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CONSEQUENTIAL DAMAGES: *HADLEY V. BAXENDALE* UNDER THE UNIFORM COMMERCIAL CODE

Paul S. Turner*

For my own part I think that, although an excellent attempt was made in *Hadley v. Baxendale* to lay down a rule on the subject [of damages], it will be found that the rule is not capable of meeting all cases; and when the matter comes to be further considered, it will probably turn out that there is no such thing as a rule, as to the legal consequences of damages, applicable in all cases.

—Wilde, B.¹

The term “consequential damages” has often been used with respect to harm suffered as a “consequence” of the breach of duty, but not as a direct and immediate and foreseeable consequence. The use of this expression should be abandoned.

—Arthur Linton Corbin²

The use of this term “consequential damage” “prolongs the dispute,” and “introduces an equivocation which is fatal to any hope of a clear settlement.” It means both damage which is so remote as not to be actionable, and damage which is actionable. Sometimes it is used to denote damage, which, though actionable, does not follow immediately, in point of time, upon the doing of the act complained of; what ERLE, C.J., aptly terms “consequential damages to the actionable degree.”³

“Consequential” or “special” damages . . . are not defined in terms in the Code, but are used in the sense given them by the leading cases

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1. Note, *An Economic Approach to Hadley v. Baxendale*, 62 NEB. L. REV. 157 (1983) (quoting Sir James Plaisted Wilde, Baron Judge of the Court of Exchequer, in *Gee and Others v. Lancashire and Yorkshire Ry. Co.*, 6 H. & N. 211, 220-21, 158 Eng. Rep. 87, 91 (1860)) [hereinafter *An Economic Approach*].

2. ARTHUR LINTON CORBIN, 5 CORBIN ON CONTRACTS § 1011, at 87 (1964) [hereinafter CORBIN ON CONTRACTS].

3. *Eaton v. B. C. & M. R. R.*, 51 N.H. 504, 519 (1872).

on the subject.⁴

ARTICLE 1 of the Uniform Commercial Code contains general provisions, including definitions and interpretative principles, that apply to all other articles in the U.C.C. In the summer of 2000, at the annual meeting of the National Conference of Commissioners on Uniform State Laws, a draft of a revised version of Article 1 was presented to the uniform law commissioners.⁵ The commissioners are expected to approve a revised version of Article 1 in substantially the form of the 2000 Annual Meeting Draft and present it to legislatures of the various states.⁶

The subject of damages is addressed in section 1-305(a) of the 2000 Annual Meeting Draft of Article 1 in the following sentence:

The remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law.⁷

The damages provision in the 2000 Annual Meeting Draft of section 1-305 (quoted above) does not differ substantively in any way from its apposite section 1-106(1) of the current version of Article 1.⁸ Neither version defines the damages terms that are used, i.e., "remedies," "consequential damages,"⁹ "special damages," and "penal damages."

This paper considers the use of the term "consequential damages" by practitioners and in the U.C.C. What is meant by the term? What damages are meant to be included or excluded under the U.C.C. provisions pertaining to consequential damages? If there is any ambiguity that makes these questions difficult to answer, should the drafters of the revised U.C.C. Article 1 seek to resolve it?

Part I of this paper discusses the treatment of consequential damages under the common law. Part II reviews the use of the term in the U.C.C. Part 3 conveys some of the author's thoughts on the issues raised in Parts I and II.

4. See U.C.C. § 1-106, cmt. 3 (1995).

5. A draft U.C.C. Article presented at the 2000 Annual Meeting is referred to in this paper as the "2000 Annual Meeting Draft."

6. Prior to presentation to the legislatures, the co-sponsoring American Law Institute must approve the draft.

7. U.C.C. § 1-305(a) (Proposed Draft 2000).

8. See U.C.C. § 1-106(1) currently provides: "The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in this Act or by other rule of law." *Id.*

9. U.C.C. §§ 2-715 and 2A-520, however, state, confusingly, as will be shown below, what the term "consequential damages" includes. Consequential damages under Articles 2 and 2A would include other damages as well as those specified in §§ 2-715 and 2A-520.

I. CONSEQUENTIAL DAMAGES UNDER THE COMMON LAW

A. *HADLEY V. BAXENDALE*

In *Hadley v. Baxendale*,¹⁰ millers in nineteenth century Greenwich, England, contracted with the owners of a factory in Gloucester, England, to have the factory build a crankshaft to replace the broken crankshaft used to operate the mill. The factory owners asked the millers to ship the broken shaft to the factory in Gloucester before work on the new shaft was to begin so that the new crankshaft would fit the other parts of the mill. In arranging for the shipment, the millers contracted with the defendants, who were common carriers for hire from Greenwich to Gloucester, to have the broken shaft delivered to the factory in Gloucester.

The carriers, by neglect, delivered the broken shaft to the factory five days later than the two days agreed upon. As a result of this delay, the completion of the new shaft was delayed. The millers alleged in their suit against the carriers that because of the delay in completion, the mill was unable to operate as it otherwise would have been. In particular, the millers sought to recover damages for their inability to supply their customers with flour during the period of delay. They asserted that they had been obliged to purchase flour to supply to some of their customers, deprived of gains and profits, and unable to employ their workforce, to whom they were compelled to pay wages during the period of delay.

The carriers' defense in the litigation was that the damages sought by the millers were too remote. The judge referred the legal issues, as well as the fact-finding, to the jury, which was the common practice then, and the jury awarded damages of fifty pounds to the millers. On appeal, the Court of the Exchequer ordered a new trial, and for the guidance of the lower court and future courts, enunciated the general rule of recoverable damages followed by Anglo-American courts to this day.

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 as 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. If 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 the 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 con-

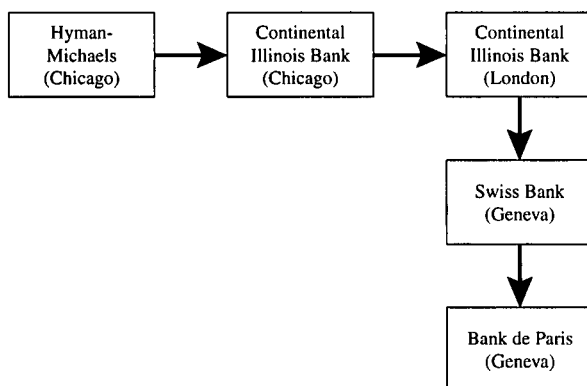
10. 9 Exch. 341, 156 E. R. 145 (1854) (reprinted in ALL E. R. REP. 1843-1860, 461 (G.F.L. Bridgman ed., Butterworth & Co. Ltd. 1965)).

temptation 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.¹¹

The court concluded on the facts before it that the plaintiffs had communicated only that the article to be carried was the broken shaft and that the plaintiffs were the millers of the mill. These facts alone, the court held, could not lead the defendant carriers to contemplate that lost profits would result from a delay in the delivery of the broken shaft. Thus, the defendant carriers were entitled to a new trial. The term "consequential damages" does not appear anywhere in the court's opinion.

