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Recovery of Consequential Damages for Product Recall Expenditures

_Bradford Stone*_

I. BACKGROUND

Under the National Traffic and Motor Vehicle Safety Act of 1966,¹ automobile manufacturers may be required to incur large recall expenditures if they manufacture an automobile that has safety impairing defects. Since many of the component parts of automobiles are supplied by independent enterprises, a safety defect in an automobile may be traceable to defective parts supplied by an independent supplier. A 238-page report by the author summarized a study that he conducted jointly with Professor Arthur F. Southwick² concerning the potential liability of a supplier of defective parts for an automobile manufacturer's recall expenditures. This article is a condensation and update of that report.³

This article inquires into the law governing the potential liability of a commercial heat treater for recall expenditures incurred by an automobile manufacturer as a result of its use of defective materials supplied to it by the heat treater. The conclusion reached here is that in determining liability courts will consider factors beyond the traditional Hadley v. Baxendale foreseeability test governing consequential damages. Although these factors may not be articulated in courts' opinions, they reflect important policy considerations that influence the results in reported product recall decisions. Although the following analy-

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3. B. Stone, Product Recall and Consequential Damages: Effects of the National Traffic and Motor Vehicle Safety Act (1971) (published by the Bureau of Business Research [now Division of Research], Graduate School of Business Administration, University of Michigan). Parts I-III of this article are the condensation of the report; Parts IV and V are the update.
sis focuses on a typical fact situation arising in the automobile industry, the principles discussed are applicable to the law of consequential damages in general.

II. HYPOTHETICAL FACT SITUATION

Suppose Heat Treater either buys 50,000 bolts or manufactures them itself. It heat treats the 50,000 bolts, then sells and delivers them to Auto Company with the knowledge that they will be affixed to the steering mechanisms of new automobiles. The bolts are sold pursuant to Auto Company’s purchase order form that states in part:

Warranty: Seller expressly warrants that all the material and work covered by this order will conform to the specifications, drawings, samples or other descriptions furnished or specified by Buyer, and will be merchantable, of good material and workmanship and free from defect. Seller expressly warrants that all the material covered by this order, which is the product of Seller or is in accordance with Seller’s specifications, will be fit and sufficient for the purposes intended.

Of the 50,000 bolt lot, 500 are defective. The defects are not immediately discovered, and the 50,000 bolts are affixed to the steering mechanisms of 50,000 automobiles.

Subsequently, several steering mechanism failures result from the defective bolts. Auto Company investigates its records and determines that the reported defective bolts all come from the lot of 50,000 sold to it by Heat Treater. Auto Company is then forced to launch a recall campaign pursuant to the provisions of the Federal Safety Act and (1) replaces 10,000 bolts

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4. Since Heat Treater in this hypothetical example sells heat-treated bolts, the governing law is the Uniform Commercial Code. If on the other hand Heat Treater were in the business of providing heat treating as a service, the governing law would be common law principles. See RESTATEMENT OF CONTRACTS § 330 (1932). Since the U.C.C. has adopted the common law rule governing consequential damages, however, the rule governing Heat Treater is the same even when it is providing a service. See U.C.C. § 2-715(1), (2)(a), Comments 1 & 2. An alternative ground for bringing heat treating as a service within the ambit of the U.C.C. is the argument that the U.C.C. applies by analogy to services. See U.C.C. § 1-102, Comment 1.

5. The Federal Safety Act provides in relevant part:

If any motor vehicle . . . contains a defect which relates to motor vehicle safety, after the sale of such vehicle or item of equipment by a manufacturer or a distributor to a distributor or a dealer and prior to the sale of such vehicle or item of equipment by such distributor or dealer:

(1) The manufacturer or distributor, as the case may be, shall immediately repurchase such vehicle or item of motor vehicle equipment from such distrib-
affixed to the steering mechanism of 10,000 autos still in the possession of dealers, and (2) seeks to replace 40,000 bolts affixed to the steering mechanism of 40,000 autos purchased by 40,000 ultimate consumers.⁴

(2) In the case of motor vehicles, the manufacturer or distributor, as the case may be, at his own expense, shall immediately furnish the purchasing distributor or dealer the required conforming part or parts or equipment for installation by the distributor or dealer on or in such vehicle and for the installation involved the manufacturer shall reimburse such distributor or dealer for the reasonable value of such installation plus a reasonable reimbursement of not less than 1 per centum per month of the manufacturer's or distributor's selling price prorated from the date of notice of such nonconformance to the date such vehicle is brought into conformance with applicable Federal Standards . . . .

If a manufacturer—
(1) obtains knowledge that any motor vehicle or item of replacement equipment manufactured by him contains a defect and determines in good faith that such defect relates to motor vehicle safety;

he shall furnish notification to the Secretary and to owners, purchasers, and dealers, in accordance with section 1413 of this title, and he shall remedy the defect or failure to comply in accordance with section 1414 of this title.

Id. § 1411.
(a) Contents of notification
The notification required by section 1411 or 1412 of this title respecting a defect in or failure to comply of a motor vehicle or item of replacement equipment shall contain, in addition to such other matters as the Secretary may prescribe by regulation —
(1) a clear description of such defect or failure to comply;

(c) Method of notification
The notification required by section 1411 or 1412 of this title with respect to a motor vehicle or item of replacement equipment shall be accomplished
(1) in case of a motor vehicle, by first class mail to each person who is registered under State law as the owner of such vehicle and whose name and address is reasonably ascertainable by the manufacturer through State records or other sources available to him;

(4) by certified mail or other more expeditious means to the dealer or dealers of such manufacturer to whom such motor vehicle or replacement equipment was delivered; and

(5) by certified mail to the Secretary, if section 1411 of this title applies.

Id. § 1413.
6. The cost of conducting the recall campaign will probably be substantial. The following estimates are not unrealistic:
Assuming that Heat Treater is liable for breach of an express warranty, Auto Company can recover actual damages. However, the amount of actual damages recovered would probably be relatively insignificant. The more important question is whether Auto Company can recover the costs of the recall campaign as consequential damages.

III. Analysis

A. Auto Company's Argument for Recovery

Section 2-714(3) of the Uniform Commercial Code (U.C.C.) states, "In a proper case any incidental and consequential damages under the next section may also be recovered." U.C.C. section 2-715(2) then states,

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

Taken at face value, this statute seems to imply that Heat Treater is liable for the costs of the recall campaign that Auto Company is required to conduct under the Federal Safety Act. Heat Treater at the time of contracting had reason to know (in

$350,000—Cost of reimbursing dealer for the expense of installing new bolts plus reimbursement of not less than one percent per month of Auto Company's selling price prorated from date of notice of the defect to the date the vehicles are brought into conformity with federal standards as required by 15 U.S.C. § 1400 (1976).

$80,000—Cost of mailing notices to 40,000 purchasers pursuant to 15 U.S.C. §§ 1411, 1413 (1976).


$820,000—Total

7. Actual damages for the heat-treated bolts are small. In this example, the cost of heat treating 50,000 bolts would be approximately $125. The cost of the bolts plus the cost of the heat treating would be approximately $2,000. These combined costs are small when compared with approximate total recall cost of $820,000.

8. U.C.C. § 2-714(2) states, "The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount."
fact did know) Auto Company’s general or particular requirements and needs, i.e., that the bolts were to be used in steering mechanisms. Since any defect relating to motor vehicle safety imposes upon Auto Company the obligation to conduct a recall campaign pursuant to the Federal Safety Act, Heat Treater would be liable for the losses resulting from its breach of warranty, including the costs of the recall campaign. Comment 2 to U.C.C. section 2-715 clarifies the meaning of “reason to know” by referring to that phrase’s historical origins:

Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller’s breach. The “tacit agreement” test for the recovery of consequential damages is rejected. . . . The older rule at common law which made the seller liable for all consequential damages of which he had “reason to know” in advance is followed . . . . Subparagraph (2) carries forward the provisions of the prior uniform statutory provision [Uniform Sales Act] as to consequential damages resulting from breach of warranty . . . .

It is apparent from this comment that an understanding of the history of consequential damages is essential in order to grasp the significance and meaning of U.C.C. section 2-715 relating to consequential damages.

B. Historical Development of the Law

1. Older common law rule

The leading case in the area of consequential damages is Hadley v. Baxendale. In Hadley the shaft of plaintiff’s steam-mill had broken and was delivered to defendant, a carrier, who agreed to deliver it to an engineer so that it could be used as a model for a new shaft. The carrier did not deliver the shaft promptly, which resulted in plaintiff’s mill remaining idle for a longer period of time than it would have otherwise. Plaintiff brought a contract action claiming damages for profits lost while the mill was idle. The court held that plaintiff could not recover damages for the loss of profits:

Now we think the proper rule in such a case as the present is this:—Where two parties have made a contract which one of

them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them. Now the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract.¹¹

The court therefore held that damages are not recoverable unless they were within the contemplation of the parties at the time of contracting. Conversely, damages contemplated by the parties are recoverable.

Professor McCormick summarizes the Hadley v. Baxendale rule as follows:

The leading case of Hadley v. Baxendale lays down the rule that damages for breach of contract can be recovered only for such losses as were reasonably foreseeable, when the contract was made, by the party to be charged. In other words, such losses must be either of the type usually resulting from breach of like contracts, or, if unusual, the circumstances creating the special hazard must have been communicated to the defaulter before he made the bargain.¹²

¹¹. Id. at 151.
¹². C. McCormick, DAMAGES 562 (1935). Professor McCormick makes the following observations concerning the Hadley v. Baxendale rule:
Professor McCormick notes, however, that the *Hadley v. Baxendale* rule has retained considerable elasticity. In discussing what constitutes notice of special circumstances sufficient to impose liability for consequential damages upon a contract breacher, he notes that

the decisions differ greatly, and it seems that the court’s holding as to the sufficiency of the notice is likely to depend on the fairness of the particular claim for consequential loss, and especially upon whether the defendant’s breach was deliberate, or excusable, and upon the proportion between the risk sought to be imposed upon defendant and expected gain under the contract.\(^{15}\)

2. *Tacit agreement test*

An alternative test to determine the allowability of consequential damages was enunciated in decisions after *Hadley v. Baxendale*. The “tacit agreement test” required not only that the consequential damages be foreseeable at the time of contracting, but also required a showing that the defendant had expressly or impliedly agreed to assume liability for the consequential damages.\(^{14}\)

The leading American case adopting the tacit agreement
test was *Globe Refining Co. v. Landa Cotton Oil Co.* In *Globe* a Kentucky buyer of cotton-seed oil brought an action against a Texas seller for failure to deliver the oil as agreed. Under the agreement the seller was to deliver the oil to the buyer's railroad cars in Texas. The buyer alleged that the seller knew that buyer had to send its railroad cars from Kentucky to Texas to pick up the oil and therefore sought consequential damages for the expense of the wasted trip. The trial judge held, based on information found on the face of the complaint, that consequential damages were not recoverable. This holding was affirmed by the United States Supreme Court. Writing for the Court, Justice Holmes stated that plaintiff's recovery depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.

It may be said with safety that mere notice to a seller of some interest or probable action of the buyer is not enough necessarily and as a matter of law to charge the seller with special damage on that account if he fails to deliver the goods. The tacit agreement test has never received wide acceptance by the courts. The rule merely adds the fiction of a tacit promise to the original fiction of "contemplation" and seldom is there anything in the situation more definite and mandatory than the judge's sense of justice to tell him to find the presence or absence of this silent promise to assume the risk. The recurrent cropping up of the idea in the opinions of the courts indicates that some of the judges have found the conception useful in giving expression to this sense of the justice of the situation. If so, this serves as its justification.

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15. 190 U.S. 540 (1903).
16. Id. at 544-45.
18. C. McCormick, *supra* note 12, at 580. However useful the idea may be for inclusion in appellate opinions, its value as a formula for use in the instructions at the trial is questionable. It has been held, however, that the issue whether defendant has impliedly agreed to be responsible for consequential losses should, if the evidence raises doubt, be left to the jury. Lonergan v. Waldo, 179 Mass. 135, 60 N.E. 479, 88 Am. St. Rep. 365 (1901), Crane's Cases on Damages, 98. But it may well be assumed in most cases that, if the issue of "contemplation" is explained and submitted the fur-
Perhaps the most articulate defense of the tacit agreement test was formulated by Professor Bauer who argued:

On the facts in Hadley v. Baxendale, the "contemplation of the parties" formula was used as a restriction upon the amount of the damages. The formula was not one that could properly be used to increase damages, but the seemingly unwise application of the dictum that damages may be recovered for contemplated loss has led to numerous recoveries of damages for losses of such a nature that it seems at least highly questionable whether the defendant could possibly have regarded himself as assuming any liability for them when he made the contract.

