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Damages for Sellers under the Code's Profit Formula

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DAMAGES FOR SELLERS UNDER THE CODE'S PROFIT FORMULA*

by

*Roy Ryden Anderson***

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I. OVERVIEW

WHEN a buyer repudiates a sales contract, unjustifiably rejects contract goods or revokes acceptance of them, or is otherwise in breach prior to final acceptance of the goods, the Uniform Commercial Code provides the aggrieved seller with four remedial damage alternatives. These alternatives are: (1) actions for the unpaid contract price

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under section 2-709;¹ (2) the contract price minus the resale price under section 2-706;² (3) the difference between the market price at the time and place for tender and the unpaid contract price under section 2-708(1);³ or (4) the profit plus reasonable overhead under section 2-708(2).⁴ This Article focuses on the last alternative, the profit formula, with the purpose of demonstrating that the courts for good reason regard the profit formula as the most important Code damage remedy for sellers. Further, this Article explains the intricacies of proving at trial a recovery based on the profit formula.

Professors Summers and White begin their discussion of section 2-708(2) with the statement: "This section addresses a group of problems that the drafters did not formulate well and presumably did not understand well."⁵ The end their discussion with woe: "It is a section of great promise, still largely unfulfilled. It began life as a graft on 2-708(1), bloomed before it was enacted into law, and was finally enacted in such a gnarled mutation that it now barely accommodates some of the cases for which it was originally designed."⁶

Although there is much truth in this statement, the situation is not quite so bad. Actually, commentators have had a great deal more difficulty assessing the parameters of section 2-708(2) than have the courts. All have been greatly aided by the remarkable early articles by Professor Harris,⁷ whose discussion of sellers' damage remedies under the Code sharpened the focus on the profit formula as the most important of those remedies.⁸

The profit formula is indeed the dominant damage remedy. It applies to

1. U.C.C. § 2-709 (1977). The price action is severely restricted by § 2-709 if the buyer's breach occurs prior to the time the goods have been accepted. The price action is available only if the goods are not reasonably resalable or have been lost or destroyed after the risk of loss has passed to the buyer. *Id.* § 2-709(1).

2. *Id.* § 2-706; *see id.* § 2-703 (conditions under which § 2-706 recovery available).

3. *Id.* § 2-708(1).

4. *Id.* § 2-708(2) provides:

If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

5. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 274 (2d ed. 1980).

6. *Id.* at 288.

7. *See* Harris, *A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared*, 18 STAN. L. REV. 66 (1965) [hereinafter Harris, *Sales Act Results*]; Harris & Graham, *A Radical Restatement of the Law of Seller's Damages: California Results Compared*, 18 STAN. L. REV. 553 (1965); Harris, *A Radical Restatement of the Law of Seller's Damages: New York Results Compared*, 34 FORDHAM L. REV. 23 (1965); Harris, *A Radical Restatement of the Law of Seller's Damages: Michigan Results Compared*, 61 MICH. L. REV. 849 (1963); Harris, *A General Theory for Measuring Seller's Damages for Total Breach of Contract*, 60 MICH. L. REV. 577 (1962) [hereinafter Harris, *General Theory*].

8. *See* also Childres & Burgess, *Seller's Remedies: The Primacy of UCC 2-708(2)*, 48 N.Y.U. L. REV. 833 (1973), for a general guide to interpreting and applying the Code's lost-profit measure of damages.

all sellers who are left at "lost volume" as a result of the buyer's breach.⁹ A lost volume seller is one that has fewer customers than it can supply. A breach by one of its buyers causes a decrease of one transaction in the volume of its business and the economic loss of the profit associated with that transaction. The seller does not make up for this loss by reselling the goods to a buyer who would have purchased from the seller in any event. No subsequent resale of the goods by a lost volume seller should be applied to mitigate the damages owed by the breaching buyer unless the resale was one that the seller could not have made except for the buyer's breach.¹⁰ It is for this reason that the resale formula of section 2-706 will not compensate the lost volume seller. The resale formula measures damages on the basis of the contract price minus the resale price, thereby crediting the buyer with the full amount received by the seller on a subsequent resale of the goods. The resale formula will be compensatory only when the calculation is based on a true resale, one that the seller could not have made but for the buyer's breach.¹¹ By definition, a lost volume seller is one that resells the goods to a party to whom it could have sold regardless of the breach.¹²

Professor Hawkland succinctly describes the lost volume seller situation as follows:

A simple illustration of a situation in which damages based upon the difference between the market and the contract prices do not make the seller whole is one in which the subject of the sale involves goods that sell for a standard price. For example, suppose an automobile dealer sells a car to a buyer for \$7,500, its list price; that the buyer repudiates the deal and refuses to take possession of the car, or pay for it, and that the seller sells the same car to another customer for \$7,500. In this case, the seller would not want to use the resale rule of section 2-706 to measure his damages, because there is no difference between the resale price and contract price. Nor would he want to use the rule for damages stated in subsection 2-708(1), for there is no difference between the market and contract prices. This might suggest that the seller had not been injured by the repudiation, but the seller has lost a profit because of the breach. If the buyer had not breached, the seller would have sold two cars instead of one, for it may be safely assumed that the second purchaser would have bought another car. Stated differently, if it is assumed that the seller has an unlimited supply of cars at his disposal, the buyer's breach costs him a sale, because no matter how many cars the seller may sell in a given period, he would have sold one more had

9. Professor Harris coined the term "lost volume" to describe this particular phenomenon. See Harris, *General Theory*, *supra* note 7, at 599-600. The terminology has become widespread in both judicial decisions and commentary.

10. See *Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722, 725 n.6, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1194 n.6 (Me. 1983).

