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CONSEQUENTIAL DAMAGES EXCLUSIONS UNDER UCITA

by Douglas E. Phillips†

ABSTRACT

The Uniform Computer Information Transactions Act ("UCITA") elicits both love and hate, but decision time is here. Two states have enacted UCITA, several others are considering it, and UCITA choice-of-law clauses are already beginning to appear in software license agreements and other computer information contracts. This article focuses on how UCITA affects a pivotal issue: enforceability of contract clauses that exclude consequential damages. Losses from software development gone awry often far exceed the customer's investment and the developer's return. Under the Uniform Commercial Code, questions remain about the enforceability in certain circumstances of consequential damages exclusions. UCITA answers these questions by providing that such exclusions survive the failure of essential purpose of a limited remedy, so long as the agreement expressly provides that the exclusion is independent of the agreed remedy. Does UCITA's answer honor or depart from U.S. commercial law's longstanding focus on the parties' "bargain in fact"? Only a close comparison of UCITA with existing law can reveal its true philosophical and practical effects.

INTRODUCTION

Views about UCITA diametrically diverge.¹ Nevertheless, state leg-

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¹ Compare UCITA Prefatory Note (stating that "UCITA is a statute for our time"), with Cem Kaner, Symposium: Uniform Computer Information Transaction Act: Software Engineering and UCITA, 18 J. Marshall J. Computer & Info. L. 435, 546 (1999) (stating that "UCITA is pushing us down the wrong path").
islatures in which UCITA is now pending, and lawyers who assist clients in computer information transactions, must place their bets. Versions of UCITA have been enacted in Maryland and Virginia, and other states are considering enactment. In negotiating software licenses and other computer information transactions, lawyers are being confronted with proposed contractual choice-of-law clauses that invoke UCITA. Moreover, UCITA contains provisions that enable parties not only to opt in, but also—with some restrictions—to opt out. UCITA's effects will project far into the future. For all these reasons, judgments about UCITA need to be made now.

UCITA's scope is broad, and its effects must be gauged against the rules and principles that otherwise apply. As a result, useful judgments about UCITA are most likely to emerge not from blanket characterizations, but from a collection of assessments focused on particular issues. In an effort to offer one such assessment, this article addresses how UCITA is likely to affect one of the most pivotal issues in large or custom computer-information transactions. That issue is whether a contractual limitation or exclusion of consequential damages will be upheld even if the licensee or other customer is able to show that circumstances have caused the agreement's limited remedy to fail of its essential purpose.

UCITA's treatment of this question is either highly customer-friendly or highly pro-vendor, depending on which commentator one con-

4. UCITA § 104. Subject to specified rules, the parties may agree that [UCITA], including contract-formation rules, governs the transaction, in whole or part, or that other law governs the transaction and [UCITA] does not apply, if a material part of the subject matter to which the agreement applies is computer information or informational rights in it that are within the scope of [UCITA], or is subject matter within [UCITA] under Section 103(b), or is subject matter excluded by Section 103(d)(1) or (2).

Id.
5. The failure of essential purpose doctrine, which this article discusses, is not the only legal basis on which a contractual exclusion of consequential damages can be overcome. For example, fraud in the inducement may defeat such a contractual clause. VMark Software, Inc. v. EMC Corp., 642 N.E.2d 587, 594 (Mass. Ct. App. 1994) (stating that “a party may not escape liability for misrepresentation by resort[ing] to such provisions” as “damage limitation . . . clauses of [an] agreement,” because “even sophisticated businessmen must deal with each other honestly and may not induce contractual relations by material misrepresentations”). Failure of essential purpose is important, however, because it provides a basis to avoid consequential damages exclusions without showing fraud, which typically must be pleaded with particularity and supported by clear and convincing evidence. See id.
For example, one observer concluded that UCITA Section 803, which deals with failure of essential purpose, provides "a significant protection for all licensees, including consumer and mass-market licensees" as well as business licensees. Another, however, maintained that "UCITA fixes [the failure of essential purpose] problem (for sellers) . . . ." As the polarity of these remarks suggests, determining UCITA's effect on consequential damages exclusions requires a closer look. Inevitably, the investigation leads to a review of the failure of essential purpose under the Uniform Commercial Code ("UCC"), the varying judicial solutions to the interpretative conundrum that the UCC's language on this key issue has spawned, and the concept of bargain in fact that underlies UCC Article 2.

