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Commercial Law—The U.C.C. and Disclaimer of Consequential Damages—Cambern v. Hubbling, ____ Minn. ____, 238 N.W.2d 622 (1976); Kleven v. Geigy Agricultural Chemicals, 303 Minn. 320, 227 N.W.2d 566 (1976)

where the promisee reasonably relies on the oral contract and injustice would otherwise result, assertion of the equitable estoppel doctrine should be allowed. Section 217A, however, apparently has been adopted by only one state to date.[35]

While the Minnesota Supreme Court has consistently required a representation or concealment of material facts as a prerequisite to applying the doctrine of equitable estoppel, dictum in *Sacred Heart* indicates that it may, in a proper case, take a contract out of the Statute of Frauds in the absence of a representation or concealment of material facts if there is sufficient detrimental reliance.[36] While arguments can be made for doing this and thereby relaxing the current requirement of conduct "akin to fraud," injustice has not resulted from the standard as applied in Minnesota to date and the consistent application of a well-defined standard has much merit. A case may arise where a change in standards is required, but the facts of *Del Hayes* and *Sacred Heart* did not give rise to the equities necessary to justify such a change. Thus, the court properly held that the facts of *Del Hayes* and *Sacred Heart* were insufficient to establish equitable estoppel. The mere breach of an oral agreement, which probably occured in both cases and which the jury found in *Sacred Heart,* is insufficient to establish equitable estoppel.[37] Some reliance by a party will arise from any oral contract, and if that reliance were enough to establish equitable estoppel, the Statute of Frauds would be rendered meaningless.[38]

Commercial Law—THE U.C.C. AND DISCLAIMER OF CONSEQUENTIAL DAMAGES—*Cambern v. Hubbling,* ____ Minn. ____, 238 N.W.2d 622 (1976); *Kleven v. Geigy Agricultural Chemicals,* 303 Minn. 320, 227 N.W.2d 566 (1975).

In two recent cases involving agricultural losses, the Minnesota Supreme Court was required to determine the validity of disclaimers of consequential damages under the Uniform Commercial Code, and to

35. McIntosh v. Murphy, 52 Hawaii 29, 469 P.2d 177 (1970), *noted in* Annot., 54 A.L.R.3d 707 (1974). For a discussion of this case and the RESTATEMENT (SECOND) OF CONTRACTS § 217A (Supp. Tent. Draft No. 4, 1969), see Note, *The Doctrine of Estoppel Gains a Foothold Against the Statute of Frauds,* 1 CAP. U.L. REV. 205 (1972). The 1973 version of section 217A is substantially the same as the 1969 version.

36. The court stated: "We are mindful that the situation may arise where the character and magnitude of the detrimental reliance of the party seeking an equitable estoppel may be so great as to require, upon equitable principles, taking a contract out of the statute of frauds." 305 Minn. at 327-28, 232 N.W.2d at 923.

37. *See, e.g.,* Hurst v. Thomas, 265 Ala. 398, 403, 91 So. 2d 692, 697 (1956). If it could, the Statute of Frauds would, in effect, be nullified.

38. *See* Sacred Heart Farmers Coop. Elevator v. Johnson, 305 Minn. 324, 327, 232 N.W.2d 921, 923 (1975); Del Hayes & Sons, Inc. v. Mitchell, 304 Minn. 275, 284, 230 N.W.2d 588, 594 (1975).

determine what types of losses constitute consequential damages which are subject to such disclaimers.