11. See generally Anderson, *Plunging the Depths of the Seller's Resale Remedy Under the Uniform Commercial Code*, 50 J. AIR L. & COM. 411 (1985) [hereinafter Anderson, *Plunging the Depths*].

12. See Anderson, *Mapping the Labyrinth of Sellers' Damages*, 10 LITIGATION 10, 12-13 (1983); Harris, *Sales Act Results*, *supra* note 7, at 80-83.

the buyer not breached.¹³

A retail seller of fixed-price goods is typically an example of a lost volume seller. Such a seller represents one group definitely contemplated by the drafters of section 2-708.¹⁴ Retail sellers of fixed-price goods, however, are but one example. Lost volume sellers may include wholesalers of goods at varying prices. The test is whether the seller has fewer customers than it can supply or, in other words, more goods than it has customers. A typical example of the lost volume seller that recurs with frequency in the reported decisions is the so-called middleman or jobber. In the present context a middleman or jobber refers to a seller who never actually acquires the goods. The seller does not sell over the counter or out of stock, but rather purchases goods from a source of supply to accommodate orders of buyers. Clearly, so long as this type of seller has a source of supply that exceeds the volume provided by customers, a breach by any customer places the seller in a lost volume situation.

13. 3 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-708:04, at 331-32 (1982). Professor Hawkland goes on to say:

In one sense, however, this may not be true, because buyer number one may have sold his car to buyer number two and thus have deprived the seller of that opportunity, if no breach had occurred. That possibility involves assumptions that should not be made lightly in favor of a breaching party, and a heavy burden should be placed upon him should this speculation be offered to defeat the seller's claim to his lost profit.

Id. at 332. Professor Hawkland's qualification is perhaps in response to recent commentary from economist lawyers that few sellers are actually left at lost volume because of a buyer's breach. One premise for this extraordinary suggestion is that the breaching buyer could have sold the contract goods to the purchaser so that the seller could not have made both sales. To date, the commentary has not caused pause in judicial decisions, and it should not cause undue concern to find once again an analytical gap between actuality and economic cost curves. The most widely cited commentary on point is a remarkable article, Goetz & Scott, *Measuring Sellers' Damages: The Lost-Profits Puzzle*, 31 STAN. L. REV. 323 (1979). See also Goldberg, *An Economic Analysis of the Lost-Volume Retail Seller*, 57 S. CAL. L. REV. 283 (1984); Shanker, *The Case for a Literal Reading of UCC Section 2-708(2) (One Profit for the Reseller)*, 24 CASE W. RES. L. REV. 697 (1973). In responding to another facet of this commentary one scholar said:

To be a genuine lost-volume seller, a seller must establish that he in fact had the capacity to enter into additional contracts, that he had the ability to successfully negotiate a second sale with the person who purchased the goods following the original buyer's breach, and that his marginal expenses of taking on an additional contract would not have been any higher than the expenses he would have incurred on the original transaction. This criticism may be accurate from an economist's perspective, but it asks too much of the law.

G. WALLACH, THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE 8-18 (1981) (footnote omitted).

14. U.C.C. § 2-708 comment 2 (1977) states:

The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to recovery of "profit" to show a history of earnings, especially if a new venture is involved.

Section 2-708(2) also applies to all the cases in which the seller properly discontinues, or fails to begin, manufacture of goods because of a buyer's breach. These cases will be referred to as the incomplete goods cases.¹⁵ Whether or not a seller should mitigate damages following a buyer's breach by completing manufacture of the goods is governed by section 2-704.¹⁶ As a rule of thumb, a seller should probably complete manufacture of the goods in any case in which it reasonably appears at the time of the buyer's breach that the goods can be resold at a profit, at a price that exceeds total direct costs of manufacture.

The courts have come to apply the profit formula of section 2-708(2) as a matter of course to all lost volume and incomplete goods situations. Since these two situations almost certainly account for the vast majority of actual mercantile cases, the profit formula of section 2-708(2) is indeed the most important of sellers' damage remedies. The comparative difficulty of proving both entitlement to and the amount of section 2-708(2) damages, however, has probably discouraged sellers from making use of the profit formula.

Proving damages under section 2-708(2) is appreciably more difficult than is proving them under the resale formula of section 2-706. The fact that section 2-708(2) does not enjoy a popularity fairly reflective of its standing is no doubt also attributable to the provision's confusing meaning. Read literally, the provision cannot be applied correctly. This frustrating irony is enough in itself to discourage the busy practitioner in the preparation of a case. The statute provides that the buyer may recover reasonable overhead,¹⁷ thereby presumably indicating that such a thing as unreasonable overhead exists, which the seller may not recover. As discussed below, however, reasonableness of the seller's overhead is generally irrelevant to the question of damages owed by the breaching buyer. Further, the statute reads that the buyer is entitled to receive a credit for proceeds from resale of the goods.¹⁸ This language must be read out of the statute in order for section 2-708(2) to be correctly applied to lost volume sellers. Happily, the legislative history of the provision¹⁹ supports this result, and the courts have been quite willing to follow that history and logic rather than the precise articulation of their respective state legislatures. Much of the linguistic confusion probably stems from the fact that the profit formula in goods cases was rarely used under pre-Code law, and thus, the drafters had little experience with it.²⁰

15. The reference to incomplete goods situations is intended to encompass sellers who manufacture from component parts as well as those who manufacture from raw materials. Although occasionally component sellers are discussed separately from sellers who manufacture from scratch, the distinction is one without a difference. The factors determining an incomplete goods situation are whether, as a result of the buyer's breach, the seller failed to start or discontinued manufacture of the goods and whether this decision was proper from a mitigation of damages standpoint. See 3 G. WALLACH, *supra* note 13, at 8-16; see also U.C.C. § 2-704 (1977) (mitigation of damages).