B. *EVRA V. SWISS BANK*

The leading contemporary case on consequential damages involves a bank's failure to comply with instructions to make a wire transfer. The case, decided before the adoption of U.C.C. Article 4A on wire transfers, is *Evra Corp. v. Swiss Bank Corp.*¹² In *Evra*, Hyman-Michaels Company, a Chicago dealer in scrap metals, had chartered a ship, the *Pandora*. The charter required Hyman-Michaels to pay the charter installments into the account of the *Pandora* owners at the Bank de Paris et des Pays-Bas in Geneva. Hyman-Michaels would normally pay the installments by sending wire transfer instructions to its bank, Continental Illinois Bank, in Chicago. The instructions would then be sent by Continental to its London office, then sent from the London office to Continental's correspondent, Swiss Bank in Geneva, and finally sent from Swiss Bank to the Bank de Paris in Geneva for the credit of the *Pandora's* owners. The flow of these payment instructions is illustrated below.



11. *Id.* at 151; ALL E.R. REP.1843-1860, at 465.

12. 673 F.2d 951 (7th Cir. 1982).

Because vessel charter rates had increased sharply after the charter for the *Pandora* was entered into, the owners wished to terminate Hyman-Michaels' rights under the charter. Thus, when the payment due in October 1972 was late, the owners sent a notice of termination to Hyman-Michaels. The notice was rejected by Hyman-Michaels, however, and the ensuing dispute was referred to a panel of arbitrators appointed pursuant to the charter. The panel, noting that arbitrators were inclined to show latitude towards charters, ruled that the charter had not been terminated.

In the following year, the *Pandora* owners were afforded another opportunity to terminate the charter. A payment, due on April 26 in the amount of \$27,000, was not received by the vessel owners by that date. Hyman-Michaels in Chicago had issued payment instructions on April 25, and a telex from Continental Bank in London was sent on April 26th to Swiss Bank in Geneva. However, the telex failed to reach the appropriate banking personnel at Swiss Bank. The Swiss Bank telex machine may have been out of paper or the administrative personnel at the machine may have failed to carry the message to the banking department. In any case, Swiss Bank failed to act on the telex, and it was later determined that Swiss Bank was at fault.

On April 27, the vessel owners again sent a notice of termination to Hyman-Michaels. Again, the notice was rejected, and Hyman-Michaels sought to pay the \$27,000 to the vessel owners, despite the fact that the deadline for payment had passed.

In the case of the previous late payment, Hyman-Michaels had wired the funds directly to the owners' account in Geneva shortly after receiving the termination notice. However, this time, Hyman-Michaels sought to make payment indirectly through Swiss Bank in the usual manner illustrated above. Time passed while the missing telex from Swiss Bank to the Banque de Paris was hunted without success. It was not until five days after the termination notice was sent that Swiss Bank attempted to make the deposit at the Banque de Paris. However, this time, Banque de Paris refused the payment.

As before, the issue of termination was submitted to arbitration. This time, the arbitrators were less inclined to show Hyman-Michaels any latitude. Noting that Hyman-Michaels had not acted promptly after it learned of the late payment due on April 26, the panel ruled against Hyman-Michaels, thereby terminating the charter. Hyman-Michaels then sued the banks involved in the funds transfer.

The principal issue in the litigation was whether Swiss Bank was liable to Hyman-Michaels for the lost profits resulting from the termination of the charter. Hyman-Michaels had sub-chartered the *Pandora* at market rates, which had grown to twice the rates in the charter, and the lost profits, based on the difference between the charter and sub-charter rates, were estimated to exceed \$2 million.

In the decision by Judge Posner, the *Evra* court applied Illinois common law, particularly the Illinois progeny of *Hadley v. Baxendale*, includ-

ing *Siegel v. Western Union Telephone Co.*¹³ In *Siegel*, Western Union negligently misdirected a \$200 money order. Had the order been directed properly, the \$200 would have been legally bet on a horse that won and paid \$1,650. The plaintiff sued Western Union for the \$1,450 "lost profit." The court, however, applied the rule in *Hadley v. Baxendale*, holding that the plaintiff could not recover its lost profit because Western Union had no knowledge of the use of the funds.

The *Evra* court concluded that *Siegel* was authority for exonerating Swiss Bank, stating that the reason for the holding was to be found in the "animating principle" of *Hadley v. Baxendale*: that "the costs of the untoward consequence of a course of dealings should be borne by that party who was able to avert the consequence at least cost and failed to do so."¹⁴ In *Evra*, the court found that Hyman-Michaels may have been able to avert the consequences of its breach, but had behaved imprudently. Having barely avoided termination after the 1972 late payment, it waited until the last minute to send instructions to make the April 1973 late payment that resulted in the termination of the charter. On the day it received the notice of termination, Hyman-Michaels was imprudent, the court commented, for it failed to "pull out all the stops to get payment to the Banque de Paris on that day, and instead [it dithered] while Continental and Swiss Bank wasted five days looking for the lost telex message."¹⁵

The *Evra* court noted the link between the rule in *Hadley v. Baxendale* and both the doctrine of avoidable consequences and the tort principle that limits liability to the "foreseeable consequences" of the defendant's carelessness. In its emphasis on the failure of Hyman-Michaels to behave prudently when prudent behavior would apparently have avoided the loss, *Evra* may be said to have put a theoretical economics gloss on the traditional view of *Hadley v. Baxendale*.¹⁶ In any event, the fundamental holding in *Evra*, as in *Siegel*, seems to be simply that only damages that the defendant might reasonably have foreseen are available to the aggrieved party. The *Evra* court stated, "Swiss Bank did not have enough information to infer that if it lost a \$27,000 payment order it would face a liability in excess of \$2 million."¹⁷

C. VARIOUS FORMULATIONS OF THE *HADLEY V. BAXENDALE* RULE—CONSEQUENTIAL DAMAGES

What are "consequential damages?" Most practitioners would agree that the term refers to damages that a person in the position of the breaching party would not reasonably have foreseen at the time of contracting.¹⁸ They would also agree that such damages should not be avail-

13. 37 N.E.2d 868 (Ill. App. 1941).

14. *Evra*, 673 F.2d at 957.

15. *Id.*

16. Judge Posner is a noted exponent of applying economics theory to legal issues. See *An Economic Approach*, *supra* note 1.

17. *Evra*, 673 F.2d at 956.

18. See CORBIN ON CONTRACTS, *supra* note 2, at § 1007.

able to the aggrieved party, or at least that they are not generally available under the common law. In *Hadley v. Baxendale*, for example, the court found that the carriers might not have reasonably foreseen that the mill owners would sustain lost profits by reason of the delay in delivering the broken crankshaft. The unforeseeable lost profits of the millers would thus constitute “consequential damages” (as most practitioners would use the term today).