In *Kleven v. Geigy Agricultural Chemicals,*[1] several farmers purchased herbicide for use on their farmland. The farmers sued the manufacturer-seller for breach of an express warranty of fitness and merchantability because only some of their fields treated with the herbicide displayed good weed control. The jury found the manufacturer had breached the warranty and that as a direct result of this breach the farmers sustained damages of $2,146.20 for the cost of the herbicide and expenses incurred in applying the product. The jury also found that consequential damages were excluded from the manufacturer's implied warranty under a disclaimer provision. The trial court ruled that the farmers' crop losses and tilling costs constituted consequential damages and therefore declined to order judgment for such losses.[2] The supreme court affirmed and held that surrounding circumstances and the nature of the product made the disclaimer reasonable and operative.[3]

In *Cambern v. Hubbling,*[4] cattle farmer-buyers made an oral contract with a cattle raiser to purchase 179 calves. When the buyers received the calves, they failed to read the receipt of sale, which contained a disclaimer of consequential damages. Shortly after delivery, the calves showed signs of illness and within the following three month period eighty-one calves died. In an action for breach of an implied warranty of fitness, the jury awarded the buyer $19,386.62 as damages for the cost of the dead calves and the expenses resulting from proper treatment of the calves. The trial court initially excluded the disclaimer as unconscionable but added by memorandum that no agreement had ever been reached between the parties to include the disclaimer in the sales contract.[5] The supreme court held that the latter was the more sound reason to exclude the disclaimer of consequential damages and that therefore the unconscionability issue need not be met.[6]

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1. 303 Minn. 320, 227 N.W.2d 566 (1975).
2. *Id.* at 321, 227 N.W.2d at 568.
3. *Id.* at 329, 227 N.W.2d at 572.
4. ___ Minn. ___, 238 N.W.2d 622 (1976).
5. *Id.* at ___, 238 N.W.2d at 623-24.
6. *Id.* at ___, 238 N.W.2d at 624. However, the trial court deviated from the usual measure of damages for a breach of warranty, the difference at the time and place of acceptance between the value of the goods actually accepted and the value they would have had if they were as warranted, contained in MINN. STAT. § 336.2-714(2) (1976). After noting that this was not intended to be the exclusive measure of damages for a breach of warranty, see *id.* at ___, 238 N.W.2d at 625 n.4, the supreme court accepted the trial court's explanation for the deviation:

> Where the subject matter of the sale is a sick animal it is much more reasonable to measure damages by the expense and result of proper treatment and to calculate the effect of either failure or success, or both, than to base damages on what must be a highly speculative evaluation at the time of sale when the

In both *Kleven* and *Cambern*, the Minnesota Supreme Court faced the issue of the enforceability of disclaimers of consequential damages challenged as being unconscionable. A major obstacle to recovering consequential damages arises where the buyer has signed a contract in which the seller disclaims all liability for such damages. Where the parties expressly provide for an exclusive remedy in substitution for the damages recoverable under the Uniform Commercial Code, that remedy normally is the buyer's sole recourse.[7] The buyer, however, may attempt to nullify the disclaimer by claiming it is unconscionable, as did the buyers in *Kleven* and *Cambern*. The court in *Kleven* found that a buyer may rely upon either of two code sections to establish unconscionability.[8] Section 2-302 allows the court to refuse to enforce a contract or any of its provisions if necessary to avoid an unconscionable result;[9] and Section 2-719(3) permits a court to allow the normal U.C.C. remedies where a limitation on consequential damages would be unconscionable.[10]

The U.C.C. does not define the term "unconscionable," but the basic test is "whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract."[11] In addition, a disclaimer of consequential damages is prima facie unconscionable when the disclaimer is for personal injuries caused by consumer goods.[12]

By not finding the disclaimers to be unconscionable, the Minnesota

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degree of response to treatment is necessarily an unknown factor.

Id. at ____, 238 N.W.2d at 625.

7. *See* MINN. STAT. § 336.2-719(1) (1976); 2 R. ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE §§ 2-719:6, :10 (1971); 3A R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 14.09[2] (1976).

8. 303 Minn. at 327-28, 227 N.W.2d at 571-72.