16. U.C.C. § 2-704(2) (1977).

17. *Id.*

18. *Id.*

19. See *infra* notes 150-53 and accompanying text.

20. See *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 397-98, 285 N.E.2d 311, 313-14, 334

It is important to note that section 2-708(2) establishes as a prerequisite to the availability of the profit formula proof that the market formula in section 2-708(1) "is inadequate to put the seller in as good a position as performance would have done."²¹ Fortunately, the reported decisions make clear that neither lost volume sellers nor sellers left with incomplete goods as a result of the buyer's breach will have serious difficulty in proving this prerequisite. The market formula of section 2-708(1) will compensate neither of these sellers. The market formula hypothecates that the seller will be able to resell the goods at the market price at the time and place for tender, as provided in the formula. Since an actual resale of the goods is presumed, the market formula suffers the same compensatory inadequacies for the lost volume seller as does the resale formula.²² Further, because a resale of completed goods is the presumption underlying section 2-708(1), the market formula is not intended to apply to, and will not compensate, sellers left by the breach with incomplete goods.²³ The profit formula of section 2-708(2) is clearly the compensatory damage formula in both lost volume and incomplete goods cases. The formula promises to become more widely used under the Code as the trial bar becomes more familiar with the mechanics of the calculations under the formula and as the courts continue to demonstrate a flexible attitude toward problems of proof thereunder.

II. THE PARAMETERS OF THE PROFIT FORMULA

A. *The Lost Volume Seller*

As with the resale formula of section 2-706, the market formula of section 2-708(1) will not work to compensate a lost volume seller because the market formula presupposes a resale of goods at the market price provided by the formula. Also, since in the lost volume seller situation the goods can be resold after a contract breach, the seller will not be entitled to an action for the price under section 2-709.²⁴ Thus, the profit formula not only works well to make whole the lost volume seller, it is the only available compensatory damage alternative under the Code.²⁵

When the seller is able to establish its lost volume status, the courts have uniformly held that damages under the market formula do not place the seller in the same position it would have occupied had the breach not occurred.²⁶ In one case involving a contract to supply and install carpeting the

N.Y.S.2d 165, 169, 10 U.C.C. Rep. Serv. (Callaghan) 950, 953-54 (1972) (court noting new statute).

21. U.C.C. § 2-708(2) (1977).

22. See *supra* text accompanying notes 10-11.

23. See Anderson, *Pitfalls for Sellers and Buyers Under the Market Formula of Section 2-708*, 4 REV. LITIGATION 251, 258-65 (1985).

24. See U.C.C. § 2-709(1)(b) (1977).

25. Some history indicates that the drafters of the Code contemplated the lost volume seller situation when they drafted § 2-708(2). See J. WHITE & R. SUMMERS, *supra* note 5, at 274-75.

26. Cases allowing the lost volume seller access to the profit formula under § 2-708(2) include: *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 33 U.C.C. Rep. Serv. (Callaghan) 1669 (1st Cir. 1982); *Blair Int'l, Ltd. v. LaBarge, Inc.*, 675 F.2d 954, 33 U.C.C. Rep. Serv.

court went so far as to hold that the seller was entitled to the profit formula even if the breach did not cause the seller to lose any volume in its sales.²⁷ The court set forth two alternative reasons why section 2-708(2) provided the appropriate damage measurement. The first related to the seller's volume situation. The court said that the seller might be considered a single lost volume seller.²⁸ The court agreed with the seller's position that, regardless whether the buyer breached the purchase contract, the seller could have sold carpet to the final resale purchasers of the carpet that was the subject of the breached contract.²⁹ Because of the breach, therefore, the seller made only one sale, the resale, instead of two, and thus lost the entire profit from the breached sale.³⁰ As an alternative to the lost volume rationale the court held that the seller was entitled to recover lost profit under section 2-708(2) because of the mixed nature of the breached contract.³¹ The court reasoned that, since the contract was for both a goods sale and installation service, a recovery under the market formula based on the market price for the goods would not compensate the seller for the profit it would have made on the service aspect of the contract.³²

The court's analysis allowing profit formula recovery because of the mixed nature of the contract is flawed. No reason exists why, for purposes of achieving compensation and avoiding windfalls as mandated by section 1-106,³³ the court could not have bifurcated the damage recovery for the

(Callaghan) 1242 (8th Cir. 1982); *TCP Indus. v. Uniroyal, Inc.*, 661 F.2d 542, 32 U.C.C. Rep. Serv. (Callaghan) 369 (6th Cir. 1981); *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 28 U.C.C. Rep. Serv. (Callaghan) 1039 (5th Cir. 1980); *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F.2d 251, 14 U.C.C. Rep. Serv. (Callaghan) 415 (4th Cir. 1974); *Great W. Sugar Co. v. Mrs. Allison's Cookie Co.*, 563 F. Supp. 430, 36 U.C.C. Rep. Serv. (Callaghan) 164 (E.D. Mo. 1983); *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 26 U.C.C. Rep. Serv. (Callaghan) 406 (E.D.N.Y.), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *Comeq, Inc. v. Mitternacht Boiler Works, Inc.*, 456 So. 2d 264, 39 U.C.C. Rep. Serv. (Callaghan) 488 (Ala. 1984); *Neumiller Farms, Inc. v. Cornett*, 368 So. 2d 272, 26 U.C.C. Rep. Serv. (Callaghan) 61 (Ala. 1979); *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 39 U.C.C. Rep. Serv. (Callaghan) 802 (Ct. App. 1984); *Capital Steel Co. v. Foster & Creighton Co.*, 264 Ark. 683, 574 S.W.2d 256, 25 U.C.C. Rep. Serv. (Callaghan) 1349 (1978); *Distribudor, Inc. v. Karadanis*, 11 Cal. App. 3d 463, 90 Cal. Rptr. 231, 8 U.C.C. Rep. Serv. (Callaghan) 36 (1970); *Snyder v. Herbert Greenbaum & Assoc., Inc.*, 38 Md. App. 144, 380 A.2d 618, 22 U.C.C. Rep. Serv. (Callaghan) 1104 (1977); *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 285 N.E.2d 311, 334 N.Y.S.2d 165, 10 U.C.C. Rep. Serv. (Callaghan) 950 (1972); *Kaiserman v. Martin J. Ain, Ltd.*, 112 Misc. 2d 768, 450 N.Y.S.2d 135, 31 U.C.C. Rep. Serv. (Callaghan) 1374 (N.Y. App. Term. 1981); *see also Schiavi Mobil Homes, Inc. v. Gironda*, 463 A.2d 722, 725-26, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1194-95 (Me. 1983) (failure to mitigate damages prevents access to profit formula); *Lake Erie Boat Sales, Inc. v. Johnson*, 11 Ohio App. 3d 55, 463 N.E.2d 70, 72-73, 38 U.C.C. Rep. Serv. (Callaghan) 845, 848-49 (1983) (evidence insufficient for lost volume status).