With the real decision in Hadley v. Baxendale, based upon the rule that damage neither actually contemplated or natural and probable cannot be recovered, probably no one has any quarrel. Damages in this class are clearly not within the terms of the contract. There seems to be no ground on which to say that the defendant has assumed liability.

The dictum that probable damages, or the damages contemplated by the parties, can be recovered, has not commanded the same respect of courts as has the principal rule of the case, and it would seem that it is right that it should be so. Such a dictum seems extreme. Even results actually contemplated and discussed by the parties when making the contract may actually be elements for which the defendant has not assumed liability.19

3. The modern rule

Despite the arguments advanced by Professor Bauer and others, the tacit agreement test never received widespread acceptance by the courts. The Restatement of Contracts, for example, adopted the Hadley v. Baxendale rule and makes no reference to—and consequently rejects—the tacit agreement test.20

ther embroidery of "implied agreement" will be apt to mean nothing to the jury or too much.

Id. at 580 n.59.
19. See Bauer, supra note 14, at 690, 702.
20. See Restatement of Contracts § 330 (1932):
In awarding damages, compensation is given for only those injuries that the defendant had reason to foresee as a probable result of his breach when the contract was made. If the injury is one that follows the breach in the usual course of events, there is sufficient reason for the defendant to foresee it; otherwise, it must be shown specifically that the defendant had reason to know
This position is understandable, especially since the Reporter for the Restatement was Professor Williston, who in his own writings showed no particular approval of the tacit agreement test. Furthermore, the U.C.C. follows a similar approach by adopting the rule formerly applied under the Uniform Sales Act that expressly rejects the tacit agreement test.

C. Application of Relevant Law to Heat Treater's Situation

Section 2-715(2)(a) of the U.C.C. adopts the older common-law rule as stated in the Restatement of Contracts section 330. Therefore, whether Heat Treater sold heat-treated bolts to Auto Company or heat-treated bolts sent to it for that purpose by either Auto Company or a bolt manufacturer (in which case the common-law rule as to services is applicable), the analysis and result determined by a court should be substantially similar. Heat Treater's liability for consequential damages in either case will depend upon whether those damages were "foreseeable."

It has been assumed that Heat Treater knew that the bolts in question were to be affixed to the steering mechanisms of automobiles, and therefore knew that any defects in the bolts would impair automobile safety. Because a safety related defect imposes upon Auto Company the duty to conduct a recall campaign, the expenses of a recall campaign would certainly be a foreseeable result of Heat Treater's breach.

However, before we assume that all is lost for Heat Treater if it had reason to know or foresee the recall campaign, and without the further limitation that it tacitly or impliedly agreed to assume such liability, let us survey certain current case law.

the facts and to foresee the injury.

Comment:

One who has committed a breach of contract is bound to pay damages only for such injury as he had reason to foresee when he made the contract. This does not mean, however, that the defendant must have had the resulting injury actually in contemplation or that he promised either impliedly or expressly to pay therefor in case of breach.

23. This assumption accords with the reality of the typical factual setting. Each of the "big three" auto manufacturers has its particular designation for critical parts. The fact that suppliers will be furnishing critical parts likely to relate to motor vehicle safety is amply brought to these suppliers' attention by entries on purchase orders and other documents.
24. See note 5 supra.
In *Keystone Diesel Engine Co. v. Irwin*, plaintiff, a dealer in diesel engines, sought to recover $623.08 as compensation for repair work it had performed on a diesel engine it had previously sold to defendant. The price of the engine was approximately $3,000. Defendant counterclaimed, alleging that he had suffered lost profits totaling $5,150 as a result of various engine breakdowns and seeking damages in that amount. The trial court struck the counterclaim because the claim for lost profits was too speculative.

On appeal, the Supreme Court of Pennsylvania had little difficulty concluding that the damages for lost profits could be easily measured and stated that "[t]he real issue to be determined is whether the damages sought for loss of profit were within the contemplation of the parties to the contract here in dispute."28

In concluding that liability for lost profits was not within the contemplation of the parties, the court apparently adopted the tacit agreement test, stating:

"‘[O]ne of two contracting parties ought not to be allowed to obtain an advantage which he has not paid for . . . . If [a liability for the full profits that might be made by machinery which the defendant was transporting . . . ] had been presented to the mind of the ship owner at the time of making the contract, as the basis upon which he was contracting, he would at once have rejected it . . . The knowledge must be brought home to the party sought to be charged, under such circumstances that he must know that the person he contracts with reasonably believes that he accepts the contract with the special condition attached to it.’"

In the case at bar, no facts are alleged that would put the plaintiff on guard to the fact that the defendant would hold the plaintiff responsible for any loss of profit arising from the inability to use the engine in question.27

Thus, what "contemplation of the parties" means to this court is not merely reasonably foreseeing the injury, but actually contemplating that the buyer will hold the seller liable for such injury. Such a concept, along with the court's quoting *Globe*

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26. Id. at 224, 191 A.2d at 378.
with approval, shows that the court is applying the tacit agreement test. Even so, that test was flatly rejected in the comments to U.C.C. section 2-715 as well as in comment a of Restatement of Contracts section 330.

Keystone did not go unchallenged. In 1970, Adams v. J.I. Case Co. was decided by the Appellate Court of Illinois. In Adams seller had sold a crawler-loader tractor to buyer for an installment price of $14,896.75. Buyer was engaged in a bulldozing business as a general contactor for hire at $12.00 per hour. The business required him to perform various types of work, all of which the seller was aware. The tractor was defective, and although buyer called the defects to seller's attention on April 19, 1966, seller did not correct them until July 17, 1967. As a consequence, buyer lost 810 work hours or approximately $9,995.00 while the tractor was standing in seller's shop. The tenor of the court's evaluation of the buyer's claim is gleaned from the following statement:

[Sellers] were under a duty to make timely repairs called for by their warranty but the [sellers] took an inordinate amount of time in making the repairs, that they were willfully dilatory or were careless and negligent in their work of compliance, with the result that [buyer] has suffered direct and consequential damage.

Then, and most relevant to our inquiry, the court stated:

The [sellers] call attention to the case of Keystone Diesel Engine Co. v. Irwin, 411 Pa. 222, 191 A.2d 376, in which it was held that the "special circumstances" were the communication to the seller at the time of entering into the contract of sufficient facts to make it apparent that the subsequently claimed loss of profits was within the reasonable contemplation of the parties. The court remarked that the buyer had alleged no facts which would make the seller aware that the buyer intended to hold him responsible for any loss of profits resulting from inability to use the engine there involved.

... In their Official Comment upon UCC 2-715(2) its framers make it clear that the "tacit agreement" test for the

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28. See note 22 supra.
29. See note 20 supra.
32. Id. at 400, 261 N.E.2d at 6.
recovery of consequential damages is rejected. The language of that section should not be so narrowly construed as to require a prior understanding or agreement that the seller would be bound for consequential damages in the event of his breach. If that is the holding of the Keystone . . . case it must be rejected. The Official Comment further states that the older Common-Law rule which made the seller liable for all consequential damages of which he had “reason to know” in advance is followed, modified to require reasonable prevention of loss by cover or otherwise. The Code provision and the Official Comment make it clear that strictures are not to be applied to the plain meaning of the Code by adherence to what the parties may have agreed or contemplated at the time of sale. Rather, each case is to be considered on its merits touching upon the issue of special circumstances arising in that particular case. In the instant case, it is alleged that the plaintiff’s particular needs in his tractor business and his existing contracts were known to the defendants and that plaintiff was relying on their judgment; but notwithstanding this, the defendants were wilfully dilatory or careless and negligent in making the corrections or repairs called for in their warranty. We hold these allegations to be sufficient to show “special circumstances” required by UCC 2-714(2) and that consequential damages have resulted and may be recovered pursuant to UCC 2-715(2)(a).88

Other distinctions exist between Keystone and Adams besides the respective courts’ different positions on the tacit agreement test. In Keystone the engine sold for approximately $3,000; the consequential damage sought amounted to $5,150. In Adams the installment price of the tractor was $14,896.75; the consequential damages sought amounted to $9,995.00. Hence, the damages were greater than the purchase price in Keystone. In addition there was no hint in Keystone that the seller had not acted in good faith. Furthermore, the engine was inoperative for only twenty-seven days. In Adams by contrast, the sellers were “wilfully dilatory or were careless and negligent,” with the result that the buyer lost 810 work hours because the tractor could not be used for approximately 15 months. Apparently these differences had a bearing on the results of the two cases.

The court in Keystone applied U.C.C. section 2-715(2)(a), the comments to which reject the tacit agreement test. Why

33. Id. at 404-06, 261 N.E.2d at 8-9.
then did the court deny recovery for consequential damages, even though the defendant-seller probably had reason to foresee the harm? Some of the possible answers to this question have already been given here and in other discussions concerning the tacit agreement test as well as in the requirement regarding notice of special circumstances; others will be discussed shortly.

Dean Leon Green, in referring to the foreseeability test, has commented:

The formula is one for use in determining whether the interest involved is protected by the agreement. And it is not a contemplation of consequences from a possible breach, but a contemplation of interests which may be protected by the contract. Parties, in making contracts, rarely contemplate the losses which would result from its breach. But they do count the advantages they will gain from its performance. What interests does the contract promote or serve? These are actually considered in most part, and those which are shown to have been considered or reasonably falling within the terms in view of the language used and the background of the transaction, mark its boundaries—the limits of protection under it. . . . The point to be emphasized here is that contemplation or foresight of the parties as to the consequences which may follow a breach of the contract is utterly immaterial in this process except as one of the many factors to be taken into consideration in determining the larger problem of whether the injured interest fell within the protection of the contract terms. More than this, it is highly misleading and pernicious to emphasis it as the sole or controlling factor.34

Thus, if we are going to make an educated prediction about what a court will actually hold in this area of consequential damages—regardless of what reasons it may give for so holding—we must realize that the foreseeability test is only one of many factors to be taken into consideration. It is, in the words of Dean Green, “highly misleading and pernicious to emphasize it as the sole or controlling factor.”

We are not yet at the crux of the matter and must further probe by asking what factors the court (or jury, or both) will consider in arriving at its conclusion. Utterances found in case law and in scholarly writings are qualified by expressions like “reasonable,” “prevention of hardship,” “just,” “fair,” and “scope of protection,” by “attitudes not capable of exact quanti-

34. L. Green, Rationale of Proximate Cause 51, 52 (1927).
D. Unarticulated Factors in Consequential Damage Cases

The principal factors that the author believes a court will consider relevant in reaching a conclusion—whether articulated in a written opinion or not—will be discussed at length in the following pages. They include:

1. Is the seller compensated for the risk?
2. Does a gross disparity exist between the compensation received by the seller and the damages sought by the buyer?
3. Was the seller's breach willful?
4. By interpretation and construction, how have the parties contracted to allocate risk?
   a. Did the seller and the buyer agree to extend liability to include the damages in question, or to limit it to preclude such liability?
   b. Are the seller and the buyer in a relatively equal bargaining position, or does a significant disparity exist between them?
   c. Is the agreement between the seller and the buyer so one-sided that the court will not enforce their agreement?
   d. Were the terms of the agreement reached by meaningful bargaining or are they essentially “boilerplate”?
   e. Which party chose the language of the agreement?
5. Which party can most economically bear the risk?

1. Is the seller compensated for the risk?

Justice Holmes stated in *Globe Refining Co. v. Landa Cotton Oil Co.* that “one of two contracting parties ought not to be allowed to obtain an advantage he has not paid for.”\(^{35}\) Surely in many other cases the courts have thought like Holmes but used the traditional language of “contemplation of the parties,” and “reason to foresee” the harm.

If we suppose a situation where a seller has calculated a risk, insured against it, and added the cost of such insurance to the price of his product or service, it would be clear that seller is compensated for the risk and consequently should bear such risk

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\(^{35}\) 190 U.S. at 545 (quoting British Columbia Sawmill Co. v. Nettleship, L.R. 3 C.P. 499, 508 (1868)).
as between himself and buyer. On the other hand, seller is not compensated for the risk in situations where the risk is unknown, or where it is known but not subject to any degree of calculation so as to be insurable; consequently, no attempt is or can be made to add a cost factor to the price of the product or service. Thus, a court may be inclined not to require seller to bear this risk.