9. MINN. STAT. § 336.2-302 (1976) provides:

> (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
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> (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

10. MINN. STAT. § 336.2-719(3) (1976) provides: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."

11. U.C.C. § 2-302, comment 1 (1972 version).

12. *See* note 10 *supra*.

court followed the trend of courts in other jurisdictions, which are reluctant to utilize the unconscionability doctrine in cases not involving consumer products or personal injuries.[13] Generally, in a commercial setting, a contract will not be held unconscionable unless necessary to prevent oppression or unfair surprise,[14] and the courts normally will require a greater showing that the contract or provision works a hardship on the party invoking the unconscionability doctrine than is required in consumer cases.[15]

Read together, *Cambern* and *Kleven* suggest that in normal commercial transactions, the court will be reluctant to find a disclaimer of consequential damages to be unconscionable. The court's treatment of the two cases indicates it will look to at least four factors in determining whether such a disclaimer will be enforced. First, the *Kleven* court considered the nature of the product.[16] The herbicide involved was a highly technical and specialized chemical substance designed to control selectively certain weeds and plants in a field. An incorrect choice of the herbicide as the solution for a farmer's particular problem would probably not produce the desired result. A manufacturer may quite reasonably wish to protect itself from warranty litigation, brought by disappointed buyers, arising from the uninformed and unsupervised application or use of a very technical and specialized product.

Second, the court considered the degree to which proper function of the product, even if correctly selected to cure a particular problem,

13. *See, e.g.*, Cryogenic Equip. Co. v. Southern Nitrogen, Inc., 490 F.2d 696, 698-99 (8th Cir. 1974) (disclaimer upheld in commercial setting where both parties to contract were experts and no disparity in bargaining power appeared); Cyclops Corp. v. Home Ins. Co., 389 F. Supp. 476, 481 (W.D. Pa. 1975) (limitation in commercial contract between large business entities not unconscionable where neither personal injury nor property damage was involved); Royal Indem. Co. v. Westinghouse Elec. Corp., 385 F. Supp. 520, 524-25 (S.D.N.Y. 1974) (commercial setting, no showing of unequal bargaining power, and expertise of both parties to contract resulted in reluctance to hold a disclaimer unconscionable); Wilson Trading Corp. v. David Ferguson, Ltd., 23 N.Y.2d 398, 404, 244 N.E.2d 685, 688, 297 N.Y.S.2d 108, 112 (1968) (reluctance to call limitation unconscionable where sole remedy failed of its essential purpose and could be construed as such); Schroeder v. Fageol Motors, Inc., 86 Wash. 2d 256, 261, 544 P.2d 20, 25 (1975) (en banc) (in purely commercial transactions exclusionary clauses are prima facie conscionable and burden of establishing unconscionability rests upon party attacking).

14. *See generally* R. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 44, at 126-27 (1970).

15. *Compare* Bill Stremmel Motors, Inc. v. IDS Leasing Corp., 89 Nev. 414, 418-19, 514 P.2d 654, 657 (1973) *and* Schroeder v. Fageol Motors, Inc., 86 Wash. 2d 256, 261, 544 P.2d 20, 25 (1975) *with* Morris v. Chevrolet Motor Div., 114 Cal. Rptr. 747, 752 (Ct. App. 1974) *and* Walsh v. Ford Motor Co., 59 Misc. 2d 241, 242-43, 298 N.Y.S.2d 538, 539-40 (Sup. Ct. 1969).

16. *See* 303 Minn. 320, 329, 227 N.W.2d 566, 572 (1975). The court took judicial notice of the facts that the herbicide was a technical, specialized chemical used to eradicate only certain weeds selectively and that the eventual yield of a farm crop is affected by numerous factors such as soil, weather, seed, and weeds. Because of these variables, limited favorable results could be expected by the parties.

could be defeated by factors beyond anyone's control.[17] Increased yields, the desired effect of the herbicide, could be affected by the condition of the soil, weather, seed, weeds, and other uncontrollable factors.[18] Under such circumstances a manufacturer cannot guarantee results, and a disclaimer of consequential damages may not be unreasonable.