27. *Snyder v. Herbert Greenbaum & Assoc., Inc.*, 38 Md. App. 144, 380 A.2d 618, 625, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1113 (1977).

28. 380 A.2d at 624, 22 U.C.C. Rep. Serv. (Callaghan) at 1112.

29. *Id.*

30. *Id.* at 625, 22 U.C.C. Rep. Serv. (Callaghan) at 1113.

31. *Id.*

32. *Id.*; *see also Coast Indus. v. Noonan*, 4 Conn. Cir. Ct. 333, 231 A.2d 663, 665-66, 4 U.C.C. Rep. Serv. (Callaghan) 582, 583-84 (1966) (applying § 2-708(2) by analogy to construction service contract).

33. U.C.C. § 1-106 (1977).

goods and services aspects of the contract.³⁴ Thus, if the seller was not left at lost volume, but rather was able to resell the carpet to a buyer to whom it could not have sold but for the breach, the amount received from the resale should have mitigated the damages owed by the buyer. The cases so hold.³⁵

As noted earlier, a well-recognized example of the lost volume seller is the so-called jobber or middleman. So long as the available source of supply of a jobber or middleman exceeds the purchases made by customers, a breach by any of the customers will obviously leave this type of seller in a lost volume situation. Professors Summers and White misleadingly state the conditions necessary for a jobber or middleman to recover on the basis of the Code's profit formula. They suggest that such a seller must meet the two conditions of having never acquired the contract goods and of having been commercially reasonable in deciding not to acquire them.³⁶ Actually, whether the jobber or middleman has acquired the goods makes no difference. What is important is whether the jobber or middleman has available to it through its sources of supply more goods than it can sell. If at the time of the buyer's breach the seller has ordered and received the buyer's goods and is able to resell the goods to another, it does not lose its status as a lost volume seller so long as it can show that it could have made both the sale to the breaching buyer and the resale.

Professors Summers and White are certainly correct that to recover under section 2-708(2) the jobber or middleman must act in a commercially reasonable manner with respect to a decision not to acquire the goods. Commercial reasonableness should be judged in terms of whether or not the seller could have mitigated damages by acquiring the goods and reselling them. Mitigation would be possible in cases in which the demand of the seller's customers for the goods exceeds the seller's supply, or in cases in which the seller, by acquiring the goods, would be able to resell goods to a buyer to whom the seller could not have sold but for the breach.

The reported decisions consistently have recognized the jobber or middleman as a lost volume seller and have allowed the seller access to the profit formula of section 2-708(2).³⁷ If such a seller can mitigate damages by acquiring the goods and reselling them, however, the indications are that courts will require the seller to do so or suffer the consequence of being denied recovery for any damages that could have been mitigated. Thus, in

34. For a case applying different damage measures to the goods and nongoods aspects of a contract, see *Foster v. Colorado Radio Corp.*, 381 F.2d 222, 226-27, 4 U.C.C. Rep. Serv. (Callaghan) 446, 448-49 (10th Cir. 1967).

35. *Coast Trading Co. v. Cudahy Co.*, 592 F.2d 1074, 1081-82, 25 U.C.C. Rep. Serv. (Callaghan) 1037, 1045 (9th Cir. 1979); *Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722, 725-26, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1194-95 (Me. 1983). See generally Anderson, *Plunging the Depths*, *supra* note 11, at 482-86 (resale mandatory when it results in mitigation of damages).

36. J. WHITE & R. SUMMERS, *supra* note 5, at 278.

37. See *Blair Int'l, Ltd. v. LaBarge, Inc.*, 675 F.2d 954, 960, 33 U.C.C. Rep. Serv. (Callaghan) 1242, 1250 (8th Cir. 1982); *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 215, 28 U.C.C. Rep. Serv. (Callaghan) 1039, 1042 (5th Cir. 1980); *Distribu-Dor, Inc. v. Karadanis*, 11 Cal. App. 3d 463, 90 Cal. Rptr. 231, 236, 8 U.C.C. Rep. Serv. (Callaghan) 36, 41 (1970).

one case the breaching buyer argued that the jobber's contract with its source of supply restricted the sale of the contract goods solely to the breaching buyer. The breaching buyer further argued, however, that the jobber was free to sell to other purchasers goods previously ordered and that its failure to mitigate damages by doing so was unreasonable. The court found the evidence equivocal and upheld the decision of the trial court in favor of the jobber on this "close question."³⁸

In a clearer decision on point the seller was a retailer of mobile homes. The buyer breached, but later produced a substitute buyer, his father, who was willing and able to purchase the goods for the full contract price. In remanding the case, the court held that the seller should not receive any profit formula or resale formula recovery that could have been avoided by selling the goods to the substitute buyer.³⁹

Both these cases illustrate an important point to the present discussion that a seller may be a lost volume seller generally, but not occupy such a status under the particular facts of the case being tried. If the seller resells the goods to one who would not have purchased from the seller except for the buyer's breach, or if the seller fails to mitigate damages by making a sale to such a substitute buyer, the seller has not lost, or should not have lost, volume as a result of the buyer's breach. Thus, the seller will not be allowed to measure its loss based on the profit formula of section 2-708(2).

