deliberateness, and caution support a conclusion that section 2-201, the Statute of Frauds, is mandatory despite the absence of express language in the section.<sup>16</sup> Commentary in both Revised Article 1 and Amended Article 2 reinforce this conclusion.<sup>17</sup> Likewise, Article 2's Parol Evidence Rule is a substantive rule governing the admissibility of extrinsic evidence to establish that a term or terms omitted from the record were agreed to and should be enforced as part of the agreement.<sup>18</sup> The rule limits the character of evidence that the fact finder may consider in determining the enforceable circle of assent between the

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11. See *supra* text accompanying notes 1–4.

12. PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (UNIDROIT 1994) [hereinafter UNIDROIT Principles].

13. *Id.* art. 1.2.

14. See *id.* art. 4.3.

15. See U.C.C. §§ 2-201, 2-202 (2000); *infra* notes 16–22 and accompanying text.

16. UCC section 2-201 reads as follows:

2-201 Formal Requirements; Statute of Frauds.

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

U.C.C. § 2-201 (2000). See generally JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS § 19.1 (5th ed. 2003) (describing the public policy supporting the statute of frauds and also impliedly recognizing the statute of frauds as a mandatory provision).

17. See U.C.C. § 1-302 cmt. 1 (2001); U.C.C. § 2-201 cmts. 1, 4 (2003) (stating “three definite and *invariable* requirements” for a sufficient memorandum and the effect of a failure to satisfy the provision (emphasis added)).

18. See U.C.C. § 2-202 (2000).

parties.<sup>19</sup> The rule states a general public policy goal of giving deference to a record *intended* by the parties as a final expression of some or all of their agreement.<sup>20</sup> Terms upon which confirmatory memoranda agree and a record determined by the courts to be intended as a final expression are subject to the rule's protection.<sup>21</sup> A statement that the Parol Evidence Rule shall not be applied to a record or a general attempt at opting out of the Code is ineffective for circumscribing the court's ability to apply prevailing analysis to the record. Parties must comply with the principles of the Parol Evidence Rule, such as the use or omission of a merger clause, to drive the court's analysis as it seeks to glean the intent of the parties regarding the effect of the final writing.<sup>22</sup>

*A. Opting-In the Convention on Contracts  
for the International Sale of Goods*

Could the parties opt-in the Convention on Contracts for the International Sale of Goods<sup>23</sup> by designating the CISG rather than the UNIDROIT Principles as section 1-302 suggests?<sup>24</sup> Revised section 1-301 grants broad party autonomy to commercial parties in choosing the applicable law, only limiting their designation to that of a state<sup>25</sup> in domestic transactions.<sup>26</sup> However, the majority of jurisdictions codifying Revised Article 1 enacted former section 1-105 as a non-uniform provision rather than Revised Article 1 section 1-301.<sup>27</sup> The non-uniform enactment restricts party designation to

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19. *See id.*

20. *See id.*

21. *Id.*

22. *See, e.g.,* Telecom Int'l Am. Ltd. v. AT&T Corp., 280 F.3d 175, 190–92 (2d Cir. 2001). *But see* L.S. Heath & Son, Inc. v. AT&T Info. Sys., 9 F.3d 561, 569 (7th Cir. 1993) (holding that the writing was not completely integrated despite the presence of a merger clause).

23. Currently, 67 nations are parties to the treaty, with the treaty entering into force for the last two parties, Liberia and Paraguay, on October 1, 2006 and February 1, 2007, respectively. United Nations Commission on International Trade Law, Status of the 1980 United Nations Convention on Contracts for the International Sale of Goods, [http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html) (last visited Oct. 5, 2006).

24. *See* U.C.C. § 1-302 cmt. 2 (2001).

25. "'State' means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States." *Id.* § 1-201(38).

26. *Id.* § 1-301(c)(1).

27. States adopting the non-uniform provision of former Section 1-105 (2000) for their Choice of Law rule include: ALA. CODE § 7-1-301 (Supp. 2006); ARK. CODE ANN. § 4-1-301 (Supp. 2005); CONN. GEN. STAT. § 42a-1-301 (Supp. 2006); DEL. CODE ANN. tit. 6 § 1-301

the law of a state or nation that has a reasonable relationship to the transaction.<sup>28</sup>

Whether the state codified the more restrictive choice of law provision or the promulgated version, use of the UNIDROIT Principles for variable default provisions is facilitated by designating the law of a state in the agreement, such as Alabama, and the presence of Revised section 1-302 as a part of that state's laws.<sup>29</sup> The same should be true for designating the CISG as the source of law for all variable provisions. Section 1-302 of Alabama's Code authorizes the designation of "bodies of rules or principles applicable to commercial transactions," such as, "those that are promulgated by intergovernmental authorities such as UNCITRAL . . . ."<sup>30</sup> Certainly, the parties may, in a section by section variance on the consequences of the default provisions of the Code, create an agreement that is consistent with the provisions of the CISG.<sup>31</sup> But, whether the shorthand designation of the CISG is effective must be resolved. The CISG was promulgated by UNCITRAL.<sup>32</sup> However, one must ask whether, as positive law in Alabama and nations that have acceded to the CISG, the CISG is, for a domestic transaction, something more than a "body of rules" and, therefore, ineligible for selection under the commentary to Revised section 1-302.<sup>33</sup>

At the very least, one might argue that selection of the CISG, by employing Revised section 1-302 and Comment 2, appears contrary to the spirit of the promulgated version of Revised section 1-301—

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(2005); HAW. REV. STAT. § 490:1-301 (Supp. 2005); IDAHO CODE ANN. § 28-1-301 (Supp. 2006); MINN. STAT. § 336.1-301 (Supp. 2006); MONT. CODE ANN. § 30-1-301 (2005); NEB. REV. STAT. § 1-301 (Supp. 2005); NEV. REV. STAT. § 104.1301 (Supp. 2005); N.M. STAT. § 55-1-301 (2005); OKLA. STAT. tit. 12A, § 1-301 (Supp. 2005); TEX. BUS. & COM. CODE ANN. § 1.301 (Vernon Supp. 2006); VA. CODE ANN. § 8.1A-301 (Supp. 2006).

28. UCC section 1-105(1) reads as follows:

Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

U.C.C. § 1-105(1) (2000) (current version at UCC § 1-301 (2001)).

29. See *infra* note 30 and accompanying text.

30. ALA. CODE § 7-1-302 cmt. 2.

31. See *id.*

32. See United Nations Convention on Contracts for the International Sales of Goods, G.A. Res. 35/51, ¶ 8, U.N. Doc. A/RES/35/51 (Dec. 4, 1980).

33. See U.C.C. § 1-302, cmt. 2 (2001).

the specific statutory provision governing choice of law. Section 1-301 limits party autonomy in domestic transactions to designating the law of a “state.”<sup>34</sup> This conclusion, however, is a hasty one. Pursuant to the Supremacy Clause,<sup>35</sup> the CISG is the law of every state in the Union;<sup>36</sup> consequently, the spirit of promulgated section 1-301 is not violated.<sup>37</sup> Likewise, in those jurisdictions with the non-uniform codification of section 1-301,<sup>38</sup> the fact that the CISG addresses goods in cross-border transactions is irrelevant. If the transaction is reasonably related to the state or nation whose law the parties designated, as in our hypothetical case of Alabama, the spirit of section 1-301 is not violated. Indeed, because the CISG is commercial law governing commercial transactions within its scope in the State of Alabama,<sup>39</sup> the CISG is more appropriate than designating the UNIDROIT Principles. Furthermore, the designation of the CISG as the source of law for variable provisions does not offend the Code’s goals of uniformity and simplicity of commercial law.<sup>40</sup> The parties are free to tailor their agreement, making it relevant to their needs for terms that otherwise state broad, general standards of reasonableness.

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34. *See id.* § 1-301.

35. U.S. CONST. art. VI, § 2.

36. *See* CISG, *supra* note 4.

37. The United State Supreme court stated:

Federal law is enforceable in state courts not because Congress has determined that federal courts would otherwise be burdened or that state courts might provide a more convenient forum—although both might well be true—but because the Constitution and laws passed pursuant to it are as much laws in the States as laws passed by the state legislature. The Supremacy Clause makes those laws “the supreme Law of the Land,” and charges state courts with a coordinate responsibility to enforce that law according to their regular modes of procedure. “The laws of the United States are laws in the several States, and just as much binding on the citizens and courts thereof as the State laws are. . . . The two together form one system of jurisprudence, which constitutes the law of the land for the State . . . .”

Howlett v. Rose, 496 U.S. 356, 367 (1990). *See generally* Henry M. Hart, Jr., *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489 (1954) (stating that the interaction between the federal and state governments is complex, ultimately there is only one system of law in the United States).

38. *See, e.g.*, ALA. CODE § 7-1-301 (Supp. 2005).

39. *See* U.S. Ratification of 1980 United Nations Convention on Contracts for the International Sale of Goods, 52 Fed. Reg. 6262 (Mar. 2, 1987).

40. *See* U.C.C. § 1-103 (2001).

*B. Designating the Law of a Nation in a Domestic Transaction*

Consider an attempt by domestic parties to designate the law of a foreign nation for the variable provisions of Article 2. Suppose that Buyer, with a business in Nebraska, and Seller, with a business in Alabama, agree that Nebraska state law will govern their sales transaction. Both Alabama and Nebraska have codified the non-uniform version of section 1-301.<sup>41</sup> The parties also agree that the UNIDROIT Principles will govern all variable rights and obligations. Such an agreement is supported by UCC section 1-302 and its commentary.<sup>42</sup> The parties further agree that the Ontario Frustrated Contracts Act<sup>43</sup> will apply to their transaction and govern issues of exemption. This designation, however, may be more than a “body of rules” and, therefore, ineligible for selection under the commentary to Revised section 1-302.

Clearly, the parties may draft a provision defining the rights and obligations of the parties upon the occurrence of a frustrating event, with the analogous effect to that under the OFCA.<sup>44</sup> State law empowers the parties to vary the terms of default provisions.<sup>45</sup> Nevertheless, designating the OFCA, which is a body of rules on frustrated contracts, may not be as effective as a draft provision delineating the rights and obligations that are a by-product of the OFCA. Using the shortcut designation—the OFCA—rather than stating the consequences of the application of the OFCA, the parties incur the risk of a domestic court’s misconstruction of the effect of the foreign law. Designating the OFCA in a contract is comprehensive because it necessarily includes all case law construing and applying the provision.

More importantly, Comment 2 to the promulgated version of UCC section 1-301 provides the definition of the permissible scope of the term “bodies of rules or principles” for section 1-302.<sup>46</sup> These bodies of rules or principles must be promulgated by *intergovernmental organizations* such as UNCITRAL or

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41. See ALA. CODE § 7-1-301 (Supp. 2006); NEB. REV. STAT. § 1-301 (Supp. 2005).

42. See U.C.C. § 1-302 cmt. 2. (2001).

43. Frustrated Contracts Act, R.S.O., ch. F.34 (1990) [hereinafter OFCA].

44. See ALA. CODE § 7-1-302; NEB. REV. STAT. § 1-302.

45. ALA. CODE § 7-1-302; NEB. REV. STAT. § 1-302.

46. U.C.C. § 1-301 cmt. 2 (2001).

UNIDROIT.<sup>47</sup> The OFCA is not promulgated by an intergovernmental organization and thus fails to satisfy this definition. The designation also violates the limited circumscription on party autonomy in domestic transactions.

In jurisdictions with the more restrictive, non-uniform version of section 1-301, the OFCA may be designated only *if* the transaction is reasonably related to Ontario; otherwise, the designation should be ruled ineffective.<sup>48</sup> The non-uniform version of UCC section 1-301 states a strong public policy on the designation of law that is reasonably related to the transaction.<sup>49</sup> Unless the transaction bears a reasonable relationship to Ontario, the court should not apply Ontario law.<sup>50</sup> Likewise, the limitation to party autonomy in the promulgated version of 1-301 effectively bars the shorthand designation of the OFCA. Here, the power is limited to the designation of the law of a state.

