NOTES AND COMMENTS

LIMITATIONS ON FREEDOM TO MODIFY CONTRACT REMEDIES

Compensation, says the venerable case of *Jaquith v. Hudson*,¹ is the only law of contract. True, contract does not exist apart from remedy and all remedies attempt to compensate the person who depended on performance, and thus to encourage performance by future contracting parties. This, however, is only the first use of remedy. Compensation emphasizes what the parties expected from the contract.² But "compensation" has proved as flexible as "consideration" and has not prevented the fashioning of remedy for purposes other than effectuating intent of the parties. To study these purposes, this Comment focuses on three common contractual terms attempting to modify judicial remedies: disclaimers of warranties in sales agreements, stipulated damage provisions, and arbitration clauses in commercial contracts.

It has long been familiar learning that courts are reluctant to enforce broadly drafted disclaimer of warranty clauses, are eager to strike down stipulated damage provisions as penalties, and give only lip service to the arbitration principle. It is also axiomatic that these judicial responses are from the unequal bargaining positions of the parties, the fact that the contract is standardized with take-it-or-leave-it terms, and in general the unfairness of enforcement. But unconscionability is not easily defined and the prevention of elementary unfairness is only part of the explanation of judicial scrutiny of pre-set remedies. Judicial responses to warranty disclaimers, liquidated damages, and arbitration clauses illustrate particularly well three reasons for judicial control distinct from the nebulous notion of unconscionability. The parties to the agreements in these areas are often of equal bargaining power, the terms of the contracts are usually bargained over, and enforcement of the clauses in accordance with the intent of the parties would often not be unconscionable.

In law of sales, courts have evolved a concept of fair remedy in order to assure a minimum recovery to a disappointed buyer—a sale must be at least an exchange of value. To the extent that disclaimers of warranty deny this fair remedy, many courts have disallowed disclaimers, even when the parties to the agreement are experienced businessmen. The idea of fairness behind the judicial clash with disclaimers is thus more subtle than protection of the ignorant consumer against the omnipotent seller.

In supervising stipulated sums, courts have established an ideal of accuracy, resting on the proposition that recovery must be measured ultimately by court-

1. 5 Mich. 123 (1858).
2. This is true because the aim of compensation is to put parties where they would have been had the contract been performed. What was expected is ultimately a question of what the parties intended performance to mean. *Cf.* Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854).
evolved rules. The sum which the parties have set must be "reasonable" in light of actual damages. But the measure of actual damage is the remedy which would ordinarily be available in the absence of stipulated damages. Courts thus preserve their own rules of recovery in the name of accurate measurement because behind these rules lie clear judicial policies, the most important of which is limitation of liability for breach of contract.

Control of arbitration and the awards of arbitrators stem from awareness of a need for certainty in commercial dealings—the kind of certainty which courts promote through their ability to respond to the present case while establishing a rule for the future based on the practice of the past.

These reasons are neither discrete nor completely expressed in the above summaries. The purposes of judicial regulation of remedy and the interrelation of purposes become tangible only through exploration of the cases.

DISCLAIMERS OF WARRANTY

The warranties of quality in goods sold are a model for the thesis that societal needs mold the remedies which courts command. Originally sounding in tort as an action akin to fraud and deceit, warranty slowly developed into assumpsit (the seller promised). As courts met the realities of the market place—that buyers generally are not experts in the wares they purchase, that individuals are often literally at the mercy of the seller's statements about the goods, and that buyers are diffuse and unable to band together for protection—the warranty took its form as a collateral promise or set of promises about quality implied in sales contracts. Concern about the unequal contracting positions of buyers and sellers was not the only reason courts were eager to imply warranties. They desired also to establish a framework for sales in which there would be an exchange of value. Thus, courts inferred express warranties of quality from the seller's statements about his wares, and implied warranties apart from any particular statement. Implied are warranties of title, of merchantability, and of fitness for a particular purpose, the last arising only if the seller knows the purpose for which the goods are purchased.

3. For good detailed analyses of the development of warranty, see Llewellyn, On Warranty of Quality, and Society: I, 36 Colum. L. Rev. 699 (1936); id., II, 37 Colum. L. Rev. 341 (1937); Note, Warranties, Disclaimers and Parol Evidence Rule, 53 Colum. L. Rev. 858 (1953); Note, WARRANTIES OF KIND AND QUALITY UNDER THE UNIFORM REVISED SALES ACT, 57 Yale L.J. 1389 (1948).

4. 1 Williston, Sales 197 (2d ed. 1924); Prosser, Torts 705 (1941).

5. Prosser, Torts 669-70 (1941).


7. The Uniform Commercial Code (hereinafter, UCC) divides warranties into express, if based on the language or action of the parties, and implied, if imported into the bargain by law without reference to the language or action of the parties. See U.C.C. §§ 2-313, 2-315. The Uniform Sales Act (hereafter, USA), promulgated in 1906 as a codification of the better case law of the nineteenth century, drew a conceptual distinction between warranties arising from the seller's promises or representations (USA § 12) which were "express," and warranties based on the seller's descriptive language (USA § 14) or samples (USA
The existence of warranty in a sale opens extensive possibilities of remedy: the buyer can bring an action for breach of warranty, measuring damages by the difference in value between the goods as warranted and as delivered; he has an action for consequential damages arising from breach of warranty; he can counterclaim for damages when the seller sues for price; or he can seek rescission because of the breach of warranty. Under the Uniform Commercial Code, the buyer can also return the goods and sue for damages as if the goods were not delivered at all.\(^8\)

The seller’s answer to warranty was the disclaimer.\(^9\) A disclaimer attempts to curtail some or all of the possibilities of remedy which warranty provides and to influence the court’s analysis of what each party promised.\(^10\) Through the disclaimer, in other words, the seller seeks to limit the scope of his undertaking; because warranties of quality reflect the usual expectation in a sale, the seller, in effect, declares that he is giving less than the norm.

Many courts have afforded full effect to disclaimers of express or implied warranties;\(^11\) the Uniform Sales Act specifically recognizes the seller’s power to limit the remedies usually available upon breach.\(^12\) Even when the disclaimer abrogates warranties which courts have painstakingly evolved—merchantability, for instance—courts have upheld them. An example is *Shafer v. Reo Motors,*\(^13\) a 1953 case which one commentator called “the high point” in effectuating a disclaimer.\(^14\) The disclaimer was of any liability for defects in a car after 90 days or 4,000 miles. A short time after the warranty period had elapsed, the

\(^8\) UCC § 2-711.

\(^9\) Note, 23 MINN. L. REV. 784-85 (1939) (tracing the use of disclaimers to disarm buyers).

\(^10\) In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller’s obligation. Thus, a contract is normally a contract for a sale of something describable and described . . . .

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon, good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

UCC § 2-313, Comment 4; cf. a similar comment to the warranty sections of the Uniform Revised Sales Act (1944 draft).

\(^11\) See, e.g., McDonald Credit Service v. Church, 49 Wash. 2d 400, 301 P.2d 1032 (1956); W. F. Dollen & Sons v. Carl R. Miller Tractor Co., 214 Iowa 774, 241 N.W. 307 (1932).

\(^12\) USA § 71.

\(^13\) 108 F. Supp. 659 (1952), aff’d, 205 F.2d 685 (1953).

\(^14\) Hogan, The Highways and Some of the By-ways in the Sales and Bulk Sales Articles of the Uniform Commercial Code, 48 CORNELL L.Q. 1, 6 n.24 (1962).
car developed defects causing a wreck and grave consequential damages. The buyer sued on an implied warranty of merchantability and of fitness for use as a car. But the court said:

The implied warranty arises independently and outside of the contract and is imposed by operation of law. Nevertheless in making a warranty of a motor vehicle, the seller may put any limitation he chooses on the character of the warranty or the time during which it is to remain in effect...\textsuperscript{15}

In another recent case, the Second Circuit held a disclaimer of all warranties to exclude buyer's recovery when the kind of hemp delivered was not what he had ordered.\textsuperscript{16}

In such cases courts view disclaimers as an expression of the intent of the parties, treating them like any other defining term in the agreement. In allowing disclaimers to preclude implied warranties, these courts apparently view implied warranties as indicia of intent only in the absence of more explicit evidence. Where there is an expression of intent to limit the remedies arising from warranties, these courts allow it to prevail. To this extent courts have treated remedies as a matter over which the parties may bargain.

This view of disclaimers as an ordinary term of the contract, however, is not unanimous. Disclaimers have acquired a long, tortured history through judicial interpretation, or more candidly, judicial construction, designed to avoid the effects of the term.\textsuperscript{17} Courts often disallow disclaimers which deprive the buyer of a fair remedy, that is, those remedies arising from warranties which would apply in the absence of a contract provision disclaiming them. In cases involving consumers, courts have repeatedly avoided the effect of disclaimers.\textsuperscript{18} The unwary, inexperienced purchaser, without bargaining power, faced with a standardized contract he cannot understand, has aroused judicial concern. The effort to protect him from the hazards of disclaimer has enmeshed the courts in a hundred-year war with the draftsman.\textsuperscript{19} As the courts denied effect to one set of words, the sellers devised another. Neither side has been completely successful in the battle; airtight disclaimers sometimes rob the naïve consumer of remedy, but the seller can never be sure of this result. The determination of the courts to protect the consumer, at the cost of seller's intent in limiting his undertaking, has a clear history in a long line of cases.\textsuperscript{20}

\textsuperscript{15} 108 F. Supp. at 661.
\textsuperscript{16} Dadourian Export Corp. v. United States, 291 F.2d 178 (1961). This was, however, a governmental sale of surplus goods which the court said specifically was "no ordinary contract between buyer and seller." Id. at 182.
\textsuperscript{17} Authorities cited at note 3 supra examine this historically. The following law review notes collect many examples of court construction to avoid the effect of disclaimer: 23 MINN. L. REV. 784 (1939); 31 COLUM. L. REV. 1325 (1931); 1939 WIS. L. REV. 459.
\textsuperscript{18} Note, Warranties of Kind and Quality Under the Uniform Revised Sales Act, 57 YALE L.J. 1389, 1400, 1404 (1948).
\textsuperscript{20} Vold, op. cit. supra note 7, at 468-70; Prosser, supra note 6, at 164.
preservation of a sale as an exchange of value is behind protection of consumers, courts have not clashed directly with intent of the parties in consumer cases. Rather, courts have been able to conclude that the parties did not voluntarily agree to the disclaimer provision, either because the buyer was not aware of the fine-print disclaimer or because the buyer had neither choice of terms nor opportunity to bargain.

But the consumer context is not the only one in which courts have denied disclaimers. Sometimes courts are equally unwilling to give effect to a disclaimer in a contract between experienced businessmen who can be expected to know the terms of the agreement. When courts disallow disclaimers between experienced dealers, the contract is usually in a standardized form. Yet form contracts are a common way of transacting business and courts do not hesitate to enforce the other provisions of these contracts. It is not the fact of the form contract alone which accounts for the special treatment given disclaimers.

Disallowance of disclaimers rests upon the proposition that they are not ordinary terms, but infringe upon remedies established by courts and must be scrutinized and prevented if they eliminate a fair remedy. To courts taking this view, implied warranties are more than a judicial construct to ascertain intent in the absence of other indicia; warranties are assurances that the buyer is not left without value from his bargain. In effect, these courts declare that there is a minimum expectation from dealing which the parties cannot contract away. "The purchaser," said Lord Ellenbrough in 1815, "cannot be supposed to buy goods to lay them on a dunghill." Courts have often implicitly added, "even if he apparently agrees to this result." Thus something more is at work in the prevention of effective disclaimers than judicial hostility to overreaching resulting from the unequal bargaining positions between professional sellers and inexpert buyers. What is at work is a belief that bargaining about breach in a sales contract should be discouraged because such bargaining often leaves the buyer without any value from the contract and without recourse for its absence. Such a situation is unconscionable, regardless of the identity of the parties and the circumstances surrounding the making of the contract.

Behind this conclusion lie many factors, some peculiar to sales transactions. At base, perhaps, is a feeling that in the classic contract situation, the exchange,


23. Kessler, supra note 22, at 631 passim.

24. Gardiner v. Gray, 4 Camp. 144, 171 Eng. Rep. 46, 47 (1815). This is the case courts generally cite as establishing implied warranties in sales. Prosser, supra note 6, at 120. The case deals with a contract for "waste silk" between an experienced buyer and seller.
there must be a guarantee of remedy if contract law is to afford any protection to the expectations of the parties. Expectations in sales, at least, are founded on an exchange of value, and the expectations are not lessened by a disclaimer. Agreeing upon the results of breach, moreover, is particularly undesirable under the pressures of commercial dealing, where the parties are often intent on quick performance and where there exists a whole range of possible injuries of which the parties cannot be aware at the time of contracting. Economic needs and immediate market obligations (for example, resale contracts) may create situations in which unconscionably hard bargains might be struck. Also a factor is the social advantage of confining the terms the parties can bargain about. Contract law may be more of a facility for the parties if it allows them to concentrate on price and bargain for it, against a background of fixed rules about remedy, than if it necessitates bargaining over the unforeseeable consequences of an unpredictable breach.

Moreover, courts

25. A parallel is the vehement controversy over government contracts. The fundamental notion that in a contract there must be a meaningful remedy seems to be the background of the dissenting opinion in United States v. Wunderlich, 342 U.S. 98 (1951). In Wunderlich, the Court gave a wide scope to the standard "disputes" clause which the Government puts in its contracts, providing that all contested questions of fact arising in performance of the contract will be decided finally by the contracting officer. The Court held that this clause effectively precludes judicial review of any questions other than fraud or bad faith. This review is narrower than that given similar clauses in non-government construction contracts (where, for instance, the architect may be named as the decider of fact) and is also narrower than the review given after arbitration. See text at note 146 infra. Three Justices dissented, arguing that this was an unfair denial of remedy.

Before Wunderlich, the courts had been giving the findings of the contracting officer broad review. See Note, 66 Harv. L. Rev. 154, 155 (1952) (collecting cases). A recent commentator was probably right when he observed that a government contract is less than a contract: it is a "convenient administrative device for the government to get its procurement work done." Schultz, Proposed Changes in Government Contract Dispute Settlement: The Legislative Battle Over the Wunderlich Case, 67 Harv. L. Rev. 217 (1953). Thus the decisions in connection with the contract are merely administrative decisions, which like other administrative decisions, affect private individuals.

But the traditional idea of contract has prevented this analysis from stilling the controversy over Wunderlich. Many of those who oppose the decision seem to do so because the form of the transaction involved is a contract: the idea that there must be an effective remedy (which implies one given by an impartial judge) is absolute and basic.

26. Macaulay, Restitution in Context, 107 U. Pa. L. Rev. 1133, 1142 (1959), suggests this idea in a slightly different context. The article names as one of the "consistent themes about the relationship of law and economic activity running through the legal framework of bargaining," the idea that the legal system should "facilitate rational planning for profit and protect against losses caused by such reliance when expectations are not realized."