DISCUSSION

FAILURE OF ESSENTIAL PURPOSE UNDER THE UCC

In software licenses and other computer information transactions, as in contracts for traditional sale of goods, "consequential damages exclusions are hands down the most significant limitation of liability . . . ." Potential liability for consequential damages can be "enormous." Indeed, as businesses of all kinds increasingly rely on software for essential functions, software failure can cause devastating consequential loss. For example, in one case, a software customer sought to recover $21 million paid for software that allegedly failed to perform as warranted, and also sought to recover an additional $30 million allegedly


7. Towle, supra n. 6, at 455.

8. Kaner, supra n. 1, at 491. Jean Braucher, Uniform Computer Information Transactions Act (UCITA): Objections from the Consumer Perspective, 5 Cyberspace Law. 2 (Sept. 2000) (stating that UCITA "[e]liminates the key benefit of the Article 2 doctrine of failure of essential purpose of a limited remedy" because UCITA "[e]xpressly permits boilerplate to preserve exclusion of incidental and consequential damages even when an agreed exclusive remedy fails or is unconscionable."); contra James C. McKay, Jr., UCITA and the Consumer: A Response to Professor Braucher, 5 Cyberspace Law. 9 (Nov. 2000). "[T]here is no 'key' benefit of Article 2 that is disturbed by UCITA. UCITA does benefit consumers, however." Id.


10. Id.

lost as an indirect result of the breach. On another occasion, software that cost only $204,000 allegedly caused the user to incur consequential damages of $2.8 million.

Because consequential damages can far exceed the price a software company receives for its product, vendors commonly seek to limit or exclude consequential damages. In recent years, as software transactions have become increasingly prevalent, an increasing variety of contractual arrangements has emerged. Consequential damages are sometimes allowed, at least up to certain limits. Nevertheless, vendors often insist on contractual protection against them. The value of a contractual limitation or exclusion of such damages, however, depends on the likelihood that if the exclusion is challenged, a court will enforce it. This likelihood, in turn, often depends on the choice of applicable law. The future, and perhaps the very survival, of contracting parties may ride on the result.

Substantial pre-UCITA authority applies Article 2 of the UCC to software transactions. UCC Section 2-719(2) provides: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in [the UCC]." The UCC permits the buyer to recover consequential damages in appropriate cases. UCC Section 2-719(3), however, provides: "[c]onsequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.

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14. Phillips, supra n. 11, at 154. "The far-reaching effects of software failure may expose software vendors to equally far-reaching liability. Vendors, ranging from fragile start-up companies to substantial enterprises, recognize that the costs of one failed project can consume the profits from scores of successes." Id.
15. See generally id.
16. Id. at 175.
18. Id.
19. See e.g. Advent Sys. Ltd. v. Unisys Corp., 925 F.2d 670, 676 (3d Cir. 1991); RRX Indus. v. Lab-Con, Inc., 772 F.2d 543, 546-47 (9th Cir. 1985); NMP Corp. v. Parametric Tech. Corp., 958 F. Supp. 1536, 1542 (N.D. Okla. 1997); Colonial Life Ins. Co., 817 F. Supp. at 239. Although Article 2 is labeled "sales," it applies to "transactions in goods," including "specially manufactured goods." U.C.C. § 2-102. This language has provided a basis for applying Article 2 to transactions in software even when they are characterized as licenses and even when the software is specially developed.
If a vendor has given a limited repair warranty, but cannot or does not correct software flaws, the limited repair warranty may fail of its essential purpose. Are consequential damages therefore recoverable?

Courts have split over how subsections 2 and 3 of UCC Section 2-719 interact. One approach is to conclude that if an exclusive or limited remedy fails of its essential purpose, then Section 2-719(2) authorizes all UCC remedies, including consequential damages, without regard to whether a separate limitation of exclusion of consequential damages is unconscionable under Section 2-719(3). This view is often characterized as holding that the two subsections are "interdependent." A second approach, under which a consequential damages exclusion is less vulnerable, is to conclude that the two subsections are "independent." This approach maintains that even if a limited remedy fails of its essential purpose under Section 2-719(2), a consequential damages exclusion survives failure of essential purpose under Section 2-719(3) unless it is unconscionable and, under Section 2-719(3) when the loss is commercial, such exclusions presumptively are not unconscionable.

As the Minnesota Supreme Court pointed out in 1995, "[t]he effect of the failure of a limited remedy to meet its essential purpose presents a most vexing problem that has plagued courts ever since the adoption of the Uniform Commercial Code." Substantial pre-UCITA authority exists on both sides of the question and in the middle as well. This authority is important in assessing whether the consequential damages exclusion is likely to be upheld under the law that governs a transaction. Under current law, if the applicable law is that of a jurisdiction that adopts (1) the interdependent view in which the failure of essential purpose of a limited remedy automatically defeats a separate consequential damages exclusion or (2) an intermediate position short of the independent view, the vendor—despite its best drafting efforts—may find itself facing a very substantial consequential damages exposure.