Revised section 1-302 states a broad freedom of contracting, but this freedom is limited to varying the effect of default rules and establishing standards for measuring the obligations of good faith, diligence, or reasonableness. A variation of the default rules may be achieved by stating rules other than the Code which will govern the contract or by designating “recognized bodies of rules or principles” to govern the relationship.<sup>51</sup> Recognized bodies of rules and principles reasonably include references to INCOTERMS,<sup>52</sup> the UCP,<sup>53</sup> and international conventions designed to harmonize diverse national laws.<sup>54</sup>

### III. CONTRACTING OUT: DRAFTING THE AGREEMENT

#### A. *Hybrid or Mixed Transactions*

The prevailing test for the applicability of Article 2 to hybrid

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47. *Id.*

48. *See* U.C.C. § 1-105 (2000).

49. *See id.*

50. *See id.*

51. U.C.C. § 1-302 cmt. 2 (2001).

52. INT’L CHAMBER OF COMMERCE, INCOTERMS 2000 (2000).

53. INT’L CHAMBER OF COMMERCE, ICC UNIF. CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (revised ed. 1993).

54. *See* U.C.C. § 1-302 cmt. 2 (2001).

transactions is the “predominate feature” or “purpose” test.<sup>55</sup> Courts use other labels, including “essence of the agreement,” when ascertaining the thrust or purpose of the agreement between the parties.<sup>56</sup> If the predominate feature of the agreement is the goods component of the transaction, Article 2 and its warranties apply to the entire obligation of the seller, including the service component.<sup>57</sup> Whether the “mix” is goods and services, or goods, intangibles, and real estate, courts consider the language of the contract and the intrinsic worth of the goods relative to the contract price.<sup>58</sup> If the “mix” is goods and services, the nature of the supplier’s business in general and, specifically, in the contract in question, becomes relevant.<sup>59</sup>

In drafting the agreement, the scrivener can drive the court’s determination by reflecting an intent that the predominate purpose of the agreement is the provision of a service and not the acquisition of goods. The following factors are given considerable weight as a court seeks to determine the “purpose” or “essence” of the agreement: the title of the agreement as a service or licensing

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55. *Coakley & Williams, Inc. v. Shatterproof Glass Corp.*, 706 F.2d 456, 459–60 (4th Cir. 1983) (explaining the predominate feature or purpose test).

56. *See generally id.*; *Proto Constr. & Dev. Corp. v. Superior Precast, Inc.*, No. 99-CV-2851(NG), 2002 WL 1159593 at \*7 (E.D.N.Y. May 28, 2002) (discussing the “main objective sought to be accomplished by the contracting parties” or the “dominant element of the agreement” (quoting *Hunter’s Run Stables, Inc. v. Triple H. Constr. Co.*, 938 F. Supp. 166, 168 (W.D.N.Y. 1996))).

57. *See Besicorp Group, Inc. v. Thermo Electron Corp.*, 981 F. Supp. 86, 95 (N.D.N.Y. 1997) (applying Massachusetts law); *Pittsley v. Houser*, 875 P.2d 232, 235 (Idaho Ct. App. 1994) (remanding the case for failure to apply the UCC to a contract for the purchase and installation of carpet); *B & B Refrigeration & Air Conditioning Serv., Inc. v. Haifley*, 25 U.C.C. Rep. Serv. (CBC) 635, 636 (D.C. Super. Ct. 1978). *But see Coca-Cola Bottling Co. of Cape Cod v. Weston & Sampson Eng’rs, Inc.*, 695 N.E.2d 688, 691 n.6 (Mass. App. Ct. 1998) (declining to apply the UCC to a contract for the design, construction, operation, and completion of a wastewater treatment facility).

58. *See, e.g., Dravo Corp. v. White Consol. Indus.*, 602 F. Supp. 1136, 1140–41 (W.D. Pa. 1985) (holding that under the “*essential bulk of the assets to be transferred*” test, the parties’ transaction was not one for sale of goods because two assets that represented more than half of the purchase price for two subsidiaries were (a) the ideas conveyed in drawings and tracings, and (b) a five-year non-competition agreement); *Robertson v. Ceola*, 501 S.W.2d 764, 766–67 (Ark. 1973) (holding that the essence of the agreement to install tile in the owner’s home was a personal services contract despite the \$15,000 cost for the tile supplied, the \$12 per hour charge for installation, plus 15% of cost of goods charged by the installer); *McFadden v. Imus*, 481 N.W.2d 812, 813–14 (Mich. Ct. App. 1992) (employing the “*reasonable totality of the circumstances test*” the court held that the UCC did not apply to the sale of an automobile dealership that included real estate, good will, and hard assets).

59. *Coakley & Williams*, 706 F.2d at 460.

agreement;<sup>60</sup> a statement that the purchaser's primary goal or purpose is not the acquisition of goods but rather the acquisition of *the* supplier's expertise and skill as a service provider;<sup>61</sup> an indication that the agreement is a deviation from the supplier's ordinary course of business as a seller of goods; and a statement of the total purchase price without allocating a portion for the value for the goods.<sup>62</sup> By employing these features, the parties effectively opt-out of Article 2 with the obligation of performance imposed by its warranties.

### *B. Agreements Within the Scope of Article 2*

A seller seeking to contract out of Article 2 will have one of three goals or a combination thereof: (1) minimizing its obligation of performance; (2) minimizing the buyer's right to complain about the performance received; or (3) minimizing its *responsibility* for failing to deliver goods consistent with its obligation of performance. A combination of the three is possible under Article 2. Although domestic jurisprudence does not obligate the seller to negotiate in good faith, the enforceability of an agreement may be challenged if it is so imbalanced that it is unconscionable.<sup>63</sup>

#### 1. Minimizing the Seller's Obligation of Performance

As a general principle, a seller may minimize its obligation of performance without violating its duty of good faith and, thus, curtail

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60. *See, e.g.,* Saint Anne-Nackawic Pulp Co. v. Research-Cottrell, Inc., 788 F. Supp. 729, 734 (S.D.N.Y. 1992) (holding that the title of the agreement and the small percentage of the purchase price allocated to services drove the determination of the applicability of the UCC to the transaction); Space Leasing Assocs. v. Atl. Bldg. Sys., Inc., 241 S.E.2d 438, 441 (Ga. Ct. App. 1977) (holding that the title of a subcontract for the construction and installation of a metal roof, "Contract for Sale and Erection of Dixisteel Building(s)," raised a question of fact of whether the subject of the transaction was goods).

61. *Care Display, Inc. v. Didde-Glaser, Inc.*, 589 P.2d 599, 605 (Kan. 1979) (holding that the development of an artistic or design concept rather than the actual physical production of a display booth and the materials to be used in the display booth were the primary concerns during contract negotiations); *Westvaco Corp. v. Int'l Chimney Corp.*, 672 N.Y.S.2d 330, 331 (App. Div. 1998) (holding that the four-year statute of limitations of UCC Section 2-725 was applicable when a clause in the contract provided that "to the extent that the agreement involved the purchase of services, such services were to be regarded as goods for the purpose of determining the obligations of the parties").

62. *Inhabitants of the City of Saco v. Gen. Elec. Co.*, 779 F. Supp. 186, 197 (D. Me. 1991) (the court considered the recital, the fixed fee that did not allocate the price between the components of the agreements, and the title of the agreement).

63. RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. c (1981); *see also infra* notes 80–81 and accompanying text (discussing unconscionability as a policing tool for Article 2 transactions).

its obligation of satisfying the standards of performance established and imposed by Article 2. Indeed, Article 2 provides the mechanism for such reductions. By employing effective disclaimers of implied warranties that satisfy the conspicuousness requirement,<sup>64</sup> the obligation to meet industry standards or those imposed by a course of dealing is avoided.<sup>65</sup> This freedom to contract out of the standards of performance and privately order the relationship is subject to regulation by public law. Policing tools such as the doctrine of unconscionability<sup>66</sup> and the buyer's reasonable expectations are used to adjust the seller's obligation. Likewise, contract formation principles control the sudden use of a disclaimer or the repeated use of a disclaimer in an ongoing contractual relationship based on the exchange of forms.<sup>67</sup> Express warranties are not obviated with the same ease as implied warranties.<sup>68</sup>

*a. Express warranties*

A seller may use affirmations, descriptions, promises, and samples or models to induce the buyer's agreement to purchase his or her wares. Article 2 treats these expressions as express warranties and obligations of performance when such affirmations, descriptions, and samples or models are part of the basis of the bargain.<sup>69</sup> This principle gives effect to the buyer's reasonable expectation as induced by the seller's conduct. More importantly, express warranties cannot be disclaimed.<sup>70</sup> Any negation of express

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64. Section 1-201 defines conspicuous as a term written, displayed, or presented in a way that it "ought to be noticed" by a reasonable person. U.C.C. § 1-201(10) (2001).

65. U.C.C. Section 2-316 reads as follows:

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

U.C.C. § 2-316 (2000).

66. *Id.* § 2-302; *see, e.g.*, *Martin v. Joseph Harris Co.*, 767 F.2d 296, 299–303 (6th Cir. 1985) (questioned on other grounds).

67. *See, e.g.*, *Trans-Aire Int'l v. N. Adhesive Co.*, 882 F.2d 1254, 1262 (7th Cir. 1989); *Diamond Fruit Growers, Inc. v. Krack, Co.*, 794 F.2d 1440, 1445 (9th Cir. 1986); *Tuck Industries v. Reichhold Chemicals, Inc.*, 542 N.Y.S.2d 676, 678 (App. Div. 1989); *Se. Adhesive Co. v. Funder Am., Inc.*, 366 S.E.2d 505, 507 (N.C. Ct. App. 1988).

68. U.C.C. § 2-316.

69. *Id.* § 2-313.

70. *See id.* § 2-313 cmt. 1; *id.* § 2-316(1).

warranties must be construed, if reasonable, as consistent with the express warranty; if it is not reasonable to do so, the negation fails.<sup>71</sup> A seller may not induce a bargain and create a reasonable expectation that the goods will conform to the description or sample and then disclaim the obligation.<sup>72</sup> Notwithstanding the statutory limitation on disclaiming an express warranty, a seller may achieve such a result through the use of a merger clause in the final agreement.

Assume the seller makes a statement regarding the quality of the goods with the expectation of including a merger clause in the agreement. The inclusion of a merger clause in the subsequent written agreement bars the admission of evidence of prior oral or prior written express warranties,<sup>73</sup> negating the seller's obligation to perform consistent with the statements, affirmations, descriptions, promises, and samples or models that it used to induce the transaction. Article 2's prohibition on disclaiming express warranties is subject to the Parol Evidence Rule,<sup>74</sup> one of the mandatory rules of Article 2.<sup>75</sup> If evidence of the express warranty is inadmissible, the buyer cannot prove the obligation and it is not, therefore, a part of the contract. Some courts avoid this effect by holding that, although the written agreement contains the merger clause, (1) it is not "*intended*" by *both* parties as a final expression,<sup>76</sup>

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71. *Id.* § 2-316(1).

72. *Id.* § 2-316 cmt. 1.

73. U.C.C. Section 2-202, the Parol Evidence Rule, reads as follows:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented (a) by course of performance, course of dealing, or usage of trade (Section 1-303); and (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

*Id.* § 2-202.

74. *Id.* § 2-316(1).

75. *See supra* notes 18–22 and accompanying text.