Rational bargaining is ... facilitated by standard allocations of risk in certain common or important transactions. One can then bargain about the important question of price without bothering about other things.

Id. at 1143.

The concept of fixed rules of law as a background against which the parties contract appears in the civil law, in the concepts ius dispositiveum rules which are always implied in a contract unless the parties agree otherwise, and ius cognens rules which agreeing cannot change. See Weber, Law in Economy and Society 191-95 (1954).
cannot determine whether the remedy which the parties attempted to set is fair if it is bound up with the contract price and other terms of the agreement.

A sampling of those cases where courts have refused to enforce disclaimers confirms the thesis that often courts are determined to preserve a fair remedy in contract. In each of these cases the contract was either bargained about or the buyer was an experienced professional; in some, both elements are present. A line of contract construction which at first view looks incredible reaches from *Bekkevold v. Potts* \(^{27}\) in 1927 to *Frigidinners v. Branchtown Gun Club* \(^{28}\) in 1954. In *Bekkevold*, the much cited classic of its kind, the contract was for sale of a tractor, a hitch, and other equipment. The farmer informed the seller of the purposes for which he needed the equipment but the sales contract read, “No warranties have been made in reference to said motor vehicle by the seller to the buyer unless expressly written herein at the date of purchase.” None was written therein. The buyer sued to recover the purchase price, claiming an implied warranty of fitness for a particular purpose. The seller relied on the disclaimer. The court, however, found that the language of the disclaimer did not exclude warranties implied by law because no action by the parties would have been necessary to include them in the first place, and only warranties created by the parties are excluded by these disclaimers. In *Bekkevold*, the court cast its decision in terms of the intent:

> The parties intended to say no contractual warranties had been made . . . [but] not to exclude the implied warranty.\(^{29}\)

In *Frigidinners*,\(^{30}\) the disclaimer read: “This contract contains the entire agreement between the parties, no other warranties have been given.” The court

Section 1-107 of the 1950 *projet* of the Uniform Commercial Code incorporated a “fixed rules” concept:

> The rules enunciated in this Act which are not qualified by the words “unless otherwise agreed” or similar language are mandatory and may not be waived or modified by agreement.

This provision recognized that there is a law regulating contract making which courts will seldom allow parties to change by agreement, and which is a useful framework *within which* the parties should agree. But the provision was eliminated in the final version of the Code. For a discussion of the attempt to incorporate the proposed section in the final Code, and of the background of the provision, see Comment, *Certainty of Promise in the Law of Sales*, 30 Tul. L. Rev. 568, 571-73 (1956). Even under the present Code (1958 ed.) there is some acknowledgment of a “background of law against which parties contract,” in the following provisions:

1. Parties are not free to vary the statutes of limitation in the Code. Section 2-725 allows limitation to not less than one year but does not allow extension.
2. Agreements about damages must be “reasonable,” § 2-718.
3. Consequential damages may be limited or excluded, but this is subject to a test of unconscionability in § 2-302. Limitation of consequential damages for personal injuries in consumer goods is *prima facie* unconscionable. Section 2-719(3).

See also §§ 1-102, 4-103(1), 9-501(3). See text at notes 61-73 *infra* for an exposition of the theory that warranties may not be freely disclaimed.

\(^{27}\) 173 Minn. 87, 216 N.W. 790 (1927).
\(^{29}\) 173 Minn. at 90, 216 N.W. at 791.
applied the same analysis as in Bekkevold. Careful drafting obviates this reasoning, but it is an interesting reasoning because it so clearly reveals a conception of contractual terms operating outside of anything the parties do. Implicit is an idea of warranty, with its concomitant possibilities of remedy, not only as a minimal guarantee to the expectations of purchasers but also as a background for all sales-contracting. Indeed the court in Bekkevold made this rationale of implied warranties quite explicit:

The law annexes [the warranty] to the contract. It writes it, by implication into the contract which the parties have made. Its origin and use are to promote high standards in business and to discourage sharp dealings. It rests upon the principle that “honesty is the best policy” and it contemplates business transactions in which both parties may profit.

A second line of construction revealing judicial interest in preserving a fair remedy, at the cost of intent of the parties, is that which reaches from Austin v. Tillman in 1922 to Burr v. Sherwin Williams in 1954. In Austin the contract was for an asphalt-mixing plant as described in a catalogue. The plant shipped had weak and broken parts. After the seller and the buyer worked together on the machine for several weeks, trying to make it work properly, the seller demanded that the buyer either accept or reject the plant. The buyer refused because no other asphalt-mixing machines were available and he had construction contracts to meet. The buyer kept the machine and used it for several months, though it constantly needed repair and never produced at a proper capacity. When the seller sued for price, the buyer counterclaimed for damages and won over $10,000. On appeal, the seller relied on the contract term:

If for any cause, when testing the machine, defects should develop . . . we are to return the machine to you and the amount we have paid [will be] refunded and this order cancelled.

This term in effect limits the remedy for a breach of warranty of fitness to return of the machine, eliminating the possibility of retaining the goods and recouping damages. The provision was not unusual but enforcing it would result in compelling the buyer either to return immediately a machine he needed and could not replace, or to pay for a seriously defective machine and give up recovery of any damages. The court, in an amazing piece of construction, said that the disclaimer applied only to the machine which was the subject of the contract, and since the machine delivered had numerous defects, it was not the

31. The procedural context of Frigidiners was that of a buyer seeking to open a confessed judgment. The court decided that the disclaimer did not prevent the buyer from claiming breach of warranty as a good defense to the claim upon which the judgment was founded. Thus, the appeals court upheld the lower court’s discretion in opening the judgment.

33. 104 Ore. 542, 209 Pac. 131 (1922).
35. 104 Ore. at 546, 209 Pac. at 132.
one contracted for; therefore the term could not affect it. The dissent demolished this argument:

If the machine had been all that the defendant claims it ought to have been, the clause... would have been utterly useless. There is presented the very situation which the parties contemplated might be possible and they provided in advance for its adjustment.\(^{36}\)

But it was the dissent.

In *Burr v. Sherwin Williams*,\(^{37}\) the Supreme Court of California faced a disclaimer on an insecticide which read “buyer assumes all risks in use,” and “no warranty as to use.” The insecticide contained a small amount of an impurity fatal to cotton and when used completely destroyed the buyer’s crop. The court read the label on the can which contained a list of the chemicals included and said:

[The] disclaimer was limited to a denial of any warranty that a substance which meets this description is an effective or safe insecticide... there is nothing in the disclaimer which suggests that Sherwin Williams was refusing to warrant that the liquid in the drum was compounded so as to conform with the description and was free from any impurity which would make it unusable for the general purposes of a product of the kind ordered by the plaintiff.\(^{38}\)

Although on its face this is a more reasonable interpretation than that in *Austin*, it is likely that the very thing the seller intended was to protect himself against was crop loss.\(^{39}\) Thus, in both *Austin* and *Burr*, courts dealing with experienced commercial contractors\(^ {40}\) found that regardless of the contract terms, the parties must have intended to contract for basically

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36. *Id.* at 596, 209 Pac. at 148.
38. *Id.* at 683, 268 P.2d at 1043.
39. The label included a chemical analysis of the ingredients, cautionary instructions, and this sentence:

Buyer assumes all risk in use or handling, whether in accordance with directions or not.

The sentence immediately preceding the last read:

Seller makes no warranty of any kind, express or implied, concerning the use of this product.

In the context of all the printing on the label, the buyer’s claim is not farfetched that this last sentence quoted above was intended as a disclaimer of the warranties of quality and merchantability. The sentence would have been redundant, if not unnecessary, if it had meant merely that the seller was disclaiming responsibility for negligent use of a poisonous substance.

40. In *Burr*, a farmer’s agents were the purchasers of the spray. The agents were a professional crop sprayer and representatives of a farmer’s cooperative association, all presumably experts in their work. The court, in fact, held that though the disclaimer did not exclude an implied warranty of merchantable quality, there was no privity between Sherwin Williams and the farmer. Thus, the court reversed the verdict for the plaintiff, suggesting, however, that in a new trial, the description on the cans might well raise an express warranty for which no privity is required.
merchantable goods. The court in each case simply refused to allow the elimination of the remedies usually available, for elimination of such remedies would leave the buyers with little benefit from the contracts.

A third revealing approach is that taken in Meyers v. Land, a 1951 Kentucky case in which the buyers of a defective machine for making cement blocks sought return of the purchase price in the face of a disclaimer limiting remedies to repair or replacement. The court wrestled with the disclaimer, part of a contract between experienced businessmen, and concluded that although the disclaimer was "effective," it did not apply to this case because the failure to deliver a machine which worked amounted to a failure of consideration. There was "no delivery of what was bought." But "what was bought" is the warranty question; the reason warranties are made and implied is to clarify exactly what the bargain was about. There is failure of consideration only if the thing delivered has no worth, and here the allegation was that the machine "did not do what it was designed to do." In one sense the machine was worthless to the buyer. But accepting the disclaimer as an ordinary substantive term of the contract.

41. This line of construction is much like a British development which preserves a fair remedy in sales and other "exchange" contracts by denominating some contract terms "fundamental." Roughly, the doctrine is that some terms are so basic to the "core," "essence," or "root" of the contract that no disclaimer can effectively eliminate them.

The case which established the doctrine was Alexander v. Railway Executive, [1951] 2 K.B. 882, in which a performer left his luggage in a railway cloakroom and railway officials broke it open and handed it over to another person. The railway officials relied on a contract exempting them from any duty whatever to protect or insure stored possessions. But the court found that no clause could exempt the railway from such "a fundamental breach" of a bailment contract.

The doctrine has had a confused career, with some commentators contending that a fundamental breach means no more than total non-performance of the contract or failure of consideration. A case taking this view is Smeaton Hanscomb & Co., Ltd. v. Sasson I. Setty Sons & Co., 2 All E.R. 1471 (1953).

Whatever its future, the fundamental term doctrine is an English analogue of attempts by American courts to prevent the elimination of remedy in the face of agreement and in the name of fairness.

For a technical discussion of the fundamental term, see Melville, The Core of a Contract, 19 Mod. L. Rev. 26 (1956).

42. 314 Ky. 514, 235 S.W.2d 988 (1951).

43. The difficulties to which this approach can lead are well illustrated by a similar distinction which English courts made between "warranties" and "conditions" in contracts. Where the difference between goods contracted for and delivered is so great as to be a difference in "kind" rather than "degree," see T. & J. Harrison v. Knowles & Foster, [1917] 2 K.B. 606, 610, there has been a breach of condition, which no disclaimer can affect. From this distinction came the renowned proposition that a sterile bull is not a bull, Cotter v. Luckie, [1918] 2 N.Z.L. Rep. 811. The search for the point at which a promise becomes a "condition" rather than a "warranty," like the search for the point at which the goods delivered are defective enough to be a failure of consideration, takes the court along a path fraught with uncertain distinctions and artificial rules.

44. Cf. J. I. Case Threshing Machine Co. v. Gidley, 28 S.D. 101, 132 N.W. 711 (1911) (denominating as "clearly erroneous" instructions which indicated that a breach of warranty was equivalent to a failure of consideration).
agreement which limits the seller's undertaking ineluctably leads to the conclusion that the buyer received all the consideration that he bargained for. And the court did so accept the disclaimer and thus felt precluded from considering warranty as a means of affording relief. But the court refused to accept the conclusion that such a reading of the disclaimer compels:

Anyone brought up to believe that for every wrong there is a remedy will pause before saying that the seller will escape liability merely by putting in an order blank a statement to the effect that there is no assurance that the buyer will get a machine that will work. We have paused for the moment and have readily concluded that the avoidance of liability under such a circumstance is not permitted by law.45

The difficulties in this approach became apparent four years later when the same court faced a disclaimer similar to the one in Meyers in a contract for the sale of a truck.46 The truck went out of control a few weeks after purchase; plaintiff argued there was failure of consideration since a truck which would not operate properly failed to fulfill the contract. But the court found that too many other factors were present; the truck evidently worked for a short time, the seller had not been asked to remedy defects, and there was some evidence of negligence on the part of the buyer. Following its analysis in Meyers, the court felt the disclaimer prevented an inquiry into whether this was a merchantable truck of good quality.47 The court distinguished Meyers v. Land, recognizing its true basis:

Since the equities of the situation do not justify a rescission of the contract on the theory of failure of consideration and the sales contract excluded all implied warranties, the court should have directed a verdict for the appellant.48

Had the court desired to decide for the plaintiff in this case, it would have had considerable difficulty in either following or distinguishing Meyers. Here the truck worked too well to call it a failure of consideration and yet the disclaimer was a fair one between experienced commercial men. The difficulty would have resulted from the court's earlier failure to say simply that a seller cannot exclude a promise that his goods are basically merchantable where it is clear from the consideration paid and the nature of the goods that the buyer was not bargaining for worthless goods. It is the idea that there must be a fair remedy in contract which has occasionally led courts to merge warranty with consideration; finding a fair remedy excluded by the disclaimer, the courts turn to the most basic contract requirement, consideration, proclaim it missing, and prescribe a remedy.49

47. Id. at 351.
48. Ibid.
49. The analysis in Meyers v. Land has recurred through the years. See, e.g., Richardson v. Messina, 361 Mich. 364, 368, 105 N.W.2d 153, 155 (1960):

   Equipment sold as automatic in its operation is impliedly warranted to be automatic and a failure of automatic operation involves a failure of consideration . . . .
Another indication that the aim of courts in limiting disclaimers is preservation of fair recovery is the distinction running through the law between cases in which the buyer seeks rescission, or the difference in value between the goods as warranted and as delivered, and those cases in which he asks consequential damages, or those damages in excess of the price of the goods purchased. A disclaimer is often given effect to preclude recovery of consequential damages for breach of an implied warranty where, in light of the consideration received by the seller, the imposition of liability far in excess of the purchase price does not seem justified. But even when a disclaimer is allowed to prevent recovery of consequential damages, some recovery for breach of an implied warranty might nevertheless be permitted. The seed cases provide an example of the different treatment of basal recovery and consequential damages. Wide disclaimers of any responsibility for the crop are usually made with sales of seed. Again and again, courts have upheld these disclaimers in the face of suits for crop loss, a consequential damage which might destroy the seed business were the risk borne by the seller. On the other hand, courts have departed from holding the disclaimer so effective as to allow the seller to recover the purchase price for the seeds. And when the buyer has sued for the difference between the value of the seeds he received and those he expected, he has sometimes been successful. This distinction in the remedies given is rarely

50. See Donnelly v. Governair Corp., 145 F. Supp. 699 (N.D. Cal. 1956), where the buyer of refrigeration equipment which was defectively wired sued for huge consequential damages, including payments for substitute facilities and food spoilage. The court limited the buyer's recovery to the cost of rewiring. In so doing the court stressed the failure of the buyer to give proper specifications, but the decision also rested on the effect of the disclaimer to exclude, at least, liability for consequential damages. See also, Charles Lachman Co. v. Hercules Powder Co., 79 F. Supp. 206 (E.D. Pa. 1948).