Third, the *Kleven* court noted that the disclaimeer and the risks presented by the first two factors had been fairly disclosed to the buyer at the time the contract was consummated.[19] When the existence of the disclaimer and the risks are disclosed, at the time the bargain is struck, to a buyer who can understand and appreciate them, the likelihood of subsequent unfair surprise is minimized. In *Cambern,* existence of the disclaimer had not been disclosed by the seller before a binding contract had been entered.[20] The *Cambern* court, reluctant to hold a disclaimer in a commercial contract unconscionable, simply held that the disclaimer was not part of the contract.[21]

Fourth, *Kleven* dictum indicates that a manufacturer's refusal to make necessary repairs or otherwise mitigate damages by replacing the product or rescinding the contract might be considered.[22] Whether or not rising to the level of bad faith, such conduct may be unfair or unreasonable when surrounded by known circumstances out of which consequential damages might well arise.

In *Kleven,* the court faced the additional problem of determining what types of losses constitute consequential damages under a disclaimer provision.[23] Under the U.C.C., the distinction between consequential and direct damages is controlled by Sections 2-714 and 2-715. Section 2-714(2)[24] provides the measure of damages for a breach of war-

17. 303 Minn. at 329, 227 N.W.2d at 572.

18. *Id.*

19. *Id.*

20. ___ Minn. at ___, 238 N.W.2d at 624.

21. *Id.*

22. The *Kleven* court included in its analysis the rationale underlying MINN. STAT. § 336.2-719(1) (1976) that every sales contract must provide at least some fair remedy in case of breach. *See* 303 Minn. at 327, 227 N.W.2d at 571. The court cited with approval the Kansas case, Steele v. J.I. Case Co., 197 Kan. 554, 419 P.2d 902 (1966), in which the seller's disclaimer of consequential damages was voided because the seller knew that his failure to refund the purchase price or to replace farm machinery would result in a substantial crop loss to buyers. *See* 303 Minn. at 327-28, 227 N.W.2d at 571-72. While the *Kleven* court approved the reasoning of the Kansas case, it arrived at the opposite result because the factual situations were dissimilar.

23. *See* 303 Minn. at 324-27, 227 N.W.2d at 569-71. This problem, of course, was not faced by the court in *Cambern* because in that case the disclaimer provision was held to be inoperative and therefore the court did not have to distinguish between direct and consequential damages. Instead, the court concluded that between MINN. STAT. § 336.2-714 (1976) and MINN. STAT. § 336.2-715 (1976) the plaintiff could recover for the losses he suffered. *See* ___ Minn. at ___, 238 N.W.2d at 624-25.

24. MINN. STAT. § 336.2-714(2) (1976) states: "The measure of damages for breach of

ranty: the difference between the value of the goods at the time and place of acceptance and the value they would have had if they had been as warranted. This formula operates unless "special circumstances show proximate damages of a different amount,"[25] which suggests that the buyer under Section 2-714(2) will receive either direct or consequential damages, but not both. Section 2-714(3),[26] however, modifies this result by allowing the buyer in a proper case to recover, in addition to any direct damages, incidental and consequential damages under Section 2-715.[27]

In defining consequential damages, the U.C.C. has adopted the time-honored rule first expressed in *Hadley v. Baxendale,*[28] and adopted by the Minnesota court in *Paine v. Sherwood,*[29] that direct damages arise out of the breach itself, while consequential damages are those damages arising foreseeably from the breach.[30] The *Kleven* court referred to the leading Minnesota case of *Despatch Oven Co. v. Rauenhorst*[31] for assistance in determining what constitutes consequential damages.[32] Consequential, as opposed to direct, damages were defined by the *Rauenhorst* court as damages which "do not arise directly according to the usual course of things from the breach of contract itself, but are rather those which are the consequence of special circumstances known to or reasonably supposed to have been contemplated by the parties when the contract was made."[33]

Under the *Rauenhorst* test, the court in *Kleven* determined that only the cost of the herbicide and expenses in its application were recoverable

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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."

25. *Id.*

26. MINN. STAT. § 336.2-714(3) (1976) provides that "[i]n a proper case any incidental and consequential damages under the next section may also be recovered."