Suppose, however, that the millers notified the carriers that a delay in delivering the broken shaft would result in a shutdown of the mill, thereby resulting in the mill owners’ losing profits? Under these circumstances, most practitioners, I believe, would probably agree, in accord with the decision in *Hadley v. Baxendale*, that the lost profits *would be* available as damages to the mill owners. Would the practitioners also agree, however, that the lost profits had retained their character as “consequential damages?” Or would they reason that the loss of profits was no longer “consequential” damages because the loss had become foreseeable by reason of the notice? The question is not a substantive one, but a terminological one. If we assume that the lost profits are available to the millers because of the notice to the carriers, should the damages continue to be called “consequential” or should they be called something else?

I doubt that most practitioners have given much thought to this question, but I suspect that many practitioners might take the view that when otherwise unforeseeable damages become foreseeable because the breaching party has advance notice of the circumstances, the damages should no longer be called consequential. That view would be consistent with what seems to be the typical application of the term “consequential” to damages that are *not available* to the aggrieved party.

In any case, if we wish to distinguish between unforeseeable damages (the damages conventionally known as “consequential damages”) and otherwise unforeseeable damages that become foreseeable because the breaching party is advised of the special circumstances, what shall we call the latter kind of damages? In this paper we will call these damages “advised consequential damages.”

The U.C.C. fails to define the term “consequential damages” although it uses the term in a number of provisions. Moreover, the term is used differently in different articles of the U.C.C.

Section 1-106 seems to use the term “consequential damages” in the most often used sense. In this sense, “consequential damages” are simply remote and indirect damages that would not normally be reasonably foreseeable by the breaching party at the time of contracting. In this simple sense, consequential damages are normally not recoverable by the breaching party. Section 1-106(1) of the current version of Article 1 and Section 1-305(a) of the 2000 Annual Meeting Draft of Article 1 appear to use the term in this simple sense. They do not indicate whether the term excludes “advised consequential damages,” that is, remote and indirect

damages that have become foreseeable because the breaching party is advised of the special circumstances that give rise to the damages.

A somewhat more complex use of the term "consequential damages" would exclude "advised consequential damages" and thus make such damages arguably available to the aggrieved party.

Articles 2 and 2A use the term "consequential damages" idiosyncratically to refer to *recoverable foreseeable* damages. As suggested below, the consequential damages contemplated in Articles 2 and 2A are probably principally what we call in this paper "advised consequential damages." Complicating matters a bit further, Articles 2 and 2A add the concept of "incidental damages." Incidental damages are generally the costs that the aggrieved party incurs in unwinding the transaction after the breaching party has breached the sales or lease contract.

Sections 3-411 and 4A-404 allow the aggrieved party to recover "consequential damages" only after receipt of notice of the special circumstances that may give rise to the damages. Thus, in these sections, the term "consequential damages" unambiguously includes "advised consequential damages."

Sections 4-402(b), 4A-305 and 5-111 also use the term "consequential damages." The use of the term in these and the other sections of the U.C.C. referred to above are discussed in greater detail in Part II of this paper.

How have both courts and authors expressed the rule in *Hadley v. Baxendale*? They have formulated a number of distinctions in addition to the distinction between foreseeable and unforeseeable damages. One such distinction is between "general" damages and "special" damages. General damages, which are normally available to the aggrieved party, are said to be the damages that would normally be expected to arise in the ordinary course from the breach. Special damages (a term used in section 1-106), which are normally not available, are said to be those that arise from special circumstances that would not ordinarily be foreseeable by the breaching party. Another formulation is that the recoverable damages, those that a reasonable person might anticipate would result from the breach, are "natural" damages. Finally, another distinction that is often made is between "direct" and "indirect" damages. Direct damages, sometimes called "proximate" damages, are generally foreseeable damages, i.e., recoverable damages. Indirect or "remote" damages are usually special unforeseeable damages that are not recoverable.

"Compensable" is a word that normally means "recoverable." "Compensatory" or "statutory compensatory" damages may be used to mean recoverable damages as specified under particular provisions of the U.C.C. (for example, the difference between the market price and the contract price under section 2-708), and recoverable under the particular provision (rather than recoverable generally as foreseeable damages as, for example, under Article 1 or under the general contract rule in *Hadley v. Baxendale*).

Finally, the term “consequential damages” is commonly applied, as we noted above, in its simplest sense to refer to damages that are said to arise as a “consequence” of the breach but would not be foreseeable at the time of contracting to a reasonable person in the position of the breaching party. In this context, the term “consequential” is virtually synonymous with the terms “unforeseeable,” “indirect,” “special,” and “remote” and antonymous with the terms “foreseeable,” “direct,” “general,” “natural,” “ordinary” and the like. In this simple sense, consequential damages are not recoverable, but they may become recoverable when the aggrieved party has given notice of the special circumstances giving rise to the damages to the breaching party or when the breaching party otherwise is aware of the special circumstances. In this paper, we use the term “advised consequential damages” to describe damages that have changed their character in this manner in order to distinguish them from consequential damages that are not advised to the breaching party and thus generally not recoverable.

Of course, many of these terms overlap others. The reader may well have formed the opinion at this point that the use of these terms is more complicated than it needs to be. It’s no surprise that Professor Corbin favored couching the rules simply in terms of foreseeability and advocated that the use of the term “consequential damages” be abandoned.¹⁹

The confusion resulting from the plethora of damages terms described above may be seen in the use of the term in “consequential damages” clauses commonly used in contract provisions in which a party disclaims its liability for such damages. The disclaimer is intended normally to constitute a waiver by one party, the waiving party, of its right to seek damages from the other party when the other party, the disclaiming party, would not ordinarily reasonably have foreseen the damages.

The drafters of consequential damages clauses commonly make two errors. First, the disclaimers often have the waiving party disclaim its right to “incidental” as well as “consequential” damages, as in the following example from the American Bar Association’s *Model Electronic Payments Agreement and Commentary*:²⁰ “9.3 Neither party shall be liable to the other under this Agreement for any special, *incidental* or consequential damages. . . [Emphasis supplied].”

Counsel for the waiving party very often fails to object to the waiver of incidental damages in the mistaken belief that incidental damages are the same as, or a form of, consequential damages. As noted in this paper, the term is used in Articles 2 and 2A to refer to expenses incurred by the aggrieved party in the unwinding of the sales or lease transaction after

19. See *id.* §1011.

20. The Agreement, often referred to as the “Model Trading Partners Agreement,” is the product of the ABA’s Electronic Data Interchange and Information Technology Division of the Section on Science and Technology. It is available from the ABA at Publication Orders, P.O. Box 10892, Chicago, IL 60610-0892, 1-800-285-2221. See also section 5B2 of the *Home Banking Agreement* (4th draft dated February 15, 2000) produced by the Task Force on Home Banking Agreement in my files but not yet publicly available.

the breach has occurred. Incidental damages should not normally be waived.