52. Sellers of seed now often warrant the seed to the extent of assuring the purchase price. See, e.g., Gilbert v. Reuter Seed Co., 80 So. 2d 567 (La. 1955). Cornelli Seed Co. v. Ferguson, 64 So. 2d 162 (Fla. 1953) traces the history of judicial attitudes toward disclaimers in sales of seeds. The case establishes a distinction in the allowance of damages, based on whether the seed was of a completely different variety from that ordered, so that the crop loss could only have resulted from the seller's mistake.

In Charles Lamori & Son v. Globe Laboratories, 35 Cal. App. 2d 248, 95 P.2d 173 (1939), the buyer sued for the loss of stock from disease allegedly caused by a serum purchased from the seller. On the labels of the serum appeared:

... since we have no control over diagnosis, method of administration or handling of this serum after it leaves our possession, we waive all responsibility following the use.

The court affirmed a judgment awarding the seller a new trial, declaring that the statement was "a disclaimer of warranties or at least a limitation of liability" which would bar a suit for damages and leave the buyer with the sole remedy of rescission and recovery of the purchase price.
articulated in opinions. The Uniform Commercial Code recognizes it, however, and appears to allow parties greater latitude to limit the consequential damages from breach of warranty than to eliminate any possibilities of recovery through disclaimers.\(^{53}\)

These examples of techniques used by some courts in dealing with disclaimers—construing broadly worded disclaimers ineffective as to warranties implied by law; insisting on some minimum standard of merchantability in goods; calling a defect in quality a failure of consideration; and showing greater concern for the preservation of elementary rights of contract recovery than for recovery of consequential damages—all illustrate the thesis that these courts conceive their function in determining the effect of disclaimers in sales contracts as the preservation of a fair remedy. Though it is true that standardized sales contracts, often made with inexpert consumers, present peculiar opportunities for overreaching, some courts are also interested in preventing the unconscionability of there being less than a fair remedy for contracts between experienced businessmen. By limiting the effectiveness of disclaimers, these courts concentrate on what the parties should have agreed to and protect an ideal of a fair bargain in which there is an exchange of value by assuring a remedy to the disappointed buyer.

In the past, courts have pursued their goals in the sales field by the process of adverse construction. This has involved them in familiar difficulties, so well set out by Professor Llewellyn:

[T]he admission that the clauses in question are permissible in purpose and content... [invites] the draftsman to recur to the attack. Give him time and he will make the grade. Second, since... [the courts] do not face the issue, they fail to accumulate either experience or authority in the needed direction; that of marking out for any given type of transaction what the minimum decencies are. ... Third, since they purport to construe and do not really construe, nor are intended to, but are instead tools of intentional and creative misconstruction, they seriously embarrass later efforts at true construction. ... \(^{54}\)

The time may come when courts will realize the awkwardness of their position and shift to open refusal to enforce disclaimers which deny a fair remedy.

53. UCC § 2-316 includes three subsections which, taken together, make it very difficult to disclaim a basic warranty. (See text at notes 61-73 infra.) Then subsection (4) of § 2-316 provides:

Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy.

Comment (2) to § 2-316 says that:

This article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty.... Under subsection (4) the question of the limitation of remedy is governed by the section referred to rather than by this section.

The section allowing limitation of remedies is less stringent than § 2-316. The Code is therefore more willing to allow parties to limit the consequential damages from breach of warranty than to allow them to disclaim any possibilities of recovery through disclaimers.

54. Llewellyn, Book Review, 52 Harv. L. Rev. 700, 703 (1939),
A few cases portend such developments. At the end of Llewellyn's seminal article in 1937, On Warranty of Quality and Society, appeared the prediction that by the late 1950's courts would openly move to the position that freedom of contract is not binding in the remedy area, that the attitude of courts would become:

...what [have] ... you ... to demonstrate that you didn't agree or that some real portion of the public suffers by holding you and people like you to your agreement?

The striking fulfillment of the prophecy is Henningsen v. Bloomfield Motors, Inc., in which the New Jersey Supreme Court confronted the standard automobile manufacturer and dealer disclaimer of warranty. The purchaser of a new car drove it only 400 miles when it unaccountably went out of control. Because the car was a total wreck, plaintiff had difficulty in making a prima facie case of negligence and chose to sue for his damages upon an implied warranty of merchantability. The dealer relied upon the standard disclaimer which limited recovery to replacement at the factory of defective parts. Considering the effect of the disclaimer at length, the court found that it attempted to eliminate any effective remedy, and intimated, as no other court had ever done, that the disclaimer was void as against public policy.

To be sure, Henningsen is an extreme case, and also a consumer case, which may not establish a precedent for ordinary commercial contracts. Yet much of the judicial hostility toward disclaimer clauses which originated in consumer situations has carried over to contracts between experienced businessmen. Henningsen is extreme because the express warranty, which excluded all others, was illusory. Thus, the buyer was left with a worthless car and no recourse against the seller or manufacturer. This result, however, is similar to those that courts have avoided through construction in the cases involving agreements between businessmen or agreements in which the terms were bargained over. Moreover, the kind of warranty and disclaimer which the court struck down in Henningsen is not very different from those that have been construed away in contracts between businessmen. The court clearly considered its decision as part of the line of cases it cited where disclaimers were construed away, not because they were in standardized contracts but because they eliminated effective remedies.

The language gave little and withdrew much. In return for the delusive remedy of replacement of defective parts at the factory, the buyer is said to have accepted the exclusion of the maker's liability for personal injuries arising from the breach of the warranty and to have agreed to the elimination of any other express or implied warranty. An instinctively felt sense of justice cries out against such a sharp bargain.

55. 37 Colum. L. Rev. 341, 403-04 (1937).
57. See text at notes 26-52 supra.
58. See, e.g., the disclaimers in Meyers v. Land, 314 Ky. 514, 235 S.W.2d 988 (1951); Austin v. Tillman, 104 Ore. 542, 209 Pac. 131 (1922).
59. 32 N.J. at 393-95, 161 A.2d at 88-90.
60. Id. at 388, 161 A.2d at 85 (emphasis added).
There ought to be a law to protect against this, and the court said there is: when warranties are disclaimed the disclaimer must be bargained for and equitable. 61

In the same vein as Henningsen is Marino v. Maytag Atg. Washer Co., 62 a lower New York court case decided in 1955. Here the buyer, a consumer, received a washing machine which never worked satisfactorily in spite of frequent repairs. The warranty was limited to replacement of defective parts. Though the disclaimer was clearly printed on a label attached to the machine and though there was little doubt that the buyer had understood it, the court found that the company should repay the purchase price. Expressing doubts about the ethics of an express warranty which instead of protecting the buyer actually harms him by limiting the seller's liability, the court held that the company's attempt to disclaim the warranty of merchantability was ineffective. Since the contract had said specifically that the warranty of replacement was given in lieu of all others, express or implied, the court's holding amounted to a decision that the disclaimer was ineffective because unfair.

The warranty sections of the Uniform Commercial Code 63 incorporate the idea that courts must look beyond the disclaimer in determining its effect. The Code's interpretive possibilities may point the way to articulation of the hither-to half-expressed determination by some courts to prevent the elimination of a fair remedy. 64 Section 2-313 of the Code provides:

61. Henningsen referred to the Uniform Commercial Code; it might have cited the unconscionability section of the UCC, § 2-302, for its policing of the bargain. See 74 Harv. L. Rev. 630, 631 (1961).

Many of the cases cited in Comment 1 to § 2-302 involve disclaimers of warranty. But the disclaimer section of the UCC does not cross-refer to the unconscionability section, so that disclaimers in all situations do not raise suspicions of oppression and unfair surprise. It is generally thought, see, e.g., Note, 109 U. Pa. L. Rev. 401 (1962), that the unconscionability section is directed primarily at contracts which in their inception or operation are oppressive. But insofar as the unconscionability section represents an attempt to encourage open policing of contracts in a larger interest, it is closely related to the discussion in the text.


63. These sections are:
   Section 2-313 which defines express warranties.
   Section 2-314 which deals with the implied warranty of merchantability.
   Section 2-315 which covers the implied warranty of fitness for a particular purpose.
   Section 2-316 which deals with the modification or exclusion of warranties.

Unless otherwise noted all references are to the 1958 official version of the Code. The Code is in effect in 14 states, with many others considering its passage. Only Pennsylvania, however, has enacted the Code exactly as recommended by its sponsors, the American Law Institute. The practice of other states has been to establish a commission to recommend changes in the Code passage.

64. The Code, for instance, does not indulge in the subterfuge of the Uniform Sales Act which declared in § 15 that, "there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract to sell or a sale, except as follows . . . .", a statement followed by provisions which in effect created warranty in most sales. The Code openly acknowledges warranty as the norm.
Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

The seller's statements about the goods usually define the sale, not only because they indicate his intention but because from such statements the expectations of the buyer may be inferred. If a disclaimer contradicts the expectations arising from statements or affirmations of the seller, the disclaimer should fail. The seller may not give with one hand and snatch away with the other.

The background for section 2-213 lies in Llewellyn's argument in the 1930's that every sale is for some definable thing and that the court in fashioning a fair remedy must search out what was sold. Llewellyn rested his argument on section 14 of the Uniform Sales Act (a general codification of sales law in effect in 37 jurisdictions since the early 1900's). Section 14 reads:

Where there is a contract to sell or a sale of goods by description, there is an implied warranty that the goods shall correspond with the description...

Llewellyn's thought was that a sale by description demands at least that the goods conform to the description, that a disclaimer in effect denying the description destroys the "essence" of bargain. His aim in the technical statutory argument he made for this construction was to mitigate the effect of section 71 of the Sales Act which provides that the parties may by agreement vary any of the usual terms, including remedies, of sales contracts. He saw the

65. Llewellyn, supra note 51, at 387.
67. USA § 14.
68. Llewellyn, supra note 51, at 386.
69. Professor Llewellyn must have been aware, as well, of the interpretive possibilities he was providing. "Sales by description" is a term with no fixed content. See Note, 31 Colum. L. Rev. 1325, 1332 (1931) (citing cases) on the "elasticity" of the term "description." With only a little twisting, a court can bring any sale in which dealing takes its usual course within the category "sale by description." Cf. Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817 (3d Cir. 1951), decided under the USA, in which the Court of Appeals found a disclaimer of implied warranties ineffective because a sale of
"trend of the times" promising that "this time, the growing perception of judges that there is more to contract than following the parties' lead will prove cumulative rather than remaining the desultory found-and-then-forgotten thing so many past inventions in sales law have been."70

Under the Code, a description now raises an express warranty, as do any statements or promises or showings of samples which become a "basis of the bargain." In this language the "iron section" approach reappears: that which is the "basis of the bargain" cannot be disclaimed.

The 1952 version of the Code, enacted in Pennsylvania, openly adopted the "iron section" approach by providing in the section on exclusion or modification of remedies (section 2-316) that "If the agreement creates an express warranty, words disclaiming it are inoperative."71 The present Code (1958) section weasels a little in a lot more words:

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, negation or limitation is inoperative to the extent that such construction is unreasonable.72

Although it is not a cutback on substance, the new wording is a retreat from the openness of the search for and determination to enforce "the basis of the bargain," and this is regrettable. The reasoning behind the forthright language of the earlier Code still stands, however. If the warranty is "the basis of the bargain," it is illogical to allow its disclaimer. No seller can eliminate the basis of the bargain. Internal indications also reveal that the change in the Code's language has not seriously limited the interpretive possibilities of the warranty section. Section 2-313, defining express warranties, remains unchanged, its language still differs from that of the sections on the implied warranties of fitness and merchantability which apply "unless excluded or otherwise modified...."

A significant term in both the present and earlier versions of section 2-316 (on the modification or exclusion of warranties) is creates—"if the agreement creates" rather than "if the agreement contains" an express warranty. The implication of the word is that the basis of the bargain is in both the recorded dealings and the logical expectations of the parties; the fact of dealing creates warranties, the written contract need not contain them. The word has not been changed in the 1958 version which also talks of the "creation of an express warranty." Thus, the new wording says in effect that if the disclaimer denies the basis of the bargain, it is unreasonable and inoperative. A further indication

"a generator, 1136 KW at 870" was a sale by description and the failure to generate full power thus violated an express warranty. The lower court had held no express warranty in the description and that the disclaimer prevented any implied warranty. 94 F. Supp. 311 (D. Del. 1950).

70. Llewellyn, supra note 51, at 386 n.119.
71. UCC § 2-316(1) (1952).
of what the basis of the bargain language means may be gleaned from one of
the Code’s immediate ancestors, the Uniform Revised Sales Act. It provided
that implied warranties cannot be disclaimed if:

[T]he circumstances indicate that a reasonable person in the position of the
buyer would, despite such general language, be in fact relying on the mer-
chantable quality of the goods or their fitness for a particular purpose.

The early section shows the drafters’ preoccupation with a course of deal-
ing apart from the agreement. This is still evident in the “basis of the bargain”
language. An express warranty under the Uniform Sales Act, however, must
include both the natural tendency of an affirmnational to induce purchase and
reliance by the buyer. The basis of the bargain language shifts from the
Uniform Sales Act’s idea that an express warranty must include an element of
buyer’s provable reliance on the seller’s statement to the idea that the bargain
incorporates the buyer’s reasonable expectations from the seller’s actions. The
Code invites courts openly to search into the course of dealing, all that was
said, shown, written, to find what describable, defined thing the parties bar-
gained about. The Comments to section 2-313 underline the invitation to inter-
pretation. Comment 5 says that the course of dealing and the usage of the trade
should influence what will be considered a basis of the bargain. Though this
might restrict the recovery in some cases, it clearly indicates that the courts
are not confined to the words of the contract for their interpretation of what
the bargain includes. Comment 4 states that “a contract is normally for some-
thing describable and described ... the courts will not recognize a material
deletion of the seller’s responsibility.” Comment 8 adds that all statements by
the seller become a “basis of the bargain” unless good reason is shown to the
contrary.

The enlargement of the express warranty section and the inclusion in it of
the “basis of the bargain” concept recognize the importance of descriptions,
promises, and statements in a sale. Courts should look to the reasonable ex-
pectation which these expressions raise before considering the meaning of a
disclaimer. The same idea of a sale as generally including certain expectations
and implying standard methods in dealing is present in the Code’s section on
the implied warranty of merchantability (2-314). For the first time, merchant-

73. The Uniform Revised Sales Act project later became the Uniform Commer-
cial Code project with a later version of the URSA as Article II of the Code. In effect, the
URSA was an early draft of Article 2. See Note, Warranties of Kind and Quality Under
the Uniform Revised Sales Act, 57 YALE L.J. 1389 (1947). The URSA received only
academic approval; no state passed it.