22. U.C.C. § 2-719(3).
23. See Phillips, supra n. 11, at 176.
25. Id.
26. Id.
27. Id.
28. Id.
30. See id.; see also infra nn. 40-100 and text accompanying.
31. Intl. Fin. Servs., Inc., 534 N.W.2d at 267. Conversely, although a customer ordinarily should not rely at the contract drafting stage on the possibility that an agreed term will be unenforceable, the customer generally is better off under the law of a state that may not enforce provisions restricting the customer's damages. Even if the matter is not fully liti-
The UCITA Approach

UCITA Section 803(b) parallels UCC Section 2-719(2) in adopting the failure of essential purpose doctrine\textsuperscript{32} UCITA Section 803(d) parallels UCC Section 2-719(3) in permitting exclusions of consequential damages unless they are unconscionable.\textsuperscript{33} Unlike UCC Article 2, however, UCITA also includes, in Section 803(c), the following provision: "Failure or unconscionability of an agreed exclusive or limited remedy makes a term disclaiming or limiting consequential or incidental damages unenforceable unless the agreement expressly makes the disclaimer or limitation independent of the agreed remedy."\textsuperscript{34}

The key word here is "unless." Presumably, to make the consequential damages exclusion enforceable under the UCITA standard despite an agreed remedy's failure of essential purpose, the agreement simply needs to recite, as indicated by the "unless" clause, that the consequential damages exclusion is independent of the agreed remedy.\textsuperscript{35} The UCITA Official Comment states: "If the agreement expressly states that the terms are independent, there is no reason in principle to preclude enforcement of that agreement."\textsuperscript{36} Although there may be questions about how courts will construe this new law, UCITA was clearly intended to resolve this issue.\textsuperscript{37}

On its face, then, UCITA offers a recipe for drafting a consequential damages exclusion that is likely to be given effect despite a limited remedy's failure of essential purpose. Only if a vendor neglects to follow the recipe or is forced in a negotiation to depart from it, does the vendor face a serious risk that such protection will be denied. Does this result make the vendor better off and the customer worse off than under current law? The answer, of course, depends on current law.

Comparing UCITA to Current Law

The vendor advantage under UCITA—and the corresponding customer disadvantage—are likely to be greatest when the alternative is to apply state law under which a limited remedy's failure of essential purpose defeats a consequential damages exclusion. Despite the longstanding nature of the debate over this issue under UCC Article 2, state law
remains firmly divided.\textsuperscript{38}

\textit{The "Interdependent" View}

Decisions under the laws of several states appear to indicate that a consequential damages exclusion automatically disappears when a limited remedy fails of its essential purpose. These states include Arkansas,\textsuperscript{39} Hawaii,\textsuperscript{40} Idaho,\textsuperscript{41} Michigan,\textsuperscript{42} Missouri,\textsuperscript{43} Nebraska,\textsuperscript{44} Ohio,\textsuperscript{45} Oklahoma,\textsuperscript{46} Wisconsin,\textsuperscript{47} and possibly other states.\textsuperscript{48} Although a number of the controlling decisions involve consumer purchases, the failure of essential purpose doctrine under the UCC does not distinguish between consumers and commercial customers. Thus, under decisions that construe the laws of any of these states, a consequential damages exclusion is potentially vulnerable to a contention that a limited remedy has failed of its essential purpose. In contrast, UCITA appears to offer a decided advantage to vendors.

The interdependent view is often based on what its proponents consider to be a literal reading of UCC Section 2-719. As the Eighth Circuit remarked in a 1982 decision, "[a] finding of unconscionability is, as a matter of logic, simply unnecessary in cases where section 2-719(2) applies."\textsuperscript{49} If, under Section 2-719(2), the failure of essential purpose means that "remedy may be had as provided in" the UCC, this reasoning

\textsuperscript{38} See infra nn. 40-100 and accompanying text.


\textsuperscript{40} Earl M. Jorgenson Co. v. Mark Constr. Co., 540 P.2d 978, 986 (Haw. 1975).


\textsuperscript{43} Givan v. Mack Truck, 569 S.W.2d 243, 247 (Mo. Ct. App. 1978); R.W. Murray Co. v. Shatterproof Glass Corp., 758 F.2d 266, 272 (8th Cir. 1985).

\textsuperscript{44} John Deere Co. v. Hand, 319 N.W.2d 434, 437 (Neb. 1982).


\textsuperscript{47} Murray v. Holiday Rambler, Inc., 265 N.W.2d 513, 526 (Wis. 1978); Ragen Corp. v. Kearney & Trecker Corp., 912 F.2d 619, 625 (3d Cir. 1990).

\textsuperscript{48} There is apparent support for the interdependent view under the law of Alabama and Florida as well. See Typographical Serv., Inc. v. Itek Corp., 721 F.2d 1317, 1320 (11th Cir. 1983) (Fla. law); Volkswagen of America, Inc. v. Harrell, 431 So.2d 156, 164 (Ala. 1983). Finally, as discussed in the text accompanying nn. 94-100 infra, there is mixed authority under Pennsylvania law.