Second, the disclaiming party may mean to include "advised consequential damages" in the disclaimer but fail to do so in the belief that "consequential damages" include advised consequential damages. A prudent drafter for the disclaiming party would probably want to couch the disclaimer along the following lines:

Neither party shall be liable to the other under this Agreement for any special or consequential damages *even if such party has been advised of the possibility of such damages . . .* [Emphasis supplied].²¹

D. THE RESTATEMENT FORMULATION OF THE *HADLEY V. BAXENDALE* RULE

Professor Corbin was a consultant to the Second Restatement of Contracts project, and the Restatement drafters followed his counsel that the term "consequential damages" "should be abandoned."²² The Restatement drafters then couched the rule in terms of foreseeability and omitted the term "consequential damages."²³ The Restatement formulation states:

- (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.²⁴

The Comment in the Restatement to the rule quoted above further explains the application of the rule:

The mere circumstance that some loss was foreseeable, or even that some loss of the same general kind was foreseeable, will not suffice if the loss that actually occurred was not foreseeable. It is enough, however, that the loss was foreseeable as a probable, as distinguished from a necessary, result of his breach. Furthermore, the party in

21. Section 9.3 of the *Model Electronic Payments Agreement and Commentary*. See also section 6.3 of the ABA's *Model Funds Transfer Services Agreement and Commentary*, available as indicated in the preceding footnote. For a model that fails to cover advised consequential damages, see section VB2 of the *Home Banking Agreement* referred to in the preceding footnote; see also section 16(a) of the *Letter of Credit Application and Agreement* by James G. Barnes published in *Uniform Laws Annotated*, vol. 4, *Uniform Commercial Code Forms and Materials*, §5-104-Form 11; *West's Legal Forms*, vol. 15 *Commercial Transactions*, § 62.3-Form.5; and *Uniform Commercial Code Legal Forms*, vol. 2, § 5A:6.

22. See *supra* note 2.

23. Restatement (Second) of Contracts § 347 uses the term "consequential loss" to "include such items as injury to person or property resulting from defective performance." RESTATEMENT (SECOND) OF CONTRACTS § 347, cmt. c. (1981). The aggrieved party's right to consequential loss under the Restatement is subject to the general foreseeability requirements of the rule in section 351, which omits the word "consequential" entirely.

24. *Id.* § 351(1)(2)(a)(b).

breach need not have made a “tacit agreement” to be liable for the loss. Nor must he have had the loss in mind when making the contract, for the test is an objective one based on what he had reason to foresee. There is no requirement of foreseeability with respect to the injured party.²⁵ In spite of these qualifications, the requirement of foreseeability is a more severe limitation of liability than is the requirement of substantial or “proximate” cause in the case of an action in tort or for breach of warranty.²⁶

As to the terminology, and in particular to the use of the term “consequential damages”:

The damages recoverable for loss that results other than in the ordinary course of events are sometimes called “special” or “consequential” damages. These terms are often misleading, however, and it is not necessary to distinguish between “general” and “special” or “consequential” damages for purposes of the rule. . . .²⁷

II. CONSEQUENTIAL DAMAGES UNDER THE U.C.C.

Article 1

Section 1-305(a) of the 2000 Annual Meeting Draft of Article 1 is quoted in the introduction to this paper. Both that version and section 1-106(1) of the current version of Article 1 generally provide that consequential or special damages “may not be had” except as specifically provided in the Uniform Commercial Code or “by other rule of law.”

The term “consequential damages” would seem to be used in Article 1 in the simplest sense of the term, that is, to refer to damages that a person in the position of the breaching party would not reasonably have foreseen at the time of contracting. If the breaching party had been advised at the time of contracting of the special circumstances giving rise to the damages, the damages would thus become foreseeable. Would they then remain unavailable within the ambit of the Article 1 provision? Stated otherwise, are such damages, which we refer to in this paper as “advised consequential damages,” generally available or not available to the aggrieved party under Article 1 of the U.C.C.? Article 1 is ambiguous with respect to this question.

The phrase “other rule of law” is also used ambiguously. Consequential damages would seem to be available under section 1-106(1) of the current Article 1 and section 1-305(a) of the 2000 Annual Meeting Draft of Article 1 only when explicitly authorized under other provisions of the U.C.C. or under other *statutory* law. Conceivably, however, “other rule of law” may include the common law or even mean that the damages are

25. The aggrieved party's ability to foresee the damages is irrelevant under the contemporary version of the rule. In *Hadley v. Baxendale*, the damages would have been those “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 [emphasis supplied].” See *supra* note 10.

26. See RESTATEMENT (SECOND) OF CONTRACTS § 351, cmt. a.

27. *Id.* at § 351, cmt. b.

generally available, except to the extent that other rules of law make them unavailable. This ambiguity has been noted,²⁸ but the drafters of section 1-305(a) of the 2000 Annual Meeting Draft of Article 1 have not addressed it.

Articles 2 and 2A

Article 2 governs the rights and obligations of sellers and buyers in the sale of goods. Article 2A governs the rights and obligations of lessors and lessees in the lease of goods.

Articles 2 and 2A, uniquely among the articles of the U.C.C., provide for three kinds of damages: (i) "statutory compensatory" (the term is the author's term and not a term used in the U.C.C.); (ii) "incidental;" and (iii) "consequential" (in the special sense in which that term is used in Articles 2 and 2A.). To aid in understanding what constitutes consequential damages under these articles, it is helpful briefly to review the other kinds of damages available under Articles 2 and 2A.

The term "statutory compensatory" or "compensatory" damages, as used in this paper, refers to damages available under provisions in which Articles 2 and 2A specify how to calculate particular damages. To calculate the damages due to a buyer of goods, for example, when the seller has wrongfully repudiated the contract or failed to deliver the goods, Article 2 specifies alternative formulas under which the buyer may recover (i) the difference between the cost of alternative goods purchased by the buyer and the contract price of the goods that were to have been delivered by the seller²⁹ or (ii) the difference between the market price and the contract price.³⁰ If the aggrieved buyer has accepted the goods, Article 2 provides that the buyer may recover the loss resulting in the ordinary course of events from the seller's breach.³¹ If the seller is in breach of warranty with respect to the accepted goods, Article 2 provides that the buyer may recover the difference in value between the goods and the value they would have had if they had been as warranted.³²

Other compensatory damages provisions in Article 2 specify how to calculate the damages due to the seller when the buyer is in breach of contract.³³ Similar provisions of Article 2A specify how to calculate compensatory damages in the case of the lessor's or the lessee's breach.³⁴ All of these damages, due to the aggrieved party under Articles 2 and 2A, are referred to in this paper as "statutory compensatory" damages.