74. UNIFORM REVISED SALES ACT (1946 draft).

75. USA § 12 defines an express warranty:

Any affirmation of fact or any promise by the seller relating to the goods is an ex-
press warranty if the natural tendency of such affirmation or promise is to induce
the buyer to purchase the goods, and if the buyer purchases the goods relying there-
on. No affirmation of the value of the goods nor any statement purporting to be a
statement of the seller’s opinion only shall be construed as a warranty.
ability is defined by statute, and the definition is unrestrictive since it says that "goods to be merchantable must be at least . . . " and then lists such qualities as "fit for the ordinary purposes for which such goods are used," and "pass without objection in the trade under the contract description." The section on exclusion or modification of warranties provides that a disclaimer of merchantability must specifically mention "merchantability" and if written must be conspicuous. But merchantability, even if mentioned and conspicuous, will not be so easy to eliminate from a contract. Comment 11 to section 2-314 says that merchantability is so "commonly taken for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution." It also says that if merchantability is disclaimed, the section on disclaimer, 2-316, should be read with special reference to subsection 4 which covers not the elimination of warranty but the limitation of recovery once liability under the warranty is established. Subsection 4 cross-refers to section 2-719, the general section on modification of remedies and section 2-719 cross-refers to section 2-302, the unconscionability section. Moreover, the first comment to section 2-719 says:

... the very essence of a sales contract [is] that minimum adequate remedies be available. . . . Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion. . . .

The attention given merchantability in the Code is symptomatic of the trend the law is taking. Merchantability is a developing warranty. More and more, courts are using it to express the idea that every bargain was for something of value and thus must have a remedy to render to the promisee the equivalent of the thing promised.

76. The Uniform Sales Act did not define merchantability. For various court interpretations of the warranty, see Bogart, Cases on the Law of Sales 506-07 n.26 (2d ed. 1947). See also Isaacs, The Industrial Purchaser and the Sales Act, 34 Colum. L. Rev. 262 (1934), discussing merchantability in sales between merchants.

77. UCC § 2-316(2).

78. The cross-reference to § 2-302 is not in the text of the Code section but is attached to the Comments, which are designed to shed light on the text.

79. In an article on The Implied Warranty of Merchantable Quality, 27 Minn. L. Rev. 117 (1943), Professor Prosser illustrated how this flexible guarantee has grown to include not only genuineness according to the description and saleability in the market, but also fitness for the ordinary uses and purposes for which such goods are made and sold. He then predicted that the "time may yet come when it will be extended to include a grade or quality not totally inconsistent with the price." A very recent Illinois case, Appleman v. Fabert Motors, Inc., 30 Ill. App. 2d 424, 174 N.E.2d 892 (1961), is one signal of the further broadening of merchantability which Prosser predicted. The purchaser of a new automobile claimed her car was a "lemon." Nothing was drastically wrong with it, but it never ran well and was under constant repair. Plaintiff claimed a warranty of merchantability and the court, though hesitating verbally, ordered a return of the purchase price and said that since the automobile business has been one of the leading businesses of the past half century:
The earlier version of the Code was even more explicit in its recognition that merchantability is one of the constants of sales contracting. It required "specific" language for disclaiming merchantability as well as providing that if such specific language "creates an ambiguity in the contract as a whole it shall be resolved against the seller." The Pennsylvania courts, the only ones to interpret this version of the Code, showed great facility in preventing dis-claimer of merchantability. For instance, a vendor of whiskey measures for use in bars sold them without "warranty, guarantee or representations of any kind or nature" and "without any express or implied warranties." This was held not specific enough to exclude an implied warranty of merchantability. In Willman v. American Motor Sales Co. & Chrysler Corp., the court found a disclaimer of "all implied warranties" insufficient to escape liability, saying that appropriate language for disclaiming the warranty of merchantability should "make plain that there is no warranty that their product is reasonably suited for use as an automobile." The court in Willman frankly articulated the assumption of all the warranty sections of the Code; a sale generally takes a certain form. For instance, there are statements and promises from which expectations arise, and both parties assume basic merchantability in the goods. From this form, certain remedies follow. If the remedies are eliminated the form must be changed drastically and openly.

As yet there is no reliable indicator of the effect of the Code's more open expression of the necessity of a fair remedy. Pennsylvania courts are the only A purchaser of a new automobile has the reasonable right to expect an automobile completely new in every respect and part, properly constructed and regulated, to provide safe, trouble free and dependable transportation.

Id. at 431, 174 N.E.2d at 896.

The opinion sounds as if the court had been listening to the advertising of car dealers. Perhaps it had, and perhaps the opinion stands for the proposition that automobile purchasers should receive a "good" car for a high price.

80. Section 2-316 of the 1952 edition of the Code provided:
(2) Exclusion or modification of the implied warranty of merchantability or of fitness for a particular purpose must be in specific language and if the inclusion of such language creates an ambiguity in the contract as a whole it shall be resolved against the seller . . . .

81. The Code has been in effect in Pennsylvania since July 1, 1954.


83. 44 Erie (Pa.) L.J. 51 (1960).

84. See also Tumpson & Co. v. Castelli, 20 Beaver (Pa.) L.J. 127 (1958); Holland Furnace Co. v. Jackson, 106 Pittsburgh (Pa.) L.J. 341 (1958).

85. For a prediction by a court that the Code will make a difference in the way modifications of remedy are handled, see Hall v. Everett Motors, Inc., 340 Mass. 430, 165 N.E. 2d 107 (1950), in which the Supreme Court of Massachusetts felt itself bound by a very broad disclaimer to deny recovery for severe damage caused by defective wiring in an automobile. The court said:

This is not the kind of an agreement which commends itself to the sense of justice of the court. We hope that should a similar case arise under the Uniform Commercial Code we shall not be so bound by precedent.
The Code was not then in effect in Massachusetts, but the court cited § 2-316 which may limit the free disclaimer of warranties, apparently thinking that section could have led them to a different result.

86. In Hartman v. Green, 17 Somerset (Pa.) L.J. 134 (1954), a refrigerator purchased on a bailment lease caught fire due to defective wiring, burning the plaintiff's house down and injuring his wife. A full disclaimer was in the bailment contract. But the court refused to allow the term to operate to deprive the plaintiff of damages, saying that it was the "policy" of the Uniform Commercial Code and the Pennsylvania courts not to allow this general disclaimer of implied warranties. This is the explicit rationale of the opinion, though the approach seems to be that the parties bargained for a refrigerator without dangerous flaws. The court spoke of:

'[T]he practical consideration that buyers in the ordinary course of retail business, do not intend to bargain for any risks in connection therewith . . . .

In Miller & Co. v. Gibbs, 6 Lebanon (Pa.) L.J. 344 (1958), the buyers of storm windows were promised that when sealed with coroseal the windows would prevent drafts. The windows never accomplished this goal. The sales contract signed by the buyer included a disclaimer:

It is understood that the entire contract is contained in this agreement and that no other agreement or understandings, verbal or written, shall be binding on the contractor . . . .

No warranties, either express or implied, shall attach thereto except those expressly made a part [of the agreement.]

The court simply ignored the disclaimer in its analysis of the situation, passing over it by citing Frigidinnies v. Branchtown Gun Club, 176 Pa. Super. 643, 109 A.2d 202 (1954), which was somewhat inapposite because it involved much more general language. The court's opinion is based on the thought that:

[D]efendants were not merely purchasing storm windows as such, but were purchasing the same for the specific purpose of eliminating air leakage and drafts in their house . . . .

By thus looking to the purpose of the bargain and just ignoring the law (there was no discussion of whether the language was "specific" enough to disclaim an implicit warranty), the court actually found that the seller's representations about the efficacy of the storm windows were a "basis of the bargain" and could not be disclaimed.

87. See Note, 19 LA. L. REV. 165 (1958), comparing the warranty sections of the Uniform Commercial Code and the Louisiana Civil Code.

88. LA. Civ. Code art. 2520 (1870) provides that redhibition is the avoidance of a sale when some defect in the purchased goods makes them either absolutely worthless or their uses so inconvenient and imperfect that it must be supposed that the buyer would not have purchased the goods had he known of the defect.

Art. 2529 makes redhibition possible even when the seller's declarations were made in good faith, if the declarations were the buyer's principal motive in purchasing.
warranty is whether the buyer would have purchased the article had he known of the defect.89 The courts in Louisiana have consistently applied the broad statutory provisions to protect against disclaimer and assure a fair remedy.90 The major effect of the provisions has been to cut down the number of warranty cases, of which there are significantly fewer than in common law jurisdictions.91 This is the natural and beneficial result of defining the seller's obligations and fewer cases may be the result under the Code as time passes.

Another result of the Uniform Commercial Code's general approach to disclaimers is the opening of new possibilities for construction under the Uniform Sales Act. The idea that some warranties are so basic to the bargain that they cannot be disclaimed is not novel. But the construction has been seldom, if ever, used. Perhaps the Uniform Commercial Code will point the way to greater flexibility in the Uniform Sales Act.92 The Code, like the Uniform Sales Act, includes a section which specifically provides for the modification of remedies:93

Art. 2531 and 2545 set the remedies available in redbhibitory action. If the seller's statement was made in good faith, buyer may recover the price and expenses. If the seller was aware of the vice, the buyer may recover damages as well.

Arts. 1934(2) and 2547 provide that if the seller was guilty of fraud, buyer may recover all damages, even beyond that was within the contemplation of the parties.

Art. 1764 provides that warranties may be excluded or modified. But it has been held that extremely specific language is necessary to exclude warranties. See, e.g., Kuhlmann v. Purpera, 33 So. 2d 84 (La. App. 1947) (sale of second hand truck "as is" did not exclude all warranties).

89. LA. CIV. CODE arts. 2520, 2476 (1870).
90. See, e.g., Radalee, Inc. v. Automatic Firing Corp., 81 So. 2d 830 (La. 1955). The buyer-retailer in this case sued the manufacturer-seller of defective air conditioners. He sought the purchase price and damages for the cost of shipping and storage and the loss of good will. The seller relied on a warranty limited to replacement of parts and claimed that the machine could have been fixed. But the court found that the test was not the value of the machines but whether the buyer would have purchased them had he known of the defect.
91. See Note, 23 Tul. L. Rev. 119, 120 (1948), referring to the paucity of non-warranty cases in Louisiana.
92. A recent case, decided under the Sales Act, verges toward Code analysis. In Jarnot v. Ford Motor Co., 191 Pa. Super. 422, 156 A.2d 568 (1959), the court refused to allow a warranty limited to replacement of any defective part to prevent a suit for the cost of repairs when a defective kingpin caused the wreck of a tractor-trailer. The court's opinion is reminiscent of Willman v. American Motor Sales Co. & Chrysler Corp., 44 Erie (Pa.) 51 (1960) (see text at note 83 supra). It found that the express warranty limited to repair and replacement "had no bearing on the question of liability . . . where the failure of a defective part results in damages covered by another and distinct implied warranty of merchantability and fitness of the vehicle for the intended use." The warranty had limited damages from a defective part to repair and replacement, but it had not excluded all implied warranties. Thus, the court said that to exclude merchantability and fitness, the language of the disclaimer must be very specific. Decided in Pennsylvania in 1959 under the Uniform Sales Act, because the sale was made before the Code passed, the case demonstrates the influence of the Code's approach while indicating a path of construction which non-Code jurisdictions could follow.
93. USA § 71 (1950); UCC § 2-719.
(1) Subject to the provisions of (2) and (3) of this section . . . .
   (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
   (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable . . . .

Section 71 of the Sales Act spoke of rights, duties, and liabilities being "negatived or varied," but the Code uses "in addition to or in substitution for" language, implying that remedies may not be eliminated altogether. More importantly, subsection (2) of the Code to which the first is specifically made subject is explained in the comment:

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

Thus, the court is left to pursue its own remedies if it finds that the limitation of remedy clause—the disclaimer—leaves a party without substantial benefit from the agreement.

The section does, however, indicate that parties are free to make their own bargain, and presumably provides a court with statutory support in allowing wide scope to party agreement about remedies. Yet courts have used the similar provision under the Uniform Sales Act with extreme reticence, seldom

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94. USA § 71 provides:
   Where any right, duty or liability would arise under a contract to sell or a sale by implication of law, it may be negatived or varied by express agreement . . . .

95. UCC § 2-719 Comment 1.

96. Cf. the language in a similar section of the Uniform Revised Sales Act:
   Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, as when it deprives the buyer of the substantial value of the contract or of the use or disposition for which the seller at the time of contracting had reason to know the goods were intended, remedy may be had as provided in this Act.

URSA § 122(2) (1948 Draft).

97. UCC § 2-719 Comment 1: "Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect."

But as Cardozo might say, this section is "instinct with tokens of a purpose to encompass with limitations and conditions." See text at note 190 infra.

There is a presumption against the exclusiveness of the remedy set by the parties, § 2-719(1)b. Limitation of consequential damages is especially made subject to a test of unconscionability, § 2-719(3).

And even the comment quoted above takes back much when it says that "reasonable agreements limiting or modifying remedies are to be given effect." (Emphasis added.)
making it the basis of decisions even when upholding party alterations of remedy. This raises the implication that courts are not willing to acknowledge a broad freedom in the parties to change remedies. And often, such freedom does not exist.

**Stipulated Damages**

Courts do not flatly say that parties may not provide for the payment of a stipulated sum for breach of contract. Indeed, courts regularly enforce such sums as "liquidated damages," but generally only after ascertaining that the sum is a fair remedy. This regulation of set sums is done by elaborate rules of construction, rules so flexible that in any case a set sum could be called either an invalid penalty or valid liquidated damages. Professor Corbin recognizes that neither term has any content when he defines "penalty" and "liquidated damages" in terms of what courts do:

> When the provision is one that will be enforced by the court, the amount specified therein is called liquidated damages. In cases where enforcement is denied, it is said that the parties have provided for a penalty or a forfeiture.  

Judicial treatment of the stipulated damage provision reveals a great gap between rhetoric and reality. Freedom of contract is the reason for the rhetoric. The reality springs from several sources, some of which are the same as the concerns of courts in other areas of party modification of remedy and some of which pertain only to stipulated damage clauses.