76. *See, e.g.,* Husky Spray Serv., Inc. v. Patzer, 471 N.W.2d 146, 148–52 (S.D. 1991) (applying North Dakota law and holding that “where the express representations made by seller are claimed to be inconsistent with the form language of the contract, parol evidence may be admitted to determine whether the written contract is a final expression of the parties’ agreement and whether the warranty, or disclaimer thereof, was part of the bargain explicitly negotiated between the parties”); O’Neil v. Int’l Harvester Co., 575 P.2d 862, 865 (Colo. Ct. App. 1978) (holding that oral express warranties and seller’s conduct after the sale raised a material issue of

(2) the merger clause is unconscionable,<sup>77</sup> or (3) the seller's conduct is fraudulent, thereby nullifying the merger clause's bar on the admission of evidence of fraud as a recognized exception to the Parol Evidence Rule.<sup>78</sup> Despite these alternatives, merger clauses and disclaimers have been upheld even in consumer transactions.<sup>79</sup>

To dissuade lessors from engaging in such conduct, Article 2A specifically addresses this type of duplicitous conduct in consumer transactions. The comment to section 2A-108(2)<sup>80</sup> provides that "[t]o make a statement to induce the *consumer* to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, *may* be unconscionable."<sup>81</sup>

#### *b. Warranties of future performance*

A seller effectively limits its obligation of performance when it eschews making express warranties, especially express warranties of

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whether the writing was intended as a final expression); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 214 (1989) (explaining that an agreement or negotiation prior to or contemporaneous with the adoption of the writing is admissible to establish that an agreement is not integrated or that it is only partially integrated).

77. *Seibel v. Layne & Bowler, Inc.*, 641 P.2d 668, 671 (1982) (holding that an inconspicuous merger clause provided little evidence of the parties' intent and was unconscionable; the merger clause did not bar admission of the express oral warranties).

78. *See, e.g., Lou Bachrodt Chevrolet, Inc. v. Savage*, 570 So.2d 306, 307–08 (Fla. Dist. Ct. App. 1990) (holding that where buyer alleged fraudulent inducement, parol evidence rule did not bar admission of affirmations that induced the sale containing an "as is" warranty). *But see* *Sunset Pointe at Silver Lakes Assocs. v. Vargas*, 881 So.2d 12, 13–14 (Fla. Dist. Ct. App. 2004) (limiting, in a nongoods setting, *Lou Bachrodt Chevrolet*, 570 So.2d 306, to the introduction of evidence that does not contradict the writing).

79. *See, e.g., Green Chevrolet Co. v. Kemp*, 406 S.W.2d 142, 143–44 (Ark. 1966) (holding that buyer's testimony that seller made an oral warranty of repair before the parties signed a writing with a merger clause was inadmissible because the testimony contradicted the writing); *Avery v. Aladdin Prod. Div., Nat'l Serv. Indus.*, 196 S.E.2d 357, 358 (Ga. Ct. App. 1973) (holding that parol evidence establishing an oral warranty of "good condition" was inadmissible because it contradicted the writing that disclaimed all warranties and contained a statement that no representations exist beyond those in the writing; the court further held that the writing was not unconscionable).

80. U.C.C. section 2A-108(2) reads as follows:

With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

U.C.C. § 2A-108(2) (2000).

81. *Id.* § 2A-108 official cmt. (emphasis added); *accord* U.C.C. § 2A-108 official cmt. (2003).

future performance. Without a warranty of future performance, an action accrues for a breach of warranty upon tender of delivery.<sup>82</sup> Even though a defect may be latent, a breach of warranty occurs at tender of delivery, including any installation, and the statute of limitations commences to run.<sup>83</sup> In such cases the goods are only warranted to *conform* to express warranties at tender of delivery, not beyond.<sup>84</sup> The discovery rule is inapplicable and the statute of limitations commences at delivery without the necessity of the buyer's discovery of the defect.<sup>85</sup>

A seller may effectively erode a buyer's right to complain about the quality of performance by omitting a warranty of future performance and reducing the statute of limitations to the permissible one year.<sup>86</sup> However, attempted repairs after delivery and before the lapse of the limitation period may operate as "repair estoppel" as recognized in several jurisdictions.<sup>87</sup> "Repair estoppel" is employed by jurisdictions to toll or arrest the running of the statute of limitations to protect buyers if a seller engages in *affirmative* acts to defeat the buyer's cause of action.<sup>88</sup>

#### i. Creating a warranty of future performance

Warranties of future performance expressly warrant that the goods will perform or retain specified qualities for a stated period of time.<sup>89</sup> Language such as "the goods will be free from defects in materials and workmanship for a period of the earlier of 50,000 miles or 5 years" creates a warranty of future performance. When the seller creates a warranty of future performance, accrual of the

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82. U.C.C. § 2-725(2) (2000).

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* § 2-725(1).

87. *Agristor Leasing v. Kramer*, 640 F. Supp. 187, 190–91 (D. Min. 1986) (applying Minnesota law and holding that the buyer failed to establish a representation to serve as a basis of an estoppel for tolling the statute of limitations); *Ranker v. Skyline Corp.*, 493 A.2d 706, 709 (Pa. Super. 1985) (recognizing that repair estoppel will toll the statute of limitations if the seller has attempted to repair a defect and made "a representation that the repairs have cured or will cure the defect" and holding that the doctrine was not satisfied in this case); *see also* *Rose City Paper Box, Inc. v. Egenolf Graphic Mach. Int'l Inc.*, 827 F. Supp. 646, 650 (D. Or. 1993) (addressing the use of equitable estoppel to bar the assertion of the statute of limitations as a defense).

88. *Id.*

89. *See* U.C.C. § 2-313 (2000).

buyer's cause of action awaits discovery of the breach.<sup>90</sup> Also, the statute of limitations commences to run when the breach is or should have been discovered.<sup>91</sup> Because statements constituting warranties of future performance are strictly construed, ambiguous language such as "years of trouble free boating"<sup>92</sup> and the "wood is deep-treated to *permanently* protect against rot"<sup>93</sup> are not warranties of future performance.<sup>94</sup> Although imprecise, a statement by a seller that its product would "out-last the product previously used to treat [the buyer's] millwork," a period of twenty-six years, was held by the Eighth Circuit to create a question of fact for the jury.<sup>95</sup>

Article 2A's accrual provision is distinguishable.<sup>96</sup> It employs the more lenient discovery rule of tort law rather than the stringent rule codified in unamended Article 2.<sup>97</sup> In a lease transaction, an action accrues for breach of warranty when the act or omission that is the basis for the breach is or should have been discovered.<sup>98</sup> No warranty of future performance is required to suspend the running of the statute of limitations until discovery; a lessee is protected from the running of the statute of limitations before the discovery of the lessor's breach.<sup>99</sup>

Article 2A's discovery rule is justified by more than a desire for leniency by its drafters. The contractual relationship between the lessor and lessee is distinguishable from that of the buyer and the

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90. *Id.* § 2-725(2).

91. *Id.*

92. *Sherman v. Sea Ray Boats, Inc.*, 649 N.W.2d 783, 791 (Mich. Ct. App. 2002).

93. *Selzer v. Brunsell Bros.*, 652 N.W.2d 806, 814 (Wis. Ct. App. 2002).

94. *See, e.g., R.W. Murray Co. v. Shatterproof Glass Corp.*, 697 F.2d 818, 823 (8th Cir. 1983) (applying Missouri law which requires an unambiguous indication that the goods are warranted for a specified period of time and finding an express warranty of future performance); *Selzer*, 652 N.W.2d at 814 (holding that vague language will not create a warranty of future performance).

95. *Marvin Lumber & Cedar Co. v. PPG Indus.*, 223 F.3d 873, 880 (8th Cir. 2000) (applying Minnesota law).

96. UCC Section 2A-506(2) states that "[a] cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later." U.C.C. § 2A-506(2) (2000).

97. *Id.* § 2A-506(2) official cmt.; *see also* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 11-9 (4th ed. 1995) (distinguishing the applicable accrual of the statute of limitations for sales transactions and tort actions).

98. U.C.C. § 2A-506(2).

99. *Id.*

seller. Similarly, the position of the lessee vis-a-vis the goods is very different from that of the buyer. Parties to a lease transaction have an on-going relationship for the lease term and may resolve malfunctions as a process of the on-going relationship. The lessor's residuary interest in the goods warrants a continuing dialogue with the lessee. In recognition of the on-going relationship, and unlike section 2-725, section 2A-506 permits the extension of the statute of limitations beyond the four-year default period.<sup>100</sup> Unlike the buyer who acquires title to the goods, the lessee has no right to sell the goods and repurchase substitute goods when those tendered fail to satisfy its needs. Unless the nonconformity substantially impairs the value of the goods to the lessee, no right of revocation of its acceptance is available.<sup>101</sup>

Article 2's stringent non-discovery rule was adopted to implement the general public policy of encouraging immediate litigation within a period that some argue is consistent with the general record retention practices of commercial parties.<sup>102</sup> The 2003 Amendments to Article 2 maintain the previously established policy goal but with some increased leniency. The amended Statute of Limitations maintains the four-year default rule without granting parties the ability to extend it but adds a one-year discovery rule.<sup>103</sup> A buyer must sue for breach of warranty within four years of tender of delivery, including installation, or within one year after the breach was or should have been discovered, but not beyond five years after the action otherwise accrues.<sup>104</sup>

Consider the following illustration of the effect of the amendment to section 2-725. The Seller makes an express warranty regarding the quality of the goods. The Seller delivers the goods on March 15, 2002. The warranty was not a warranty of future performance and, therefore, the action accrues on March 15, 2002. The Buyer discovers the defect, or should have discovered the defect, on March 18, 2006.

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100. *Id.* § 2A-506(1) official cmt. This section "does not incorporate the limitation found in Section 2-725(1) prohibiting the parties from extending the period of limitation." *Id.* Purposes.

101. *Id.* § 2A-517(1).

102. WILLIAM D. HAWKLAND & FRED MILLER, UNIFORM COMMERCIAL CODE SERIES § 2A-506 (2000); U.C.C. § 2-725 official cmt. (2000).

103. U.C.C. § 2-725(1) (2003).

104. *See id.*; *id.* § 2-725(3).

Here, the Buyer's action is time barred under both the general and discovery provisions of amended Article 2, unless the action is commenced on or before March 15, 2007. Under the general provision, the action is time barred on March 15, 2006, four years after tender of delivery and accrual of the action. Although the buyer is given a year from the date that the breach is or should have been discovered, March 18, 2007, the discovery period cannot exceed five years from the accrual of the action or March 15, 2007. Inclusion of the discovery rule period in the statute prevents the inadvertent loss of the right to sue because of time spent in the fourth year investigating the malfunction, providing the seller with notice, permitting repairs, and engaging in negotiations. The amendment is a reasonable attempt to facilitate good faith resolution by the parties without the need for the buyer to commence an action to avoid the loss of its rights.

The amendment to Article 2 also permits parties to reduce the statutory period to not less than one year.<sup>105</sup> If the parties reduce the limitations period to three years without referencing the one-year discovery period, is the discovery period lost? The answer should be yes. In the absence of an agreement between the parties to include a discovery period, any variance of the default rule should completely abrogate, rather than partially abrogate, the four-year/one-year discovery provision. Maintaining the discovery portion of the default rule<sup>106</sup> defeats the goal of the parties in reducing the period for which the seller remains obligated. By agreement, the parties might substitute an absolute four-year limitations period and eliminate the one-year discovery rule that is a part of the default provision, or create a general two-year limitations period with a one-year discovery rule. The Code's general public policy of freedom of contracting supports this flexibility.

*c. Unconscionability: policing seller's attempts  
to minimize its obligation of performance*

Both Article 2 and the Restatement authorize courts to employ the doctrine of unconscionability to police oppressive and unfair

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105. *Id.* § 2-725(1).