\textsuperscript{49} Hartzell v. Justus Co., 693 F.2d 770, 774 (8th Cir. 1982) (applying South Dakota law); see also Ehlers v. Chrysler Motor Corp., 226 N.W.2d 157, 161 (S.D. 1975). This reasoning, however, has been questioned by the South Dakota Supreme Court. See Johnson v. John Deere Co., 306 N.W.2d 231, 237-38 (S.D. 1981).
goes, then a clause that purports to limit remedies that otherwise “may
be had” under the UCC—such as consequential damages—can no longer
be given effect.\footnote{50} Section 2-719(3), however, is also part of the UCC, in
which it is “provided” that consequential damages may not “be had” if
the agreement contains an exclusion of such damages and the exclusion
is not unconscionable.\footnote{51} Perhaps because of the resulting interpretive
quandary, the interdependent view is far from universal.

\textit{Mixed Approaches}

Decisions under the laws of a second set of jurisdictions—including
the commercially important states of California,\footnote{52} Illinois,\footnote{53} New
Jersey,\footnote{54} and Washington,\footnote{55} as well as Colorado,\footnote{56} Connecticut,\footnote{57} Indiana,\footnote{58} and, before UCITA, Maryland\footnote{59}—are more difficult to classify.
These decisions, which tend to seek middle ground, try to avoid problems
with the language of UCC Section 2-719 by departing from, or supple-
menting, the language. In so doing, they adopt standards that do not
necessarily lend themselves to uniform application, and as a result, they
do not provide clear-cut assurance that a consequential damages exclu-
sion will be enforced. Thus, UCITA offers the vendor a potential advan-
tage over pre-UCITA law in these states as well.

For example, the Ninth Circuit has issued decisions under both Cali-
fornia and Washington law that require a case-by-case factual analysis.
In \textit{Milgard Tempering, Inc. v. Selas Corp.},\footnote{60} the court relied on a prediction that “Washington courts would take a case-by-case approach and examine the contract provisions to determine whether the exclusive remedy and damage exclusions are either ‘separable elements of risk allocation’ or ‘inseparable parts of a unitary package of risk-allocation.’”\footnote{61}
This standard, however, arguably just recasts the question, leaving it to a court’s essentially *ad hoc* judgment to decide whether the exclusive remedy and damage exclusion should fall together. In *Milgard*, the court held the consequential damages exclusion invalid after extensive failed repair efforts by the seller, observing that the buyer “did not agree to pay $1.45 million in order to participate in a science experiment.”62 One may wonder how many buyers do.

The *Milgard* court’s ultimate emphasis on the extent of the buyer’s loss, rather than the structure of the “package of risk-allocation,” is reminiscent of an earlier decision under California law in which the Ninth Circuit held in a computer contract case that a consequential damages limitation was “expunged” by the limited remedy’s failure of essential purpose where the seller’s default under the limited remedy of repair was “total and fundamental.”63 At least one pre-UCITA Maryland decision seems to follow this standard.64 Under such a standard, the facts of the transaction may determine whether the breach is sufficiently “fundamental” to overcome the exclusion.65

New Jersey law also leaves the door open to consideration of particular circumstances.66 In *Chatlos Systems, Inc. v. National Cash Register Corp.*,67 a 1980 computer case under New Jersey law, the Third Circuit held that a consequential damages exclusion was enforceable, despite failure of the essential purpose of a limited remedy, unless the exclusion is unconscionable.68 In *Kearney & Trecker Corp. v. Master Engraving Co.*,69 a 1987 decision, the New Jersey Supreme Court stated that it was adopting the reasoning of *Chatlos*.70 The standard actually set forth by the New Jersey high court, however, seems by its terms to provide for at

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62. *Id.* at 709.
63. *RRX Indus.*, 772 F.2d at 547.
67. 635 F.2d 1081 (3d Cir. 1980).
68. *Id.* at 1087.
69. 107 N.J. 584.
70. *Id.* at 598.
least some factual analysis on a question other than unconscionability.\textsuperscript{71} The Kearney court held: "[I]t is only when the circumstances of the transaction, including the seller's breach, cause the consequential damage exclusion to be inconsistent with the intent and reasonable commercial expectations of the parties that invalidation of the exclusionary clause would be appropriate under the Code."\textsuperscript{72} This standard seems to allow the possibility under New Jersey law of overturning a consequential damages exclusion based on the parties' "reasonable commercial expectations."\textsuperscript{73}