This idea of compensation for risk is manifested specifically in the law of bailments, where certain carriers under federal acts like the Interstate Commerce Act are allowed to limit their liability to a certain dollar amount for loss or damage to their passengers’ baggage, provided each passenger is afforded a chance to pay a larger fee for the carrier to assume an increased risk. Hence, if a passenger declares a higher value for his baggage than the limited dollar amount of the carrier’s liability under this act, the carrier liability in dollar terms will be greater, but the passenger will have paid a larger fee to compensate the carrier for the additional risk assumption. Courts are likely to apply the “compensation for risk” logic by way of analogy to damages.

37. The analogy may be stronger with respect to rules within the U.C.C. itself. For example, the sections of the Interstate Commerce Act cited in note 36 supra are paralleled by U.C.C. §§ 7-204(2) and 7-309(2), where the compensation for risk concept is spelled out. (Comment 1 to U.C.C. § 1-102 and comment 2 to U.C.C. § 2-313 encourage reasoning by analogy to the U.C.C. even when the U.C.C. is not directly applicable.) The appropriate sections that may be applied by analogy include:

U.C.C. § 7-204. Duty of Care; Contractual Limitation of Warehouseman’s Liability.

(2) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage, and setting forth a specific liability per article or item, or value per unit of weight, beyond which the warehouseman shall not be liable; provided, however, that such liability may on written request of the bailor at the time of signing such storage agreement or within a reasonable time after receipt of the warehouse receipt be increased on part or all of the goods thereunder, in which event increased rates may be charged based on such increased valuation, but that no such increase shall be permitted contrary to a lawful limitation of liability contained in the warehouseman’s tariff, if any. No such limitation is effective with respect to the warehouseman’s liability for conversion to his own use.

U.C.C. § 7-309. Duty of Care; Contractual Limitation of Carrier’s Liability.

(2) Damages may be limited by a provision that the carrier’s liability shall not exceed a value stated in the document if the carrier’s rates are dependent upon value and the consignor by the carrier’s tariff is afforded an opportunity to declare a higher value or a value as lawfully provided in the tariff, or where no
2. Does a gross disparity exist between the compensation received by the seller and the damages sought by the buyer?

Related to the previous question of whether the seller is compensated for the risk is whether a gross disparity exists between the compensation received by seller and the damages sought by buyer. If so, courts may be persuaded to deny liability regardless of the rationale relied upon to support such a result—e.g., no implied agreement to pay for such damage.

This phenomenon has been observed by many writers, including Professor McCormick, who after reviewing certain cases states:

In determining whether to tighten or relax in a particular case the curb upon the damages in contract cases, which they exert through the flexible concepts of "notice" and "reasonable contemplation," it seems probable that two factors, of which the rule itself take no account, exert a deep influence: First, the proportion between the burden which would be imposed on the defendant and the amount of compensation or gain which accrued to him under the contract.88

Another commentator, Professor Bauer, analyzes the following hypothetical case that uses facts similar to those in Hadley v. Baxendale:

[In this case] C, a carrier, contracts to carry for D a crank shaft to be used in D's mill. The shaft is worth $10. The freight charge is 50 cents. If the shaft is not delivered on time, the loss to D may be $5,000 a day during the delay. Assume that notice of the likelihood of such loss by reason of the delay has been given to C at the time of the making of the contract. Still may not the non-assumption of such liability for such contemplated

tariff is filed he is otherwise advised of such opportunity; but no such limitation is effective with respect to the carrier's liability for conversion to its own use.

38. C. McCormick, supra note 12, at 574. In his discussion of the tacit agreement test Professor McCormick points out:

Instances occur where it seems to the courts that a reasonable business man, under the circumstances, might be entirely aware of the probability of heavy damage to the other party in case of a breach, but would not understand or anticipate that he would be answerable for such damage if he should be unable to fulfill his undertaking. Often this is true in cases where the risk arises from some entirely separate or "collateral" engagement of the other party with third persons and where the hazard is so disproportionately heavy as not to be adequately compensated by the consideration received in the present venture by the one upon whom the liability would fall.

Id. at 575-76.
result be implied as well as expressed? May not the implication of nonassumption arise from usage, the habits of dealing of the parties, the smallness of the consideration paid, or the general circumstances of the case?39

3. Was the seller’s breach willful?

Of course this question is supposed to be irrelevant to the issue of damages in a contract action since the theory of damages is to compensate plaintiff, not penalize defendant.40 This theory is repeated endlessly. For example, Justice Holmes in Globe said that even though the defendant “maliciously caused the plaintiff to send [its] tanks a thousand miles,” the willfulness of the breach did not strengthen plaintiffs’ claim for special damages.41 Professor Bauer has stated in this regard,

Aversion and disgust and hatred excited by a defendant’s willful breach of contract, and pity aroused by the predicament in which another defendant is placed by his honest and unintentional breach of contract, have swayed judges, as well as juries, in the actual administration of the law.

Although this tendency to make the lot of the transgressor more at fault a harder lot is ordinarily a silent one, to be discerned only by a careful study of the facts, verdict, and judgment in the case, there are many instances, even in contract cases, where a court has expressly recognized the propriety of so administering justice as to make the result more severe upon the defendant more seriously at fault in the breach of his contract . . . Such a tendency may not appeal to the lawyer-logician attempting to apply supposed exact rules of law with ideal syllogistic regularity; but the tendency, actually existing and functioning in an important way, must be noticed and reckoned with. It often affects seriously the measure of damages.42

Similarly, Professor McCormick has noted that the degree of the defendant’s willfulness is important in determining whether consequential damages will be allowed.

The French Civil Code clearly draws the line here, and protects

40. See U.C.C. § 1-106; RESTATEMENT OF CONTRACTS § 329, Comment a (1932), states, “In awarding compensatory damages, the effort is made to put the injured party in as good a position as that in which he would have been put by full performance of the contract . . . .”
41. 190 U.S. at 547.
42. Bauer, supra note 14, at 700, 701.
against unforeseen risks of the breach of contract only one who has not acted in bad faith. Evidence that our courts share the tendency to widen the liability of the deliberate contract breaker, as distinguished from one who has by misfortune or mistake failed to carry out his promise, is furnished by the instances where the courts in their opinions have called attention to the willfulness of the defendant. In the view of the present writer, this tendency is a wholesome one. . . . Our rules should sanction, as our actual practice probably does, the award of consequential damages against one who deliberately and wantonly breaks faith, regardless of the foreseeability of the loss when the contract was made. We shall then have completed the process, begun piecemeal in Hadley v. Baxendale, of borrowing from the French Civil Code its theory of damages in contract. 43

4. By interpretation and construction of the agreement, how have the parties contracted to allocate risk?

   a. Did the seller and the buyer agree to extend liability to include the damages in question, or to limit or preclude such liability? Provided no public policy is contravened, parties normally may agree whether certain consequential damages will or will not be allowed against a defaulting seller. An explicit statement in the contractual agreement will certainly suffice. But if no such explicit statement exists, an agreement may be found to be implied without being vulnerable to the argument that the tacit agreement test is being applied contrary to the comments in U.C.C. section 2-715, and comment a of the Restatement of Contracts section 330. Comment a to Restatement of Contracts section 330 states:

   One who has committed a breach of contract is bound to pay damages only for such injury as he had reason to foresee when he made the contract. This does not mean, however, that the defendant must have had the resulting injury actually in contemplation or that he promised either impliedly or expressly to pay therefore in case of breach. If he does so promise, he is bound just as he is by any other promise. Whether or not such a promise was made is mainly a question of interpretation; and what performance was promised—the meaning of the promise—is wholly a question of interpretation. If such in-

43. C. McCormick, supra note 12, at 581. Thus, by enlarging consequential damages for willful breach of contract, the law does not penalize the breacher but instead more fully compensates the aggrieved party for damages resulting from the breach.
terpretation shows that the defendant promised to carry the risk of certain losses, it is his duty to pay them; and if he commits a breach of this duty, the question of legal remedy in damages arises. This question of remedy is not one of interpretation; it is determined by the rules for estimating damages that are applicable to promises to pay a sum of money, liquidated or unliquidated. When making a contract, the contractor may look ahead as far as he likes; and in many cases he has power to limit in advance the payment to be made in case of some nonperformance. But there must always come a point at which interpretation ceases and the application of the law of remedies begins. [Emphasis added]

As one might imagine, it is an art to determine where interpretation of the contract ceases and where the application of the law of remedies begins. Given, for instance, the U.C.C. provisions concerning usage of trade, course of dealing, and course of performance, surely some latitude exists when a court or jury does not wish to make the seller bear the consequential loss. These U.C.C. provisions enable them to find that the agreement did not require Heat Treater to bear this loss, without the necessity of using the tacit agreement test to make that finding.

b. Are the seller and the buyer in a relatively equal bargaining position, or does a significant disparity exist between them? This factor by itself may not be of overpowering significance, but in combination with other factors discussed below it does have an effect. The suspicion arises that the party with the greater bargaining power may have overreached.

c. Is the agreement between the seller and the buyer so one-sided that the court will not enforce their agreement? This question is pertinent in contexts involving contracts of adhesion or, under U.C.C. provisions, the doctrine of unconscionability. Unconscionability is not defined in the U.C.C., but comment 1 to section 2-302 relates that it involves "oppression" or "unfair surprise." It does not, however, involve a disturbance of allocated risks because of superior bargaining power. "The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case,

44. See U.C.C. § 1-205.
45. See U.C.C. §§ 1-205, 2-208.
47. See U.C.C. § 2-302.
the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.”

The above may be tested with Auto Company’s warranty clause:

Warranty: Seller expressly warrants that all the material and work covered by this order will conform to the specifications, drawings, samples or other description furnished or specified by Buyer, and will be merchantable, of good material and workmanship and free from defect. Seller expressly warrants that all the material covered by this order, which is the product of Seller or is in accordance with Seller’s specifications, will be fit and sufficient for the purpose intended.

In insisting upon this express warranty that the goods be in accordance with Auto Company’s specifications, Auto Company is hardly oppressive. The further question of whether the costs of Auto Company’s recall campaign constitute consequential damages is a matter of construing the appropriate rule of law, not a matter of interpreting the language of an agreement and deciding whether that language is unconscionable. It does not seem likely, for example, that the U.C.C.’s provisions in sections 2-714 and 2-715 regarding consequential damage would be construed as unconscionable.

If the warranty clause explicitly recited that Auto Company would be able to recover as consequential damages the costs of a recall campaign, a more direct issue of unconscionability would be presented. To date, most warranty cases dealing with unconscionability have involved an attempt by a seller to limit or preclude liability for consequential damages. The question that arises when a buyer insists upon being allowed to recover all damages he in fact has suffered, though they amount to several times more than the seller’s compensation for his efforts, is different from the one raised when a seller seeks to limit or preclude the damages a buyer may recover, though the buyer has sustained such injuries. Nevertheless, if the buyer insists upon a clause allowing him all consequential damages in spite of the fact that the amount might drive seller out of business, a court may be influenced to hold the agreement unconscionable.

50. Id.
d. Were the terms of the agreement reached by meaningful bargaining or are they essentially boilerplate? Professor Llewellyn has suggested the following about the construction of form, or boiler-plate, agreements:

Instead of thinking about "assent" to boiler-plate clauses, we can recognize that so far as concerns the specific, there is no assent at all.

... There has been an arm's-length deal, with dickered terms. There has been accompanying that basic deal another which, if not on any fiduciary basis, at least involves a plain expression of confidence, asked and accepted, with a corresponding limit on the powers granted; the boiler-plate is assented to en bloc, "unsight, unseen," on the implicit assumption and to the full extent that (1) it does not alter or impair the fair meaning of the dickered terms when read alone, and (2) that its terms are neither in the particular nor in the net manifestly unreasonable and unfair. Such is the reality, and I see nothing in the way of a court's operating on that basis, to truly effectuate the only intention which can in reason be worked out as common to the two parties, granted good faith.51

Problems akin to contracts of adhesion and unconscionability would of course come to bear in deciding whether boiler-plate terms are "manifestly unreasonable and unfair."