106. *Id.* (stating that the default discovery period is "one year after the breach was or should have been discovered, but no longer than five years after the right of action accrued").

surprise in contractual relationships.<sup>107</sup> Prevailing authority recognizes two components of the doctrine, procedural and substantive unconscionability.<sup>108</sup> Both must be present before a term or terms may be held unenforceable.<sup>109</sup> Procedural unconscionability controls the nature and quality of the buyer's assent to the terms of the agreement.<sup>110</sup> Assent must not be extracted through oppression, the absence of meaningful choice, the absence of the opportunity to read and understand the terms, or in the presence of unequal bargaining strength.<sup>111</sup> Substantive unconscionability assays the fairness of the terms that are unduly favorable to one party or unduly harsh to the other in light of existing public policy.<sup>112</sup>

The doctrine of unconscionability is generally thought to be unavailable to police transactions between commercial parties because of the need to establish both procedural unfairness, unfairness in the bargaining process, and substantive unfairness.<sup>113</sup> Although the evidence of procedural unfairness may in fact be slight or non-existent, courts deviate from this general rule and apply the doctrine of unconscionability in a commercial context when addressing a case that involves substantively egregious terms.<sup>114</sup> In these cases, the terms are more than harsh and, indeed, rob one party of rights that reflect a significant public policy in our jurisprudence

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107. U.C.C. § 2-302 (2000); RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981).

108. *See, e.g.*, *Rite Color Chem. Co., Inc. v. Velvet Textile Co., Inc.*, 411 S.E.2d 645, 650 (1992) (upholding the trial court's finding of the absence of substantive unconscionability and impliedly recognizing that a finding of unconscionability is impossible without this element); *Hahn v. Ford Motor Co., Inc.*, 434 N.E.2d 943, 951 (Ind. Ct. App. 1982) (recognizing the two-prong test); *Zapatha v. Dairy Mart, Inc.*, 408 N.E.2d 1370, 1377 n.13 (Mass. 1980) (identifying the two prongs of the unconscionability test).

109. *See Hahn*, 434 N.E.2d at 951; *Zapatha*, 408 N.E.2d at 1377 n.13.

110. *See, e.g.*, *Martin v. Joseph Harris Co.*, 767 F.2d 296, 300–01 (6th Cir. 1985) (questioned on other grounds).

111. *See generally* *Leasing Serv. Corp. v. Broetje*, 545 F. Supp. 362 (S.D.N.Y. 1982) (recognizing extremely one-sided contract terms may be unconscionable); *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.D.C. 1965) (holding contract should not be enforced when unconscionability exists at time contract is formed); *Stenzel v. Dell, Inc.*, 870 A.2d 133 (Me. 2005) (discussing unconscionability of arbitration clauses).

112. *See, e.g.*, *Carboni v. Arrospide*, 2 Cal. Rptr. 2d 845, 848 (Ct. App. 1991); *Nw. Acceptance Corp. v. Almont Gravel, Inc.*, 412 N.W.2d 719, 724 (Mich. Ct. App. 1987); *PacTel Fin. v. D.C. Marine Serv. Corp.*, 518 N.Y.S.2d 317, 318–19 (N.Y. Dist. Ct. 1987).

113. *See* *Byrd Motor Lines, Inc. v. Dunlop Tire & Rubber Corp.*, 304 S.E.2d 773, 776–77 (N.C. Ct. App. 1983) (stating the general view that a finding of an unconscionable limited remedy is rare for commercial parties because the relationship is unlikely to be one-sided).

114. *See infra* note 115.

such as the right to an effective day in court, or the right to a fair adjudication of the rights of the parties.<sup>115</sup> When such rights are abrogated, the seller's limitation of its obligation of performance may be held ineffective.<sup>116</sup>

*C. Minimizing the Right to Complain  
Regarding the Seller's Performance*

Article 2 not only establishes standards for the seller's performance, but it also provides several mechanisms for the buyer to "complain" if the seller fails to meet the standards imposed either by law, such as the implied warranties,<sup>117</sup> or by the express warranties<sup>118</sup> contained in the agreement. However, this right and opportunity to complain may not only be minimized contractually but also effectively abrogated.

A buyer's first opportunity to object to the quality of the goods is after an inspection of the goods. The buyer may "complain" by making a grumbling statement, or by rejecting the goods<sup>119</sup> or by demanding an adequate assurance of performance.<sup>120</sup> This right to inspect the goods, unless the parties otherwise agree, is exercisable before payment and acceptance of the goods.<sup>121</sup> Getting payment before inspection can be achieved under current Article 2 through the use of a shipping term that requires either payment against documents<sup>122</sup> or payment upon delivery without inspection.<sup>123</sup> The

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115. *See, e.g.*, *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 176–77 (Cal. 1981) (involving arbitration clauses in a non-Code case between sophisticated business parties—absence of fair adjudication); *A & M Produce Co. v. FMC Corp.*, 186 Cal. Rptr. 114, 124 (Ct. App. 1982) (involving a contract "between an enormous diversified corporation (FMC) and a relatively small but experienced farming company (A & M)"); *Constr. Assocs. v. Fargo Water Equip. Co.*, 446 N.W.2d 237, 244 (N.D. 1989) (finding unconscionability when buyer, a small construction firm, entered into a contract that lacked negotiation, had terms that created an unfair surprise on buyer, and provided for a limited remedy at delivery that failed of its essential purpose); *First Fed. Fin. Serv. v. Derrington's Chevron, Inc.*, 602 N.W.2d 144, 147–48 (Wis. Ct. App. 1999) (holding that a Wisconsin forum selection clause was unconscionable in a finance lease between California gas station owners with thirty years experience and finance lessor when attention was not called to the terms on the reverse side of the contract that created the finance lease and omitted the finance lessor's identity).

116. *See supra* note 115.

117. U.C.C. §§ 2-314, 2-315 (2000).

118. *Id.* § 2-313.

119. *Id.* § 2-601.

120. *Id.* § 2-609.

121. *Id.* § 2-513(1).

122. *Id.* § 2-513(3)(b).

same results can be achieved under the 2003 Amendments to Article 2 by an agreement that INCOTERMS will govern the shipping obligations and rights of the parties and by agreeing on the appropriate term to achieve the desired effect.<sup>124</sup>

The seller can further limit the buyer's right of inspection by obtaining an agreement on the scope, time, and place of inspection.<sup>125</sup> Absent an agreement, the buyer may inspect "at any reasonable place and time and in any reasonable manner."<sup>126</sup> Pushing the envelope even further, the parties may contractually limit or define the time within which the buyer must give notice of the defects and the time within which to reject the goods.<sup>127</sup> Such limitations set the standard for measuring the reasonableness of the buyer's conduct and are enforceable unless the agreed to standard is *manifestly* unreasonable.<sup>128</sup>

Courts construing the term to determine whether it is "manifestly unreasonable" seek to determine if the term or the operation of a term strips one of the parties of a right or remedy that was either *bargained for*,<sup>129</sup> or granted by a default rule or standard of a particular article.<sup>130</sup> Described as a limitation on the right of

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123. *Id.* § 2-513(3)(a).

124. *See* INT'L CHAMBER OF COMMERCE, *supra* note 53; U.C.C. § 1-302 cmt. 2 (2003).

125. *But see* Plateq Corp. v. Machlett Labs., Inc., 456 A.2d 786, 789 (Conn. 1983) (holding that a buyer did not have the right to inspect *after* installation of the goods).

126. U.C.C. § 2-513(1) (2000). U.C.C. § 2-513 provides:

(1) *Unless otherwise agreed* and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

*Id.* (emphasis added).

127. *Id.*

128. UCC section 1-302(b) reads as follows:

The obligations of good faith, diligence, *reasonableness*, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, *may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.*

*Id.* (emphasis added).

129. *See, e.g.,* Wilson Trading Corp. v. David Ferguson, Ltd., 244 N.E.2d 685, 688-89 (N.Y. 1968) (holding that the operation of a notice provision stripped the buyer of a remedy for defects that were covered by an express warranty but were not discoverable until after the elapse of the notice period).

130. *See, e.g.,* Morgan Bldgs. & Spas, Inc. v. Turn-Key Leasing, Ltd., 97 S.W.3d 871, 880

parties to anticipate and allocate business risks, the construction involves an assessment of the terms of the agreement not the process of bargaining.<sup>131</sup> The manifestly unreasonable test is deferentially applied,<sup>132</sup> without regard to inequity in bargaining strength. The parameter of the test is the agreement itself, including by definition, the relevant course of dealings, trade usage, and course of performance of the parties.<sup>133</sup>

The manifestly unreasonableness test assumes that the agreement falls within the boundary set for conscionable conduct.<sup>134</sup> Hence, the assumption is that the agreement is not subject to invalidation by the doctrine of unconscionability because of oppressive or inequitable dealing unless separately alleged. Although a court may consider many of the same factors such as the language of the terms, the circumstances existing at the time of contracting, and the operation of the terms when addressing either the manifestly unreasonableness test or unconscionability, the scope of inquiry differs.<sup>135</sup> Under the manifestly unreasonableness test, the bargaining process is not an issue. The concerns that drive an assessment of whether a bargain was procedurally unconscionable or whether unfairness occurred in the bargaining process are irrelevant.<sup>136</sup> The focus of the inquiry is whether the agreement has abrogated a right or remedy that is guaranteed by either a default provision or prior bargaining, or whether the agreement has merely defined when that right has been satisfied.<sup>137</sup> If the agreement

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(Tex. App. 2003) (holding that the terms of an amended joint venture agreement were manifestly unreasonable because the terms deprived the buyer's right to advance notice as guaranteed by U.C.C. Article 9).

131. See *PPG Indus. v. Shell Oil Co.*, 919 F.2d 17, 19 (5th Cir. 1990) (addressing whether a force majeure clause that exempted non-performance for explosions within or beyond the control of seller contravened U.C.C. § 1-102(c) duty of good faith and diligence).

132. See *id.* (stating that the manifesting unreasonableness standard is deferentially applied to "contracts of such sophisticated parties as PPG and Shell"). But see *Borowski v. Firststar Bank Milwaukee, N.A.*, 579 N.W.2d 247, 251–53 (Wis. Ct. App. 1998) (holding that a fourteen-day notice period for customers to notify bank of unauthorized signature or alteration was not manifestly unreasonable).

133. U.C.C. § 1-302 cmt. 1 (2001); see also *Nat'l City Bank v. Plechaty Cos.*, 661 N.E.2d 227, 230 (Ohio Ct. App. 1995) (finding affidavits and oral evidence relevant and not excluded by the parol evidence rule in examining the reasonableness of the agreement).

134. *Hart Eng'g Co. v. FMC Corp.*, 593 F. Supp. 1471, 1480 (D.R.I. 1984).

135. See *id.*

136. See, e.g., *Borowski*, 579 N.W.2d at 250–53 (giving deference to the parties' agreement despite unequal bargaining power between the parties).

137. See *supra* notes 129 and 130.

merely establishes a standard for determining if a right granted by a default provision or a bargained for term has been satisfied and the effect of the standard does not abrogate the right or obligation, the term is not manifestly unreasonable.

*D. Minimizing the Seller's Responsibility  
for the Quality of Its Performance*

Complaining about the quality of seller's performance extends to arbitrating<sup>138</sup> or litigating the dissatisfaction. Again, a seller may effectively rob the buyer of this right by shortening the statute of limitations to the permissible one-year limit,<sup>139</sup> by effectively liquidating damages,<sup>140</sup> or by providing an exclusive remedy.<sup>141</sup> Damages, as measured by Code formulae, are not otherwise available if the liquidated or limited remedy is enforceable.<sup>142</sup>

1. Liquidating damages

Traditionally, the common law permitted liquidated damages as a convenient method of providing a pre-estimate of the probable loss.<sup>143</sup> If, at the time of contracting, the likely damages, by their nature, were uncertain and difficult to determine and the amount fixed was reasonably considered to be the actual, compensable loss to be suffered in the event of breach, the term was deemed a liquidated damages provision and not a penalty.<sup>144</sup> Courts considered several factors in reaching their determination of the reasonableness of the sum fixed. Did the parties: (1) *intend* to agree on liquidated damages and not a penalty; (2) at contracting, was the anticipated harm or injury caused by the breach difficult to ascertain, uncertain, or difficult to prove;<sup>145</sup> and (3) was the stipulated sum a

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138. See generally Christopher R. Drahozal, *Is Arbitration Lawless?*, 40 LOY. LA. L. REV. 187 (2006) (discussing the role of law and equity in arbitration decisions, and finding that generally, arbitration is not used as a means of sidestepping the law).