B. The Full Capacity Seller; Mitigation of Damages

If goods are in completed form at the time of a buyer's breach, the seller may or may not be left in a lost volume situation. For present purposes, a seller who does not lose volume as a result of a breach will be referred to as a full capacity seller. If the goods can be resold, a full capacity seller has more customers than it can supply. The breach enables such a seller immediately to reenter the market and resell the goods. Assuming the seller has followed the basic requirements of section 2-706, the seller may then recover against the breaching buyer damages based on the Code's resale formula. Of course, if buyer demand exceeds the available supply, the resale formula will not likely allow any damage recovery because the resale price will probably equal or exceed the price of the breached contract. Further, since the goods can be resold, the seller would not be entitled to an action for the price.⁴⁰

What happens if, rather than reselling the goods, the seller decides to hold them past the time for a commercially reasonable resale and comes into court requesting damages based on section 2-708? Although the question is arguable, there is no suggestion in the Code that the seller should not be allowed recovery under the market formula of section 2-708(1). The situation can be analyzed as if the seller itself purchased the contract goods at

38. *TCP Indus. v. Uniroyal, Inc.*, 661 F.2d 542, 551-52, 32 U.C.C. Rep. Serv. (Callaghan) 369, 382 (6th Cir. 1981).

39. *Schiavi Mobile Homes, Inc. v. Gironde*, 463 A.2d 722, 725-26, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1194-95 (Me. 1983).

40. *See* U.C.C. § 2-709(1)(b) (1977).

their market value at the time and place for tender. The market value purchase price, in effect, mitigates the damages owed by the breaching buyer. Furthermore, little, if any, damages will result from the application of the market formula because, with demand exceeding supply, the market price will be close to, if not in excess of, the price of the breached contract.

May a full capacity seller who has not resold the goods recover damages for lost profit under section 2-708(2)? Professors Summers and White have suggested that such a seller may recover, at least if the seller can show that the market formula is inadequate to compensate for the loss.⁴¹ Assume a seller contracts to sell goods for \$10,000 and that direct costs in the goods are \$6,500. The seller thus anticipates a profit, including reasonable overhead, of \$3,500. The buyer breaches, and the market price at the time and place for tender is \$8,000. If the seller is operating at full capacity, the seller's compensatory damages, ignoring incidental damages, are \$2,000. The seller can recoup the remainder of the expected profit by reselling the goods at the market price of \$8,000.

On these facts, both the market formula of section 2-708(1) and the resale formula of section 2-706 will produce the identical \$2,000 recovery. If the seller actually resells the goods for less than the \$8,000, section 2-706, of course, will allow the greater recovery. Assume, however, that the seller does not resell, but holds the goods until trial when their market value has declined to \$7,000. The seller argues that the profit lost as a result of the breach is \$3,500 and that the court should allow recovery of this amount under section 2-708(2) because, with the goods now being worth only \$7,000, the market formula does not restore the seller to the position it would have occupied had the buyer performed.⁴² The market formula will only allow the \$2,000 recovery, the difference between the market price at the time for tender and the contract price.

Professors Summers and White would grant the seller the profit recovery and dismiss as unrealistic any concerns that this result would encourage sellers to forego resale and speculate on a higher recovery under the profit formula.⁴³ Their conclusion may or may not be true, but it misses the point. The seller's position is specious, not because the seller acted insidiously, but because it acted unreasonably by failing to mitigate damages. After the buyer's breach a ready resale market was available, and the seller could have resold the goods for approximately \$8,000, producing compensatory damages of \$2,000.

The cases to date that have considered to any extent this bizarre situation indicate that an affirmative duty does fall upon full capacity sellers to resell the contract goods following breach or be denied any damages that could thereby have been avoided. It is, after all, purely the seller's fault that it

41. See J. WHITE & R. SUMMERS, *supra* note 5, at 279-81.

42. See U.C.C. § 2-708(2) (1977) (profit formula available only if market formula inadequate).

43. "[W]e suspect this is not the way people in business behave." J. WHITE & R. SUMMERS, *supra* note 5, at 281.

comes to trial not having resold the goods and in a position in which only the profit formula of section 2-708(2) will make it whole. For example, in one case the plaintiffs, wheat farmers, contracted to sell their entire crop to the defendant. The defendant breached because of a shortage of railroad cars to ship the wheat to market. The sellers were obviously in a full capacity situation, having agreed to sell their entire crop to the defendant. The court denied recovery of any damages to the sellers, noting that the market price at the time of breach was roughly double that of the contract price and that the sellers should simply have resold their wheat.⁴⁴ One wonders why the goods were not resold. Real people generally do not act as the plaintiffs did, especially when the resale market has doubled. Possibly, the goods were not truly resalable, but, if they were not resalable, the sellers simply failed in their burden of proof with respect to a price action under section 2-709.⁴⁵ In no event on the facts of the case should recovery have been based on the profit formula.