Another mixed approach appears to be similar to—and perhaps, in part, is a model for—the UCITA approach. In Cooley \textit{v.} Big Horn Harvestore Systems, \textit{Inc.},\textsuperscript{74} the Colorado Supreme Court appeared to place itself squarely in the interdependent camp, but with a key modification enabling a vendor to draft an enforceable exclusion.\textsuperscript{75} The court declared:

When a purchase agreement establishing that the only warranty provided is a warranty to repair or replace defective parts contains NO SEPARATE PROVISION UNAMBIGUOUSLY RECORDING THE INTENT OF THE PARTIES TO PROHIBIT A BUYER'S RECOVERY OF CONSEQUENTIAL DAMAGES EVEN WHEN SUCH SOLE REMEDY FAILS OF ITS ESSENTIAL PURPOSE, the buyer is entitled by virtue of section 4-2-719(2) to the statutory remedy of consequential damages [in the event of failure of essential purpose] notwithstanding a general contractual disclaimer to the contrary. The purchase agreement here contains no such provision; thus the trial court properly concluded that the plaintiffs were not foreclosed from recovering consequential damages.\textsuperscript{76}

Although the Cooley court struck down the consequential damages exclusion before it, the court's rationale gives sellers—and, in the present context, software vendors—a clear indication how to write a consequential damages exclusion that appears likely to survive failure of a limited remedy's essential purpose.\textsuperscript{77} The absent provision in the Cooley purchase agreement was "a separate provision unambiguously recording the intent of the parties to prohibit" consequential damages even when a sole contractual remedy fails of its essential purpose.\textsuperscript{78} By implication, the presence of such a provision would have made the exclusion enforcea-

\textsuperscript{71}. See \textit{Id.}
\textsuperscript{72}. \textit{Id.} at 600.
\textsuperscript{73}. A similar result appears possible in Connecticut, where a federal district court has predicted that the Connecticut Supreme Court would follow Kearney. \textit{McKernan v. United Technologies Corp.}, 717 F. Supp. 60, 71 (D. Conn. 1989).
\textsuperscript{74}. 813 P.2d 736.
\textsuperscript{75}. \textit{Id.} at 748.
\textsuperscript{76}. \textit{Id.} (emphasis added).
\textsuperscript{77}. \textit{Id.}
\textsuperscript{78}. \textit{Id.}
ble. In other words, even though Cooley adopts the interdependent view on its facts, it allows the parties to make Sections 2-719(2) and 2-719(3) independent by clearly stating that they are doing so.\textsuperscript{79} A vendor, under this approach, can achieve the vendor's desired result with careful drafting (and the customer's acquiescence), but risks paying the price if it fails to address the issue in the agreement's express terms.

There is, however, one key contrast between Cooley and the approach taken in UCITA, which further illustrates how UCITA can provide greater assurance that a consequential damages exclusion will be enforced. In Cooley, the court stated: "[A] remedy fails of its essential purpose if it operates to deprive a party of the substantial value of the contract. . . . The [buyer] purchase had value only to the extent the [product] functioned, as advertised . . . ."\textsuperscript{80} On this basis, a failure to repair was held to constitute a failure of essential purpose of a limited warranty, even though the warranty provided that in the event of a defective product or part, the manufacturer, at its option, would "repair or allow credit for such part . . . ."\textsuperscript{81}

In contrast, the official comment to UCITA Section 803 states:

Courts must ask what was the purpose of the agreed remedy. A different purpose exists for remedies limited to replacement or repair, and remedies that include a remedy consisting of a refund right. In the absence of a refund remedy, the purpose is to provide a functioning product. In cases where the remedy includes a right to a refund, the purpose is to return money that was paid for the defective performance.\textsuperscript{82}

The comment to UCITA Section 803 concludes that only if the remedy requires replacement or repair, but not a refund, does the agreed remedy contemplate a functioning product.\textsuperscript{83} The comment thus appears to suggest that, so long as a vendor offers a refund remedy and is actually prepared to grant the refund, the limited remedy should not under UCITA be deemed to fail of its essential purpose, even though the remedy, as in Cooley, also includes, in the alternative, a repair remedy.

From the vendor's standpoint, the official comment to UCITA Section 803 suggests an additional technique for enhancing enforceability of consequential damages exclusions.\textsuperscript{84} This technique is simply to include in the limited remedy a refund right along with any repair warranty.\textsuperscript{85} If it does so, and arguably even if the refund is only partial, the vendor can contend that the purpose of the limited remedy, taken as a whole, is

\textsuperscript{79} Id.
\textsuperscript{80} Id. at 744-45.
\textsuperscript{81} Id. at 744 (emphasis added).
\textsuperscript{82} UCITA § 803, Off. Cmt.
\textsuperscript{83} Id.
\textsuperscript{84} Id.
\textsuperscript{85} Id.
not to provide a functioning product, but merely to allow the customer to recover whatever refund is provided in the event the product does not function. On this view, if the refund is provided, the limited remedy does not fail of its essential purpose, and the possible effects of such failure need not even be considered.