Thus, for example, a situation might arise where Heat Treater had sold goods to Auto Company according to Auto Company's purchase order form which included considerable boiler-plate language. Further assume that a court then adopted Llewellyn's suggested technique of construing the boiler-plate language. In such a case, Heat Treater has engaged in a blanket assent to the boiler-plate language on Auto Company's form on the assumption that such language is neither unreasonable nor unfair. If Heat Treater cannot obtain insurance to protect against the risk or pass any anticipated costs on to Auto Company, and thus cannot be compensated for such a risk, is boiler-plate language that includes a provision allowing damages for recall expenditures "manifestly unreasonable and unfair"? The potential liability is great enough to spell the likelihood of Heat

Treater’s economic disaster. Auto Company is presumably in a position to bear such expenses and add them to the cost of its goods. Under such circumstances a court will undoubtedly be inclined to rule that such language is indeed "manifestly unreasonable and unfair."

e. Which party chose the language of the agreement? One might argue that because Auto Company chose the language pursuant to its boiler-plate form contract, it could have explicitly provided that Heat Treater would be liable for the costs of the recall campaign. The fact that this was not set out in the agreement, as well as the fact that the costs of the recall would likely be financially catastrophic to Heat Treater, strengthen the argument that a court can avail itself of a canon of interpretation that construes the language of a contract against the person who chose it. In addition, who chose the language is probably another aspect of factor (a) above concerning the interpretation of the seller-buyer contract.

5. Which party can most economically bear the risk?

This question concerns what is likely to be the most important single factor in determining the extent of Heat Treater’s liability. It is often argued that “manufacturers, as a group and an industry, should absorb the inevitable losses which must result in a complex civilization from the use of their products, because they are in the better position to do so, and through their prices to pass such losses on to the community at large.”

52. Utterances are to be construed most strongly against the person responsible for them. It is a general principle of interpretation that an utterance is to be interpreted most strongly against the party who was responsible for it. This is particularly true, if the contract has been embodied in a writing, and if that writing was prepared by the skilled adviser of one of the parties, or if the person who drew it had special competence in such matters.
G. Griswold, Contracts § 104 (Rev. ed. 1964). See also Restatement (Second) of Contracts § 206.

Those who suffer injury from defective products are unprepared to meet its consequences. The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business. It is to the public interest to discourage the marketing of products having defects that are a menace to the public. If such products nevertheless find their way into the market it is to the public interest to place the responsibility for whatever injury they may cause upon the manufac-
Even though this idea of "risk spreading" seems to influence the courts, it is interesting to note Chief Justice Taft's dissenting opinion in *Lonzrick v. Republic Steel Corp.*, in which he wrote:

> There is considerable appeal to the idea of spreading the risk of loss to an individual from a particular activity over those who engage in that activity and profit from it. However, before determining to do so with respect to the manufacture and sale of a particular product, a court should at least consider questions such as:

1. What additional liability would be involved?
2. Could insurance be procured against such additional liability?
3. If so, what would its cost be?
4. Could such cost be passed on to buyers of the product?

How can a court know the answers to such questions? A court such as this has no means of even exploring them. However, these are problems which a legislature can fully explore.

Also, in this regard Professor Farnsworth has stated:

> Consideration should be given to such factors as the respective abilities of the parties, at least in those standard situations, to prevent the loss, to bear the loss, and to distribute the risk. The law tends, more and more, toward imposing loss upon the party who is best able to do these things.

... Consideration should be given to the magnitude of the business and the availability and cost of liability insurance.

Courts and legislatures are frequently persuaded by the risk-spreading argument. The developing law of credit cards, which provides for distribution of loss from fraud, is an appropriate illustration. Congress has amended the Federal Truth in

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Id. at 462, 150 P.2d at 441 (Traynor, J., concurring).
54. 6 Ohio St. 2d 227, 218 N.E.2d 185 (1966).
55. Id. at 249-50, 218 N.E.2d at 200.
Lending Act by adding section 133,\(^{57} \) in which a credit card holder's liability for the unauthorized use of the credit card is either precluded or limited to $50 under appropriate circumstances. This preclusion or limitation is apparently a recognition by Congress that the credit card issuer is the party who may most effectively bear significant and substantial risks of loss.

How do the above principles relate to Heat Treater's potential liability for consequential damages suffered by Auto Company as the result of a recall campaign? They show that the risk of the expense of a recall campaign could probably most economically be borne by Auto Company. Relying upon the above principles, the most appealing case for Heat Treater is made with the following points:

1. Its business is an economically small unit.
2. It does all or most of its business with Auto Company.
3. Its potential liability is not subject to any degree of calculation that would enable it to obtain insurance or set aside a reserve fund to cover the potential loss.
4. The potential liability is so great that imposing the actual liability upon it would probably spell economic disaster.

Heat Treater is in no position to calculate the risk, add it to the costs of its product or service, and thereby spread it among its several buyers. Auto Company, on the other hand, can economically spread the costs of the recall among the purchasers of its automobiles. Moreover, self-insurance, which involves setting aside a reserve fund to cover such contingencies, is further discouraged by the federal tax laws that may not permit deductions for contributions to such a fund.\(^{58} \)

Auto Company of course can argue that in this day of increased pressure for consumer protection, manufacturers and suppliers are more likely to produce quality goods if they are

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\(^{58} \) "Only a few reserves voluntarily established as a matter of conservative accounting are authorized by the Revenue Acts. . . . Many reserves set up by prudent businessmen are not allowable as deductions." Brown v. Helvering, 291 U.S. 193, 201-02 (1934). See A. KRAGAN & J. MCNULTY, FEDERAL INCOME TAXATION 729-35 (3d ed. 1979); W. ANDREWS, BASIC FEDERAL INCOME TAXATION 295-96 (2d ed. 1979). Accordingly, Heat Treater may not reduce its taxable earnings by reserves established to meet a recall contingency. Further, even if Heat Treater were able to accumulate reserves after taxes, these reserves arguably may be subject to attack as unreasonable accumulations under the federal accumulated earnings tax (the purpose of the act is to discourage nonpayment of dividends to avoid the income tax at the shareholder level on the receipt of dividends). I.R.C. §§ 531-37. See H. HENN, LAW OF CORPORATIONS, § 339 at 692 (2d ed. 1970).
held accountable for defective goods. This argument is refuted, however, by two facts. First, Heat Treater would have a legal liability to some extent; it would simply not extend to all the recall expenses. Secondly, Heat Treater must produce satisfactorily or lose Auto Company's future business. If it does most or all of its business with Auto Company, it would suffer disastrous economic consequences if it did not produce quality goods. Mere survival provides motive enough for high quality.

Auto Company might further argue that insurance to protect against a risk diminishes the incentive to be careful to avoid such risk. In those instances, however, where insurance companies are required to honor claims because of recalls, future premiums are likely to be significantly increased or coverage unattainable if the insurer’s losses are too high. Accordingly, this argument is without significant merit.

An argument in Heat Treater's favor is that economic ruin to Heat Treater hurts both Auto Company and the consumer. The premise is that Auto Company uses Heat Treater's goods or services because their quality is at least as high as Auto Company could produce itself and the cost is lower. If Auto Company recovers from Heat Treater the costs of a recall campaign, Heat Treater will probably be put out of business as a consequence of the large amount of money involved. Now, since no one can risk a venture that might entail losses of such magnitude, Auto Company itself undertakes the heat treating. The quality may or may not be as high; the costs are probably greater. When the next recall campaign occurs, Auto Company pays the cost since it has no supplier to proceed against. Nothing has been accomplished. The ultimate consumer receives no greater quality but must pay a higher price. The heat treater is

59. Concerning the effect of a strict foreseeability test on the consumer, Professor Nordstrom observes:

The difficulty with framing this question [of liability] in terms of foreseeability is that it *misdirects the attention of the legal system*. One of the bases for warranty liability is that it spreads the risk of non-conforming products among all users of that product.

The answer to this question [of liability] can probably be best found if the idea of foreseeability is ignored and attention is focused on the concept of risk-shifting, already discussed, and on the ultimate costs involved in making products safer. The immediate result of a finding of product liability may be the bankruptcy of concerns producing the product or a withdrawal of that product from the market, or both. That product may never be remarshaled (even though it benefited thousands of persons) just because the financial risks to the
put out of business even though its services were more than competitive in the market place.\textsuperscript{60}

E. Construing Laws in the Common Law Tradition

It has been shown that courts consider numerous factors that are totally unrelated to the concept of foreseeability in applying the rule of \textit{Hadley v. Baxendale}. This consideration of outside factors raises the following question: In arriving at its conclusion, is it proper for a court to consider factors \textit{not} taken account of in the formal rule of law being construed?

Some observers and courts might feel justified in holding that a seller is liable if he had reason to foresee the harm simply because it is the "rule." It should make no difference that the seller is not compensated for the risk, that a gross disparity exists between the compensation received by seller and the damages sought by buyer, and so on, since these factors are not included within the "rule." Such reasoning does not fully comprehend the traditional methodology of construing common-law rules like that of \textit{Hadley v. Baxendale}.

Common-law rules acquired their status as rules not because they were decreed by arbitrary judicial fiat, but because they were supported by sound reasoning. Therefore, according to Professor Llewellyn, precedent should be tested against three types of reasoning:

[First] [t]he reputation of the opinion-writing judge counts heavily (and it is right reason to listen carefully to the wise). Secondly, "principle" is consulted to check up on precedent, and at this period and in this way of work "principle" means no mere verbal tool for bringing large-scale order into the rules, it means a broad generalization which must yield patent sense as well as order, if it is to be "principle." Finally, "policy," in terms of prospective consequences of the rule under consideration, comes in for explicit examination by reason in a further test of both the rule in question and its application.\textsuperscript{61}

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\textsuperscript{60} Federal antitrust laws reflect in part a national policy discouraging the concentration of economic power. Allocating the risk of very large, uninsurable recall expenses to small economic units seems to run contrary to this policy. See Stone, \textit{infra} note 138, at 15-16 nn. 70-74.

\textsuperscript{61} K. Llewellyn, \textit{supra} note 51, at 36.
Thus in determining whether certain precedent should be applied in a given factual context, judges rightfully consider whether the reasoning that gave rise to the rule supports its application to the case at hand. Professor Llewelyn calls this the "Grand Style of the Common Law." Although this method of decision-making has seldom been expressed, it has been characteristic of common-law judging for years. To support this point Professor Llewellyn notes upon Justice Cardozo:

“What is new in juristic thought today,” was Cardozo’s final word almost thirty years ago, “is chiefly the candor of its processes. Much that was once unavowed and kept beneath the surface is now avowed and open. From time immemorial lawyers have felt the impulse to pare down the old rules when in conflict with the present needs. The difference is that even when they yielded to the impulse, it was their habit in greater measure than today to disguise what they were doing, to disguise the innovation even from themselves, and to announce in all sincerity that it was all as it had been before.”

This method of interpreting and applying common-law rules is also applicable even where the frozen language of a statute is involved. As Professor Llewellyn observes, “If a statute is to make sense, it must be read in a light of some assumed purpose. A statute merely declaring a rule, with no purpose or objective, is nonsense.” A court in applying a statutory rule will want to know if the facts in the case before it fall within the principle or

62. Id.
63. The proposition that legal rules can be understood only with reference to the purposes they serve would today scarcely be regarded as an exciting truth. The notion that law exists as a means to an end has been commonplace for at least half a century. There is, however, no justification for assuming, because this attitude has now achieved respectability, and even triteness, that it enjoys a pervasive application in practice. Certainly there are even today few legal treatises of which it may be said that that author has throughout clearly defined the purposes which his definitions and distinctions serve. We are still all too willing to embrace the conceit that it is possible to manipulate legal concepts without the orientation which comes from the simple inquiry: toward what end is this activity directed? Nietzsche’s observation, that the most common stupidity consists in forgetting what one is trying to do, retains a discomforting relevance to legal science.

In no field is this more true than in that of damages.

64. K. Llewellyn, supra note 51, at 266-67.
reason of the rule, i.e., the case before the court must satisfy not only the language of the statutory rule but also the reasons underlying the rule.

Professor Llewellyn's analysis of deciding appeals in the common-law tradition is significant for two reasons. First, his reputation and perceptive insight lend weight to his observations, and "it is right reason to listen carefully to the wise." Second, he was the Chief Reporter of the U.C.C., and his ideas about the proper construction of statutory materials have been embodied in the U.C.C. and its comments. His influence is particularly seen in section 1-102.66

Section 1-102. Purposes; Rules of Construction; Variation by Agreement.