"Incidental" damages, the second category of recoverable damages under Articles 2 and 2A, are generally costs associated with the unrav-

28. See HAWKLAND, U.C.C. SERIES § 1-106:4 (Supp. 2000) [hereinafter HAWKLAND, U.C.C. SERIES].

29. See U.C.C. § 2-712.

30. See *id.* § 2-713.

31. See *id.* § 2-714.

32. See *id.*

33. See *id.* §§ 2-708 - 2-709.

34. See generally U.C.C. §§ 2A-508 - 2A-532.

eling of the sales or lease transaction after the breach has occurred. Incidental damages resulting from a breach by the seller under Article 2, for example, include costs incurred by the buyer in (i) rejecting nonconforming goods, (ii) purchasing alternative goods, and (iii) taking care of delivered goods before they have been rejected.³⁵ Incidental damages resulting from a breach by the buyer under Article 2 include expenses incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, and in connection with the return or resale of the goods.³⁶

The incidental damages due to the aggrieved lessor or lessee under Article 2A are similar to those due an aggrieved party under Article 2.³⁷ Incidental damages are specified in lists that are not intended to be exhaustive in sections 2-710, 2-715(1), 2A-520(1), and 2A-530.³⁸ These incidental damages are recoverable in addition to the compensatory damages described above.

The third category of damages recoverable under Articles 2 and 2A is "consequential damages." These consequential damages are not the same as the consequential damages that are unavailable in section 1-106. The term is not defined in Articles 2 or 2A, but under provisions that state what consequential damages "include," it seems that the term is intended principally to refer in Articles 2 and 2A to what we have designated above as "advised consequential damages." These are damages that would not ordinarily be foreseeable, but have become foreseeable because the breaching party was aware at the time of contracting of the special circumstances that gave rise to the damages. These special circumstances are called "particular requirements and needs" in Articles 2 and 2A. For example, under the "include" clause in Article 2, "consequential damages" resulting from the seller's breach include: "any loss resulting from general or *particular requirements and needs* of which the seller at the time of contracting had reason to know. . . ." [emphasis added]³⁹

Similarly, under the "include" clause in section 2A-520(2), "consequential damages" resulting from the lessor's breach include losses resulting from general or particular requirements and needs of which the lessor at the time of contracting had reason to know.

35. See HAWKLAND, U.C.C. SERIES, *supra* note 28, § 2-715:2. Under section 2-715(1), incidental damages resulting from the seller's breach include "expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or breach." *Id.*

36. See U.C.C. § 2-710.

37. See *id.* §§ 2A-520, 2A-530.

38. Section 2-710 applies to the seller's damages and section 2-715 to the buyer's damages in sales transactions. Section 2A-520 applies to the lessee's damages and section 2A-530 to the lessor's damages in lease transactions.

39. U.C.C. § 2-715(2). The damages may only be recovered when they "could not reasonably be prevented by cover or otherwise." *Id.*

The seller or lessor, of course, would normally have reason to know of the “general” requirements and needs of the buyer or lessee. While damages arising from these requirements and needs may be literally recoverable as consequential damages under the foregoing described provisions, they would also, under normal circumstances, probably be recoverable under other provisions of Articles 2 and 2A as statutory compensatory damages.

Thus, for example, if the market price of the goods exceeds the contract price, a reasonable person in the position of the seller would be aware that the damages to the buyer resulting from the seller’s failure to deliver the goods would include the difference between the prices. These damages would arise out of the “general” needs of the buyer and would literally be recoverable as “consequential damages” under the provisions quoted above, but they also would be recoverable as compensable damages under section 2-708. Thus the “consequential damages” recoverable as such by the buyer or lessee under Articles 2 and 2A, (i) would not be the remote, indirect damages that are typically thought of as “consequential damages” and (ii) would not normally be the “general” foreseeable damages that may be thought of as the “natural” consequences of the breach. The former would not be recoverable at all, and the latter would normally be recoverable as compensable damages.

Rather, the “consequential damages” recoverable as such under Articles 2 and 2A would principally be the special, indirect, remote damages that would not ordinarily be foreseeable, but, in the particular case, are foreseeable because the breaching party is aware of the special circumstances, that is, the “particular requirements and needs” of the aggrieved party that have given rise to the damages. These are the damages we refer to in this paper as “advised consequential damages.”

In addition to advised consequential damages, the Articles 2 and 2A consequential damages would include such foreseeable incidental damages and compensatory general damages as might not be recoverable as such under Articles 2 and 2A. These would be recoverable as consequential damages resulting from the “general” requirements and needs of the aggrieved party of which the breaching party has reason to know.

Finally, consequential damages under Articles 2 and 2A also include injury to persons or property when the damages “proximately” result from a breach of warranty.⁴⁰

It may be noted here that consequential damages are not available to the seller or lessor when the buyer or lessee is in breach under the current versions of Articles 2 and 2A. These damages would be available, however, under the 2000 Annual Meeting Drafts of these Articles.⁴¹

Professor Hawkland’s review of damages cases under Articles 2 and 2A yields an analysis that is similar to the foregoing analysis. He states

40. *See id.* §§ 2-715(2)(b), 2A-520(2)(b).

41. *See* U.C.C. §§ 2-708 – 2-710, §§ 2A-527 – 2A-530 (Proposed Draft 2000).

that many courts have found three elements with respect to which the recovery of damages is available.⁴² First, the aggrieved party can recover damages resulting in the ordinary course of events from the breach. These are “ordinary,” “proximate,” “general,” or “natural,” and may be had, Professor Hawkland states, without proof of foreseeability. Second, the aggrieved party can recover damages that a reasonable person would have foreseen “in the great multitude of cases.” Here the actual loss that occurred must have been foreseeable. Third, the aggrieved party can recover damages that flow from special circumstances that were communicated to the breaching party at the time of contracting “assuming these losses were foreseeable consequences of the breach in the light of the fact that the promisor had knowledge or reason to know of these special circumstances.”⁴³ Professor Hawkland’s third category is embodied in the term “advised consequential damages” as used in this paper.

We have noted that the term consequential damages is typically used in contract clauses and by the courts as a synonym for “special” or “indirect” damages, that is, for damages resulting from requirements and needs of which the defendant at the time of contracting *did not* have reason to know. This usage is directly the opposite of the usage in Articles 2 and 2A. Stated differently, the term “consequential damages” is typically used to mean damages that are not reasonably foreseeable, while Articles 2 and 2A use the term to mean damages that *are* reasonably foreseeable. In my view, the U.C.C. would have better served practitioners if it had made uniform the use of the term instead of perpetuating its conflicting use.

Despite the conflict in terminology, however, the damages formulations in Articles 2 and 2A are entirely consistent with the rule formulated in *Hadley v. Baxendale* and, for that matter, with the consequential damages provisions in the other articles of the U.C.C. The difference is not in the results that the different formulations would produce but rather in the formulations themselves.