A potential customer response to this argument, if the refund remedy is accompanied by a repair remedy, is that both UCC Section 2-718(2) and UCITA Section 803(b) state that otherwise available remedies may be had if “an exclusive or limited remedy” fails of its essential purpose. This language seems to indicate that the failed remedy need not be “exclusive” so long as it is “limited.” A contract, of course, can contain only one exclusive remedy, but it can contain more than one limited remedy. A limited remedy of repair can fail of its essential purpose, even though a separate limited remedy of refund is fulfilled. The customer could contend that under the language of both the UCC and UCITA, such a failure is enough. Nevertheless, the official comment to the UCITA Section 803 seems likely to encourage the view that an alternative refund remedy avoids application of the essential purpose doctrine based on a failure to repair.

Thus, in the second set of jurisdictions with case-by-case or mixed standards, UCITA also appears to offer potential vendor advantages in the application of the failure of essential purpose standard under an agreement that is properly drafted from the vendor's point of view. UCITA may also offer a greater degree of predictability in comparison with standards that delve into particular circumstances to arrive at an answer.

The “Independent” View

Under the law of a third set of jurisdictions, there is substantial authority that a consequential damages exclusion, unless unconscionable, survives a limited remedy's failure of essential purpose. This group most notably includes New York, but also includes Alaska, Georgia,

86. Id.
87. U.C.C. § 2-718(2) (emphasis added); UCITA § 803(b) (emphasis added).
88. Id.
89. Id. (emphasis added).
90. Id. § 803, Off. Cmt.
Iowa,\textsuperscript{94} Kentucky,\textsuperscript{95} Massachusetts,\textsuperscript{96} Minnesota,\textsuperscript{97} New Hampshire,\textsuperscript{98} South Carolina,\textsuperscript{99} Tennessee,\textsuperscript{100} Utah,\textsuperscript{101} and in a pre-UCITA decision, Virginia.\textsuperscript{102} In comparison with such authority, UCITA provides less of a vendor advantage, if any. In fact, if a vendor did not update its form agreements to reflect UCITA’s drafting requirements as outlined above, the vendor could be better off under existing law in these jurisdictions.

The independent approach of this third set of states was characterized by a Connecticut federal district court in 1989 as the view supported by the “current trend.”\textsuperscript{103} Whereas most of the pro-customer authority originates before 1989, the pro-vendor states include four—Alaska, Massachusetts, Minnesota, and Utah—in which state supreme courts have resolved the issue since 1989 in favor of the independent approach.\textsuperscript{104} The independent approach also seems to have gained more support in cases involving sophisticated buyers, as contrasted with the consumer buyers of products such as motor homes under some of the earlier, interdependent decisions.

Nevertheless, it would be premature to assume that the independent approach necessarily will prevail, absent UCITA, under the laws of states in which the highest court has not yet ruled. Pennsylvania law provides a clear illustration. The Pennsylvania Supreme Court, like the majority of state supreme courts, has not decided the independent/interdependent question. In recent years, several decisions of federal district courts under Pennsylvania law have adopted the pro-vendor approach.\textsuperscript{105}

\begin{footnotes}
\item[97] Intl. Fin. Servs., Inc. v. Franz, 534 N.W.2d 261, 269 (Minn. 1995); contra Soo Line R.R. Co. v. Fruehauf Corp., 547 F.2d 1365, 1373 (8th Cir. 1977).
\item[104] See supra nn. 73, 77, 78, 82.
\end{footnotes}
Recently, however, in a software dispute, the U.S. District Court for the Eastern District of Pennsylvania rendered a decision that bucks the "current trend." In Caudill Seed & Warehouse Co. v. Prophet 21, Inc., the plaintiff's claim arose from a software license agreement. The software allegedly failed to function as warranted, and the defendant allegedly "failed to fix problems with the software despite numerous requests," requiring the plaintiff to obtain software from another company.

In refusing to dismiss the complaint based on a clause excluding consequential damages, the court observed that the parties had "stumbled into a legal quagmire that has divided courts across the nation." The court acknowledged decisions adopting the independent view, but disagreed with their "logic and . . . conclusions" and predicted that the Pennsylvania Supreme Court would not follow them.

Whether or not the Caudill Seed holding eventually prevails as the law of Pennsylvania, the decision demonstrates that software vendors cannot take for granted the outcome of disputes on this issue under state law that has not been clearly settled by a state supreme court, even when pro-vendor lower court authority exists. Thus, UCITA may offer the vendor an advantage in such states.