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

Llewellyn's influence is also seen in comment 1 to Section 1-102, which states in part:

1. Subsections (1) and (2) are intended to make it clear that:

66. See also S. MENTSCHIKOFF, COMMERCIAL TRANSACTIONS 3-12 (1970).

[A problem] arises when the situation has changed in fact but seems to be one which on its face fits the factual preconditions of the rule. Now what do you do? What courts tend to do in that situation is to misconstrue the language of the rule in order to exclude the situation. They say that it is different, that it isn't really within the factual preconditions, although on any fair reading it is, because they want to escape the consequence. What the Code [in Comment 1 to U.C.C. § 1-102] did was to give specific authority to the court in that situation not to mishandle the language of the text, but to say this is a factual situation which is different in terms of its reason and therefore we will not apply the rule; we will limit the rule so that it excludes the situation. The court's opinion would then move in terms of why the factual situation before the court ought as a matter of policy and reason to be excluded even though it seems to fall within the language of the statute.

Id. at 11.

Professor Llewellyn, commenting on the drafting philosophy of the U.C.C., has also stated that "open-ended drafting, with room for courts to move into and readjust over the decades had been a basic piece of the planning." K. LLEWELLYN, supra note 51, at 183 n.186.
This act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.

The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

Under the methodology of the common-law tradition that also applies to statutory law according to Llewellyn, the critical question arises as to the "purpose and policy of the rule or principle in question." Clear expositions of the purposes or policies underlying Hadley v. Baxendale are surprisingly elusive. Professor Williston states the following about the policies underlying the "reason to foresee the harm" rule in Hadley:

The true reason why notice to the defendant of the plaintiff's special circumstances is important is because, just as the court of equity under circumstances of hardship arising after the formation of a contract may deny specific performance, so a court of law may deny damages for unusual consequences where the defendant was not aware when he entered into the contract how serious an injury would result from its breach. The defendant is charged with the apparent value of the performance that he promised, not with what ultimately proves to be its value.67

The Williston rationale can be applied to the situation of Heat Treater and Auto Company. Heat Treater is charged with the apparent value of the service or goods that it promised. It based the price for which it agreed to furnish the goods or service upon their apparent value. If it was reasonably apprised of the unusual consequential injury for which it would be accountable, such as recall expenditures, it might: (a) refuse to enter into such an agreement; (b) charge more for its performance to com-

67. 11 S. Williston, Contracts § 1357 at 295 (3d ed. 1968).
pensate it for the additional risk; (c) contract expressly with plaintiff (Auto Company) that it will not be accountable for such additional risk;\textsuperscript{68} or (d) contract anyway without charging more or limiting its liabilities by contract, but taking its chances that the injury will not occur. Accordingly, Auto Company will take the position that the policy underlying Hadley, according to Williston, is fulfilled if Heat Treater had reason to foresee the risk of the recall but voluntarily contracted. It is thus fairly charged with the apparent value of its performance including risks of recall. If it therefore wishes to take its chances that recall expenses will not arise, it should be able to do so.

Heat Treater would presumably respond to Auto Company's position that the "true reason" for requiring notice of special circumstances (the special circumstances in this instance being a recall campaign) is that a defendant may be "charged with the apparent value of the performance that he promised." Consequently, defendant would have an opportunity to choose among these alternatives: (a) refusing to contract, (b) charging more to compensate for the additional risk if it does contract, (c) contracting to limit the risk, or (d) contracting without charging more for the risk and electing to take its chances that recall expenses will not arise. What happens, however, if most of Heat Treater's business is with Auto Company? In light of the disparate bargaining power, Heat Treater really does not have a free choice whether to charge for the risk, to contractually limit its liability, or to refuse to sell.

Professor Havighurst stated the problem of unequal bargaining power this way:

The donkey who is offered the carrot has no real choice unless he is well-fed or has other means of nourishment available. If he is starving, he\textit{must} move when offered the carrot more surely than he is required to do so when threatened with the stick. This thought was expressed two hundred years ago by Lord Chancellor Northington—with reference to men, not donkeys—when he said that "necessitous men are not, truly speaking, free men."\textsuperscript{69}

Continuing its argument, Heat Treater concedes that it may be fair to charge defendant with the apparent value of its performance (including recall expenses if defendant has notice of plain-\textsuperscript{68}

\textsuperscript{68} See 190 U.S. at 545.
tiff’s special circumstances) where defendant has an actual choice between selling or not selling to a particular buyer. But, Heat Treater argues, it is not fair to so charge if it has no other realistic choice. Necessitous men may engage in imprudent commitments.

Moreover, Heat Treater will take a broader view of the policy underlying Hadley in the view expressed by Fuller and Perdue. They state:

The [Hadley] case may be said to stand for two propositions: (1) that it is not always wise to make the defaulting promisor pay for all the damage which follows as a consequence of his breach, and (2) that specifically the proper test for determining whether particular items of damage should be compensable is to inquire whether they should have been foreseen by the promisor at the time of the contract. The first aspect of the case is much more important than the second. . . . It declares in effect that just as it is wise to refuse enforcement altogether to some promises (considerationless, unaccepted, "social" promises, etc.) so it is wise not to go too far in enforcing those promises which are deemed worthy of legal sanction.

. . . . .

In its second aspect Hadley v. Baxendale may be regarded as giving a grossly simplified answer to the question which its first aspect presents. To the question, how far shall we go in charging to the defaulting promisor the consequences of his breach, it answers with what purports to be a single test, that of foreseeability. The simplicity and comprehensiveness of this test are largely a matter of illusion. . . . As in the case of all "reasonable man" standards there is an element of circularity about the test of foreseeability. "For what items of damage should the court hold the defaulting promisor? Those which he should as a reasonable man have foreseen. But what should he have foreseen as a reasonable man? Those items of damage for which the court feels he ought to pay." The test of foreseeability is therefore subject to manipulation by the simple device of defining the characteristics of the hypothetical man who is doing the foreseeing. By a gradual process of judicial inclusion and exclusion this "man" acquires a complex personality; we begin to know just what "he" can "foresee" in this and that situation, and we end, not with one test but with a whole set of tests. This has obviously happened in the law of negligence, and it is happening, although less obviously, to the reasonable
According to Fuller and Perdue, Heat Treater would advance this argument about the policy of Hadley: The test of foreseeability is a cover for a developing set of tests. The standard is "reason to foresee," which interjects the "reasonable man" concept. Consequently, the one test of foreseeability is in reality a whole set of tests directed toward resolving questions arising from the proposition "that it is not always wise to make the defaulting promisor pay for all the damage which follows as a consequence of his breach."\(^\text{71}\) Or, as Fuller and Perdue succinctly state: "[Hadley is] a compromise between no enforcement and complete but too onerous enforcement of the promise. . . . [T]he test of foreseeability is permitted to obscure the more fundamental implication of the case, which is that it is unwise to impose too onerous consequences on breach of contract."\(^\text{72}\)

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70. Fuller & Perdue, supra note 63, at 84, 85.

71. Id. at 84.

72. Id. at 87. Compare U.C.C. § 2-615 (Excuse by Failure of Presupposed Conditions), Comment 1, which states: "This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting." (Emphasis added) Further, note R. Nordstrom, Law of
The above argument portrays the foreseeability test as a cover for a set of underlying tests. But what is the set of tests that the "reasonable man" will apply in determining the wisdom of either allowing or disallowing plaintiff all the damages that follow as a consequence of defendant's breach? Clearly, the factors described earlier in this article provide the basis for this set of tests.

Heat Treater would refer at this point to Professor Llewellyn's tests for precedent which reflect the common-law (and U.C.C.) methodology that a "rule" such as Hadley applied to a particular fact situation must make good sense. In this situation it does not. On the one hand, although Heat Treater may have reason to foresee the recall, it has no real choice. If it wishes to stay in business, it must sell to Auto Company and forgo adding the risk of recall expenditures to its price. This course is the only one open to it, even though damages sustained in a recall, if recovered against it, may well put it out of business. On the other hand, Auto Company can spread the risk of recall expenditures among its customers. The Hadley principle of "compromise between no enforcement and complete but too onerous enforcement of the promise"\(^7\) of defendant is fulfilled by allowing Auto Company to recover ordinary damages (e.g., the difference between the value of goods or services as warranted and the value as they actually are) but not special damages covering expenses of the recall campaign.

A rule disallowing Auto Company all damages in the circumstances described above, even though those circumstances may have been foreseen by Heat Treater, is within the methodology of the common law (and the U.C.C.), wherein "rules" are adapted to meet new circumstances that were unforeseen when the rule was first promulgated.

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Sales § 107 (1970), which states that:

The Code contains three sections [including § 2-615] which state general principles relieving the seller from full performance of his contractual obligations. They can be rationalized within the law of contracts in several ways. They can be explained under the language of excuse, impossibility, impracticability, or even implied promise or condition. The most accurate way, however, to explain these sections is to consider the risks which the parties shifted by their agreement. (Emphasis added)

73. Fuller & Purdue, supra note 63, at 87.
IV. RECENT DEVELOPMENTS

A. Forecasting Results of Litigation

The preceding section has identified and examined the factors that courts will undoubtedly consider in product recall cases. Although there has been a dearth of case authority concerning this recall-expenditures-as-consequential-damages issue, the case authority that does exist and the comments by leading scholars indicate a sufficiently clear pattern to permit forecasting the results of future product recall cases. Aside from the question of foreseeability of harm, Heat Treater likely will not have a legal obligation to Auto Company for expenditures involved in a recall campaign in the following circumstances:

1. Heat Treater is not compensated for the risk; the greater the compensation, the greater the likelihood of liability.
2. A gross disparity exists between the compensation received by Heat Treater and the damages sought by Auto Company. The smaller the disparity, the greater the likelihood of liability.
3. The defect giving rise to the recall occurred even though Heat Treater was not at fault. The relative difficulty of avoiding defects is a factor in determining fault. The greater the degree of fault, the greater the likelihood of liability.
4. Auto Company wields the principal bargaining power. Since it uses a form contract and chooses the language of the contract, it could have clarified the ambiguity concerning recall damages. Consequently, in the absence of such clarification, Auto Company is likely to bear the risk of recall expenditures.
5. Auto Company is in the best position to bear the risk of the recall expenditures if:
   (a) Heat Treater is an economically small unit;
   (b) Heat Treater does all or most of its business with Auto Company;
   (c) Heat Treater's potential liability for recall costs is not subject to any degree of calculation that would permit it to obtain insurance or set aside a reserve fund that would be recognized for tax purposes;
   (d) The potential liability to Heat Treater is so great that imposing such liability upon it would probably spell economic disaster; and
   (e) Auto Company can spread the costs of the recall among its automobile purchasers. The greater the size of Heat Treater as an economic unit, the less is its dependence on Auto Company for its survival, and the greater is the likelihood of its liability. A decrease in
Heat Treater's dependence on Auto Company would strengthen the argument that it is in a position economically to bear the risk of the recall.

Subsequent to the original study, some developments have occurred that validate these factors. Three cases involving recovery of consequential damages for product recall expenditures have been decided. Two of the cases involved government contracts; the other involved a regular commercial contract. In addition, section 351 of Restatement (Second) of Contracts, entitled "Unforeseeability and Related Limitations in Damages," has been promulgated by the American Law Institute.

B. The Aerodex and Franklin Cases

In United States v. Aerodex, Inc.,74 Aerodex contracted to sell to the United States Department of the Navy 300 new, unused master rod bearings, part number 171815 at a cost of $90 each, totaling $27,000. The bearings supplied by Aerodex to the Navy were not part number 171815 but part numbers 117971 and 117971Y10, which had been reworked by Aerodex. The reworked bearings were received and accepted by the Navy without the "100% final inspection" required by the contract. A number of them were installed in aircraft engines. When the Navy discovered that the bearings were not the ones contracted for, it removed and replaced those that had been installed at a cost of $160,919.75

The district court held that Aerodex was liable under the Federal False Claims Act.76 The Fifth Circuit affirmed, holding that the deliberate mislabeling, coupled with the fact that the delivered parts did not actually meet the specifications of the contract, compelled a finding of liability under the Act. Furthermore, the court stated that the government's failure to inspect did not insulate Aerodex from liability for its own fraud.77 The measure of damages under the False Claims Act was twice the purchase price of $27,000 plus $6,000 in penalties.78

With regard to the recovery of the $160,919 cost of the "retrofit" operation as consequential damages, the court ruled that

74. 469 F.2d 1003 (5th Cir. 1972).
75. Id. at 1006.
77. 469 F.2d at 1010.
78. Id. at 1011.
Aerodex was liable for breach of warranty unless it could establish an adequate defense.\textsuperscript{79} Aerodex's main defense was that the government's failure to conduct the "100\% final inspection" precluded it from any remedy for the breach of warranty. The court responded:

These arguments are irrelevant because the breached warranty was an express one. Aerodex expressly warranted that the delivered bearings were of a specific serial number, when in truth they were not. . . . The government was therefore entitled to rely solely upon Aerodex's express warranty describing the bearings, and its failure to inspect the delivered bearings is of no legal consequence.\textsuperscript{80}

The court entered judgment of $160,919 for consequential damages in addition to the $60,000 award under the False Claims Act.\textsuperscript{81}

Nowhere in its opinion did the court of appeals cite authority for its decision to award consequential damages. The district court, however, had noted that

\[\text{the costs incurred by the United States in the recall and retrofit of engines in which discrepant bearings had been installed were a direct and natural consequence of the deception practiced by the defendants.}\]\textsuperscript{83}

Although the district court did not give authority for its statement, its emphasized language is \textit{Hadley v. Baxendale} phraseology. The court apparently followed the common law (and U.C.C.) rule of reason to know or foresee.