The basic proposition is that the seller will be obligated to mitigate damages by a reasonable resale when possible.⁴⁶ An excellent case on point, discussed earlier, involved a seller who was a retailer of mobile homes. Such retailers are usually lost volume sellers. Because of various personal difficulties the buyers of one of the seller's mobile homes breached the contract. The father of one of the buyers, however, immediately came forward and made a firm and reasonable offer to purchase the mobile home so that his son would not lose the deposit that had been paid. The facts clearly established that the father would not have otherwise offered to purchase the home. Again evidencing the fact that real people sometimes act unrealistically, the seller refused the father's offer and resold the home to a third party. The seller then sought to add insult to injury by seeking recovery against the breaching buyers for the lost profit under section 2-708(2). The seller argued that it was a lost volume seller entitled to a recovery on the basis of the profit formula. The court noted the long-standing rule of contract law that an aggrieved party has an affirmative duty to mitigate damages and that this common law duty survives under the Code.⁴⁷ The court then held that because the plaintiff refused to sell to the father, it could not assert that it had lost profits on the sale to the third party.⁴⁸

The court correctly decided the case. Furthermore, the holding is consistent with the mandate of section 1-106 that the Code's remedies be liberally

44. *Desbien v. Penokee Farmers Union Ass'n*, 220 Kan. 358, 552 P.2d 917, 927, 20 U.C.C. Rep. Serv. (Callaghan) 102, 109 (1976); *see also* *Zippy Mart of Alabama, Inc. v. A & B Coffee Serv., Inc.*, 380 So. 2d 833, 835, 28 U.C.C. Rep. Serv. (Callaghan) 396, 398 (Ala. 1980) (in computing damages for lost profit court must determine whether seller could have mitigated damages by reselling goods).

45. *See* U.C.C. § 2-709(1)(b) (1977) (after buyer's breach seller may recover price of contract goods if reasonable effort to resell goods fails or if circumstances indicate resale attempt would be unavailing).

46. *Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722, 726-27, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1196-97 (Me. 1983).

47. *Id.*

48. *Id.*

administered to the end of achieving compensation, no more and no less.⁴⁹ The case also well demonstrates the proposition that lost volume is a particular rather than a general concept. Regardless of a seller's general situation, it is not left at lost volume if a particular buyer's breach allows it to make a reasonable resale that it could not have made but for the breach. Whether a particular breach leaves the seller at lost volume is often a close question, and a jury finding thereon will not be lightly disturbed.⁵⁰

Of course, if a full capacity seller does act realistically and actually resells the goods, all would agree that the seller's recovery must be based on the resale formula and not on section 2-708(2).⁵¹ One case has even held that a full capacity seller who conducts a commercially unreasonable resale, so that the resale formula of section 2-706 cannot properly be used, will only recover damages computed on the difference between the contract price and the amount that would have been received from a commercially reasonable resale.⁵² Thus, the common law concept of mitigation of damages is very much alive under the Uniform Commercial Code.

C. *Incomplete Goods; Component Sellers*

If a buyer breaches prior to the time the seller has begun manufacture of the goods under contract, or after the seller has begun manufacture but before completion, and the seller reasonably decides not to complete manufacture of the goods,⁵³ the seller may base an action for damages on the profit formula of section 2-708(2). This rule results in part from a process of elimination. The price action is not available since the seller has not completed the goods and thus cannot tender them to the breaching buyer.⁵⁴ The resale remedy is not available because the seller does not have any completed goods to resell. The market formula of section 2-708(1) is also not available because the formula contemplates an actual resale of completed goods.⁵⁵ Only the profit formula of section 2-708(2) remains as a compensatory remedy for the seller.⁵⁶

A simple hypothetical demonstrates the inadequacy of the market formula

49. See U.C.C. § 1-106 (1977).

50. *TCP Indus. v. Uniroyal, Inc.*, 661 F.2d 542, 552, 32 U.C.C. Rep. Serv. (Callaghan) 369, 382 (6th Cir. 1981).

51. See *Lake Erie Boat Sales, Inc. v. Johnson*, 11 Ohio App. 3d 55, 56, 463 N.E.2d 70, 72, 38 U.C.C. Rep. Serv. (Callaghan) 845, 847 (1983).

52. *Coast Trading Co. v. Cudahy Co.*, 592 F.2d 1074, 1083, 25 U.C.C. Rep. Serv. (Callaghan) 1037, 1046 (9th Cir. 1978).

53. Section 2-704 allows a seller to discontinue the manufacture of goods following a buyer's breach if the seller acts "in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization . . ." U.C.C. § 2-704 (1977).

54. See *id.* § 2-709(2).

55. See Anderson, *supra* note 23, at 259-61.

56. Although other classes of aggrieved sellers may also be entitled to measure their damages in accordance with . . . [§ 2-708(2)], it is enough for this case to note that a seller of uncompleted components whose market is composed solely of the buyer in breach cannot adequately measure his damages in any other way. *Bead Chain Mfg. Co. v. Saxton Prod., Inc.*, 183 Conn. 266, 439 A.2d 314, 320, 31 U.C.C. Rep. Serv. (Callaghan) 91, 99 (1981).