To an even greater extent than in sales, courts refuse to treat stipulated damages like other terms of the agreement expressing the intent of the parties and thus controlling upon the court. Present here is the same feeling that remedy is something more than a subject of bargaining between the parties. But the fear is not, as with disclaimers, that buyers will be left remediless, but that enforcement of the stipulated damages will afford a party greater recovery than he would otherwise receive under prevailing principles of contract law. In policing stipulated damages, one purpose of the courts is maintenance of the policy running through contract law that recovery for breach of contract should be limited. Such a policy is most openly expressed in the rule of Hadley v. Baxendale, limiting consequential damages to what was in the contemplation of the parties. It is also present in such rules as the duty to mitigate damages, the requirement of certainty for lost profits, and the definite rules established for measure of loss, such as the difference between the contract and market price. These rules seem to rest on the proposition that it is socially undesirable for one party to bear excessive liability resulting from a breach of contract. Judicial refusal to allow recovery of a stipulated sum when there

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98. 5 Corbin, Contracts § 1058, at 283 (1951). (Hereinafter cited as Corbin).
99. For a good summary of court attitudes toward liquidation of damages see Fritz, "Underliquidated" Damages as Limitation of Liability, 33 Texas L. Rev. 196, 196-98 (1954).
100. 9 Ex. 341, 156 Eng. Rep. 145 (Ex. 1854).
101. See Sedgwick, A Treatise On the Measure of Damages 32-34 (1869); 5 Corbin § 1019.
is no actual injury suffered as a result of the breach and the cases in which the set sum is enforced when it is reasonable in light of the remedy which would usually be available reflect this same concern. 102

Generally, the extent of breach and amount of injury resulting from it cannot be clearly seen until after the event. At this time, a court can accurately assess damages in light of judicial policies, most importantly, limitation of liability. Courts viewing the stipulated sum after breach look to see if it is reasonable in light of what has actually occurred. This desire for accurate measurement of injury after breach is based upon a preference by courts for their own remedies. They are the experts at after-the-fact measurement of the results of breach, and they do a great deal of it when passing on the validity of liquidated damage clauses. The turn of events may make a pre-set remedy compensatory or not compensatory; the court determines which.

The desire for accurate calculation of injury in light of judicial policies dominates regulation of stipulated sums. But other rationales are also important, some of which are in varying degrees present in judicial treatment of all pre-agreed remedies. Such regulation may represent a decision that it is better for a bargain to be founded upon the value of performance to each party rather than upon an estimation of the harm of non-performance. It would seem that both an intention to perform and a belief that the person with whom one is contracting intends to perform heighten the chances of actual performance. In addition to this psychological advantage, there is an economic advantage in having choices made by people possessing knowledge relevant to those choices. Thus, it is better for each party to contract for the benefit of performance to him, a subject upon which he is expert, rather than for the harm which breach could bring him or the other party, which he cannot know in advance with the same certainty. Protection against unfairness is also a part of the close regulation of stipulated damages. As in sales contracts, there is the danger that the eagerness of, or the economic pressure on, one party to conclude the bargain may lead him to agree to an unfair penalty. 103

Acceptance by courts of accords after breach 104 suggests, however, that it is not primarily fear of unconscionability or unequal bargaining power which has aroused caution toward stipulated sums. Rather, courts have established by

102. See text at notes 115-24 & notes 107-09 infra.

103. It is characteristic of men, however, that they are likely to be beguiled by the "illusions of hope, and to feel so certain of their ability to carry out their engagements in future, that their confidence leads them to be willing to make extravagant promises and commitments as to what they are willing to suffer if they fail." McCormick, DAMAGES § 147, at 601 (1935). Certainly the fear of unconscionability is not actually grounded in antagonism toward compelling performance through a sum held in terrorem over the contractor. As Professor Corbin points out:

The purpose of providing for a money payment in case of breach, whether it be called penalty, a forfeiture, liquidated damages or merely a sum of money, is primarily to secure the performance promised and not to obtain the specified sum.

5 CORBIN § 1058, at 285.

104. See 6A CORBIN 1433, at 392.
their close regulation of sums set for breach a framework for commercial contracts in which parties bargain for what they know about, in an atmosphere assuming performance, against a background of compensatory remedy.\textsuperscript{105}

This examination of judicial attitudes toward liquidated damages does not mean courts never, or even seldom, enforce them. But it does mean that the terms are not automatically enforced merely because they are apparently bargained for in a commercial contract. The pattern in the stipulated damage area is regulation.\textsuperscript{106} An examination of when courts give and when they refuse enforcement illustrates the judicial concerns. Such an examination also reveals courts favorably responding to these provisions only where the stipulation facilitates bargaining between the parties.\textsuperscript{107} Rules for determining the validity of stipulated damage clauses include investigations of whether the damages or breach would be uncertain and difficult to calculate (if so, the stipulation is called liquidated damages); whether the amount fixed is disproportionate to the expected loss (a penalty); and whether one sum was set for breaches of varying degrees of harm (a penalty).\textsuperscript{108} These rules do not call for an inquiry into the amount of actual damages or even into whether there are any damages at all resulting from the breach. But courts sometimes make such an extensive investigation into actual damages that the decision whether to enforce the stipulated sum or not constitutes an independent finding on its fairness.\textsuperscript{109} Indeed, some courts have enforced the liquidated damage provision only after finding that the stipulated sum approximates the fair remedy (i.e., the remedy that would be awarded in the absence of the stipulated damage provision).\textsuperscript{110} Usually, however, courts attempt to moderate between the extremes of imposition of their own estimations of the fairest remedy and unbridled freedom to contract about remedy by policing the stipulated sum to the extent of checking its reasonableness.\textsuperscript{111}

\textsuperscript{105} Brightman, \textit{Liquidated Damages}, 25 \textit{Colum. L. Rev.} 277 (1925) inveighs against the lack of "freedom of contract" to liquidate damages.

\textsuperscript{106} 3 \textit{Williston, Contracts} § 779 (rev. ed. 1936):

\begin{quote}
in spite of the language of cases regarding the intention of the parties, there is little doubt that a sum named as liquidated damages in order to be given effect must be reasonable in amount.
\end{quote}

See Perkins v. Spencer, 121 Utah 468, 243 P.2d 446 (1952), a case in which the court openly acknowledges its regulatory function.

\textsuperscript{107} See text at notes 125-30 infra.

\textsuperscript{108} See MacNeil, \textit{Power of Contract and Agreed Remedies}, 47 \textit{Cornell L.Q.} 495, 499-501 (1962), for a review of these standards, citing many cases which reveal the use by courts of each of them.


\textsuperscript{110} Parsons Constr. Co. v. Metropolitan Util. Dist., 170 Neb. 709, 104 N.W.2d 272 (1960).

\textsuperscript{111} In the final determination of the question whether a stipulation should be construed as providing for a penalty or for liquidated damages, the guiding principle for the courts to observe should be that of "just compensation" . . . . So long as the
Thompson v. St. Charles County is typical. The contract was for the construction of a courthouse, with a sum set for every day of delay. The contractor was late but tried to show that the rental value of substitute facilities was less than the stipulated sum. The court pointed to the inconvenience of substitute arrangements, the danger of fire to the records in the old quarters, and the unfairness to the public of the delay, and found the stipulated sum reasonable. Notable is the court’s open acknowledgment that the doctrines about liquidated damages are purposefully flexible to aid the courts’ consideration of the fairness of the remedy. The Pennsylvania Supreme Court used the same approach in 1960 when it found that stipulated damages of $1,900 for failure to complete the purchase of a new $21,800 house was a reasonable remedy. The court said the $1,900 compensated the builder for his "continuing obligations of paying interest on the construction loan, insurance, taxes, broker’s commission, maintenance charges and utilities." These are typical of most cases in the area; the court decides whether the sum is a reasonable remedy rather than whether the parties thought or think it reasonable, thus maintaining control over the awarding of the amount set in the contract.

But courts and commentators have not always acknowledged the fact that reasonableness in relation to actual damages is the usual standard. They sometimes say that once it has been decided that the sum was a valid attempt at pre-estimation of difficult-to-derive-damages, the court must not let in any evidence of actual damages lest the jury be led into substituting its own estimate for that of the parties. Perhaps it was from the idea that the only relevant inquiry is intent of the parties at the time of contracting that the doctrine that actual damages need not be shown arose. This is not and never has been true. Ironically, the emphasis on the intent of the parties at the time of contracting results less from a desire to effectuate intent than from a desire to prevent it from resulting in an unjust situation. A remedy without harm is as unconscionable as a harm without a remedy. As a recent law review note points out,
the courts' traditional emphasis on intent serves to prevent unconscionability because the courts refuse to infer that the parties could have intended at the time of contracting that there be extensive liability in the face of no actual harm.\(^{117}\)

But the talk of intent illustrates how the shibboleth of freedom of contract has obscured the workings of the law of remedies. The evidence that a defendant would introduce to contest the reasonableness of a stipulated sum must frequently be exactly the same as the evidence he would adduce to prove his damages. At any rate a reading of the decisions of appellate courts indicates that considerable evidence of actual damages is introduced in the majority of cases.\(^{118}\) Moreover, a brief survey of cases cited for the proposition that actual damages are irrelevant reveals that in these cases there was undoubtedly some injury to the plaintiff, but because of the nature of the injury, ascertainment of the amount of damages was difficult.\(^{119}\) Such a case is the oft-cited *Wood v. Niagara Falls Paper Co.*\(^{120}\) The installer of turbine engines sued for the unpaid balance of the purchase price, and the buyer counter claimed the stipulated damages due for delay, $50 a day for each turbine. The court said it was unnecessary to show any loss "in view of the subject-matter and nature of the agreement and the difficulty of estimating the exact damages." The case seems to say that no actual damages need be shown. Yet both parties admitted from the first and the court noted in the opinion that failure to install the turbines on time resulted in the buyer's being unable to operate or test the rest of its new plant and machinery.

A recent case which may be equally misleading when cited for the rule that actual damages are unimportant is *McCarthy v. Tally.*\(^{121}\) The California Supreme Court reversed a lower court which had refused to enforce a stipulated sum unless some showing of actual damages were made. The Supreme Court opinion held that under the California statutory provision for liquidated damages, only three elements of proof are necessary:

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[I]n passing judgment upon the honesty and genuineness of the pre-estimate made by the parties, the court cannot help but be influenced by its knowledge of subsequent events.

5 Corbin § 1063, at 305.

118. See, e.g., *Bedford v. J. Henry Miller, Inc.*, 212 F. 368 (4th Cir. 1914); *Developments in the Law—Damages*, 61 HARV. L. REV. 113, 128, 130 (citing cases).

119. For extensive case citations, see *MacNeil*, supra note 108, at 504-07. He concludes:

Thus, on their facts, most of these cases hold only that a liquidated damage clause will be given effect . . . if the actual loss sustained is difficult to ascertain or difficult or impossible to prove.

*Id.* at 506.

120. 121 Fed. 818 (2d Cir. 1903).

121. 46 Cal. 2d 577, 297 P.2d 981 (1956), criticized in Comment, 9 STAN. L. REV. 381 (1957).
1. At the time of contracting, damages in the event of breach are impracticable or extremely difficult of ascertainment.
2. The sum was a reasonable effort to ascertain damages.
3. A breach had occurred.

The contract provided for the payment of $10,000 which was explicitly stated to be in addition to actual damages. This sum was for the loss of good will if the buyers of a summer resort failed to run it properly during the purchase period. The court found that the loss of good will was a suitable subject for liquidated damages, since it is so difficult to estimate or ascertain. Gratuitously, the court added that no actual loss of good will was apparent in the record. But the court's holding was:

[In the case under consideration, [there was] no finding that the sum of $10,000 represents a reasonable endeavor by the parties to ascertain what the damages would be in the event of a breach, and the findings as to whether, at the time the contract was entered into, the damages would be extremely difficult or impracticable of ascertainment in the event of breach were fatally inconsistent.

Whether or not a breach such as occurred in the non-operating months of a summer resort was within the contemplation of the parties is an issue to be pleaded and proved on a re-trial of the action. It appears to us that if such a breach was within the contemplation of the parties, [then] the sum of $10,000 might not represent a reasonable endeavor to ascertain what the damages would be in the event of breach.122

The case was remanded and the existence of actual damages still seemed relevant. In the absence of such damages (since there could be no loss of good will when the resort was not open) doubt is cast upon the intention and reasonableness of the parties in stipulating damages. In other cases involving the so-called "no-harm" rule, extreme difficulties of proof are universally present.123 Where damages would be difficult to prove, the parties are competent and equal, and there is some actual damage, the court will enforce the liquidated amount as a remedy peculiarly suited to this kind of situation.

The Uniform Commercial Code provision on liquidated damages (2-718) hedges on the question of the relevance of actual damages. It recognizes the force of the rhetoric of intent and also what the courts actually do:

Damages ... may be liquidated ... but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach,

122. 46 Cal.2d 577, 587, 297 P.2d 981, 987 (1956). The court's opinion, with dicta which goes considerably further than the holding, was probably directed at the confusion inherent in requiring damages to be both impracticable of estimation and actually estimated. The thrust of the opinion is that actual damages need not be proved, not that they may be non-existent.

123. See 5 CORBIN § 1062, at 300, which, after reviewing cases in which the courts say that no actual damages need be shown, concludes:

An examination of many of the cases ... shows that there was little doubt that the plaintiff suffered serious injury and that the uncertainty as to its amount remained about as great after the breach as it had been before.
the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.\footnote{MacNeil, \textit{supra} note 108, at 505-09 and accompanying notes, points out that although arguably a court could not use this provision to allow recovery where there was no actual loss by relying on the phrase “reasonable in the light of anticipated harm,” the other two requirements, difficulties of proof and nonfeasibility of other remedies, should prevent such a construction. “A clause reasonable in light of anticipated harm would probably be unreasonable under one or both of these latter provisions, if there is clearly no loss.” \textit{Id.} at 505 n.31.}{124}

In some kinds of contracts, stipulated sums are often included and often enforced without close scrutiny of the relationship between the amount of actual injury and the stipulated sum. The leading example is stipulation of damages for delay in construction contracts. An examination of why courts often allow these provisions sheds light on why they generally do not in other areas.