In a second case, \textit{United States v. Franklin Steel Products, Inc.},\textsuperscript{83} the district court faced facts strikingly similar to those of Aerodex. Franklin Steel contracted to deliver to the Navy new engine rod bearings, part number 171815, but instead delivered reworked bearings that did not conform to specifications. Al-

\begin{itemize}
  \item \textsuperscript{79} \textit{Id.}
  \item \textsuperscript{80} \textit{Id.} at 1012. One of Aerodex's supporting arguments was that the damages were not foreseeable (\textit{Hadley v. Baxendale}) since Aerodex could not have known that the government would not make the required inspections. In other words, Aerodex argued that the government should be liable for not protecting itself from Aerodex's own fraud. The argument is audacious at best. The law does not encourage fraudulence; a fraud cannot hide behind the argument that another could have discovered the fraud had he only been more careful.
  \item \textsuperscript{81} \textit{Id.} at 1013.
  \item \textsuperscript{82} \textit{United States v. Aerodex, Inc.}, 327 F. Supp. 1027, 1031 (S.D. Fla. 1970) (emphasis added).
  \item \textsuperscript{83} 482 F.2d 400 (9th Cir.), \textit{cert. denied}, 415 U.S. 918 (1973).
\end{itemize}
though the Navy was obligated under the contract to inspect the bearings before installation, it failed to do so. The defect was discovered after installation. Because of the "enormity of the hazard" to its pilots, the Navy refitted the engines with new bearings at a cost of $147,060.84

The district court held that Franklin was not liable on the ground that the Navy's duty to inspect superseded Franklin's warranty provisions.85 The Ninth Circuit reversed. The court stated, quoting from the contract, that even if the government had an obligation to inspect, "inspection and subsequent acceptance are not conclusive 'as regards latent defects, fraud, or such gross mistakes as to amount to fraud.'"86 The court concluded:

Finally, we must decide the measure of damages awardable to the government. The main issue presented is whether in addition to the contract price paid for the discrepant bearings ($28,890) the government may recover consequential damages for the retrofit operation ($147,060). In Aerodex, supra the government was permitted to recover both such damages. While in Aerodex, the court held that the contractor was also liable for fraud, for purposes of damages, that factor does not differentiate our case from Aerodex since the contracts here treat breaches involving fraud and latent defects alike.

We agree again with Aerodex in holding that Franklin is liable for all damages which are the direct and proximate result of the breach of warranty.87

84. Id. at 402-03.
85. Id. at 403.
86. Id. Footnote 3 in the court's opinion states:
The facts of the case suggest that the government could have charged the contractor with fraud or gross mistakes as to amount to fraud in light of the counterfeit nature of the bearings. See United States v. Aerodex, supra. However, since the government did not argue this theory, we do not consider it on this appeal.

Id. Footnote 4 then states:
Simple, inexpensive, nondestructive tests exist by which the government could have discovered these deficiencies, but such tests were not specified in the contract. The government had every right to rely on Franklin's express warranty that the bearings would conform to the specifications. . . . While the government may have been "contributorily negligent" in not conducting a more thorough inspection, that is not a defense to a breach of warranty claim. Brown v. Chapman, 304 F.2d 149 (9th Cir. 1962).

87. Id. at 404, 405. The language of this sentence is traditional common law liability for consequential damages as spelled out in RESTATEMENT, CONTRACTS § 330 (1932) and U.C.C. § 2-715(2)(a). Point Adams Packing Co. v. Astoria Marine Construction Co., 594 F.2d 763 (9th Cir. 1979) states in part: "[T]he decision in Franklin Steel was apparently
C. Commentary on Aerodex and Franklin

These two cases present the same issues. The only distinction between them is that the contractor in Aerodex was also held liable for fraud. In both cases the government recovered the costs of the recall as consequential damages. Both cases provide little or no discussion of why the defendants had reason to foresee the product recall. This lack of explanation is not unusual in consequential damages cases. The factors discussed in Part III of this article may be relevant in forecasting the results of litigation concerning the Hadley rule.

In Aerodex the defendant received $27,000 for the sale of the bearings and suffered consequential damages for the recall amounting to $160,919.18. Consequential damages were 5.96 times the compensation received by Aerodex. In Franklin the defendant received $28,890 for the sale of the bearings and suffered consequential damages for the recall amounting to $147,060. Consequential damages were 5.09 times the compensation received by Franklin.

In Aerodex the breach was willful and Aerodex was held liable for fraud under the False Claims Act. In Franklin the "facts of the case suggest[ed] that the government could have charged the contractor with fraud or gross mistakes as amount to fraud in light of the counterfeit nature of the bearings." In both Aerodex and Franklin, the ratio of consequential damages sought to compensation received was between five and six to one. The respective courts apparently did not believe this to be a gross differential, especially in light of the willfulness of the fraudulent breaches. In addition, the courts recognized that a failure of the bearing would have led to engine failure and endangered both the aircraft and pilots. In short, one who knowingly contracts to deliver nonconforming bearings to the government for the purpose of obtaining excessive profits, thereby imperiling aircraft, military personnel and even the nation's security, will be adjudged to have reasonably foreseen a wide scope of consequential damages.

not controlled by the U.C.C. as this case is." Id. at 766 n.4.

88. 482 F.2d at 403 n.2.
90. 482 F.2d at 403 n.2.
D. The Chris-Craft Case

Taylor & Gaskin, Inc. v. Chris-Craft Industries, Inc. 92 is presumably the first reported case to address the questions raised by the Heat Treater and Auto Company hypothetical. 93 In Chris-Craft the buyer (Chris-Craft), using its purchase order form, ordered gas tanks from the seller (Taylor & Gaskin) for its inboard pleasure cruiser, the MXA-25 Express Cruiser. The tanks were to be finished with "epoxy coating inside, paint red outside." 94 The purchase order was accompanied by a print that changed the design of the tank to require the addition of two mounting brackets, or "chocks." The print gave no directions with respect to the method of paint application, but the buyer did specify the type of tank finish to be used. 95 Seller shipped the gas tanks and buyer installed them in its pleasure cruisers. Buyer subsequently received complaints of rusting tanks. It notified seller of these complaints and suggested to seller a joint recall campaign. 96 Seller replied that any responsibility for tank problems was solely attributable to buyer. Buyer initiated a recall campaign and all but 160 of 550 tanks were replaced with hot-dipped galvanized tanks. 97 Buyer then sought to recover

92. No. 75-71030 (E.D. Mich., Jan. 31, 1980). Aerodex and Franklin are government contract cases involving a recall by the ultimate consumer. Chris-Craft is a regular commercial contract case where the manufacturer of the end product recalls and seeks recovery from its supplier.

93. See Part II supra.

94. "While Chris-Craft had utilized painted steel tanks in diesel boats prior to 1972, it had never purchased a painted steel gasoline tank." [Finding of Fact No. 4.] "Both Mr. Densmore [of Chris-Craft] and Mr. Wilkins [of Taylor & Gaskin] were aware that certain manufacturers were using an epoxy-coated slush compound tank. Chris-Craft had never purchased such a tank and Taylor & Gaskin had never manufactured a tank of this type." [Finding of Fact No. 11.] No. 75-71030, slip op. at 3, 4.

95. It should be noted that seller had previously quoted a price for hot-dipped galvanized tanks. Buyer inquired whether it was possible to obtain a lower cost and was told that ten dollars per tank could be saved by the epoxy coating inside and red paint outside. Such a tank received the approval of the Boating Industry Association on the basis that the tanks were to be covered with 1½ mils of paint and would therefore be "equivalent" to the hot-dipped galvanized tanks. Neither the Boating Industry Association nor buyer or seller performed corrosion tests on the painted tanks. Seller privately questioned the ability of the tanks to resist corrosion but did not communicate its misgivings to buyer. Subsequently, the Boating Industry Association deleted all painted steel tanks from its accepted type list and required that all steel tanks be hot-dipped galvanized.

96. Finding of Fact No. 31D, No. 75-71030, slip op. at 7.

97. The Federal Boat Safety Act of 1971 states:

§ 1464. Repair or replacement of defects; Notification by manufacturer;

Time limitation
damages from seller, including those damages attributable to the recall campaign.

The district court concluded that the contract contained both an express warranty and an implied warranty of merchantability. But seller maintained that it had complied with buyer's specifications. It painted the tanks red in accordance with the Boating Industry Association's requirement that the tanks be covered with 1½ mils of paint. Buyer responded that the principal breach by seller was the failure to apply more than one coat of paint, which created gaps in the paint surface. The gaps caused a greater vulnerability to penetration of the paint and consequent rusting within two months of installation. The court concluded:

The testimony of [Buyer's] expert . . . established that the tank would begin rusting at one to two months and would rust through in two years. Such evidence is sufficient to prove that the tanks were not merchantable at the time they left the control of the manufacturer, that is that they were not fit for the ordinary purpose of holding fuel in a marine environment,

(a) Every manufacturer who discovers or acquires information which he determines, in the exercise of reasonable and prudent judgment, indicates that a boat or associated equipment subject to an applicable standard or regulation prescribed pursuant to section 1454 of this title either fails to comply with such standard or regulation, or contains a defect which creates a substantial risk of personal injury to the public, shall, if such boat or associated equipment has left the place of manufacture, furnish notification of such defect or failure of compliance as provided in subsections (b) and (c) of this section, within a reasonable time after the manufacturer has discovered the defect: Provided, That the manufacturer's duty of notification under subsection (b)(1) and subsection (b)(2) of this section applies only to defects or failures of compliance discovered by the manufacturer within one of the following periods, as appropriate:

(1) in the case of a boat or associated equipment required by regulation to have a date of certification affixed, five years from date of certification, or
(2) in the case of a boat or associated equipment not required by regulation to have a date of certification affixed, five years from date of manufacture.

. . . .

(c) . . . The notification required by subsection (a) of this section shall contain a clear description of such defect or failure to comply, an evaluation of the hazard reasonably related thereto, a statement of the measures to be taken to correct such defect or failure to comply, and an undertaking by the manufacturer to take such measures at his sole cost and expense.


Buyer further contended that seller was negligent in the design, construction, or selection of materials used in the tanks or that it had failed to properly test the materials selected for use. In agreement with buyer's argument, the court noted that seller had used only one coat of paint even though it was aware of the tanks' susceptibility to rust. Furthermore, seller had neither discussed with the buyer its apprehensions about the tanks' possible failure nor performed any corrosion resistance tests. The court concluded:

The failure of [seller] to test for corrosion, to warn of a foreseeable failure and/or to take steps in the manufacturing process to reduce susceptibility consistent with the specifications, that is by two coats of paint, all may be said to be negligence in the manufacture of the tank.\textsuperscript{100}

The court rejected seller's argument that buyer could not recover because of contributory negligence, reasoning that "[buyer] need not establish that [seller's] negligence was the sole proximate cause of its injury."\textsuperscript{101} The court awarded buyer $25,114.58, the amount apparently paid for the tanks.\textsuperscript{102}

The court dealt at some length with the issue of recovery of recall expenditures as consequential damages. Since this is the first judicial utterance concerning this matter, it is recited essentially verbatim as follows:

Several considerations support the conclusion that [buyer] may not recover as consequential damages the cost of replacement of the subject tanks and other costs incident to the recall.