Articles 2 and 2A use “include” clauses virtually to define “consequential damages” to mean foreseeable damages, and then make consequential damages available to the aggrieved party. *Hadley v. Baxendale* makes foreseeable damages available to the aggrieved party without the use of any definition. Article 1, and other U.C.C. Articles not including Articles 2 and 2A, make consequential damages either available or not available without defining the term but in a manner that seems generally consistent with the results in *Hadley v. Baxendale* and Articles 2 and 2A (though not entirely free from ambiguity).

Articles 3, 4 and 4A

Article 3 applies to negotiable instruments, Article 4 to bank deposits and collections, and Article 4A to electronic funds transfers.

42. See HAWKLAND, U.C.C. SERIES, *supra* note 28, § 2-715:3.

43. *Id.*

Section 3-411

Section 3-411 applies to a bank that has become obligated to pay a check by accepting a certified check or issuing a cashier's check or teller's check. Subsection (b) provides that the person seeking to enforce the check "may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages."⁴⁴

The rule in section 3-411 is clear. The bank is liable only to the extent that the bank has notice of the possibility of the damages, but after the notice is received, the term "consequential" would seemingly make the bank liable for the actual damages no matter how unforeseeable, indirect or remote they would otherwise have been. The bank avoids liability, however, when the bank's refusal occurs because the bank has suspended payments, asserts a defense that it reasonably believes is available against the person seeking to enforce the check, has a reasonable doubt whether the person seeking to enforce the check is entitled to payment, or payment is prohibited by law.

Section 4-103

Under section 4-103(e), the measure of damages for the bank's failure to exercise ordinary care in handling a check is the amount of the check less an amount that would have been realized by the exercise of ordinary care. If there is also bad faith, the damages include "any other damages the party suffered as a proximate consequence."⁴⁵ The provision may not be, strictly speaking, a "consequential damages" provision because it fails to use that term. By making the bank liable, however, for "any other damages the party suffered as a proximate consequence" of the bank's conduct, the provision seems to make the bank liable for consequential damages provided the "proximateness" test is satisfied.⁴⁶ Official Comment 6 to section 4-103 states that the proximateness of the damages sought is to be tested by "the ordinary rules applied in comparable cases."⁴⁷ The cases would presumably include cases in which the issue is the availability of consequential damages, although there seems to be less of an element, or no element at all, of "reasonable foreseeability" in determining "proximate cause" than in determining whether damages are "consequential" damages.

Section 4-402(b)

Under section 4-402(b), a bank that wrongfully dishonors a check is liable to its customer for damages "proximately caused" by the wrongful dishonor. The bank's liability is limited to actual damages proved and

44. U.C.C. § 3-411(b).

45. *See id.* § 4-103(e).

46. *Id.*

47. *Id.* § 4-103, cmt. 6.

may even include damages for an arrest or prosecution of the customer "or other consequential damages." The category of "other consequential damages" is quite broad and could include mental distress.⁴⁸

Section 4A-305

Section 4A-305 specifies the damages available to the sender of wire transfer instructions when the receiving bank fails to execute the sender's instructions properly and, as a result of the bank's improper execution, (i) payment to the beneficiary of the transfer is delayed,⁴⁹ (ii) the transfer is not completed,⁵⁰ (iii) an intermediary bank designated by the originator is not utilized,⁵¹ or (iv) the receiving bank issues instructions that do not comply with the terms of the originator's instructions.⁵² It also specifies the damages available when the receiving bank fails to execute instructions that it was obliged by express written agreement to execute.⁵³ Under any of these circumstances,⁵⁴ the available damages include interest, the recovery of interest losses, the originator's expenses in the funds transfer, and incidental expenses.⁵⁵ They do not include any other amounts unless the bank has expressly agreed in writing to pay the other amounts.

The drafters of Article 4A had the decision in *Evra v. Swiss Bank*,⁵⁶ discussed in detail in Part I of this paper above, very much in mind when they wrote section 4A-305. In *Evra*, the plaintiffs sought damages resulting from the failure of intermediary Swiss Bank to act on wire transfer instructions to transfer \$27,000. As a result of Swiss Bank's failure to act, the plaintiffs lost vessel charter rights worth in excess of \$2 million and sought to recover their losses as damages from Swiss Bank. Applying the rule in *Hadley v. Baxendale*,⁵⁷ the court ruled that the plaintiffs could not recover the value of the lost charter rights because Swiss Bank could not be held to have knowledge of the circumstances giving rise to the loss.

48. See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 21-4(4th ed. 1995) [hereinafter WHITE AND SUMMERS].

49. U.C.C. § 4A-305(a).

50. *Id.* § 4A-305(b).

51. *Id.*

52. *Id.*

53. See *id.* § 4A-305(d).

54. The remedies provided in section 4A-305 do not apply to the bank's execution of fraudulent payment instructions (sections 4A-201 through 4A-204), to the bank's errors in making transfers (section 4A-303), to the bank's compliance with instructions in which the beneficiary or a bank is misdescribed (sections 4A-207 and 4A-208), or to the failure of the beneficiary's bank to pay the beneficiary after accepting a payment order for the beneficiary's account (section 4A-404).

55. It is not clear what the drafters meant by "incidental expenses." For the suggestion that plaintiffs might seek to argue that damages generally thought to be consequential are instead incidental and thus available, see WHITE AND SUMMERS, *supra* note 44, § 25-3 *et seq.* The bank's liability under these section 4A-305 provisions runs to the originator or beneficiary (subsection (a)), the originator (subsection (b)) or the sender (subsection (d)).

56. *Evra Corp. v. Swiss Bank Corp.*, 673 F2d 951 (7th Cir. 1982).

57. 9 Exch. 341,156 E. R. 145 (1854) (reprinted in ALL E. R. REP. 1843-1860, 461 (G.F.L. Bridgman ed., Butterworth & Co. Ltd 1965)).

The exposure of banks in the United States to large sums as consequential damages for failure to comply with wire transfer instructions was a significant factor in the decision to write the new Article 4A on funds transfers.⁵⁸ The Official Comments state with respect to the *Evra* opinion: "If *Evra* means that consequential damages can be imposed if the culpable bank has notice of particular circumstances giving rise to the damages, it does not provide an acceptable solution to the problem of bank liability for consequential damages."⁵⁹

The drafters of Article 4A wanted to make "consequential damages" unavailable to the sender of wire transfer instructions when the receiving bank failed to comply with the instructions. They wanted also to make "advised consequential damage" unavailable to the sender under these circumstances. Stated otherwise, they wanted to make remote, indirect and normally unforeseeable damages, i.e. "consequential damages," not available to the sender *even when the bank was aware of the special circumstances giving rise to the damages*.