**UCITA and the "Bargain in Fact"**

The Caudill Seed court reached a different decision from its Pennsylvania federal court counterparts in large part because it focused less on the specific language of either the agreement or the UCC than on the court's conception of the basic bargain.

In exchange for parting with an arsenal of legal remedies, the buyer receives from the seller one silver bullet: the seller's assurance that in the event the product does not work, she will do whatever is necessary to repair or replace the product until it works. But what happens when that silver bullet turns to dust, when the seller refuses to abide by its promise to repair or replace? The courts adhering to the Chatlos line of reasoning would leave the buyer defenseless, essentially holding that a limitation on liability clause constitutes unilateral disarmament on the part of the buyer. I believe that outcome to be unreasonable. Such a reading leaves the buyer completely at the mercy of the seller, because the buyer's only remedy is the seller's assurances that it will repair or

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106. See infra n. 107 and text accompanying.
109. Id.
110. Id. at 830.
111. Id. at 831, 833.
replace.\textsuperscript{112}

\textit{Caudill Seed} suggests that as long as courts try to ascertain the true basis of the bargain, at least some courts may be reluctant to give full effect under the UCC to consequential damages exclusions they perceive as upsetting the fundamental bargain.\textsuperscript{113} The UCC is based on “legal realism,” which attempts to supplant legal formalisms with what the law takes to be commercial reality.\textsuperscript{114} Under the UCC, the “agreement” is not necessarily the document labeled “agreement,” but rather is “the bargain of the parties in fact as found in their language or by implication from other circumstances.”\textsuperscript{115} The \textit{Caudill Seed} court’s analysis relies on a view of the overall bargain and the essential role in that bargain of a vendor’s promise to repair.\textsuperscript{116}

UCITA also defines the agreement as the parties’ “bargain in fact.”\textsuperscript{117} It has been suggested that “UCITA eschews the formalism of classical contract theory in favor of the legal realism of [UCC] Article 2.”\textsuperscript{118} Because UCITA specifies how a limited remedy’s failure of essential purpose affects a consequential damages exclusion, courts may be less likely under UCITA to decide—as in \textit{Caudill Seed}—the effect of a failure of essential purpose based on a judicial view of the actual overall bargain. UCITA seems to presuppose that an express statement in the agreement making the consequential damages exclusion independent of the agreed remedy will, at least in most instances, authoritatively define the parties’ bargain in fact in a way that allows what the \textit{Caudill Seed} court called “unilateral disarmament on the part of the buyer.”\textsuperscript{119} If so, UCITA may represent, for better or worse, a step away from the practice of allowing courts to transcend the agreement’s words in the quest to derive the bargain’s “essence.”

\textit{Willfulness and Bad Faith}

A remaining question is whether UCITA’s relatively favorable terms for vendors on the failure of essential purpose issue necessarily mean that consequential damages exclusions, if not unconscionable, will be upheld automatically. This question requires a review of several decisions

\begin{footnotesize}
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\item \textsuperscript{112} Id. at 832-33 (footnote omitted).
\item \textsuperscript{113} Id.
\item \textsuperscript{114} See Phillips, supra n. 11, at 159.
\item \textsuperscript{115} U.C.C. § 1-201(3).
\item \textsuperscript{116} See \textit{Caudill Seed & Warehouse Co.}, 123 F. Supp. 2d at 827.
\item \textsuperscript{117} UCITA § 102(a)(4).
\item \textsuperscript{118} Rustad, supra n. 20, at 563. \textit{See also} Raymond T. Nimmer, \textit{UCITA: A Commercial Contract Code}, 17 Computer Lawyer 3 (2000) (“UCITA follows a principle set out by Llewellyn and Gilmore: Commercial contract law for the major parts of our economy should be tailored and relevant to the type of transactions to which it relates.”).
\item \textsuperscript{119} \textit{Caudill Seed & Warehouse Co.}, 123 F. Supp. 2d at 827.
\end{itemize}
\end{footnotesize}
that fall squarely within the independent camp, but that still provide a possible further basis for overcoming the exclusion.

For example, in a 1990 decision,\(^ {120} \) the Massachusetts Supreme Judicial Court upheld a consequential damages exclusion despite a claim of failure of essential purpose, but the court noted that its answer might be different if the facts showed "wilful dilatoriness or repudiation of warranty obligations by the seller."\(^ {121} \) The possibility that the exclusion might be defeated in such circumstances presents an additional contractual vulnerability of such clauses, and this vulnerability may persist under UCITA. The Alaska Supreme Court, in a 2000 decision adopting the independent approach, nevertheless declined to enforce a consequential damages exclusion in a consumer case because "[t]he jury specifically found that [the vendor] acted in bad faith in failing to honor its warranty."\(^ {122} \)