The peculiarity of the “delay” situation is that it involves unusual risks which would make it difficult or impossible for the parties to evaluate the worth of performance unless they included these risks in the consideration. In a construction contract, timely performance depends on variables which range from weather conditions to labor union problems of subcontractors. At the same time, the damages from delay could be so serious and far reaching that not to provide for this contingency would subject the builder to crushing liability; he must therefore limit liability. From the prospective owner’s point of view, the imminent possibility of delay in every construction contract makes it necessary to set a sum because this damage may be of a kind very difficult to prove, or the expense of litigation and proof may be great.\footnote{5 \textit{Corbin} \S 1072.}{125} Settlement of the case or proof of damages is easier when there is a stipulated sum named in the contract. Though the prospect of litigation expenses in order to collect is present in every contract, the likelihood of delay in construction contracts lends validity to a special need for considering it. Thus, in order to induce contractors to bid and in order to assure himself of a recovery for which he need not pay a disproportionate price, the prospective owner also desires to stipulate damages. When the parties, for their mutual benefit, thus agree upon a sum, they are in effect saying loss will not be measured at all rather than attempting in advance to measure the loss which will occur.\footnote{See Fritz, \textit{“Underliquidated” Damages as Limitations of Liability}, 33 \textit{Texas L. Rev.} 196 (1954), for an explanation of the parties’ function as risk allocators. Roughly, the idea is that the law supplies the measure of losses but the parties, to some degree, have a power of allocation over what losses or elements of loss should be taken into account.}{126} Admittedly, there is a narrow line between allocating losses and actually attempting to measure those losses. But delay in construction falls on the safe side of the line because unusual risks of noncompletion are evident, are within the parties’ contemplation, and must be taken into account if the parties are to contract.\footnote{Hanlon Drydock \& Shipbuilding Co. v. G. W. McNear Inc., 232 P. 1002 (Cal. Ct. App. 1924).}{127} Often the contractor makes
his bid knowing the amount which will be set for each day of delay and figuring it into the price he sets. Thus the stipulated sum is openly and obviously bound into the consideration; the promise to pay damages up to a certain amount is a reason for awarding the contract, and the limitation of the amount of possible damages allows the builder to contract in the first place and to calculate accurately the price he should charge.\(^{128}\)

Occasionally, courts will allow the liquidated amount to act as a limitation of liability. These are cases in which the necessity and the aim in limiting liability are very clear. The allowance of the liquidated damage clause as a limitation of liability is distinguishable from the frequent refusal to allow a disclaimer in sales law the same effect. The core of hostility to disclaimers is that they often eliminate any effective recovery; the limitation of liability only restricts recovery. Indeed in the cases where courts allow limitation of liability it is clear from the amount of the consideration in relation to the promise made that it would be unfair to impose greater liability on the party than the amount set in the stipulated damage provision.\(^{129}\) Moreover, disclaimers occur in an area in which the courts have evolved an idea of what the minimum fair recovery is

128. The wide use of the "uncertainty of damages" standard for deciding whether to enforce set sums points up in another way the fact that courts in this area generally try to police the fairness of the remedy. The standard of "uncertainty of actual damages" has been incorporated in statutes in California, Montana, North Dakota, Oklahoma and South Dakota. The California provision is typical:

The parties to a contract may agree therein upon an amount presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

CAL. CIV. CODE § 1671 (1872).

The standard is normally said to be whether at the time the contract was made, damages were uncertain or difficult to prove. Professor McCormick inveighs against this rationale:

If we reflect that in general the courts enforce promises as parties make them, and that the only reason for departing from that attitude with respect to advance agreements about damages is the danger of oppression from agreement to pay an amount disproportional to the probable actual damages, it becomes apparent that the ease or difficulty of predicting what damages a judge or jury would give is of small moment. If the agreement reasonably approximates the probable damages which a court would give, why forbid the parties thus to agree, even if the damage could be readily and exactly foreseen?

McCormick, DAMAGES § 148, at 605 (1935).

The answer is that courts are not solely concerned with preventing oppression. As applied, the rationale of uncertainty of damages does not mean merely that at the time of contracting the amount of damages was uncertain. This is true of almost any losses from any contract and would make stipulated sums universally valid if it were the standard. Rather the "uncertainty" standard is applied to mean that at the time of contracting the parties can foresee that the limits and measure of which are uncertain by the usual formulae. In this situation, in order to facilitate the economic processes of the contract—to let the parties contract with a greater degree of knowledge—the courts allow the liquidation of damages.

129. Fritz, supra note 126, advocates an open investigation by courts into whether a set sum was intended as a limitation of liability when the amount of liquidated damages is unusually small.
through years of dealing with the concept of an exchange. In other areas, where
the standard of fair recovery may be less certain, the courts are more receptive
to efforts by the parties to limit liability. This is especially true because a
limitation of liability clause does not eliminate basal recovery, which is the con-
cern of the courts in preserving fairness. Most stipulated damage provisions
which limit liability operate on consequential damages and thus the effect of
the damage provision is in accord with the desire of the courts to limit to a
reasonable amount liability for consequential damages. Thus, where stipu-
lated sums serve as clear and necessary limitations of liability, they are given
effect, since they prevent excessive liability without eliminating all recovery.

Better Foods Markets v. American District Teleg. Co. illustrates the
above considerations. Defendants installed an alarm system in a grocery store.
The system failed during a theft, resulting in great loss. But the contract set
$50 as “liquidated damages” for any failure and the court limited recovery to
that amount. The term stated that the alarm company was not an insurer, and
it is doubtful that the food market paid insurance rates for the service. Even
here the court was not willing to admit easily that the liquidated damage pro-
visions could be used to limit liability. Rather, it justified its opinion in terms of
the usual stipulated damage criteria, going to some length to prove that the
amount of possible damages was not easily ascertainable (though it could be
calculated exactly by the value of what was stolen) and that the amount bore a
reasonable relation to the loss which the parties thought might be sustained.
Both of these standards, of course, have little relation to the term involved,
intended to limit liability for consequential damages rather than to estimate
damages.

Thus an examination of some of the areas in which courts generally do
respect the parties’ stipulation (construction contracts and overt attempts to
limit the liability of one party) yields the conclusion that courts will lean to-
ward enforcement when the sum is not an attempted estimation of damages.
In this situation, in order to facilitate the bargaining process—to let the parties
contract with a greater degree of knowledge—the courts allow the liquidation
of damages. The stipulated sum serves in these unusual areas the same purpose
the existence of a court remedy generally serves. It provides a background of
certainty—rules and procedures which will govern liability and limit recovery.
Freedom to contract about damages is thus given a certain limited scope.

130. See text at note 101 supra.
131. 40 Cal. 2d 179, 253 P.2d 10 (1953). See the excellent analysis of this case in
Fritz, supra note 126.
132. The stipulated sum is inserted not as an estimate of the damages which will likely
occur, but because the whole question of damages must be removed from the court’s con-
sideration if either party is to be willing or able to contract. And terms designed solely to
limit liability are of course not estimations of harm. In these situations the courts’ traditional
moderation between insuring a fair remedy and respecting intent of the parties inclines
toward the latter pole. A fair remedy was not what the term was inserted to insure; to
reject the term in such instances would be to reject not only the parties’ estimate, but also
their purpose.
Where these considerations are not present, however, courts view stipulated damage provisions with skepticism and generally refuse enforcement except where there are actual damages and the stipulated sum is reasonable in light of the actual injury. In so doing, courts express a preference for their own remedies, a preference which is based in large part upon the pervasive policy in contract law of limiting recovery for a breach. Also underlying this skepticism toward stipulated damage provisions is a feeling that bargaining about the consequences of breach is undesirable, both because it may increase the likelihood of nonperformance and because damages should be measured at a point when it can be done accurately—after the breach has occurred. In the special areas where the stipulated damage provisions are treated more favorably, these considerations do not pertain. In these situations damages cannot be measured accurately either before or after breach, and the possibility of nonperformance is so great that bargaining about its consequences can hardly affect its likelihood. And rather than harming the processes of contract by unnecessary bargaining over breach, setting a sum in certain situations facilitates agreeing by enabling the parties to evaluate performance. Moreover, when the damage provision serves to limit liability rather than increase it, the policy expressed in doctrines restricting liability for a breach is not affected.

**Contractual Provision for Commercial Arbitration**

An arbitration clause is a choice of remedy as well as a choice of forum. The procedural and substantive rules applied in arbitration, and the backgrounds of the people applying them, are different from those of a court and thus the result is often different from that which a court would reach. Arbitration is not a unitary process, however. The procedures of the American Arbitration Association (AAA) vary greatly from those of the arbitration boards of private trade groups. The AAA discourages its arbitrators from explaining their awards, does not allow them to sit on many cases in any year (so that they do not develop a pattern of response to similar situations), and asks them to choose one disputant’s case over the other’s rather than compromise between them. This latter requirement seems inconsistent with the objective of the other two, which seems to be to decide cases on the basis of commercial understanding rather than in accordance with fixed principles of law. But on a closer examination, the inconsistency disappears. For, without fixed rules of law, choosing one disputant’s case over another’s may not be distinguishable from

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132a. This section covers only commercial arbitration because arbitration of collective bargaining agreements has a background of national labor policy and is primarily directed at facilitating a continuing relationship between the parties. The courts have, however, openly maintained control of arbitration in the labor field. See United Steelworkers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960). On the difference between commercial and labor arbitration see Sturges, *A Symposium on Commercial, Industrial and International Arbitration, Foreword*, 17 N.Y.U.L. Rev. 495 (1940).

133. The material in these introductory paragraphs is largely based on the excellent article on commercial arbitration, an outgrowth of the University of Chicago study of the subject. Mentschikoff, *Commercial Arbitration*, 61 Colum. L. Rev. 846 (1961).
a compromise between the parties. The remedy offered by the AAA is thus an attempt at a fair settlement of a particular controversy without reference to past decisions or future effects on other contracts.\textsuperscript{134}

But even under the AAA rules each arbitration does not differ from every other. As parties learn what terms direct arbitrators along what paths, the situations in which the parties choose arbitration as a remedy become relatively standardized, as do the terms over which the dispute arises.\textsuperscript{135} The type of dispute most often submitted to arbitration is that between a buyer and seller over whether the goods delivered met the standard of the sample or the contract.\textsuperscript{136} Arbitrators are more likely to settle these disputes by making an allowance on the purchase price than courts are. To arbitrators the requirement of perfect tender is less important. The arbitrator may also divide a contract for a quantity of goods into parts, which a court would seldom do, and hold the buyer liable for the price of only those goods of the quality contracted for.\textsuperscript{137}

Arbitration under trade association rules tends, to an even greater degree, to establish a private system of law governing arbitrable contractual disputes. Here the arbitrators do write opinions which are circulated among the members of the association, and thus a system of precedent is established.

A New York court recently acknowledged the difference between the remedies granted by arbitrators and those afforded by courts. In Matter of Transpacific Transport and Siena Shipping Co.,\textsuperscript{138} the buyer of a defective ship sought to compel arbitration, asking expenses plus the difference between the contract price and market price of the vessel or retender and repayment of the purchase price. The seller claimed that after acceptance, retender was no longer possible and that the contract contemplated only the cost of putting the ship in the condition specified. The seller argued that the court should deny arbitration because no court would give the remedy sought, and thus this was not a controversy “which may be the subject of an action”\textsuperscript{139} as the New York arbitration statute requires. The court answered that the statute demanded only that the dispute be cognizable in a court, not that the remedy be one a court could or would give:

It is now well settled law that there may be remedies in arbitration which would not have been available in a court within conventional actions or proceedings in law or in equity.

\textsuperscript{134} Herzog, Judicial Review of Arbitration Proceedings—A Present Need, 5 De Paul L. Rev. 14, 27 (1955), objects rather violently to the method. He calls arbitration “folksy jurisprudence characterized not so much by the emergence of a new set of guiding rules but rather by the negation of basic legal principles heretofore commonly accepted in the community...."

\textsuperscript{135} Smith, Commercial Arbitration at the American Arbitration Association, 11 ARB. J. (n.s.) 13 (1956).

\textsuperscript{136} Ibid.

\textsuperscript{137} Ibid.

\textsuperscript{138} Note, Predictability of Result in Commercial Arbitration, 61 Harnv. L. Rev. 1022 (1948).

At one time courts, refusing to hold an unwilling party to his promise to bypass court procedures, denied enforcement to agreements to arbitrate.\textsuperscript{140} Prompted by the commercial demand for establishment of a regular arbitration system, legislatures in the nineteen-twenties and thirties passed the so-called "draft statutes" making enforcement of arbitration agreements mandatory.\textsuperscript{141} The New York legislation, commanding courts to give a wide scope to arbitrators, was the pioneer.\textsuperscript{142} Under the operation of draft statutes and even in states without such legislation, the expressed attitudes of courts toward arbitration has changed over the past thirty years from hostility to hospitality. Courts now regularly recognize the arbitrator's jurisdiction as beneficial.\textsuperscript{143}

But though the expressed attitudes of courts and some cases accord arbitrators a wide unpoliccd domain,\textsuperscript{144} arbitration has not become a remedy which the parties may freely choose and manipulate.\textsuperscript{145} Courts maintain control over the awarding of arbitration and over the awards arbitrators make and the control is sometimes exercised in cases which seem to give arbitration the widest scope. One commentator recently said:

[\textit{...}]though courts have done yeoman duty in giving lip service to this doctrine [plenary power of arbitrators], in actual practice they have questioned arbitrators' findings of fact, have challenged their interpretation of legal principles and have required compliance with traditional rules of law.\textsuperscript{146}

Thus, as with other terms modifying remedies, intent of the parties is only one of the considerations in deciding whether a contractual clause will displace judicial control over remedies. Judicial control of the remedy of arbitration takes various forms and comes into play at two stages: where one party seeks

\begin{itemize}
\item \textsuperscript{140} See Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942), for a description of the history of commercial arbitration and the courts.
\item \textsuperscript{141} See 12 AM. J. 38 (1957) for a list of the state arbitration statutes. For a description of the draft statutes, as well as an excellent criticism of their conception in which the author notes that the draft statutes were bitterly opposed by the American Bar Association, the Commission of Uniform Laws, and the Commercial Law League, see Phillips, \textit{The Paradox in Arbitration Law: Compulsion as Applied to a Voluntary Proceeding}, 46 HARV. L. REV. 1258 (1933). See also 6A COBBO \textsection 1441.
\item \textsuperscript{142} N.Y. CIV. PRAC. ACT §§ 1448-1468.
\item \textsuperscript{143} MacNeil, \textit{supra} note 108, at 527.
\item \textsuperscript{144} See East India Trading Co. v. Data Haji Ebrahim Haleri, 280 App. Div. 420, 114 N.Y.S.2d 93 (1952).
\item \textsuperscript{145} See Note, \textit{Judicial Innovations in the New York Arbitration Law}, 21 U. CHI. L. REV. 148 (1953), for an explanation of the thesis that New York courts have in recent years inclined toward greater control of arbitration.
\end{itemize}
to compel arbitration and where enforcement of an award already made is sought. Ultimately, the pattern of court regulation is enforcement of arbitration when it is a suitable remedy in a particular situation, with the courts always the judges of suitability. Thus, courts rather than abdicating control over arbitration, have converted it into one of the battery of remedies under their command.

The doctrines courts have developed to control the arbitration remedy do not always reveal the reasons for control. When a court refuses to compel arbitration, or when it affirms an arbitrator's award, it seldom justifies its result in general terms but talks of intent of the parties in a particular case, or use or abuse of the arbitrator's power. But this should not prevent an inquiry into the probable considerations underlying the pattern of judicial behavior. The range of reasons for court regulation of arbitration go beyond those underlying judicial responses to disclaimer and liquidated damage provisions, although many of the same considerations are present. The policy of preventing excessive liability for consequential damages appears in some cases denying effect to arbitration awards. Also, the idea that the time of contract is not ideal for determining the consequences of non-performance is reflected in cases construing narrowly the submission to arbitration. Courts' preference for their own remedies and principles of contract law is also present in some cases dealing with arbitration. For instance, a court awarding arbitration will sometimes pass on the major issues of the contract and in effect determine or greatly influence the decision that the arbitrator can make.