and the appropriateness of the profit formula to compensate an incomplete goods or components seller.⁵⁷ Assume that the contract price is \$10,000, that the market price at the time and place for tender is \$7,500, that the direct costs of manufacturing the goods would have been \$9,000, and that at the time of the breach the seller has incurred \$6,000 in partially manufacturing the goods. Assume further that the seller properly decides to discontinue manufacturing the goods, thereby saving costs of \$3,000, and that the seller is able to sell the partially manufactured goods as components or scrap for \$5,000. On these facts the seller has suffered damages of \$2,000: a lost profit of \$1,000 and unrecovered costs of \$1,000. The original *Restatement of Contracts* would allow the \$2,000 recovery under alternative formulas of the contract price (\$10,000) less expenses saved (\$3,000 plus \$5,000), or by the profit lost (\$1,000) plus the unrecovered expenses incurred (\$1,000).⁵⁸ The market formula of section 2-708(1) will not approach the \$2,000 level of compensation and, indeed, would provide for a negative recovery. The formula would allow for the contract/market differential of \$2,500, but require a deduction of \$3,000 for expenses avoided because of the buyer's breach.⁵⁹ The market formula was never intended to apply to incomplete goods cases.⁶⁰

Section 2-708(2) not only provides for the compensatory \$2,000 recovery, it reads as though it were specifically designed for the incomplete goods case. The provision states:

[T]he measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer [\$1,000], together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred [\$6,000] and due credit for payments or proceeds of resale [\$5,000].⁶¹

Another reason for the appropriateness of the profit formula in incomplete goods cases is that such cases are another example of the lost volume situation. According to Professors Summers and White, when a breach occurs before completion of manufacture and the seller chooses not to complete manufacture, the seller has lost the volume of one sale since the sale of the completed goods will never happen.⁶² Of course, even assuming the seller properly discontinued manufacture of the contract goods, the seller retains

57. A components seller is a seller obligated to assemble the contract goods from component parts. This terminology was first used in Harris, *Sales Act Results*, *supra* note 7, at 68-72, 97-98. A components seller is indistinguishable for present purposes from other types of manufacturers.

58. RESTATEMENT OF CONTRACTS § 346 comment h (1932). This provision refers to service contracts. Nevertheless, one who agrees to construct a house is in no different a damage position following breach than one who agrees to construct goods if the breach occurs prior to the time the housing or goods have been completed.

59. U.C.C. § 2-708(1) (1977).

60. Incomplete goods have no value in the market that is contemplated by the market price term of § 2-708(1). See cases cited *infra* note 97.

61. U.C.C. § 2-708(2) (1977).

62. J. WHITE & R. SUMMERS, *supra* note 5, at 276; see *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 1339-41, 39 U.C.C. Rep. Serv. (Callaghan) 802, 814-17 (Ct. App. 1984).

an obligation to mitigate damages if reasonably possible. If by discontinuing manufacture, for example, the seller's production facilities are freed up so that the seller may reasonably enter into other contracts, any profits that the seller could earn thereby should mitigate the damages owed by the breaching buyer.

To borrow from the facts of a well known pre-Code case, assume that a seller agreed to supply a buyer's requirements of pulp for one year, that the requirements absorbed ten percent of the seller's production capacity, and that, following the buyer's breach by refusal to take further pulp, the seller's production dropped from 100% to 90% of capacity. Applying the Uniform Sales Act⁶³ to these facts the court held that the market formula was inapplicable because it applied only in the case of completed goods.⁶⁴ The court then allowed the seller to recover damages based on the lost profit plus reasonable overhead.⁶⁵ The decision was correct, and the same result occurs under the Code unless the facts would show that, subsequent to the breach, the seller is reasonably able to move its production capacity back above the ninety percent level. If the seller actually does so, any profits generated thereby should offset or mitigate the seller's damage recovery.⁶⁶ If the seller unreasonably fails so to mitigate damages, it should not recover for any amount of loss that it could have avoided.⁶⁷

In sum, section 2-708(2) is the only appropriate damage formula for incomplete goods sellers. Although an occasional early decision under the Code held the contrary,⁶⁸ the recent decisions of the courts consistently consider the profit formula the appropriate recovery device.⁶⁹ The appropriate-

63. UNIF. SALES ACT § 64(4) (1906).

64. *Jessup & Moore Paper Co. v. Bryant Paper Co.*, 297 Pa. 483, 147 A. 519, 524 (1929).

65. *Id.*

66. *See Zippy Mart of Alabama, Inc. v. A & B Coffee Serv., Inc.*, 380 So. 2d 833, 835, 28 U.C.C. Rep. Serv. (Callaghan) 396, 398 (Ala. 1980).

67. *See Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722, 726, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1196 (Me. 1983).

68. *Detroit Power Screwdriver Co. v. Ladney*, 25 Mich. App. 478, 181 N.W.2d 828, 833, 8 U.C.C. Rep. Serv. (Callaghan) 504, 509 (1970); *Jagger Brothers, Inc. v. Technical Textile Co.*, 202 Pa. Super. 639, 198 A.2d 888, 890, 2 U.C.C. Rep. Serv. (Callaghan) 97, 99 (1964).