27. MINN. STAT. § 336.2-715(1) (1976) allows recovery for incidental damages while MINN. STAT. § 336.2-715(2) (1976) provides for consequential damages.

28. 156 Eng. Rep. 145 (Ex. 1854).

29. 21 Minn. 225 (1875).

30. *See* MINN. STAT. § 336.2-715(2) (1976).

31. 229 Minn. 436, 40 N.W.2d 73 (1949) (lost profits on sales of seed and feed corn caused by breach of warranty as to seed corn dryer's capabilities not recoverable as consequential damages where contract of sale exculpated seller therefrom).

32. 303 Minn. at 324, 227 N.W.2d at 569.

33. 229 Minn. 436, 445, 40 N.W.2d 73, 79. In a much earlier case, Frohreich v. Gammon, 28 Minn. 476, 11 N.W. 88 (1881), the court defined direct damages as those which arise "*from the breach itself*; that is to say, from the breach purely, and irrespective of consequential damages." 28 Minn. at 481, 11 N.W. at 89. Consequential damages were defined by the *Frohreich* court as those which would be appropriate if "one sells and warrants a thing for a particular use, upon reasonable ground for believing that, if put to such use, a certain loss to the buyer will be the probable result if the warranty is untrue." *Id.*

as direct damages, while crop losses and tilling costs arose as a proximate result of the breach and were validly disclaimed consequential damages.[34] This determination seems correct, but *Kleven* does indicate that the theoretically simple distinction between direct and consequential damages often can be difficult to apply in practice.[35] The hazy distinction between the two types of damages does leave the court with some flexibility, however, especially when a valid disclaimer of consequential damages is involved. By categorizing a loss as being a direct result of the breach, when it is arguably direct or consequential, the court can allow the plaintiff additional recovery despite the disclaimer. This flexibility may be useful to the court as a tool for balancing the equities of the parties in disclaimer cases where the unconscionability doctrine is not applicable.

Corporations—FIDUCIARY DUTY TO CREDITORS—*Swanson v. Tomlinson Lumber Mills, Inc.*, ___ Minn. ___, 239 N.W.2d 216 (1976).

In the recent case of *Swanson v. Tomlinson Lumber Mills, Inc.*,[1] the Minnesota Supreme Court expanded the common law rule that preferences are voidable when given to a director of an insolvent corporation to the detriment of corporate creditors.[2] Defendant Tomlinson was president and a director of several corporations, including Tomlinson Lumber Sales (Tomlinson Sales). He was also either the sole shareholder or joint owner with members of his family of each of the corporations.

As president of Tomlinson Sales, Tomlinson executed promissory notes totalling $209,126.26 to Burlington Northern, Inc. (Burlington), payable December 31, 1970. The notes were not paid when due and Burlington commenced suit on the notes on March 5, 1971. At that time, the assets of Tomlinson Sales were composed almost entirely of accounts receivable due from Tomlinson's other corporations. Tomlinson Sales therefore was a creditor of the other Tomlinson corporations. For no consideration, the current accounts receivable were converted by Tom-

34. 303 Minn. at 327, 227 N.W.2d at 571.

35. A comparison of two Minnesota cases suggests that the Minnesota Supreme Court does not rely on formulas or strict definitions but responds to the particular circumstances of each case by designing the damage recovery to meet the buyer's losses. In Barthelemy v. Foley Elevator Co., 141 Minn. 423, 170 N.W. 513 (1919), direct damages (difference between the value of the goods as accepted and the value of the goods if they had been as warranted) were awarded for the failure of seed wheat to mature properly. However, in Moorehead v. Minneapolis Seed Co., 139 Minn. 11, 165 N.W. 484 (1917), the court determined the damages where seed wheat entirely failed to germinate by using a more complex computation involving the value of the land's use with additions (cost of seed and planting) and deductions (value of the use remaining at the time the seed failed to germinate).

1. ___ Minn. ___, 239 N.W.2d 216 (1976).

2. *See generally* 15A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 7467-80 (rev. perm. ed. 1967).