To ensure that a receiving bank would not be liable to the sender for consequential damages (except only when the bank has expressly agreed in writing to assume such liability) – however the term "consequential damages" may be defined – the drafters of section 4A-305 specified in subsections (a), (b) and (d) the available damages described above. Then in subsections (c) and (d), they provided simply that in addition to the specified recoverable damages, other damages, "including consequential damages," are recoverable only "to the extent provided in an express written agreement of the receiving bank."⁶⁰ The drafter thus deftly avoided any ambiguity that might arise by reason of the use of the term "consequential." Only the specified damages are available. Consequential damages—whatever the term may mean—are not available.

Of course, if *Evra* were to be decided today, the exclusion of all damages for the wrongs specified under section 4A-305 other than the damages specified in the section would insulate Swiss Bank from any claim for the more than \$2 million sought by the plaintiffs. Moreover, absent any written agreement by Swiss Bank to execute wire transfer instructions received from Continental Bank, Swiss Bank would not be obliged to act on the instructions and hence not obliged to pay any damages—not even interest, incidental expenses or the plaintiffs' expenses in the wire transfer transaction. Even if one were to assume that Swiss Bank had entered into a written agreement to execute Continental Bank's wire

58. See PAUL S. TURNER, LAW OF PAYMENT SYSTEMS AND EFT § 4.02[A] (Aspen Law & Business 1999). Banks and bank regulators were concerned that large losses could lead to systemic failures.

59. U.C.C. § 4A-305, cmt. 2.

60. *Id.* § 4A-305(c) and (d). In section 4A-305(e), the drafters also provided a limited right of the aggrieved party to recover its attorney's fees. Attorney's fees are not available under the section when the claim is based on the bank's failure to execute the instructions and the funds transfer agreement provides for damages (presumably any damages—not just damages for failure to execute instructions).

transfer instructions, the agreement would be enforceable (i) only by Continental Bank, not by the plaintiffs, who had no privity with Swiss Bank and (ii) only to the extent the bank expressly agreed to assume the damages.

Section 4A-404

Section 4A-404(a) is very similar to section 3-411 described above. The latter allows the holder of a cashier's check, teller's check or certified check to recover consequential damages when the bank fails to pay the check without any of the excuses justifying non-payment specified in the section. Section 4A-404 allows the beneficiary of a wire transfer to recover consequential damages from the beneficiary's bank when the bank refuses to pay the beneficiary after the bank has accepted an incoming payment order for the beneficiary's account unless the bank proves that its reason for non-payment was based on a reasonable doubt concerning the right of the beneficiary to payment. Thus if a customer's bank that has accepted an incoming payment order for the benefit of the customer refuses to pay the customer, the bank may be liable to the customer for consequential damages resulting from the refusal "to the extent the bank had notice of the damages. . . ." ⁶¹

It may be noted here that sections 3-411 and 4A-404 both make damages labeled "consequential damages" available when the bank has been explicitly advised of the special circumstances giving rise to the damages. Stated differently, the term "consequential damages" is used in a manner that makes clear that the damages available under these sections include what we have called "advised consequential damages."

This usage might support an argument that where the term appears elsewhere in a U.C.C. provision that makes consequential damages unavailable, advised consequential damages are also unavailable. On this basis, the section 1-106 rule that consequential damages may not "be had" would make advised consequential damages also unrecoverable notwithstanding their foreseeability by the breaching party. This argument would hardly seem definitive, however, in the absence of any indication that section 1-106 was intended to overrule the foreseeability rules of *Hadley v. Baxendale*.

Article 5

Article 5 governs the rights and obligations of the parties in letter of credit transactions. The remedies available under Article 5 are specified in section 5-115, which provides generally that consequential damages are not available to an aggrieved beneficiary from a bank that wrongfully dishonors the beneficiary's presentation of documents,⁶² not available to an aggrieved applicant from a bank that wrongfully honors the presenta-

61. *Id.* § 4A-404(a).

62. *See* U.C.C. § 5-115(1).

tion,⁶³ and not available to an aggrieved beneficiary or applicant from an advising bank or bank nominated to pay under the letter of credit that is liable under Article 5.⁶⁴

As an example of a claim for consequential damages by a beneficiary, let us suppose that Lender, a commercial loan company, and Borrower are parties to a Note Agreement pursuant to which Lender loans \$500,000 to Borrower. To support Borrower's obligations under the Note Agreement, Borrower applies to Issuing Bank to have Issuing Bank issue a standby letter of credit to Lender. The letter of credit would obligate Issuing Bank to pay Lender upon the presentation a certificate to Issuing Bank prior to the expiration date of the credit. The letter of credit requires that the certificate presented to Issuing Bank state: "Borrower is in default under the Note Agreement and the sum of \$_____ is due and owing to the undersigned Lender. The undersigned Lender hereby demands payment thereof."

In response to Borrower's application, Issuing Bank issues the letter of credit in the amount of \$500,000 to Lender. In Article 5 parlance, Issuing Bank is now the "Issuer," and the Issuer is obliged to pay Lender, which has now become the "Beneficiary," upon timely receipt of the certificate. Borrower, now the "Applicant," is obliged to reimburse the Issuer if the Issuer pays the Beneficiary against receipt of a properly worded certificate.

Suppose that the Beneficiary presents a properly worded certificate, but the Issuer wrongfully refuses to pay the Beneficiary. If the Beneficiary prevails in litigation against the Issuer, the Beneficiary will be entitled to judgment for the amount stated in the certificate up to the \$500,000 amount of the credit. Suppose, however, that the Beneficiary can prove that because of the Issuer's failure to pay, the Beneficiary was compelled to default under its major credit agreement, and as a result of that default and cross-default provisions in its other loan agreements, Beneficiary was driven into insolvency with losses that support a damages claim of \$10 million. Can the Beneficiary's trustee in bankruptcy recover the \$10 million damages?

The answer must be "no" because the damages are remote and indirect and were not reasonably foreseeable by Issuer at the time the letter of credit was issued. In short, the damages are the very "consequential damages" that section 5-115(a) makes unavailable to the aggrieved beneficiary. (If there were no section 5-115, the damages would nevertheless presumably be unavailable under section 1-106.)

Suppose, however, that the Issuer had been aware of the financial condition of the Beneficiary and in particular was advised that if it failed to pay under the letter of credit, the Beneficiary would be driven into insolvency with resulting huge losses. Would the knowledge of the Issuer

63. *See id.* § 5-115(2).

64. *See id.*

make a difference that would allow the Beneficiary's bankruptcy trustee to recover the \$10 million?

Let us consider another example, this time to illustrate a claim by the applicant for consequential damages. The applicant might suffer consequential damages as a result of either the wrongful honor or the wrongful dishonor of the beneficiary's presentation. In this example, the Beneficiary owns the ocean-going vessel *Pandora* and has given possession of the vessel to the Applicant under a long-term vessel charter. Payments of \$27,000 are due periodically under the charter, and these payments are to be made by the Issuer to the Beneficiary under a "direct pay" standby letter of credit. In the letter of credit, the Issuer undertakes to pay each of the \$27,000 installments under the charter to the Beneficiary upon Beneficiary's presentation to the Issuer of a document stating: "\$27,000 is due and payable under the Charter on _____, 2001 and will become past due on _____, 2001. Demand for \$27,000 is hereby made."