First, [buyer] has failed to present any evidence that the costs of recall were within the reasonable contemplation of the parties, either by applicable industry regulations or trade practice and custom, see generally B. Stone, \textit{Product Recall and Consequential Damages}, (1971).\textsuperscript{103}

Thus, the evidence does not establish that total replacement was reasonably within the contemplation of the parties at the time of contracting.

[Buyer] selected the painted exterior for competitive reasons and chose to install the tank where it would be vulnerable

\textsuperscript{99} Id. at 22.
\textsuperscript{100} Id. at 22-23.
\textsuperscript{101} Id. at 23.
\textsuperscript{102} Id. at 24. See generally U.C.C. § 2-714(2).
\textsuperscript{103} This article is a condensation and update of the cited report. See note 3 supra.
to bilge water. Although aware of the susceptibility to corrosion of painted surfaces and in possession of the prototype tank, [buyer] failed to perform corrosion tests and apparently failed to test the tank in the prototype boat. Having done so, [buyer] cannot now be permitted to transfer the costs incident to its experimentation by a claim that the buyer at the time of entering into the contract “communicated sufficient facts to make it apparent that the damages subsequently claimed were within the reasonable contemplation of the parties. . . .”

Similarly, analyzed in terms of [seller’s] negligence, [buyer] should not be permitted to recover for those damages not proximately caused by [seller’s] negligence or caused by [buyer’s] own negligence or fault. . . .

Section 2-715(2)(b) [of the U.C.C.] requires that recoverable consequential damages are limited to losses “proximately resulting” from the breach of warranty.104

While I have credited the testimony that the tanks would have failed at two years, the evidence shows that rusting is also attributed to faulty installation, design of the support chocks and location of the tanks in the boat. The evidence does not establish that removal and replacement of all 550 tanks was “proximately caused” by [seller’s] breach.105

. . . . . . .

. . . . [After examining the evidence,] I cannot conclude that the breach proximately caused the necessity to recall and replace all the tanks and the costs incidental thereto. Moreover, nothing in the contract itself indicates that the parties contemplated that [seller] bear the risk of such damages. . . .

[Buyer] chose the words of the warranty, and had it wished to spell out that the risk of recall would be borne by [seller], it could have done so.106 As between the two parties,

104. It is submitted that recall of defective components involves economic loss and that the test is not proximate causation but rather “reason to foresee.” Compare U.C.C. § 2-715(2)(a) with id. § 2-715 (2)(b).

105. Not only must there be an appropriate causal relationship between a defective product and a product recall, the buyer has a duty to mitigate losses. For example, U.C.C. § 2-715 (2)(a) allows a recovery for foreseeable consequential damages for “any loss resulting from general or particular requirements and needs . . . which could not reasonably be prevented by cover or otherwise.”

106. Although “spelling out the risk” is suggested by Judge Boyle as the solution, this may lead to other problems. Courts often strike down provisions allocating risk as unclear, even though the risks were very clearly spelled out. In this regard, Llewellyn has stated:

We have all of us seen this kind of series of cases, haven’t we? Case No. 1 comes up. The clause is perfectly clear and the court said “Had it been desired to provide such an unbelievable thing, surely language could have been made clearer.” The counsel redrafts, and they not only say it twice as well, but they
[buyer] was in a stronger bargaining position and opted for production of an untried and cheaper tank, a risk which they now seek to transfer in toto to [seller] although they did not make [seller] aware of their particular requirements for use of the tank.

. . . .

Accordingly, I conclude that this is not a "proper case" for the imposition of incidental and consequential damages attendant to the recall.\textsuperscript{107}

\textbf{E. Commentary on Chris-Craft}

Unlike the plaintiffs in \textit{Aerodex} and \textit{Franklin}, Chris-Craft did not recover costs of the recall. The reason for the difference in outcomes is tied to one main factual distinction. Although Taylor \& Gaskin (seller) breached warranties and was even negligent, it was not dealing in a fraudulent manner as were the sellers in \textit{Aerodex} and \textit{Franklin}. Except for this difference, the other facts are quite similar. For example, the disparity between compensation received for the sale of goods and consequential damages sought was nearly the same in all three cases. In \textit{Aerodex} and \textit{Franklin} the ratio was between five and six to one, and in \textit{Chris-Craft} it was 6.84 to one.\textsuperscript{108}

\footnotesize{wind up saying, "And we mean it," and the court looks at it a second time and says, "Had this been the kind of thing really intended to go into an agreement, surely language could have been found," and so on down the line.}

\textsuperscript{1} N.Y. \textsc{Law Revision Commission} \textsc{Report} 177-78 (1954). Llewellyn made the statement in the context of unconscionable clauses, implying that the \textit{real} reason for the rejection was unconscionability. Basic contract law recognizes this problem in the rule that a term in a standardized agreement will not be enforced if the adversely affected party would not have entered into the contract had it known of the term. See \textsc{Restatement (Second) of Contracts} § 211 (1981) on standardized agreements.

\textsuperscript{107} No. 75-71060, slip op. at 27-29 (citations omitted).

\textsuperscript{108} Compensation received by Taylor \& Gaskin for the tanks amounted to $25,114.58; recall expenditures incurred by Chris-Craft, as set out in its trial brief, were:

\begin{itemize}
\item \textbf{B.} Cost of replacement fuel tanks \hspace{1cm} $56,477.50
\item \textbf{C.} Cost of replacement kits used by dealers to install the replacement tanks. \hspace{1cm} 4,306.61
\item \textbf{D.} Freight charges:
\begin{itemize}
\item 1. Drake to Chris-Craft \hspace{1cm} 1,690.93
\item 2. Chris-Craft to dealers \hspace{1cm} 6,858.54
\end{itemize}
\item \textbf{E.} Warranty claims from dealers for labor in replacing tanks. \hspace{1cm} 71,388.68
\item \textbf{F.} Incidental expenses in connection with examination, inspection and recall of tanks. \hspace{1cm} 6,000.00
\item \textbf{G.} Overhead expenses. \hspace{1cm} 25,000.00
\end{itemize}

\textbf{Total} \hspace{1cm} $171,722.26
In *Chris-Craft* the court found that buyer "failed to present any evidence that the costs of recall were in the reasonable contemplation of the parties." Yet, the court could just as well have found that seller knew that the tanks would rust and that a rusting tank with even a pinhole break could cause fumes to escape and result in an explosion. Consequently, such a safety-related defect would foreseeably trigger a recall as the probable result of the breach. The court also noted that buyer was in a superior bargaining position and "had it wished to spell out that the risk of recall would be borne by Taylor & Gaskin, it could have done so." "[N]othing in the contract itself indicates that the parties contemplated that Taylor & Gaskin bear the risk of such damages." Ostensibly for lack of contemplation the court would not award consequential damages.

Another issue mentioned by the court, which relates to its refusal to award consequential damages, was causation. The court observed that rusting was in part attributable to faulty installation, inferior design of the support chocks, and improper location of the tanks in the boat. It further noted that although buyer was aware of the susceptibility of painted surfaces to corrosion, buyer (as did seller) failed to perform corrosion tests.

What was apparently bothering the court in this opinion was the perception that buyer, for competitive reasons, unnecessarily cut a corner on a safety-related item to save ten dollars and then wanted seller to pay for the whole loss. The court reasoned:

As between the two parties, Chris-Craft was in a stronger bargaining position and opted for production of an untried and cheaper tank, a risk which they now seek to transfer in toto to Taylor & Gaskin although they did not make Taylor & Gaskin aware of their particular requirements for use of the tank.

... In short, it cannot fairly be said that a reasonable person would have contemplated at the time of contracting that the *entire* result of a recall campaign would ultimately be

109. No. 75-71030, slip op. at 27.
111. No. 75-71030, slip op. at 29.
112. *Id.*
113. In forecasting the likely outcome of a case, Professor Llewellyn has suggested that a lawyer shift his focus from what was held in a series of opinions—to be relied upon as precedent—"to what those opinions suggest or show about what was bothering and what was helping the court as it decided." *K. LLEWELLYN, supra* note 51, at 178.
borne by the manufacturer . . . .114

If the court was faced with an all or nothing choice of who would bear the expense of the recall, the Chris-Craft result seems reasonable when judged by the factors articulated earlier. Even though seller was negligent, buyer's conduct was not beyond reproach. Also, the disparity between compensation received by seller and the costs of the recall, although not grossly disproportionate, were nevertheless considerable.115 Buyer could have indicated in its purchase order who would bear the recall expenses, but it did not. And the causal link between the defective tanks and the recall is not absolute (e.g., there may have been faulty installation).

The court asserted that buyer's contributory negligence "is not a bar to recovery since, if the manufacturer's breach of duty was a proximate cause of the injury, both Michigan and Florida law allow recovery of that proportion of damages attributable to the breach. Jorae v. Clinton Crop Service, 465 F. Supp. 952 (E.D. Mich. 1979), Hoffman v. Jones, 280 So.2d 431 (1973)."116 Jorae applied the Michigan comparative negligence statute which will be discussed later.117 The court never really explained the significance of this proposition. Perhaps the allocation alluded to was entailed in their holding that Taylor & Gaskin be liable for direct damages ($25,114.58) and that Chris-Craft be liable for consequential damages ($171,722.26).118

F. Restatement (Second) of Contracts Section 351

The new Restatement (Second) of Contracts section 351 entitled "Unforeseeability and Related Limitations on Damages," constitutes a significant development in the law of consequential damages.119 Subsections (1) and (2) essentially reiterate the Hadley v. Baxendale rule.120 Subsection (3), however, is new and

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114. No. 75-71030, slip op. at 29 (emphasis added).
115. Further, there was no indication in the case that seller was compensated for assuming the risk of a product recall. It is surmised that seller was not so compensated.
116. No. 75-710030, slip op. at 23.
117. See note 132 and accompanying text infra.
118. With the promulgation of Restatement (Second) of Contracts section 351 and comment f, to be discussed at Part III F infra, it is suggested that courts will now be encouraged to view allocation of risk between seller and buyer as another solution to these matters.
120. Restatement (Second) of Contracts § 351(1) and (2) (1981) state:
A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.\textsuperscript{181}

1. Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.

2. Loss may be foreseeable as a probable result of a breach because it follows from the breach
   (a) in the ordinary course of events, or
   (b) as a result of special circumstances, beyond the ordinary course of events that the party in breach had reason to know.

The Reporter's Note to these subsections states, "Subsections (1) and (2) are based on former § 330, with changes in language to conform to the language of Uniform Commercial Code §§ 2-714(1) and 2-715(2)(a)." See U.C.C. § 2-715, Comment 1.

121. RESTATEMENT (SECOND) OF CONTRACTS § 351(3) (1981). Comment f to section 351 states:

Other limitations on damages. It is not always in the interest of justice to require the party in breach to pay damages for all of the foreseeable loss that he has caused. There are unusual instances in which it appears from the circumstances either that the parties assumed that one of them would not bear the risk of a particular loss or that, although there was no such assumption, it would be unjust to put the risk on that party. One such circumstance is an extreme disproportion between the loss and the price charged by the party whose liability for that loss is in question. The fact that the price is relatively small suggests that it was not intended to cover the risk of such liability. Another such circumstance is an informality of dealing, including the absence of a detailed written contract, which indicates that there was no careful attempt to allocate all of the risks. The fact that the parties did not attempt to delineate with precision all of the risks justifies a court in attempting to allocate them fairly. The limitations dealt with in this Section are more likely to be imposed in connection with contracts that do not arise in a commercial setting. Typical examples of limitations imposed on damages under this discretionary power involve the denial of recovery for loss of profits and the restriction of damages to loss incurred in reliance on the contract. Sometimes these limits are covertly imposed, by means of an especially demanding requirement of foreseeability or of certainty. The rule stated in this Section recognizes that what is done in such cases is the imposition of a limitation in the interests of justice.

This comment is followed by two illustrations which involve goods:

Illustrations:

17. A, a private trucker, contracts with B to deliver to B's factory a machine that has just been repaired and without which B's factory, as A knows, cannot reopen. Delivery is delayed because A's truck breaks down. In an action by B against A for breach of contract the court may, after taking into consideration such factors as the absence of an elaborate written contract and the extreme disproportion between B's loss of profits during the delay and the price of the trucker's services, exclude recovery for loss of profits.