139. See U.C.C. § 2-725(1) (2000).

140. See *id.* § 2-718.

141. See *id.* § 2-719.

142. See *id.*; *id.* § 2-718.

143. See, e.g., *Dave Gustafson & Co. v. S.D. State Highway Comm'n*, 225 N.W.2d 594, 596-97 (S.D. 1975).

144. See *Phillips v. Ben M. Hogan Co.*, 594 S.W.2d 39, 41-42 (Ark. Ct. App. 1980).

145. See, e.g., *id.* (holding that liquidated damages are enforceable if the stipulated sum is a reasonable forecast of just compensation for the injury and if the harm is difficult or incapable of accurate estimation); *Robbins v. Finlay*, 645 P.2d 623, 626 (Utah 1982) (holding that the amount

reasonable pre-estimate of the probable loss.<sup>146</sup> Despite the label applied to the term, a stipulated sum failing to satisfy the requirements was deemed a penalty and was unenforceable.<sup>147</sup> Consequently, the intent of the parties carried little if any weight in determining the character of the provision.<sup>148</sup> Of significance was the relative disparity between the pre-estimate and the actual harm suffered.<sup>149</sup> If the former was disproportionately large, the provision was an unenforceable penalty.<sup>150</sup> If the pre-estimate was inordinately low, the court may have held the provision to be unconscionable.<sup>151</sup>

The UCC authorizes and enforces the liquidation of damages if the agreed-to sums are reasonable.<sup>152</sup> Reasonableness is determined by considering: (1) the anticipated or actual harm, (2) the difficulty of proof, and (3) the availability or adequacy of other remedies.<sup>153</sup> These three factors are viewed as a retention of the “uncertainty” requirement of the common law.<sup>154</sup>

In stark contrast to UCC section 2-718, is Article 2A’s liquidated provision, section 2A-504.<sup>155</sup> Implementing Article 2A’s

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so fixed must be a “reasonable forecast of just compensation for the harm that is caused by the breach” and “the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation”).

146. *Gaines v. Jones*, 486 F.2d 39, 44 (8th Cir. 1973) (applying Missouri law, the court found liquidated damages clause calling for payment of \$75,000 upon discharge before fixed time in employment contract was reasonable forecast of harm, where discharged employee told to expect \$50,000 to \$60,000 in first year of employment); *Sw. Eng’g Co. v. U.S.*, 341 F.2d 998, 1001–02 (8th Cir. 1965) (discussing liquidated damages providing for daily damages in the event of delay beyond agreed completion date as reasonable forecast of harm in light of circumstances at the time of contracting); *McCarthy v. Tally*, 297 P.2d 981, 987 (Cal. 1956) (finding liquidated damages provision in lease agreement was not reasonable pre-estimate of harm); *Guiliano v. Cleo, Inc.*, 995 S.W.2d 88, 98–99 (Tenn. 1999) (noting liquidated damages provision in an employment contract providing for payment of current salary through the expiration of the contract upon termination without cause was reasonable pre-estimate of harm at time of contracting because it was within the contemplation of the parties that employee would not find other work and might suffer loss of professional status and prestige); JOHN EDWARD MURRAY, JR., *MURRAY ON CONTRACTS* § 125(B)(1) (4th ed. 2001); PERILLO, *supra* note 16, § 14.31.

147. MURRAY, JR., *supra* note 146, § 125(A)(1).

148. *Id.* § 125(B)(1)

149. *Id.*

150. RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981).

151. *Id.* § 356 cmt. a.

152. U.C.C. § 2-718 (2000).

153. *Id.*

154. MURRAY, JR., *supra* note 146, § 125(c)(1).

155. U.C.C. § 2A-504 (2000).

overriding goal of preserving the parties' freedom of contract,<sup>156</sup> section 2A-504 is less restrictive than its analogue in Article 2. Article 2A authorizes the parties to liquidate damages in an amount or by a formula that is *reasonable* in light of the then anticipated harm caused by the other's default, act or omission.<sup>157</sup> If the agreed to damage provision is unreasonable, remedial rights may be exercised as provided by the Article's default provisions.<sup>158</sup>

Unlike section 2-718, section 2A-504 lacks guidelines for determining the reasonableness of contractual provisions.<sup>159</sup> Courts and commentators have questioned the absence of guidelines. Commentators seeking to resolve this issue posit that a provision is reasonable "if it 'leaves [the lessor] in no better position than it would be in had the lease been fully performed.'"<sup>160</sup> Commentators have suggested that the term is reasonable if it "place[s] the lessor roughly in the same position the lessor would have been in had the first lease deal gone through."<sup>161</sup> A mere difference between the actual loss and the agreed to term, however, does not result in an unreasonable term.<sup>162</sup>

Unreasonable terms include those that permit a windfall as a result of the breach, or a double recovery of some or all of the anticipated benefits from the original lease.<sup>163</sup> Examples of unreasonable terms include: a clause granting the lessor the right to collect the present value of all future rent, plus the fair market value of the equipment at the end of the lease, without crediting the lessee for the proceeds of the sale of the goods;<sup>164</sup> a formula permitting the recovery of three times the lease payments due under the agreement

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156. *Id.* § 2A-504 official cmt.

157. *Id.* § 2A-504(1).

158. *Id.* § 2A-504(2).

159. Compare *id.* § 2A-504, with U.C.C. § 2-718 (2000).

160. See *ePlus Group, Inc. v. Panoramic Commc'ns*, 50 U.C.C. Rep. Serv. 2d (CBC) 213, 222 (S.D.N.Y. 2003) (alteration in original) (citing *Montgomery Ward Holding Corp. v. Meridian Leasing Corp.* (*In re Montgomery Ward Holding Corp.*), 269 B.R. 1, 9 (Bankr. D. Del. 2001)); see also *Coastal Leasing Corp. v. T-Bar S Corp.*, 496 S.E.2d 795, 799 (N.C. Ct. App. 1998) (holding that a liquidated damages clause was reasonable because it placed the "plaintiff in the position it would have occupied had the lease been fully performed").

161. 2 WHITE & SUMMERS, *supra* note 97, § 14-3.

162. *ePlus Group, Inc.*, 50 UCC Rep. Serv. 2d at 222 (citing *Coastal Leasing Corp.*, 496 S.E.2d at 798).

163. *Id.* at 224-25.

164. *Carter v. Tokai Fin. Servs., Inc.*, 500 S.E.2d 638, 641 (Ga. Ct. App. 1998).

(Casualty Value) and only permitting a credit for proceeds from the sale or re-lease of the goods to the extent the proceeds exceed the Casualty Value of the goods;<sup>165</sup> a provision allowing a lessor to recover more than double the amount it would have had if the lease had been fully performed;<sup>166</sup> an acceleration clause failing to discount to present-value;<sup>167</sup> a right to earned interest on early rent payments that was otherwise unavailable to the lessor without a default;<sup>168</sup> and a clause in an automobile lease requiring payment of an amount equal to one monthly lease payment in addition to an amount imposed by other provisions of the liquidated damages clause.<sup>169</sup>

*a. Anticipated harm, actual harm or both?*

The Article 2 standard for liquidated damages deviates from its precursor at common law. At common law, the liquidated damages term served as a reasonable forecast or pre-estimate of the *probable* actual loss.<sup>170</sup> Unlike at common law, the Article 2 standard permits a determination of the reasonableness of the term in relationship to the anticipated *or* actual loss sustained.<sup>171</sup>

With the promulgation of Article 2 and the Restatement, the underlying policy goals sought to be achieved by permitting the liquidation of damages shifted from merely pre-estimating probable loss when damages were unascertainable or uncertain to that of promoting efficiency by conserving judicial resources, the time invested by courts, juries, and witnesses in determining damages, and minimizing litigation expenses.<sup>172</sup> Permitting parties to agree to reasonable compensation facilitated this shift in policy and maintained the prohibition against penalties.<sup>173</sup> Consequently, both the Restatement and Article 2 permit a liquidated damages provision

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165. See *ePlus Group, Inc.*, 50 U.C.C. Rep. Serv. 2d (CBC) at 222–23.

166. *Montgomery Ward Holding Corp. v. Meridian Leasing Corp.* (*In re Montgomery Ward Holding Corp.*), 269 B.R. 1, 7 (Bankr. D. Del. 2001), *aff'd*, 326 F.3d 383 (3d Cir. 2003).

167. *Frontier Leasing Corp. v. Griffin Petroleum Inc.*, 172 F. Supp. 2d 1172, 1176 (S.D. Iowa 2001), *aff'd*, 36 F. App'x. 223 (8th Cir. 2002).

168. *Id.*

169. *Sun v. Mercedes Benz Credit Corp.*, 562 S.E.2d 714, 719 (Ga. Ct. App. 2002).

170. MURRAY, JR., *supra* note 146.

171. See U.C.C. § 2-718(1) (2000).

172. RESTATEMENT (SECOND) OF CONTRACTS § 356 cmt. a (1981).

173. See *id.* § 356; see also MURRAY, JR., *supra* note 146, § 125(c)(1).

to be enforced if the stipulated damages or formula result in compensation that is reasonable in light of either the anticipated loss or the actual loss.<sup>174</sup> Although a term might be unreasonable in light of the anticipated loss, the provision is saved if, notwithstanding the unreasonableness of the term at contracting, it is reasonable in relation to the actual loss.<sup>175</sup> Those courts that require that the term be reasonable in view of both the anticipated harm and the actual harm deviate from the mandate of the statute.<sup>176</sup> Under these two regimes, the enforceability of liquidated damage provisions has been enlarged. To avoid unnecessary litigation, the reasonableness of the liquidated damages term is generally presumed.<sup>177</sup> The complaining party, the one seeking to nullify the enforceability of the term, has the burden of proving that the term is unreasonable.<sup>178</sup>

Unlike Article 2, Article 2A, under current construction, harkens back to the common law. The term must be reasonable in view of the anticipated harm or injury.<sup>179</sup>

*b. Liquidated damages &  
the absence of harm resulting from the breach*

If an agreed upon provision is reasonable in view of anticipated harm but no harm actually occurs as a result of the breach, should the term be enforced? Courts addressing this issue are confronted with the task of determining whether the statute imposes the testing of the provision prospectively, at the time of contracting, or retrospectively, at trial;<sup>180</sup> whether to place a premium on risk assessment and allocation by the parties or favor judicial allocation of risk and resolution of the degree of compensation for the harm incurred

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174. RESTATEMENT (SECOND) OF CONTRACTS § 356; U.C.C. § 2-718(1).

175. See U.C.C. § 2-718(1); RESTATEMENT (SECOND) OF CONTRACTS § 356.

176. See U.C.C. § 2-718(1); RESTATEMENT (SECOND) OF CONTRACTS § 356.

177. See PERILLO, *supra* note 16, at § 14.31(c).

178. See *id.* See generally Allen v. Smith, 114 Cal. Rptr. 2d 898, 903 (Ct. App. 2002) (noting that a liquidated damage clause is usually valid unless shown by challenging party to be unreasonable) (citing Ridgley v. Topa Thrift & Loan Ass'n, 953 P.2d 484, 487 (Cal. 1998)).

179. See U.C.C. § 2A-504(1) (2000).

180. Watson v. Ingram, 881 P.2d 247, 249-50 (Wash. 1994) (holding that prospective determination of the reasonableness of a liquidated damages term rather than a retrospective assessment light of actual damages suffers implements the purposes of liquidated damages clauses, gives effect to risk allocation by the parties, and encourages efficient resolution of any breach).

including consequential damages;<sup>181</sup> and, as some have suggested, and whether to follow “the policy in favor of enforcing legitimate agreed damages provisions [or] the more fundamental policy which precludes windfall.”<sup>182</sup> In resolving these questions, the courts are not in agreement.<sup>183</sup> Article 2 delineates the determination of reasonableness and provides an objective basis for enforcing the intent of the parties if the term is reasonable in view of the anticipated loss at the time of contracting.<sup>184</sup> If at the time of contracting, the liquidated damages term is reasonable in light of anticipated harm, a failure to enforce the term results in a loss of the benefit sought to be achieved, not only for the parties but also the public, and a loss of transaction costs incurred to reach an agreement on the term. If a liquidated damages provision that is reasonable in view of anticipated loss is deemed unenforceable as a penalty if no actual loss occurs, reasonable parties are unlikely to invest time and other resources *ex ante* to craft a liquidated damages provision only to have their determination nullified *ex post*. Indeed, such a prevailing view only encourages litigation, negates the benefits section 2-718 was designed to provide, and frustrates the expectations of the parties.<sup>185</sup>

Article 2A permits the recovery of liquidated damages that are reasonable in light of anticipated harm when the agreement was entered. Article 2A omits the alternative basis that is provided in Article 2, thereby avoiding the confusion that the alternative has generated.