Even under New York law, which has consistently taken the pro-vendor approach to failure of essential purpose, the Second Circuit in 1995 remarked in dictum, "[t]here is some support for [the plaintiff's] contention that bad faith is an exception to the enforceability of a consequential damages exclusion under section 2-719(3)."\(^ {123} \) And, a 1996 district court case applying New York law, the court stated that, "even if the plaintiff succeeds in establishing that the limited remedy of repair has failed of its essential purpose, an exclusion of consequential damages that is not unconscionable will be given effect 'where the failure of the repair and replacement warranty is not due to bad faith or willfully dilatory conduct' . . . ."\(^ {124} \)

These federal decisions did not mention the 1994 New York Court of Appeals decision in Metropolitan Life Ins. Co. v. Noble Lowndes International, Inc.,\(^ {125} \) a software case, which held that deliberate or intentional nonperformance was not "willful" under a contractual provision permitting recovery of consequential damages for, inter alia, "willful acts."\(^ {126} \) Although this holding related to particular contractual language, the decision at least suggests that even if "bad faith" or "willfully dilatory conduct" can defeat a consequential damages limitation under New York law, the conduct may need to represent more than merely a deliberate decision not to comply with the contract. Indeed, if New York law re-

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121. Id. at 185-86.
123. McNally Wellman Co. v. N.Y. St. Elec. & Gas Corp., 63 F.3d 1188, 1198 n.9 (2d Cir. 1995).
126. Id. at 507.
quires malice or similar intent to establish an exception to enforceability under UCC Section 2-719(3),\textsuperscript{127} then New York law may be superior, from the vendor's standpoint to UCITA as enacted in Maryland.

This is so because a pre-UCITA decision by the U.S. District Court for the District of Maryland appears to recognize two exceptions to enforceability under Maryland law under circumstances well short of malice.\textsuperscript{128} In that decision, \textit{Dowty Communications, Inc. v. Novatel Computer Systems Corp.},\textsuperscript{129} the court stated that, under the UCC, the requirements of Sections 2-719(2) and 2-719(3) present "two levels of restrictions" that "must be analyzed separately."\textsuperscript{130} Nevertheless, the court went on to say that if the buyer succeeded in showing a failure of essential purpose under UCC Section 2-719(2), the buyer's opportunity to collect consequential damages would depend on showing that the consequential damages exclusion was "unconscionable," or that [the seller's] alleged reach was 'total and fundamental,' or that [the seller] acted in 'bad faith.'\textsuperscript{131}

One could argue that UCITA eliminates both the "total and fundamental" alternative and the "bad faith" alternative identified in \textit{Dowty} as grounds under Maryland law to overcome the consequential damages exclusion. As noted above, UCITA states in Section 803(c) that "[f]ailure or unconscionability of an agreed exclusive or limited remedy makes a term disclaiming or limiting consequential or incidental damages unenforceable unless the agreement expressly makes the disclaimer or limitation independent of the agreed remedy."\textsuperscript{132} The argument would be that if the agreement expressly makes the disclaimer independent of the agreed remedy, then failure of essential purpose never makes the consequential damages exclusion unenforceable, regardless of whether the breach that gives rise to such failure is total or in bad faith.

In other words, "total and fundamental" breach and "bad faith" describe the manner in which or the reasons why the remedy failed of its essential purpose and therefore arguably become irrelevant if the failure itself becomes irrelevant. But since the relevant UCC provisions do not mention "total and fundamental" breach or "bad faith" in the first place, it is unclear whether their significance is necessarily contingent on the failure of essential purpose, or whether, instead, they are sufficient in

\textsuperscript{127} See id.
\textsuperscript{130} \textit{Dowty Commun.}, 817 F. Supp. at 585.
\textsuperscript{131} Id. (emphasis added).
\textsuperscript{132} UCITA § 803(c).
and of themselves. This is especially so in the case of bad faith, which, as discussed above, courts have suggested provides a basis independent of these UCC provisions for disregarding a consequential damages exclusion.

CONCLUSION

It appears that UCITA offers advantages to vendors and corresponding disadvantages to customers vis-à-vis case law that does not clearly resolve the failure of essential purpose issue in favor of the independent view. In so doing, UCITA also appears to reduce the ability of courts to look beyond UCITA-compliant consequential damages exclusions to discern the parties' "true" bargain as it relates to such damages.133 UCITA is a complex statute, however, and as discussed just above, even the application of UCITA, at least under Maryland law as it currently stands, may not necessarily protect the vendor in disputes where "total and fundamental" breach or "bad faith" can be shown.134 For these reasons, practicing lawyers still need to weigh UCITA's pluses and minuses from the point of view of particular transactions and likely issues in those transactions, and those who consider the merits of legislation to enact a version of UCITA will want to consider not only UCITA's specific provisions, but also how far they reach and how much of existing law they are meant to displace.

133. Id. § 803.