18. A, a retail hardware dealer, contracts to sell B an inexpensive lighting attachment, which, as A knows, B needs in order to use his tractor at night on
This new subsection should produce a beneficial effect because it allows a court to formally consider factors aside from foreseeability in determining the recovery of consequential damages. No longer should courts hesitate because of the especially demanding requirement of foreseeability, to articulate the factors that actually guide them. Courts should be encouraged to express their reasons for allowing or disallowing recovery for consequential damages. The enunciation of those factors actually forming the basis of decisions will advance the quest for greater predictability in the law of consequential damages.

Comment f to Restatement section 351 points out two factors that may preclude a plaintiff from recovering foreseeable consequential damages. The first factor is extreme disproportion between the consequential loss and the price charged (an aspect of the idea that defendant be compensated for the risk). The following analysis of Professor Farnsworth, the Reporter for Restatement (Second) of Contracts:

A . . . solution [to the problem of determining liability for consequential damages] would be to preserve the test of foreseeability as the outer limit of liability in contract, but to recognize a judicial prerogative to further reduce that liability in the light of a convincing showing that although the consequences were foreseen, or at least foreseeable, the risk was not assumed by the promisor . . . . Factors that might be influential in rebutting such a showing would include the ease with which the promisor, such as a carrier or telegraph company, might have included an express limitation if it had chosen to do so, and the intentional or willful character of the breach. . . . In any event, the solution suggested here would have the dual advantage that judicial departure from the traditional test of foreseeability would be exceptional, to be made only on an affirmative showing of appropriate circumstances, and that it would be done overtly without reliance on fiction.

Farnsworth, Legal Remedies for Breach of Contract, 70 COLUM. L. REV. 1145, 1209-10 (1970) (footnotes omitted). Note that the solution Professor Farnsworth suggested in his capacity as a law review commentator was incorporated into Restatement (Second) of Contracts § 351 by Farnsworth in his capacity as Reporter for the Restatement.
second is informality of dealing (including the absence of a detailed written contract), which reflects the absence of a careful attempt to allocate the risk. These factors parallel many of those set out earlier in this article.

Comment f also states, "The fact that the parties did not attempt to delineate with precision all of the risks justifies a court in attempting to allocate them fairly." To this point it has been assumed that either plaintiff or defendant will bear all the consequential damages, but justice may require an allocation. Webster defines allocate to mean:

[T]o distribute or to divide and distribute according to relative contribution to an objective whether on an equal, proportional, or judiciously calculated basis. . . . [T]o apportion and distribute (as costs or revenues) among accounts according to some predetermined ratio or agreed measure of involvement (as degree of responsibility or benefit received.) Accordingly, justice may require, in accordance with subsection (3) of section 351, that the risk be apportioned in some manner between plaintiff and defendant. Professor Farnsworth suggests this possibility:

In an appropriate case, it is conceivable that a court might even tailor recovery so as to split the risk between the two parties and meet the objection of one commentator that the traditional rule "usually permits only all-or-nothing recovery." Courts, however, are often reluctant to allocate a risk between the litigants. Legislative bodies, it is asserted, are better equipped to handle such matters. In response to these percep-

126. Restatement (Second) of Contracts § 351, Comment f (1981).
127. Id.
129. Farnsworth, supra note 125, at 1209-10. See also Comment, Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery, 65 Yale L.J. 992, 1020 (1956); Note, The Right to Indemnity in Products Liability Cases, 1964 U. Ill. L.F. 614, which states in part:

It might be fairer, therefore, [in products liability cases] to permit contribution between sellers who have both been found negligent toward third parties. By a distribution of half the loss to each, or even by a distribution of loss in comparison to relative volumes of business, the loss could be more equitably shared by the sellers whose liability has already been established. This argument would be particularly persuasive where the retailer is operating a much larger concern than his manufacturer.

Id. at 630-31.
tions the case of *Placek v. City of Sterling Heights*\(^{130}\) is instructive. In *Placek* the state of Michigan judicially adopted the doctrine of comparative negligence. The Michigan Supreme Court discussed whether a judicial forum is the proper forum in which to adopt the doctrine of comparative negligence. In its discussion the court rebutted the three arguments against judicially-created comparative negligence. The first argument is that the legislature is better equipped to gather facts, understand the nature of the problem, and arrive at a solution. The rebuttal to this argument is that courts have the same access to facts as legislatures, that they are particularly sensitive to contributory negligence problems, and that they have much experience in judicially-created solutions. In the area of comparative negligence, courts are better equipped than legislatures to provide solutions because "this is preeminently lawyer's law."\(^{131}\)

The second argument is that the legislature possesses superior ability to enact changes while simultaneously anticipating and resolving numerous details and collateral issues. The response is that (a) most comparative negligence statutes are general in nature and leave courts to resolve the details anyway,\(^{132}\) and (b) a judicially-fashioned rule can anticipate important questions and resolve them in advance, thus avoiding the need for future litigation.\(^{133}\)

Third, it can be argued that legislative reform affords affected parties time to prepare for the change of law, which may include obtaining insurance or adjusting costs. The rebuttal is

\(^{130}\) 405 Mich. 638, 275 N.W.2d 511 (1979).

\(^{131}\) Id. at 657-59, 275 N.W.2d at 517-18 (citations omitted) (quoting Fleming, *Forward: Comparative Negligence at Last—By Judicial Choice*, 64 CALIF. L. REV. 239, 279-80, 281 (1976)).

\(^{132}\) For example, Michigan recently enacted a statute dealing with products liability actions that states:

In all products liability actions brought to recover damages resulting from death or injury to person or property, the fact that the plaintiff may have been guilty of contributory negligence shall not bar a recovery by the plaintiff or the plaintiff's legal representatives, but damages sustained by the plaintiff shall be diminished in proportion to the amount of negligence attributed to the plaintiff.

**MICH. COMP. LAWS ANN. § 600.2949(1) (1978).** It should be noted that not only are comparative negligence statutes in the briefest conceivable form, so is the U.C.C. consequential damages provision. See U.C.C. § 2-715(2)(a). This strengthens the argument for a judicially-created rule in both comparative negligence and consequential damages.

\(^{133}\) Admittedly, anticipation of future problems is limited by the rule that courts cannot render advisory opinions. Yet a judicially-fashioned rule could take many potential problems into account without violating this limitation.
that courts "long ago [broke] with the Blackstonian fiction that judicial decisions must necessarily be retroactive in operation."\textsuperscript{134}

Like comparative negligence, recovery of consequential damages is also "lawyer's law." A court, accordingly, would be acting appropriately in allocating recall expenditures between the parties "if it concludes that in the circumstances justice so requires."\textsuperscript{135}

But what factors should be used in determining the allocation of risk between parties, especially in the product recall situation? A starting point may be to reiterate one of Webster's definitions of allocate: "to apportion and distribute (as costs or revenues) among accounts according to some predetermined ratio or agreed measure of involvement (as degree of responsibility or benefit received)."\textsuperscript{136}

Some relevant factors to be considered include (1) the relative degree of fault, if any, attributable to each party (degree of responsibility); (2) the parties' relative volumes of business (degree of benefit received)\textsuperscript{137}; and, (3) the relative profit expectation of each party (again, degree of benefit received). The author, in a 1975 article,\textsuperscript{138} has made several proposals that have judicial as well as legislative relevance.\textsuperscript{139}

\section*{V. Conclusion}

We have observed and documented the fact that the "fore-

\begin{itemize}
\item \textsuperscript{134} Placek v. City of Sterling Heights, 405 Mich. at 657-59, 275 N.W.2d at 517-18.
\item \textsuperscript{135} Restatement (Second) of Contracts § 351 and Comment f (1981).
\item \textsuperscript{136} Webster's Third International Dictionary (Unabridged) (1971) (emphasis added).
\item \textsuperscript{137} See Placek v. City of Sterling Heights, 405 Mich. at 657-59, 275 N.W.2d at 517-18.
\item \textsuperscript{138} Stone, Allocation of Risk for Product Recall Expenditures: A Legislative Proposal, 1975 Det. C.L. Rev. 1.
\item \textsuperscript{139} Id. at 20-32. For example, one proposal is based upon the following ratio:
\begin{align*}
\text{Share of appropriate recall expenditures to be borne by supplier.} & \quad \text{A figure reflecting supplier's appropriate contribution to or responsibility for the end product.} \\
\text{Appropriate recall expenditures paid by manufacturer.} & \quad \text{A figure reflecting (a) manufacturer's appropriate contribution to or responsibility for the end product, or (b) an appropriate end product figure.}
\end{align*}
\end{itemize}

\textit{Id. at 26.}
seeability" test of Hadley v. Baxendale is only one of many factors to be taken into consideration when determining the recoverability of consequential damages for product recall expenditures. Of course these factors are not specifically expressed in the Hadley rule. They are, however, the principal factors that a court will consider relevant in reaching a conclusion. They include the following:

1. Is the seller compensated for the risk?
2. Does a gross disparity exist between the compensation received by the seller and the damages sought by the buyer?
3. Was the seller's breach willful?
4. By interpretation and construction of the agreement, how have the parties contracted to allocate risk?
   a. Did the seller and the buyer agree to extend liability to include the damages in question, or to limit or preclude such liability?
   b. Are the seller and the buyer in a relatively equal bargaining position, or does a significant disparity exist between them?
   c. Is the agreement between the seller and the buyer so one-sided that the court will not enforce their agreement?
   d. Were the terms of the agreement reached by meaningful bargaining or were they essentially "boilerplate"?
   e. Which party chose the language of the agreement?
5. Which party can most economically bear the risk?

The three recent product recall cases\textsuperscript{140} demonstrate that these factors will influence the results of product recall litigation. In fact, these cases seem to demonstrate that "foreseeability" states the conclusion rather than the description of the test to be applied.

The more important recent development is the promulgation of Restatement (Second) of Contracts section 351, subsection (3) of which states:

A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the

circumstances justice so requires in order to avoid disproportionate compensation.

Applying this subsection to the earlier Heat Treater hypothetical,\(^{141}\) suppose that Heat Treater for a price of $125 heat treats 50,000 bolts that are affixed to the steering mechanisms of 50,000 automobiles. At least some of the bolts are later discovered to be defective—even though Heat Treater has exercised due care—and the 50,000 automobiles must be recalled, which gives rise to expenditures of $820,000. Assume Heat Treater foresees that the defects in the bolts will trigger a recall and yet it cannot assess the risk, cannot procure recall insurance, cannot add the risk to the cost of its product, cannot set aside a fund which will be recognized for tax purposes to pay for the recall expenditure, and cannot spread the risk among its various buyers. Assume further that the recall expenditures are extremely disproportionate to the price charged ($125 price charged, $820,000 recall expenditure) and that informality of dealing (including the absence of a detailed written contract) indicates that there was no careful attempt to allocate all the risks. A court can now apply the rule of Restatement (Second) of Contracts section 351(3) and state explicitly that although Heat Treater foresaw that a recall could result from the breach, Heat Treater will not be held liable for the recall expenditures since under the circumstances justice so requires. The Court would not have to manipulate the word "foresee" to reach the just result.

Of course the Heat Treater hypothetical is subject to innumerable variations. For example: (1) the disparity between the compensation received by Heat Treater and the consequential damages sought by Auto Company may not be grossly disproportionate; (2) Heat Treater's breach may be due to its negligence or willfulness; (3) faulty installation of the bolts by Auto Company may weaken the causal link between the breach and the recall; (4) Auto Company may have breached its duty to mitigate losses, etc. Upon whom should the loss fall in these situations in order to reach the just result? Comment f to Restatement (Second) of Contracts section 351\(^{142}\) suggests that a solution may be to allocate the risks fairly. The choice need not be all or nothing.

\(^{141}\) See Part II supra.

\(^{142}\) See note 121 supra. See also Rizzo & Arnold, Causal Apportionment in the Law of Torts: An Economic Theory, 80 COLUM. L. Rev. 1399 (1980).
The adaptation and modification of the Hadley rule by Restatement (Second) of Contracts section 351 is illustrative of Llewellyn's Grand Style of the Common Law. This style fosters the "on-going production and improvement of rules which make sense on their face." Legal precedent will evolve in more orderly and predictable fashion if courts in future product recall decisions will not hesitate to state the factors that influenced them and elaborate upon the reasoning underlying the application of those factors.

143. See K. LLEWELLYN, supra note 51, at 38. See also id. at 186 (the drafting philosophy of the U.C.C. has been "open-ended drafting, with room for courts to move in and readjust over the decades"); R. Danzig, Hadley v. Baxendale: A Study in the Industrialization of the Law, 4 J. LEGAL STUD. 249 (1975) (rule of Hadley needs to be reviewed and revised in order to function in the modern world).