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181. *Cal. & Haw. Sugar Co. v. Sun Ship, Inc.*, 794 F.2d 1433, 1438–39 (9th Cir. 1986) (refusing to substitute the court’s judgment for that of the parties and enforced the stipulated liquidated damages sum of \$17,000 per day that was reasonable at contracting although the stipulated sum substantially exceeded the actual loss incurred from seller’s breach of its promise to deliver a tug boat and barge).

182. MURRAY, JR., *supra* note 146, § 125(c)(2) (emphasis omitted).

183. *See, e.g., Cal. & Haw. Sugar Co.*, 794 F.2d at 1439; *Grand Bissell Towers, Inc. v. John Gagnon Enters.*, 657 S.W.2d 378, 379 (Mo. Ct. App. 1983) (holding that because of the absence of actual damages, liquidated damages provision was unenforceable in an action for breach of a lease of commercial real property); *Watson*, 881 P.2d at 249–50; *Fields Found. v. Christensen*, 309 N.W.2d 125, 131 (Wis. Ct. App. 1981) (holding that a liquidated damages provision is a penalty is no actual harm results from the breach).

184. *See* U.C.C. § 2-718(1) (2000). *See, e.g., Banta v. Stamford Motor Co.*, 94 A. 665, 667 (Conn. 1914) (“the standard of measure is not furnished by plaintiff’s actual loss . . . but by the loss or injury which might reasonably have been anticipated at the time the contract was made”).

185. *Watson*, 881 P.2d at 851–55.

## 2. Liquidated damages as an exclusive or limited remedy: Article 2A & 2 contrasted

By extracting an agreement for an *exclusive* limited remedy, the seller further restricts the buyer's response for its failure.<sup>186</sup> Rather than receive damages or equitable relief, a buyer might agree to: accept replacement or repair of the goods;<sup>187</sup> return the goods and receive repayment of the purchase price;<sup>188</sup> accept a right to insist that the seller to buy-back the goods;<sup>189</sup> or adjust the price based on trade usage.<sup>190</sup> Without the designation of "exclusive," any limited remedy is deemed optional.<sup>191</sup> Despite the terms of section 2-719, authorities have held that exclusivity may arise from a reasonable construction of the agreement<sup>192</sup> and trade usage,<sup>193</sup> which is an

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186. See U.C.C. § 2-719 (2000).

187. See *id.*

188. See *id.*

189. See, e.g., *Kelley Metal Trading Co. v. Al-Jon/United, Inc.*, 812 F. Supp. 185, 189–90 (D. Kan. 1993).

190. See, e.g., *N. Am. Steel Corp. v. Siderius, Inc.*, 254 N.W.2d 899, 904–05 (Mich. Ct. App. 1977).

191. UCC Section 2-719(1) reads as follows:

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.

U.C.C. § 2-719 (2000) (emphasis added).

192. *CogniTTest Corp. v. Riverside Publ'g Co.*, 107 F.3d 493, 498 (7th Cir. 1997) (applying Illinois law and holding that a limited remedy provision does not need to employ the word "exclusive" if reasonable construction of the contract indicates that the parties intended a limited remedy to be exclusive). *But see Gaynor Elec. Co. v. Hollander*, 618 A.2d 532, 534–36 (Conn. App. Ct. 1993) (discussing a commercial transaction for the sale of switches to be used in the manufacture of heated handlebars; the seller's form stated that seller's liability "shall not exceed the cost of correcting defects in the goods" did not create an exclusive remedy).

193. See, e.g., *Figgie Int'l, Inc. v. Destileria Serralles, Inc.*, 190 F.3d 252, 256–57 (4th Cir. 1999) (applying South Carolina law, the court held that usage of trade under the UCC supplemented an agreement and imposed an exclusive remedy of repair, replacement, or return); *W. Indus. Inc. v. Newcor Canada Ltd.*, 739 F.2d 1198, 1204–05 (7th Cir. 1984) (applying Wisconsin law, the court rejected the contention that trade custom cannot limit liability because Section 2-719(1)(b) provides that resort to a remedy is optional unless expressly agreed to be exclusive); *Transamerica Oil Corp. v. Lynes, Inc.*, 723 F.2d 758, 765–66 (10th Cir. 1983) (applying Kansas law, the court held that usage of trade may add an exclusive remedy to an agreement); *Posttape Assoc. v. Eastman Kodak Co.*, 537 F.2d 751, 756 (3d Cir. 1976) (applying Pennsylvania law, the court held that the agreement includes trade usage or an expressed term

implied term in every agreement.<sup>194</sup> Likewise, course of dealings, another implied term in every agreement,<sup>195</sup> should provide an exclusive remedial right in those jurisdictions that recognize trade usage as a source of an exclusive remedy.<sup>196</sup>

An Article 2A liquidated damages provision may also be an exclusive remedy or a limited remedy.<sup>197</sup> If it is not only a liquidated damages provision but also an exclusive or limited remedy, all default remedies are available if, because of circumstances, the provision fails of its essential purpose.<sup>198</sup> Of concern is whether courts will mistakenly treat all liquidated damages terms as optional if the parties do not expressly provide that the provision is exclusive, even though the term is not intended as a “limited remedy.” This is especially a concern in those jurisdictions that require limited remedies to be expressly delineated as exclusive.

Article 2, section 2-719 provides that the limitation of remedial rights by parties may be exclusive, but is subject to the prior liquidated damages provision.<sup>199</sup> This language suggests that parties who liquidate their damages are not otherwise subject to the restrictions of section 2-719. These restrictions include either: identifying the remedy as exclusive or satisfying the failure of the essential purpose test.<sup>200</sup> If reasonable, a liquidated damages provision is not vulnerable to attack for failing of the essential purpose of providing conforming goods within a reasonable time.<sup>201</sup> Additionally, to prevent the term from being treated as optional to other statutorily provided damage relief it is unnecessary to identify the liquidated damages provision as exclusive.<sup>202</sup>

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that the limited remedy is an exclusive one).

194. *See* U.C.C. §§ 1-201(b)(3), 1-303 (2001).

195. *See id.* §§ 1-201(b)(3), 1-303.

196. *See id.* § 1-303.

197. U.C.C. § 2A-504(2) (2000).

198. *Id.*

199. U.C.C. § 2-719 (2000).

200. *See id.* *But see* Cognitest Corp. v. Riverside Publ'g Co., 107 F.3d 493, 496-99 (7th Cir. 1997) (testing the liquidated damages provision in this agreement for the distribution of a psychological-software program designed for use by psychiatrists and other mental health professionals under the Section 2-719 “minimum adequate remedy” test and also holding that under Illinois law the provision operated as an exclusive remedy based on the reasonable construction of the contract, not, the inclusion of the term “exclusive”).

201. U.C.C. § 2-719 cmt. 1 (2000).

202. *Id.* § 2-719 cmt. 2.

Indeed, the nature of the liquidated damages term further suggests that it is solely applicable on the issue of damages without the addition of exclusivity language.<sup>203</sup> The 2003 Amendments to section 2A-504 reinforce this conclusion by establishing that section 2A-503 is only applicable to terms that limit but do not liquidate damages.<sup>204</sup> Certainly, parties may provide that a liquidated damages term is an exclusive remedy.<sup>205</sup> The benefit that accrues from such a characterization is the exclusion of equitable relief for the seller's failure to perform as promised.<sup>206</sup> Should the injured party seek specific performance, injunctive relief, replevy, or quasi-contactual relief, the party should be denied such relief if the agreement expressly or impliedly, through course of dealings or trade usage, provides that liquidated damages are the exclusive remedy.<sup>207</sup> Without exclusivity, equitable relief may be available notwithstanding the liquidated damages term.<sup>208</sup>

#### IV. POLICING THE SELLER'S MARGINALIZATION OF BUYER'S STATUTORY RIGHT TO AN EFFECTIVE REMEDY.

##### A. *The Essential Purpose Test*

As discussed in Part II, the seller may effectively minimize its obligation of performance though the use of disclaimers, agreed-upon standards for determining when Code norms are satisfied, and merger clauses. To the degree that the seller obligates itself, even if limited to the responsibility of delivering the goods, the buyer is

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203. See, e.g., *Design Time, Inc. v. Monco of Orlando, Inc.*, 518 So.2d 454, 456 (Fla. Dist. Ct. App. 1988) (holding that the court "may not award damages in excess of that [liquidated] sum").

204. UCC section 2A-504 reads as follows:

(1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission. *Section 2A-503 determines the enforceability of a term that limits but does not liquidate damages.*

U.C.C. § 2A-504 (2000) (emphasis added).

205. See *id.* § 2A-503(2).

206. See *id.*

207. See *id.*

208. See *id.*

guaranteed remedial rights.<sup>209</sup> Although these remedial rights are subject to limitation, the limited remedial rights granted must result in a “fair quantum of remedy,” for breach of the *obligations* undertaken.<sup>210</sup> This “fair quantum of remedy” must not fail of its essential purpose.<sup>211</sup> If “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,”<sup>212</sup> it must be expunged from the agreement.<sup>213</sup> If the agreement does not provide a “fair quantum of remedy” or the remedy fails of its essential purpose, the full panoply of Article 2 remedies becomes available.<sup>214</sup>

Generally, one of two prevailing approaches is employed to determine whether a limited remedy fails of its essential purpose. Under the first approach, if the limited remedy, such as repair or replacement of the goods, is unsuccessful or not undertaken, the injured party is deemed deprived of the substantial value of the bargain, and the remedy has failed of its essential purpose.<sup>215</sup> As a result, all Code remedies become available.<sup>216</sup> For the buyer to

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209. See generally U.C.C. § 2-711 (2000) (discussing a buyer’s remedies).

210. *Id.* § 2-719 cmt. 1.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. See, e.g., *Figgie Int’l, Inc. v. Destileria Serralles, Inc.*, 190 F.3d 252, 257 (4th Cir. 1999); see also *Riegel Power Corp. v. Voith Hydro*, 888 F.2d 1043, 1046 (4th Cir. 1989) (holding that a remedy fails of its essential purpose if the seller refuses to make repairs or cannot repair the product); *RRX Indus. v. Lab-Con, Inc.*, 772 F.2d 543, 549 (9th Cir. 1985) (holding that a repair or replace remedy failed of its essential purpose because the defendant was either unwilling or unable to provide a system that worked as represented, or to fix the ‘bugs’ in the software); *Chatlos Sys. v. Nat’l Cash Register Corp.*, 635 F.2d 1081, 1085 (3rd Cir. 1980) (holding that an exclusive remedy fails of its purpose when the warrantor fails to correct the defect within a reasonable period); *AES Tech. Sys., Inc. v. Coherent Radiation*, 583 F.2d 933, 939–40 (7th Cir. 1978) (applying Illinois law, the court held that a remedy failed its essential purpose when the buyer “experienced trouble with the Laser almost from the beginning, and repeated efforts by [seller] were unsuccessful in bringing the Laser to warranted specifications for other than short periods of time”); *Caudill Seed & Warehouse Co. v. Prophet 21, Inc.*, 123 F. Supp. 2d 826, 833 (E.D. Pa. 2000) (holding that the exclusive repair and replace remedy failed of its essential purpose when the licensor refused to repair or replace the software); *John Deere Co. v. Hand*, 319 N.W.2d 434, 437–38 (Neb. 1982) (holding that a limited remedy fails of its essential purpose if “the seller is given a reasonable chance to correct defects and the equipment still fails to function properly”); *N.Y. State Elec. & Gas Corp. v. Westinghouse Elec. Corp.*, 564 A.2d 919, 929 (Pa. 1989) (holding that a remedy fails of its essential purpose if the seller is unable to put the goods in the condition warranted because of negligence in repairing the goods or the goods are beyond repair).