147. See text at notes 170-200 infra.
148. Taesch predicted in the 1930's, when the move toward widespread arbitration was only beginning, that like the canon law and the law merchant before it, arbitration would be absorbed by the common law. Taesch, Extrajudicial Settlement of Controversies: The Business Man's Opinion; Trial at Law v. Nonjudicial Settlement, 83 U. Pa. L. Rev. 147, 156 (1934). This is now coming to pass.
149. [This] discussion of "reasons" does not claim to coincide in all particulars with the actual workings of the judicial mind, certainly not with those of any single judicial mind. It is unfortunately very difficult to discuss the possible reasons for rules of law without unwittingly conveying the impression that these "reasons" are the things which control the daily operations of the judicial process. This has had the consequence, at a time when men stand in dread of being labelled "unrealistic", that we have almost ceased to talk about reasons altogether. Those who find unpalatable the rationalistic flavor of what follows are invited to view what they read not as law but as an excursus into legal philosophy, and to make whatever discount that distinction may seem to them to dictate.

150. See text at notes 187-92 infra.
151. See text at notes 182-84 infra.
152. New York courts have found various pretexts to strike down offensive awards, particularly when the remedy granted was not one which the court would have decreed.

Note, 73 Harv. L. Rev. 776 (1960) (citing cases).
153. See text at notes 164-66 infra.
In addition to these considerations, which also operate in other areas where parties regularly attempt remedy modification, the need for an "irreducible minimum of certainty in human dealings" in part determines the response of courts to arbitration clauses. Certainty is best assured by courts, which have a sense of history and concern for the future effect of a decision, as well as a desire to settle an individual case. This is not to say that the remedy a court will give is always sure and predictable—but courts are institutionally structured to consider a particular case in light of precedent and of the general aims and policies of contract law. Presumably, in order to maintain the legal framework of commercial dealing, guiding decisions must be made by such a body. Moreover, if courts are to perform their continuous function of fashioning remedies, they must maintain contact and familiarity with what the parties are attempting to achieve in various kinds of contracts. Courts cannot do this by automatically referring all contracts with arbitration clauses to private bodies for private lawmaking. In maintaining control over arbitration as a remedy, the courts also participate with the parties in standardizing the situations in which arbitration will be awarded as an appropriate remedy. This, in turn, engenders certainty by creating areas in which the courts customarily enforce arbitration awards.

Another reason for control by courts of arbitration is that generally courts are more competent to judge the third factor always present in the decision to enforce—the public interest in the contract. This includes not only the public interest discussed above in the form and development which a particular kind of dealing takes, but the public interest in a more obvious sense, such as preventing the enforcement of unconscionable or illegal contracts.


155. Judges are ... more likely ... to develop and apply principles formulated with a view toward broad social values and ... [are] aware of the cumulative impact of a series of decisions, even though each is relatively unimportant in itself.

156. See Note, 63 Harv. L. Rev. 681 (1950).

157. The graphic demonstration of this rationale of judicial action lies in the handling of cases such as, Franklin v. Nat. C. Goldstone Agency, 33 Cal. 2d 628, 204 P.2d 37 (1949). The plaintiffs, seeking enforcement of an arbitration award, were interior decorators; defendants claimed that the contract was illegal because the decorators did not have a license. The court refused to enforce the award, refusing credence to the reasonable argument that the arbitration process would be hurt if the parties were permitted to try arbitration and then if one did not like the award, to contest it on the basis of a technical illegality. The dissent agreed that the defendants had waived the defense of illegality by not opposing arbitration at the outset. But the majority was more interested in preventing illegal contracts, enforcing the State license law, and assuring that arbitration would not be used to effect illegal contracts than in preserving the integrity of the arbitration process. In a case...
The doctrines which courts have developed to control arbitration range from the subtle and semantic to open pre-emption of arbitrators' jurisdiction. Subtest of all is the idea that courts must decide the validity of the main contract before enforcing the arbitration clause. The theory is that the arbitration clause would fall with the rest of an invalid contract. If there were no agreement, there could have been no agreement to arbitrate. Section 1450 of the New York Arbitration Act seems to recognize the logic:

[If] a substantial issue as to the making of the contract . . . or the failure to comply therewith [is raised], the court shall proceed immediately to the trial thereof . . .

In the case which established this reasoning, Finsilver, Still & Moss, Inc. v. Goldberg, Maas & Co., one of the parties contested the enforcement of an arbitration clause, claiming that the contract had never been completed. Judge Cardozo, in holding that the court must settle this issue before arbitration, compared a court's duty in awarding arbitration to that of a court of equity giving specific performance. Since a court of equity has the broadest discretion to inquire into and to refuse the relief sought, this comparison raised possibilities of wide control. An examination of the progeny of Finsilver reveals that in the considerable number of cases in which an issue is raised about the validity of the underlying contract, the courts often remove large areas of the dispute from the purview of arbitration. But even more importantly, they take the opportunity to decide in a particular case whether arbitration is an appropriate remedy for that situation.

A good example of what a court can accomplish through this technique is Matter of Greane. Greane promised to devote as much time to a corporation such as this the court determination to preserve a framework of law in which arbitration is only a part is undeniable.

The same intent is present, less overtly expressed, when a court enforces arbitration after an investigation of whether there was consideration in the main contract and when a court decides that arbitration will be or has been a suitable remedy for a particular situation. Courts control arbitration in order to create and maintain a framework of certainty within which parties can deal, and to afford a consideration of the public effect of private actions.

158. An example of a less subtle tool for construction is that which the New York Court of Appeals used in 1952 in Alpert v. Admiration Knitwear Co., 304 N.Y. 1, 105 N.E. 2d 561 (1952). The buyer was seeking arbitration in a contract which provided that the seller had an unconditional right to demand payment in advance if he regarded the buyer's credit as poor. The court said there was no arbitrable issue in this case because the contract had ended when the buyer refused the seller's demand for an advance payment. But whether the buyer had refused and whether the seller had already broken the contract before making the demand for cash were issues which could have been arbitrated. The court was settling the merits when it held the seller's claim so good that there was no possibility of arbitration.

160. 253 N.Y. 382, 171 N.E. 579 (1930). Section 1450 of N.Y. Civil Practice Act was not in effect at time of this case.
161. Id. at 392, 171 N.E. at 582.
162. See notes 163-67 infra.
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as he judged fit. The corporation failed to pay Greane his salary and refused to arbitrate, alleging that Greane's illusory promise was not valid consideration. The court, after deciding that there was consideration, enforced the arbitration clause. In settling the issue of basic intent, the court took away from the arbitrators the whole question of what each party had promised and thus set the direction the arbitration would take. It also made very clear the fact that arbitration clauses will not be allowed to interfere with court made rules of contract if a case involves important questions of law or policy.

But commentators have long argued that the agreement to arbitrate is "separable" from the rest of the contract, that mutual promises to arbitrate are consideration for each other and should be enforced, without any court investigation into the validity of the underlying contract. Underlying the separability argument, which is also a semantic one, is a more basic struggle. The issues which go to the existence or validity of the contract—presence of consideration, mutuality, fraud in the inducement—overlap or are identical with the arbitrable questions, for instance, of what constitutes adequate performance or what was promised by the parties. Thus, a decision on the merits by a court on the former issues often pre-empts the arbitrator's jurisdiction. Judicial control over these basic issues, therefore, has a great effect on recovery in arbitration. Most questions relating to whether there is adequate performance can be framed in terms of failure of consideration or fraud in the inducement. Thus, a court's decision on mutuality or on the existence of the contract may also answer the question whether arbitration is a suitable remedy in a particular case. The general refusal of courts to accept the logic of the separability argument evidences their determination to retain this control over the granting of arbitration.

The New York courts have most steadily resisted attempts to institute separability—Matter of Wrap-Vertiser v. Plotnick is illustrative. Plotnick, a retailer, sought to prevent arbitration of a dispute with a manufacturer from whom he had purchased goods. In one count, he alleged damages for the manufacturer's failure to supply proper equipment; in the second, claiming fraudulent inducement, he asked damages for the $6,000 he had paid for the equipment. The court found that the second count was not arbitrable, in spite of the fact that the proof for the first and second counts would be much, if not exactly, the same. But since fraud in the inducement goes to the validity of the main contract, the court was free to settle this issue and in so doing to determine the outcome of the arbitration issue.

164. See, e.g., Note, 36 Yale L.J. 866 (1926).

If the parties have used words of general application, if they have not specifically excepted this issue [of fraud], in bargaining for an arbitration, when should the issue be taken from the arbitrators?

Id. at 873. See also, Note, 43 Colum. L. Rev. 508 (1943); 3 Williston, Contracts § 860 (rev. ed. 1936).


166. 3 N.Y.2d 17, 163 N.Y.S.2d 639 (1957).
The same issue as in *Wrap-Vertiser* was before the Second Circuit in *Robert Lawrence Co. v. Devonshire*. The court, dealing with a New York contract, decided that it was unnecessary in a non-diversity case to follow state law because the Federal Arbitration Statute had created substantive rights. Noting that New York law would dictate a different result, the court allowed an issue of fraud in the inducement to go to arbitration. But the facts of the case will probably limit its application on the separability issue. The buyer, who wanted to prevent arbitration, charged fraudulent inducement because of misrepresentation about the quality of goods purchased. The contract provided that disputes over quality would go to a trade association. The court found no difference in this case between fraud in the inducement and inadequate performance by delivery of defective merchandise. Thus the court concluded that the buyer could not prevent arbitration by characterizing his suit as one for fraud. Apparently, however, the court made some investigation of the merits of the allegations of fraud:

What Lawrence does claim is that the entire transaction was induced by fraud and that the arbitration provision necessarily falls with the rest. This contention we reject as above stated because the facts of this case do not support the argument.

The court never stated that the promise to arbitrate is separable from the rest of the agreement and therefore enforceable; nor did it admit that most arbitrable questions can be framed in terms of questions which go to the underlying validity of the contract. Thus, it appears that the court, while enforcing the arbitration clause in this case, nevertheless reserved to itself the question of deciding whether allegations about the validity of the contract are substantial enough to require a decision by the court before allowing the controversy to go to arbitration.

*Martatta v. Exercycle*, a New York case decided a few years after *Devonshire*, appears to reject *Wrap-Vertiser* and to establish the doctrine of separability. Maratta was hired as the sales manager of a firm. Fearing that the

169. 271 F.2d at 411 (emphasis added).
171. The wide use of arbitration in New York, its pioneering with the draft statute and the clarity with which various struggles over arbitration have emerged account for the predominant use of New York cases to illustrate this section of the Comment. But in reading and using New York cases, one must remember that there is a split in the Court of Appeals in attitudes toward arbitration. Judge Desmond leads those who would give broadest scope to arbitration and Judge Van Voorhis those who would openly and closely regulate the process. The split, however, is one of degree, with neither side willing to relinquish substantial court control of the arbitration remedy. See, *e.g.*, Grayson-Robinson Stores v. Iris Constr. Co., 8 N.Y.2d 133, 168 N.E.2d 377, 202 N.Y.S.2d 303 (1960), for an opinion by Judge Desmond which in words gives a great deal to arbitration but actually does not relinquish substantial judicial control. The rhetoric of the cases must be discounted...
firm would fire him after he had raised sales, Maratta demanded and received an agreement that he would be retained indefinitely as long as sales remained high. After five years, during which the firm's business improved steadily, disagreements arose between Maratta and the president of the firm. From the correspondence arising out of the disagreements, the firm gathered that Maratta had resigned; Maratta claimed that he had not and demanded arbitration, as provided in the contract. The firm opposed on the ground that the underlying contract was void for lack of mutuality; the firm had promised to retain Maratta indefinitely while he was free to leave anytime.

The court enforced the arbitration clause because the "five year course of dealing" between the parties was "evidence of an agreement." Most commentators have interpreted the decision as reading separability into the statutory provision governing arbitration in New York; therefore, the only threshold question the court should proceed to try is whether there was an agreement to arbitrate, leaving all other questions, including the validity of the underlying contract, to the arbitrators. This does not necessarily follow from the court's emphasis on the five-year course of dealing in *Exercycle* as evidencing the "making of the contract" in accordance with the New York statute. That same course of dealing could equally have created a valid underlying contract. Moreover, mention of the question of separability is conspicuously absent from the opinion of the majority.

What this case has established about the meaning of the New York statute or separability is unclear. What is clear, however, is that the court must have considered the equities of Maratta's position. The very event he feared and tried to provide against had happened: he had raised sales and the firm was trying to be rid of him. The technical requirement of mutuality might stand in the way of a court award in the case; moreover, a court might be hesitant to order Maratta's reinstatement because of restrictions on ordering specific performance of service contracts. The remedy of arbitration was therefore a peculiarly appropriate one:

by the individual attitudes and prejudices of particular judges. But this is easier in arbitration cases than usual because the positions have been clearly articulated.


173. *Exercycle*’s promise of employment for life became enforceable after Maratta rendered substantial performance in accordance with this "illusory" promise even if there had been no other consideration of any kind. His actual service exactly as foreseen and desired by *Exercycle* is the kind of "reliance that makes a return promise binding." See Restatement, Contracts § 90 (1932).

6A Corbin 1444 n.40 (1962 pocket part).

Professor Corbin’s analysis of *Maratta* is that though the arbitration agreement is not separable from the underlying contract, the mutual promises to arbitrate are consideration for each other. In this case, Maratta's promise to arbitrate could also be consideration for the firm's promise to hire him for life (as well as the firm's promise to arbitrate). Since there is nothing "illusory" about Maratta's promise to arbitrate, the court could find that it was consideration, even if Maratta's agreement to work would not support the contract.

174. *But see* Note, 110 U. Pa. L. Rev. 113 (1961), which argues convincingly that the case established separability.

Obviously, once having agreed to eschew recourse to courts of law and have its disputes with Maratta settled by arbitration, Exercycle cannot urge in opposition to arbitration that a court of law would not enforce the agreement. As long as the arbitrators remain within their jurisdiction and do not reach an irrational result, they may fashion the law to fit the facts before them.\footnote{170}

The measure of the control retained in Exercycle is summed up in the court’s declaration that a case should go to arbitration as long as the arbitrator “could rationally and legitimately base an award in favor of the party claiming arbitration.” Rationality and legitimacy are as flexible as any standards in the law today.\footnote{177}

DeLaurentas v. Cinematografica de las Americas S.A.,\footnote{178} a later case, reveals how little the court relinquished in Exercycle. The terms of the contract between a producer and film company were rendered unclear by the course of dealing mingling threats and exhortations. The film company claimed that the director had broken all his promises, and sought arbitration and damages of over a million dollars. The producer asked a stay, claiming lack of mutuality in the contract. The court answered that Exercycle stood for the proposition that “where [there are] permissible differences of interpretation, the issue is for the arbitrator, and not for the court.”\footnote{179} But the court considered the allegations about mutuality and found that though the company had not made a specific commitment in the contract, its subsequent actions in making definite promises for meetings and consultations revealed a recognition of obligation. The court said that:

It is for the arbitrators to decide what, under all circumstances, these covenants contemplated and whether petitioner did all that he was thereby required to do.\footnote{180}

But the court apparently decided the basic question of mutuality and referred the rest of the contract to the arbitrator to unravel.