The Beneficiary timely presents a properly worded document demanding payment of \$27,000, but the Issuer refuses to pay the Beneficiary. The payment becomes past due, and the resulting default allows the Beneficiary to terminate the charter and repossess the *Pandora*.

The Applicant sues the Issuer under section 5-115(b), which allows an applicant to recover actual damages resulting from the Issuer's wrongful dishonor "but not consequential damages." The Applicant had subchartered the *Pandora* at rates that were twice those paid by the Applicant to the vessel's owners. If the charter had not been terminated, the Applicant would have realized \$2 million in net subcharter income over the remaining term of the charter. May the Applicant recover the \$2 million lost profits?

The Applicant's \$2 million lost profits would surely be unrecoverable as precisely the kind of "consequential damages" that are made unavailable under section 5-115(b). The lost subcharter income could not reasonably have been foreseen by the Issuer. Would the damages be recoverable, however, if the Issuer had been made aware of the special circumstances prior to issuing the letter of credit? This example, of course, is modeled on the facts in *Evra v. Swiss Bank*. If *Evra* applies and is not overruled by section 5-115, the damages would be available to the Beneficiary if the Issuer had been aware of the circumstances.

Is *Evra* overruled by section 5-115? By contrast with the drafters of Article 5, the drafters of Article 4A unambiguously overruled *Evra v. Swiss Bank* and *Hadley v. Baxendale* with respect to the availability of advised consequential damages when a bank fails to comply with wire transfer instructions. Section 4A-305 specifies precisely the damages that are available from a bank that fails to execute wire transfer instructions and then provides that no other damages—including "consequential damages"—are available.

By contrast, the drafters of section 5-115 state simply that "consequential damages" are not recoverable. Since the term consequential damages

is not defined in Article 5 or elsewhere in the U.C.C.,⁶⁵ it is not clear whether remote and indirect damages that are consequential and thus not available under section 5-115 become available when the breaching party is aware of the special circumstances. Thus we cannot definitively answer the question posed in either of the foregoing examples.

In the process of drafting the current version of Article 5 completed in 1995, the Article 5 drafters rejected a proposal to include a provision modeled on sections 3-411 and 4A-404 discussed above. The rejected provision would have allowed a beneficiary to recover "consequential damages" for wrongful dishonor by the issuer provided that the issuer had notice of the special circumstances giving rise to the damages and the issuer was unable to show that its wrongful dishonor was based on a reasonable doubt concerning the right of the beneficiary to payment.

In the drafting process, the banks understandably sought to limit their liability in general and in particular sought to avoid exposure to consequential damages. Yet the proposal seemed to its proponents, including myself, a fairly mild one that would only rarely apply.⁶⁶

The rejection of the proposal indicates the unwillingness of many of the drafting participants to expose the banks to consequential damages. The rejection further suggests that had the drafters thought about the matter and had the issue been put to them, they might have decided to make clear that the term "consequential damages" in section 5-115 includes advised consequential damages. Stated differently, the drafters might have decided to provide that remote, indirect and unforeseeable damages are not available under section 5-115 even when the issuer is aware at the time of issuance of the special circumstances giving rise to the damages. Of course, the Article 5 drafters failed to do any such thing, however, and that failure suggests that the rule laid down in *Hadley v. Baxendale* and followed by *Evra v. Swiss Bank* and by the Restatement (Second) of Contracts is the rule under the U.C.C. On this basis, section 5-115 might allow the recovery of remote and indirect "consequential damages" when the issuer was advised of the special circumstances giving rise to the damages at the time the letter of credit was issued.

Articles 6, 7, 8 and 9

UCC Articles 6, 7, 8 and 9 do not refer to consequential damages. It seems likely that other law, possibly other law under the U.C.C. or general contract law, would govern the availability of remedies in disputes under these Articles. In any case, consequential damages are generally

65. The unique "include" clauses in Articles 2 and 2A that state that consequential damages "include" foreseeable damages confuse the analysis but clearly are irrelevant to the issue whether consequential damages include advised consequential damages in the context of Article 5.

66. See Donald J. Rapson, *Who Is Looking Out for the Public Interest? Thoughts About the UCC Revision Process in the Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249, 275 (1994). I represented the Treasury Management Association, the proponent of the proposal, in the Article 5 drafting process.

not available under these Articles by reason of the general provision making them unavailable in section 1-106. We have already noted the ambiguity with respect to the availability of remote and indirect damages under Article 1 when the breaching party knew the special circumstances giving rise to the damages at the time of contracting.

III. CONCLUSION

In the nearly half-century of the existence of the U.C.C., the issue of the availability of consequential damages under the U.C.C. does not seem to have been a particularly troublesome one in the courts. Thus while the issues noted in this paper may be thought of as having at least some theoretical vitality, they do not appear to have impeded the resolution of cases under the U.C.C.⁶⁷ Yet, to my mind, it is axiomatic that terms should be used clearly and consistently in legislation, especially in a series of uniform model laws, and even more especially in a series of uniform model laws collectively denominated as a "Code." That the term "consequential damages" is not used clearly and consistently in the U.C.C. seems, therefore, to justify the complaints, however mild, recorded in this paper.

The principal ambiguity noted in this paper concerns the availability of remote and unforeseeable damages when the breaching party has notice at the time of contracting of the special circumstances giving rise to the damages. The Article 1 drafters may have thought that the issue is best left for the courts to decide on the facts in the particular case and under the particular U.C.C. Article in which the issue arises.

The use of the term "consequential damages" in Articles 2 and 2A to denote *foreseeable* losses has always seemed lamentable to me. In the other parts of the U.C.C. and in the wide universe of contract law generally, the term typically denotes *unforeseeable* losses. In the course of preparing this paper, however, it has become clear to me that this is only at bottom a stylistic complaint, and much less significant than the fact that the conflicting usage, confusing as it may seem to me at the threshold, has seemed to work well in the narrow universe of Articles 2 and 2A.

It seems only appropriate, then, as revisions to the U.C.C. are nearly at an end, to conclude this paper with hearty congratulations to the uniform law commissioners. The revisions to the entire Code, when finally approved, will have constituted a monumental achievement.

67. In Illinois, the cases involving consequential damages under Articles 1, 2 and 2A have been very well summarized in WILLIAM B. DAVENPORT ET AL., ILLINOIS PRACTICE, vol. 2A, (West Publishing Co. 1997). The summaries indicate no confusion on the part of the courts that suggest the necessity of revisions to Articles 1, 2 or 2A.