216. U.C.C. § 2-719(2) (2000).

receive the substantial benefit of its bargain, the seller must be both willing and able to provide goods that substantially comply with the contract terms within a reasonable amount of time.<sup>217</sup>

The second approach involves the construction of the agreement. In light of the transaction type and circumstances, the court attempts to glean the intent of the parties and determine the scope and purpose of the limited remedy for which they bargained.<sup>218</sup> If the breach is one within the scope of the parties' initial expectations, the seller's compliance or non-compliance with the terms of the limited remedy determines whether the remedy fails.<sup>219</sup> If the harm resulting from the breach of the obligation undertaken was not within the contemplation of the parties, the limited remedy is unavailable as consistent with the intent of the parties, and the buyer bears the loss as the parties intended at contracting.<sup>220</sup> The non-breaching party has a fair quantum of remedy for the obligation undertaken and has agreed to substitute this quantum for damages that would otherwise be available.<sup>221</sup> The remedy is effectual, fulfilling its purpose. However, this outcome is subject to the general prohibition against unconscionable terms pursuant to section 2-302.<sup>222</sup>

*Coastal Modular Corp. v. Laminators, Inc.*,<sup>223</sup> is often cited as an example of the second approach. In *Coastal*, the buyer received a copy of the seller's brochure and agreed to purchase panels needed

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217. Jonathan A. Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 CAL. L. REV. 28, 38 (1977).

218. *See id.* at 33.

219. *See Patapasco Designs, Inc. v. Dominion Wireless, Inc.*, 276 F. Supp. 2d 472, 475–76 (D. Md. 2003); *see also Coastal Modular Corp. v. Laminators, Inc.*, 635 F.2d 1102, 1106–07 (4th Cir. 1980) (holding that the alternative limited remedy of cost of replacement or replace or repair failed of its essential purpose because the parties envisioned the replacement of defective panel before installation; consequently, discovery of latent defects after installation required the buyer to bear the cost of removing and installing replacement panels an expense to which a party with equal bargaining power would not agree); *Dowty Commc'ns Inc. v. Novatel Computer Sys. Corp.*, 817 F. Supp. 581, 585–86 (D. Md. 1992) (distinguishing the two approaches and holding the limited remedy did not fail of its essential purpose).

220. Eddy, *supra* note 217, at 38–40.

221. *See id.* at 38.

222. U.C.C. § 2-302 (2000); *see also Constr. Assocs. v. Fargo Water Equip. Co.*, 446 N.W.2d 237, 241 (N.D. 1989) (noting that the goal of Section 2-302 is to prevent oppression and unfair surprise); LARY LAWRENCE, 4B LAWRENCE'S ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-719:5 (3d ed. 2006) (discussing the rationale behind section 2-719 and the restraint on the freedom of contract so as to prevent an unconscionable result).

223. 635 F.2d 1102 (4th Cir. 1980).

for performance of its contract with the United States Navy.<sup>224</sup> In its brochure, the seller warranted that the panels would maintain their original characteristics during the life of the original installation and agreed, at its election, to either refinish or repair the panels, *or* pay for the cost of replacement for each defective panel.<sup>225</sup> Within several months after the Navy accepted the work, the Navy complained that the panels were defective.<sup>226</sup> The buyer demanded that the seller replace or repair the defective panels. The seller refused and the buyer sued.<sup>227</sup> The court determined that the purpose of the limited remedy was to provide for the replacement of defective panels *before installation*.<sup>228</sup> The latent defects were only discovered *after* installation.<sup>229</sup> The court concluded the remedy failed of its essential purpose, replacement before installation, and therefore, the buyer could resort to any remedy.<sup>230</sup>

The court's conclusion in this case is odd. If the purpose of the remedy was to provide recovery for defects occurring before and not *after* installation, the logical assumption is that the parties agreed that the buyer would bear responsibility for all other risks, including defects discovered after installation. Indeed, the purpose of the remedy was effectuated; it did not fail. The seller insulated itself from liability. But, this is not what the court appears to have meant by the phrase "before installation." Rather, the Court believed that the seller warranted the goods free from defects, patent and latent, regardless of the time of discovery.<sup>231</sup> The limited remedy of replacement *partially* failed because the defects were not discovered *before installation*.<sup>232</sup> Absent clear proof, the court was convinced that the parties did not agree to allocate the risk of undiscoverable, latent defects to the buyer because the seller warranted the goods free of all defects, patent and latent.<sup>233</sup>

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224. *Id.* at 1103.

225. *Id.* at 1103-04.

226. *Id.* at 1104.

227. *Id.*

228. *Id.* at 1106-07.

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.*

233. *Id.* at 1107.

The court said:

*It is difficult to believe that a buyer in an equal bargaining position would accede to accepting such liability for a [latent] defect caused by the seller. In the absence of clear intention, we cannot interpret an agreement as creating such a partial remedy.*

Coastal [buyer] and Laminators [seller] could have specifically agreed to limit consequential damages, but they did not. Section 2-719(3) provides that “consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.” . . . Had Laminators’ warranty specifically limited consequential damages, Coastal could have only received its costs of the material even though that represented partial failure of the essential purpose of the warranty. It seems unlikely that a buyer would agree to such a limitation in the circumstances of this case, but a *conscious acceptance* of such an agreement would bind him even in the face of a partial failure of the essential purpose of the remedy unless the limitations [of consequential damages] were unconscionable.<sup>234</sup>

An assessment of the court’s language suggests that the court was concerned that the limited remedy *was* unconscionable.<sup>235</sup> The court seemingly disbelieved that the buyer would *accept*, or knowingly assent to, liability for latent defects.<sup>236</sup> However, the buyer’s equal bargaining position appears to have inhibited a conclusion that the limited remedy was unconscionable.<sup>237</sup> The court believes that the buyer was unfairly surprised by the results, given the express warranty of freedom from defects and the loss to be borne by the buyer for the seller’s defective performance.<sup>238</sup>

Other courts have not permitted the commercial nature of the parties to abrogate the availability of unconscionability as a policing tool if disparity of bargaining power is present and pre-printed, un-bargained for terms are not called to the other’s attention.<sup>239</sup> For

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234. *Id.* (emphasis added).

235. *See id.*

236. *See id.*

237. *See id.*

238. *See id.*

239. Un-bargained for terms are those not based upon trade usage or prior course of dealings.

these courts, the resulting unfair surprise satisfies the procedural prong of the unconscionability test.<sup>240</sup> Nonetheless, the Court in *Coastal* correctly recognized, in the first instance, that the parties' purpose in agreeing to the limited remedy had to be ascertained before assessing whether the remedy failed of its essential purpose.<sup>241</sup> If the purposes and goals of the bargain are met, the second issue is whether the term is unconscionable.<sup>242</sup>

Given the "general skepticism" of unconscionability claims in commercial transactions and the reluctance "to find unconscionability in purely commercial settings,"<sup>243</sup> courts may employ the "deprived of a substantial benefit of the bargain" test as an *indirect* means of holding the term unenforceable.<sup>244</sup> Such indirect approaches should be avoided. If the buyer lacked the opportunity to negotiate the term or to knowingly assent to the term, regardless of its commercial character, section 2-302's policy of preventing unfair surprise would be triggered.<sup>245</sup> With the opportunity to read and assess the effect of the limited remedy on both patent and latent defects, the knowing assumption of risk makes the provision procedurally effective.<sup>246</sup>

However, even assuming that the limited remedy fails of its essential purpose or is held unconscionable, the court must determine the impact of such a holding on the exclusion or limitation of

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*See, e.g., Constr. Assocs. v. Fargo Water Equip. Co.*, 446 N.W.2d 237, 242 (N.D. 1989) (holding that the limited remedy of replacement was unconscionable where the buyer was a small construction firm and the seller was an "enormous, highly diversified, international conglomerate" and the term was part of the installation instructions delivered with the goods to the installation site and was neither actually negotiated or called to the buyer's attention resulting in unfair surprise. The court's focus should have been directed to whether the limited remedial term was, indeed, a part of the agreement under Section 2-207 when only packaged with the goods as part of the installation instructions).

240. *Id.*

241. *See Coastal Modular Corp.*, 635 F.2d at 1107.

242. *Id.* at 1107.

243. *Constr. Assocs.*, 446 N.W.2d at 242 (citing *A & M Produce Co. v. FMC Corp.*, 186 Cal. Rptr. 114, 124 (Ct. App. 1982)).

244. *See generally Durham v. Ciba-Geigy Corp.*, 315 N.W.2d 696, 700 (S.D. 1982) (holding that a farmer's loss of crops from an ineffective herbicide deprived the farmer of a substantial benefit since it was not in a position to bargain with a chemical manufacturer); HAWKLAND & MILLER, *supra* note 102, § 2A-503:02 n.5 (citing *Caterpillar Tractor Co. v. Waterson*, 679 S.W.2d 814, 818-19 (Ark. Ct. App. 1984)) (discussing where an exclusive remedy deprives a party of a substantial benefit of the bargain).

245. *See* U.C.C. § 2-302 cmt. 1 (2000).

246. *See Eddy, supra* note 217, at 42-44.

consequential damages. The modern trend in cases construing the relationship between the failure of an exclusive remedy and its limitation of consequential damages holds that the two clauses are independent.<sup>247</sup> The infirmity of one does not affect the other.<sup>248</sup> Construing section 2-719 as creating provisions that operate independently implements the strong public policy of freedom of contracting as required by Revised section 1-302.<sup>249</sup> The parties may abrogate this effect by express agreement, but such an agreement should state an intent to change the independent nature of the exclusive limited remedy and the limitation of consequential damages.<sup>250</sup> The exclusion of consequential damages must not be unconscionable.<sup>251</sup> Even though independent, the exclusion of

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247. *McNally Wellman Co. v. N.Y. State Elec. & Gas Corp.*, 63 F.3d 1188, 1197 (2d Cir. 1995) (noting, “a limitation on incidental or consequential damages remains valid even if an exclusive remedy fails”); *Chatlos Sys., Inc. v. Nat’l Cash Register Corp.*, 635 F.2d 1081, 1086 (3rd Cir. 1980) (stating, “[i]t appears to us that the better reasoned approach is to treat the consequential damage disclaimer as an independent provision, valid unless unconscionable”); *Patapasco Designs, Inc. v. Dominion Wireless, Inc.*, 276 F. Supp. 2d 472, 476 (D. Md. 2003) (holding that the effect of the two provisions did not make the limitation ambiguous; the facts were insufficient to resolve whether the limited remedy failed of its essential purpose, and, assuming it failed, only the test of unconscionability was applicable under the court’s projection of Maryland’s resolution of the issue); *Eastman Chem. Co. v. Niro, Inc.*, 80 F. Supp. 2d 712, 720–21 (S.D. Tex. 2000); *Ritchie Enters. v. Honeywell Bull, Inc.* 730 F. Supp. 1041, 1047 (D. Kan. 1990) (stating, “[w]hen a limited remedy fails of its essential purpose, 2-719(2) abrogates only the remedy limitation and not the warranty disclaimers”); *In re Aural*, 279 B.R. at 583–84 (Bankr. N.D. Cal. 2002) (applying California law and stating in dicta that UCC Section 2-700’s damage remedies are not consequential damages within Section 2-719(3)); *Canal Elec. Co. v. Westinghouse Elec. Corp.*, 548 N.E.2d 182, 186 (Mass. 1990) (stating, “[w]e conclude that the disclaimer of consequential damages is enforceable even though the limited repair or replacement remedy has failed of its essential purpose”); *Kearney & Trecker Corp. v. Master Engraving Co.*, 527 A.2d 429, 437 (N.J. 1987) (stating, “[w]e are also persuaded that many routine business transactions would be dislocated by a rule requiring the invalidation of a consequential damage exclusion whenever the prescribed contractual remedy fails to operate as intended”); *Schurtz v. BMW of N. Am., Inc.*, 814 P.2d 1108, 1112–14 (Utah 1991) (concluding that the plain language of U.C.C. provisions, the associated Official Comments, and policy considerations support interpreting the clauses as independent). *But see, e.g.*, *Great Dane Trailer Sales, Inc. v. Malvern Pulpwood, Inc.*, 785 S.W.2d 13, 17–18 (Ark. 1990) (noting that upon failure of the limited remedy’s essential purpose, the buyer’s remedies provided by the Code, including consequential damages, are recoverable); *Durham v. Ciba-Geigy Corp.*, 315 N.W.2d 696, 700–01 (S.D. 1982) (holding that a warranty and limitation of consequential damages in an agreement between a herbicide manufacturer and farmers who lack bargaining position to extract more favorable terms or to test the effectiveness of the product before purchasing was unconscionable).