Thus, although early judicial hostility to arbitration is no longer present, as evidenced by the recent decisions in New York in both Exercycle and DeLaurentas, these cases also reveal that judicial control through judgment of the validity of the underlying contract remains an important technique for controlling the award of arbitration as a remedy and for shaping the course of the arbitration proceedings.\footnote{181}

\footnote{176} 9 N.Y.2d at 336, 174 N.E.2d at 466, 214 N.Y.S.2d at 357-58 (1961).
\footnote{177} Note, 9 U.C.L.A. L. Rev. 214 (1962).
\footnote{179} 9 N.Y.2d at 510, 174 N.E.2d at 738, 215 N.Y.S.2d at 64.
\footnote{180} Ibid.
\footnote{181} A 1960 case which openly speaks of separability, Lummus v. Commonwealth Oil Refining Co., 280 F.2d 915 (1st Cir. 1960), can be analyzed in the same fashion as Exercycle. This case involved a dispute over the capacity of a huge oil refining plant built by Lummus. The plant operated at a loss and there were charges and counter-charges of promises made, of tests not performed, and of false profitability forecasts. The refining company charged fraud in the inducement of the contract and sought to prevent arbitration.
Another technique used by courts for controlling the use of arbitration as a remedy, one in which the court's interest in the policies underlying contractual remedy is more apparent, is construction of the intent of the parties to submit to arbitration. The issue is whether the contract term providing for submission to arbitration encompasses the particular dispute. Judicial control exercised at this point is especially important because arbitration involves giving up substantial rights, such as trial by jury, court procedures, and frequently the remedies a court would give. Professor Corbin notes that the traditional judicial hostility to arbitration does not stem from any petty jealousy of the arbitrators but from the vice of parties binding themselves to submit to private arbitration issues that, at the time of contracting, they do not have clearly in mind, which after they have arisen, one party no longer wishes to arbitrate. The fear here of parties agreeing on arbitration of all the myriad possibilities of disputes that may arise under the contract seems similar to the general hostility to agreement in advance on the consequences of breach, as evidenced in the treatment of stipulated damage clauses and disclaimers.

Typical of the latitude a court has in interpreting intent of the parties is the recent California case of Smith v. Superior Court. A partnership agreement between two brothers included a broad submission to arbitration of all "differences of opinion." During the course of the partnership, bitter familial quar-

The district court found a substantial issue of fraud which the Court of Appeals openly doubted. But rather than dispute the finding of fact, the court chose to say that the agreement to arbitrate was separable from the rest of the contract because:

[A]ny other approach sets the stage for delaying action, and invites the injured party to cast what is basically a claim for breach of warranty or failure to perform, which would be arbitrable, into an action based on fraudulent inducement.

Id. at 924.

Again, the court maintained its function of construing the agreement as to intent of the parties, deciding that the issues which the plaintiff relied on were the same ones the parties had allocated to the arbitrator, and perhaps that this case with its complicated economic analyses and its need for continuing relations between the parties was an appropriate one for arbitration. At any rate, the court clearly did not think the allegations about fraud were very serious.

182. Cf. The suggestion in Finsilver, supra note 160, that the right to have a court pass on the validity of the underlying contract may be a part of the constitutional guarantee of due process. The hesitancy of courts to enforce arbitration unless the submission is absolutely clear is illustrated in a line of New York cases. In Riverdale Fabrics Corp. v. Tiltingst-Stiles Co., 306 N.Y. 288, 118 N.E.2d 104 (1954), the court stayed arbitration, finding the term, "This contract is also subject to the Cotton Yarn Rules of 1933 as amended," insufficient to compel arbitration, though the rules included an arbitration clause. The basis of the opinion was that the term was designed to lead parties into arbitration "unwittingly, through subtlety." The majority felt that "the form of words favored by these trade associations appears to have been designed to avoid any resistance that might arise if arbitration were brought to the attention of the contracting parties...." Id. at 581.

Cf. Level Export Corp. v. Wolz, Aiken & Co., 305 N.Y. 82, 111 N.E.2d 218 (1953), in which much the same term was held sufficient to compel arbitration.

183. 6A Corbin § 1433 (1962).

rels arose, not foreseeable at the time of contracting, which made the parties unable to continue their partnership relationship. The court refused to compel arbitration of a dispute so basic that it was fatal to the partnership. Interpreting the intent of the parties in providing for arbitration to be facilitation of their continuing relationship, the court found the arbitration remedy inappropriate when there was no chance that the partnership would continue.

In addition to controlling the award of arbitration, the courts have reviewed the merits of controversies which have been arbitrated, in part through the technique of interpreting the intent of the parties. As one observer recently noted:

Of cases reported in the last 30 years in all of the States, those cases are rare indeed in which the court really seemed to disagree with either the factual or the legal conclusion of the arbitrator and yet confirmed the award. In the many cases in which the court confirmed the award with a strong statement about the finality of the arbitrator's decision on the merits, there is almost always some independent substantive treatment of the merits wherein the court indicates its agreement with the conclusions reached by the arbitrator.\(^{185}\)

This broad review has often been accomplished by comparing the arbitrator's award with the power given him by the contract.\(^{186}\) As seen in the interpretation of disclaimer clauses and liquidated damage provisions, construing the intent from the language of the submission clause can be a flexible operation in which other factors besides the meaning of the words are operative. The leading decision in this area is Judge Cardozo's in \textit{Marchison v. Mead Morrison}.\(^{187}\) The arbitration clause there was typical:

\begin{quote}
If for any reason any controversy or difference of opinion shall arise as to the construction of the terms and conditions of this contract or as to its performance, it is mutually agreed that the matter in dispute shall be settled by arbitration, each party to select an arbitrator, and the two so selected to select a third, and the decision of the majority of such arbitrators given after a full hearing and consideration of the matter in controversy shall be final and binding upon the parties, and a condition precedent to any suit upon or by reason of any such controversy or difference.\(^{188}\)
\end{quote}

The arbitrator had awarded the buyer huge consequential damages because he found that the seller's failure to deliver had caused the buyer's bankruptcy. As Judge Cardozo well knew, the doctrine of \textit{Hadley v. Baxendale} would not have allowed recovery of such consequential damages, which were clearly beyond what was within the contemplation of the parties at the time of contracting. Judge Cardozo, ignoring precedents in which the power to award damages was an assumed concomitant of the arbitrator's power to settle the dispute,\(^{189}\) held

\[^{186}\] See extensive case citation in Note, 63 HARV. L. REV. 681 (1950).
\[^{188}\] \textit{Id.} at 290, 169 N.E. 387-88.
\[^{189}\] See Note, 47 HARV. L. REV. 590 (1934), which explores the precedent for \textit{Mead-Morrison} and exposes the real basis of Judge Cardozo's decision.
that the arbitrator's action was beyond the purview of the submission clause—that clause "allowed the arbitrator to settle the dispute" but not to fix the amount of damages. He found the typical submission clause in the case "in-struct with tokens of a purpose to encompass the submissions with limitations and conditions."\textsuperscript{180}

The question is one of intention, to be ascertained by the same tests that are applied to contracts generally. Courts are not at liberty to shirk the process of construction under the empire of a belief that arbitration is beneficial, any more than they may shirk it if their belief happens to be to the contrary.\textsuperscript{181}

The arbitration statutes of Mississippi and Michigan, unlike that of New York, upon which they were otherwise modelled, specifically invest the courts with an equitable jurisdiction in their reviewing arbitration awards.\textsuperscript{182} Whether—as in these states—the statute allows it, or whether—as in others—the courts have taken it themselves, the existence of broad review does not mean that courts do not generally enforce arbitration awards and give the arbitrator's expertise real weight. But it does mean that courts seldom enforce an award without some independent examination of the merits of the case,\textsuperscript{183} and that they will not allow the arbitration award to violate established judicial or statutory policies.

Two recent New York cases, Staklinski v. Pyramid Elec. Co.\textsuperscript{184} and Grayson-Robinson Stores, Inc. v. Iris Constr. Corp.,\textsuperscript{186} illustrate judicial examination of arbitrators' awards in light of the necessity for the remedy of arbitration in certain situations. This function entails a consideration of the merits to test the appropriateness of the arbitral remedy; and both these cases included such an investigation. Staklinski involved an employment contract with a former president of a corporation, giving him a responsible position at a large salary plus a percentage of the profits. The contract was for life but provided that if Staklinski became permanently disabled, it would end after three years. A dispute arose in which the directors of the corporation claimed that they

\textsuperscript{180} Judge Crane in dissent interpreted the submission as businessmen would intend it:

Controversies and differences arising out of the terms and conditions of the contract have reference to meaning of the contract. This covers everything within its four corners. The performance of the contract does not arise out of its construction or meaning but out of its execution. The difference between the parties to the litigation arose out of the latter, that is, out of failure to perform. Default was conceded. The dispute was over the damage. The question of loss arising from non-performance, in my judgment, was within the arbitration clause. . . .

\textsuperscript{182} N.Y. at 306, 169 N.E. at 394.

\textsuperscript{184} Id. at 299, 169 N.E. at 391.


\textsuperscript{183} For an example of court technique in reviewing the merits, see Arlington Towers Land Corp. v. John McShain, Inc., 150 F. Supp. 904 (D.D.C. 1957).


had fired Staklinski because he was permanently disabled. The arbitrators reinstated Staklinski. Appealing to the court, the directors of the corporation insisted that specific performance of a personal service contract was an illegal remedy. They also claimed that the New York Corporation Law giving the directors wide responsibility for corporate affairs should prevent their being forced to continue the services of a man no longer satisfactory to them. The court upheld the award but acknowledged the relevance of the argument that the award violated the statutory power of corporation directors. The court said that they were getting what they had wanted in the contract; they knew when they included the arbitration clause that specific performance was a common arbitral remedy and that Staklinski’s reinstatement would be likely in case of a dispute. By thus meeting this argument on its own ground, the court admitted that preserving the policy of the corporation statute bore on the appropriateness of arbitration in the case.

In Grayson-Robinson Stores, Inc. v. Iris Constr. Corp., the defendant, a builder who owned property in a shopping center, contracted to erect a store and lease it to the plaintiff for twenty-five years with options to renew. But after the festivity of a mutual ground-breaking ceremony, the builder, unable to obtain financing for the project, defaulted. In keeping with a contract provision, arbitration followed, and the arbitrators awarded specific performance of the building contract. The Court of Appeals considered the builder’s plea that specific performance was inappropriate to a building contract, but upheld the award. Again, this was an unusual case. The court apparently drew upon two factors which indicated that the parties intended specific performance in cases of breach: 1. Specific performance is a common arbitral remedy. 2. The standard clause providing for escape if financing is difficult was omitted from this contract between professionals who were no doubt aware of the general use of such a clause. In addition, the issue of impossibility was considered by the arbitrators, who were experts in the building field. Finally, specific performance was appropriate because damages probably would not compensate the department store for its loss of a location in a new shopping center, a location which could not be duplicated. In other words, the court in this case, looking at the factors involved and at the future of the contract, could say that arbitration was an appropriate remedy and that the award given was appropriate. The court clearly said that the lower court had discretion to enforce or refuse to enforce the arbitration award; the finding was that the lower court had not abused its discretion by upholding the award. There is here no granting of a domain to arbitration where awards much different from those that courts would give receive automatic enforcement.

196. See Note, 45 Cornell L.Q. 581 (1960), suggesting that specific performance may be an appropriate remedy for arbitration when it is not for courts. Arbitrators can maintain a closer, more continuous, more expert supervision of performance.
198. 6 N.Y.2d at 163, 160 N.E.2d at 79, 188 N.Y.S.2d at 542.
199. 8 N.Y.2d at 133, 168 N.E.2d at 378, 202 N.Y.S.2d at 305.
Though its rationale has shaded from nineteenth century laissez-faire into twentieth century respect for expertness, freedom of contract remains a given in the law. Against this background, knowing that provisions for remedy are often bound in with other terms of the contract, one would expect a general freedom to modify the remedies available at law for breach of contract. Yet courts often prevent the free operation of contract terms attempting modification of remedy. This Comment has sought the purposes behind judicial action through a study of three terms around which much law has developed. Throughout, "courts" have been spoken of as an atavistic monolith with long-range purposes and profoundly rooted objectives which they apply in each case. This is not realistic. Yet there is enough similarity in approach from court to court from year to year and enough similarity of circumstance in the cases which arise to make worthwhile and perhaps useful the treatment of courts as sharing an accumulative wisdom.

The pattern emerging from an examination of attitudes toward disclaimers, stipulated damages, and arbitration clauses is regulation. A premise of this regulation is the knowledge that courts greatly influence bargaining by their choice of terms to enforce. Thus, for example, in some areas where courts favor the remedy set by the parties, as in some stipulated damage and arbitration situations, such terms become common and standardized. Generally, however, through persistent and unusually close scrutiny of terms which modify remedies, courts have discouraged their use. This probably reflects a desire to effectuate fully the policies embodied in court-made doctrines governing the measurement and award of damages for a breach of contract and a preference for an affirmative atmosphere in bargaining, unclouded by contemplation of non-performance.

Running through the regulation in all these areas is distaste for allowing the enforcing power to serve a private attempt which may be "harsh," "unfair," "unconscionable." The amorphous notion of unconscionability takes substance from the elaborate construction of contracts designed to negate disclaimers that leave a buyer helpless, to nullify a liquidated damage provision which would impose excessive liability, or to preclude arbitration when one contractor did not quite agree to it, or should not have agreed to it in light of subsequent events. But there is also present in the regulation a preference for the remedies which courts have evolved. The preference is based on a more sophisticated idea of fairness than simple prevention of harshness or over-reaching. Fairness includes the assurance of a basic compensatory remedy, the limitation of excessive liability, and the certainty which comes from the knowledge that the same formula will be applied for the same kind of breach. The remedies which result from the application of the judicial doctrines governing recovery for breach will best effectuate these aims.

Fairness—as best illustrated in prevention of disclaimers; accuracy—the chief concern in supervision of stipulated damages; and certainty—revealed in the control of arbitration enforcement—are the catchwords indicating why courts have reacted to modified remedies by modifying freedom of contract.