248. *See* sources cited *supra* note 247.

249. *See* U.C.C. § 1-302 (2001).

250. For a discussion of unconscionability as a tool for policing an exclusive remedy, see *supra* text accompanying notes 107–116.

251. U.C.C. § 2-719(3) (2000).

consequential damages will be unenforceable if unconscionable.<sup>252</sup> At least one court barred the enforceability of the exclusion because of the seller's bad faith.<sup>253</sup>

### B. Good Faith Performance

Code reflects an assumption that parties, as a general rule, invest minimal effort and resources in forming contractual relationships and facilitates such conduct by providing gap fillers to supplement the bargain of the parties. Commentators suggest that this approach to contracting is a by-product of the perceived inefficiency of detailed planning and negotiating.<sup>254</sup> Concomitantly, parties "rely on the good faith of their exchange partners" to perform consistently with reasonable commercial standards.<sup>255</sup> Section 1-304 of Revised Article 1 imposes, as its predecessor,<sup>256</sup> "an obligation of good faith" in the performance and enforcement of every contract or duty within the Code's ambit.<sup>257</sup> To the extent that a seller undertakes obligations of performance as part of the contractual relationship, the seller must in good faith perform the express obligations undertaken, the implied terms from course of dealing, trade usage, and course of performance, applicable suppletive gap-filling default rules, and statutory duties.<sup>258</sup> No independent duty of good faith, such as

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252. *Id.* § 2-302.

253. *Am. Tel. & Tel. Co. v. N.Y. City Human Res. Admin.*, 833 F. Supp. 962, 989–90 (S.D.N.Y. 1993) (stating that "[a] defendant may be estopped from asserting a contractual limitation of consequential damages if the defendant has acted in bad faith" (quoting *Long Island Lighting Co. v. Transamerica Delaval, Inc.*, 646 F. Supp. 1442, 1457–59 (S.D.N.Y. 1986) (holding that a conscionable exclusion of consequential damages may only be circumvented upon a showing that the defendant's conduct bars it from invoking the shield of the damage limitation))).

254. Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 371 (1980); see Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & MARY L. REV. 1223, 1267 (1999).

255. Burton, *supra* note 254, at 371.

256. U.C.C. § 1-203 (2000).

257. U.C.C. § 1-304 cmt. 1 (2001); see also RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) (restating this general principal as applicable to contracts not within the scope of an article of the UCC); E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 668 (1963) (distinguishing good faith purchase and good faith performance).

258. U.C.C. § 1-304 (2001); see *Sons of Thunder, Inc. v. Borden, Inc.*, 690 A.2d 575, 588–89 (N.J. 1997) (supplementing former Article 1's honesty in fact good faith standard with the common law implied covenant of good faith and fair dealing to find that the buyer breached its duty of good faith performance by failing to purchase the agreed quantity of clam meat, in refusing to honor the contract, and in exercising its right to terminate the agreement); *Southface*

fairness or reasonableness, is implied by section 1-304.<sup>259</sup> Rather, section 1-304 implies and imposes a duty to perform the required obligations consistent with the reasonable expectations of the parties at the time of contracting. The purpose of this duty is to avoid conduct constituting the recapture of a foregone opportunity or the exercise of a contractual right in a manner that evades the spirit of the transaction.<sup>260</sup>

Although an implied obligation, the duty may not be eliminated by agreement. Both Revised and former Article 1 expressly prohibit disclaiming the obligation to perform or enforce contractual duties in good faith.<sup>261</sup> The parties may, however, establish standards delineating the conduct or requirements for satisfying the good faith obligation, unless the agreed standard is manifestly unreasonable.<sup>262</sup> Without an agreed to standard established by the parties for determining whether the obligation of good faith has been fulfilled, courts should employ the definitional standard imposed by the

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Condo. Owners Ass'n v. Southface Condo. Ass'n, 733 A.2d 55, 58 (Vt. 1999) (each party to a contract impliedly promises that each will not do anything to undermine or destroy the other's rights to receive the benefits of the agreement). *But see* Northview Motors, Inc. v. Chrysler Motors Corp., 227 F.3d 78, 91–92 (3d Cir. 2000) (holding that Pennsylvania law would not recognize an independent cause of action for breach of an implied duty of good faith if the allegations of bad faith are identical to another claim for relief). *See generally* Richard E. Speidel, *The "Duty" of Good Faith in Contract Performance and Enforcement*, 46 J. LEGAL EDUC. 537, 544–45 (1996) (positing that a failure to adhere to a developed course of performance constitutes bad faith).

259. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB COMMENTARY ON THE UNIFORM COMMERCIAL CODE, COMMENTARY NO. 10—§ 1-203 (1994); *see, e.g.*, Aisenberg v. Hallmark Mktg. Corp., 337 F. Supp. 2d 257, 262 (D. Mass. 2004) (citing Section 205 of the Second Restatement of Contracts in a non-goods transaction and holding that the plaintiff must establish that the defendant exercised a contractual right in a manner that evades the spirit of the transaction or denies the plaintiff the benefit of the contract); *see* Harry Flechtner, *Comparing the General Good Faith Provisions of the PECL and the UCC: Appearance and Reality*, 13 PACE INT'L L. REV. 295, 307–11 (2001) (comparing the role of good faith in the UCC with that in the Principles of European Contract Law). *See generally* Autry Petroleum Co. v. BP Prods. N. Am., Inc., 59 U.C.C. Rep. Serv. 2d (CBC) 468, 471 (M.D. Ga. 2006) (stating the general rule).

260. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). *See generally* Burton, *supra* note 254 (providing a top ten list of things that professors should know about the duty of good faith in contracts); Speidel, *supra* note 258 (arguing that the expectation interest encompasses opportunity cost and that "[t]his cost perspective makes it possible to articulate an operational standard of good faith performance, which is now an implied covenant in every contract in most American jurisdictions"); Van Alstine, *supra* note 254 (arguing that the new textualist approach to statutory interpretation misapprehends the role of good faith in contractual relationships).

261. U.C.C. § 1-302(b) (2001); *see also* U.C.C. § 1-102(3) (2000).

262. For a discussion of the manifest unreasonableness standard, *see supra* notes 128–137 and accompanying text.

specific substantive Article. Revised Article 1 establishes the standard for all Articles excluding Article 5.<sup>263</sup> Parties must perform contracts and duties and enforce contracts and rights honestly—and adhere to reasonable commercial standards of fair dealing.<sup>264</sup> This standard broadens the prior merchant standard of unamended Article 2 by removing the limitation that the commercial standards of fair dealing must only conform to those of the relevant trade.<sup>265</sup> Now, prevailing community standards of fair dealing should be applicable.<sup>266</sup>

Assume a seller effectively disclaims all implied warranties and only makes an express warranty of description based on the identity of the product agreed to be sold.<sup>267</sup> Without a course of dealings or a modification or waiver occurring through the course of performance that creates an obligation of performance, the buyer only has a right to obtain the product that the seller may have sold “as is.” The buyer gets what the seller has, no more. However, the buyer may have unspoken expectations that remain unfulfilled. Such expectations may result from the price to be paid, the seller’s reputation, or the buyer’s own needs. None of these expectations, without more, result in a duty of fairness or impose a duty of reasonable performance.<sup>268</sup> A buyer’s expectation resulting from the price to be paid is best described as an assumption that the goods will conform to qualities and standards of performance exemplified in goods offered by others at a similar price. The seller’s effective use of disclaimers of implied warranties negates the duty to meet the prevailing standards for the goods sold. Likewise, an expectation created by the seller’s reputation is only controlled by the seller’s desire to preserve that reputation in the marketplace or a self-imposed moral duty of treating others fairly. The law only insists that the seller

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263. *But see Sons of Thunder*, 690 A.2d at 587 (applying the Article 1 standard and supplementing in with the common law definition of good faith rather than applying the merchant standard of Article 2 for this goods transaction).

264. *See* U.C.C. § 1-304 official cmt. 1 (2001).

265. *See* U.C.C. § 2-103(1)(b) (2000).

266. *See generally* Speidel, *supra* note 258 (arguing that refusal by one party to negotiate in good faith is bad faith).

267. *See* U.C.C. § 2-314(2)(b) (2000).

268. *See, e.g.,* *Goldman v. Barnett*, 793 F. Supp. 28, 32 (D. Mass. 1992) (applying Massachusetts law and stating in dictum that the seller has no duty to set a fair price); *Rawson v. Conover*, 20 P.3d 876, 886 (Utah 2001).

conspicuously indicate that it is not agreeing to perform consistent with prevailing standards.<sup>269</sup> Similarly, without agreeing to meet buyer's needs, expressly or impliedly by warranting that the goods will satisfy the buyer's objective for acquiring the goods, the seller is not required by law to tender goods that satisfy the buyer's objectives.<sup>270</sup> This is true despite the language of Comment 3 to section 2-715 that imposes liability for consequential losses resulting from the general *needs* of the buyer. This language does not impose a general duty on the seller to be responsible for meeting the buyer's needs. Rather, the court imposes damages on the seller because of its *breach* of the duties undertaken, such as a commitment to deliver by a specified date, or an express or implied warranty of fitness for a particular purpose, which produces foreseeable losses because of the general or particular needs known by the seller at the time of contracting.<sup>271</sup> No obligation to meet general needs without an express or implied undertaking exists in contract.

Finally, if the seller knows of the buyer's particular need for goods, a court may determine that the seller's conduct constitutes actionable fraud. Perhaps, if the requirements of intentional or negligent misrepresentation, or material concealment or nondisclosure are established, a buyer may have a cause of action for a seller's failure to meet the buyer's need. Only the policing tools of unconscionability or penalties imposed for violating state or federal regulatory standards are available to address the three defeated expectations experienced by the buyer. The duty of good faith performance and enforcement does not provide a control over the seller's attempt to minimize its obligation of performance.

## V. CONCLUSION

Although the Code recognizes freedom of contracting and

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269. U.C.C. § 1-201(10) (2001).

270. *See, e.g., Rawson*, 20 P.3d at 887 (holding that the buyer failed to establish conduct constituting negligent or intentional misrepresentation when the buyer purchased a salvaged used van that had been restored by the seller and that had prior defects that had not been repaired making the van unsafe for use by the buyer's family. The buyer testified that no warranties had been made and the written agreement effectively disclaimed all implied warranties and excluded the admissibility of express warranties).

271. "Consequential damages resulting from the *seller's breach* include 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 . . . ." U.C.C. § 2-715(2)(a) (2000) (emphasis added).

provides mechanisms for limiting and minimizing the seller's obligation of performance and responsibility for its defective performance, Code norms mandate conscionable terms and a fair quantum of a remedy for obligations undertaken. These norms function as controls over the seller's ability to minimize its obligation and responsibility for the obligations undertaken.