69. *Unique Sys., Inc. v. Zotos Int'l, Inc.*, 622 F.2d 373, 378, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1348 (8th Cir. 1980); *City of Louisville v. Rockwell Mfg. Co.*, 482 F.2d 159, 165, 12 U.C.C. Rep. Serv. (Callaghan) 840, 847 (6th Cir. 1973); *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 854, 26 U.C.C. Rep. Serv. (Callaghan) 406, 414 (E.D.N.Y.), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *American Metal Climax, Inc. v. Essex Int'l, Inc.*, 16 U.C.C. Rep. Serv. (Callaghan) 101, 114 (S.D.N.Y. 1974); *Holiday Mfg. Co. v. B.A.S.F. Sys., Inc.*, 380 F. Supp. 1096, 1105, 15 U.C.C. Rep. Serv. (Callaghan) 820, 828 (D. Neb. 1974); *Uchitel Co. v. Telephone Co.*, 646 P.2d 229, 236-37, 33 U.C.C. Rep. Serv. (Callaghan) 1678, 1682-83 (Alaska 1982); *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 1339-40, 39 U.C.C. Rep. Serv. (Callaghan) 802, 814-15 (Ct. App. 1984); *Capital Steel Co. v. Foster & Creighton Co.*, 264 Ark. 683, 574 S.W.2d 256, 259, 25 U.C.C. Rep. Serv. (Callaghan) 1349, 1353 (1978); *Bead Chain Mfg. Co. v. Saxton Prods., Inc.*, 183 Conn. 266, 439 A.2d 314, 320, 31 U.C.C. Rep. Serv. (Callaghan) 91, 99 (1981); *Cesco Mfg. Corp. v. Norcross, Inc.*, 7 Mass. App. Ct. 837, 391 N.E.2d 270, 273, 27 U.C.C. Rep. Serv. (Callaghan) 126, 129 (1979); *E-Z Roll Hardware Mfg. Co. v. H & H Prods. & Finishing Corp.*, 4 U.C.C. Rep. Serv. (Callaghan) 1045, 1047-48 (N.Y. Sup. Ct. 1968); *Paramount Lithographic Plate Serv., Inc. v. Hughes Printing Co.*, 2 Pa. D. & C. 3d 677, 694, 22 U.C.C. Rep. Serv. (Callaghan) 1129, 1139-40 (Ct. C.P.), *aff'd mem.*, 249 Pa. Super. 625, 377 A.2d 1001 (1977); *Coast*

ness of the profit formula assumes that the seller's decision to discontinue manufacture of the goods was reasonable. What if the buyer can show that the seller could have reasonably mitigated damages by completing the goods and reselling them? The next section considers this question.

D. Completion of Goods Unfinished at Breach

An incomplete or component goods seller, as such, should be entitled to the profit formula of section 2-708(2) only if its decision not to complete manufacture was commercially reasonable. In other words, if the seller could have mitigated damages by completing and reselling the goods, damage recovery should be reduced by the amount of the loss that completion and resale would have avoided. Damages would be measured on the basis of what the seller's recovery would properly have been had it completed the goods. If after completion the seller would have been in a full capacity situation, it should recover no more than the difference between the price of the breached contract and the amount that would have been brought by a reasonable resale of the completed goods, this latter figure roughly equalling the market price of the completed goods as provided by section 2-708(1). If following completion the seller would have been in a lost volume situation, the seller would still properly recover for lost profit under section 2-708(2), but no recovery should be allowed under the formula for "costs reasonably incurred"⁷⁰ if the seller could reasonably have recouped these costs by completing and reselling the goods.

Section 2-704(2) establishes the mitigation of damages requirement for sellers who have not completed assembly or manufacture of goods at the time of a buyer's breach. It provides:

Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.⁷¹

The requirement of "avoiding loss" is clear, but the Code does not explain the meaning of "effective realization." If realization refers to the seller's lost expectation on the breached contract, the meaning is probably that the seller need only act reasonably and that in mitigating the loss it may look to its own interests as well as those of the breaching buyer. Professors Summers and White support this interpretation.

Suppose the client says the damages on this contract will probably be enhanced by completing, but that he simply cannot afford to cease manufacture, lay off all his skilled employees, and thus lose many of them to other employers. Surely such a seller is making an intelligent and commercially reasonable judgment to complete even though in the narrow context of one contract he is increasing the damages to this particular

Trading Co. v. Parmac, Inc., 21 Wash. App. 896, 587 P.2d 1071, 1079, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1054-55 (1978).

70. U.C.C. § 2-708(2) (1977).

71. *Id.* § 2-704(2).

buyer. In such circumstances we should permit the seller to complete and should not find his action commercially unreasonable.⁷²

Thus in one case, after a government buyer breached by nonpayment, the seller continued making deliveries of helium. The court held that the seller's continuing delivery was commercially reasonable because the manufacture of helium was necessary to the seller's other operations and because the seller had no storage facilities for the helium nor any buyer for it other than the government.⁷³

Comment 2 to section 2-704 explains that the seller is obligated only to exercise reasonable commercial judgment.⁷⁴ The seller's decision should be assessed in light of the facts as they appear at the time the seller learns of the buyer's breach or, presumably, at a commercially reasonable time thereafter when the seller actually makes the decision.⁷⁵ Furthermore, the breaching buyer has the burden of proving the seller's unreasonableness in minimizing loss.⁷⁶

The comment refers only to a seller's decision whether to complete the goods.⁷⁷ The provision should hold with equal force to a seller's decision to discontinue manufacture or assembly.⁷⁸ This distinction is important because seldom does a merchant seller actually pull goods off the line and discontinue manufacture. In practice discontinuing manufacture, rather than completing the goods, is the course of conduct that would normally raise suspicion. Most sellers sell standardized goods that have a ready market and can be resold. This is true even for sellers who manufacture only to particular or special order by their customers. As is addressed below, if the goods can be resold at a reasonable price, the seller should complete manufacture, and in real world situations it usually does. Only if the goods apparently have no reasonable resale market, as in the case of goods manufactured to a buyer's unique requirements or fad goods for which the market has deteriorated, should the seller discontinue manufacture. Professors Summers and

72. J. WHITE & R. SUMMERS, *supra* note 5, at 290; see also Harris, *Sales Act Results*, *supra* note 7, at 72 (court should find for seller that stops production and seeks to recover components' value unless seller knew decision would enhance damages and completion of production would not have unreasonably harmed seller's interests).

73. *Northern Helex Co. v. United States*, 197 Ct. Cl. 118, 132, 455 F.2d 546, 554, 10 U.C.C. Rep. Serv. (Callaghan) 353, 363-64 (1972) (question of liability); see also *O'Hare v. Peacock Dairies, Inc.*, 26 Cal. App. 2d 345, 79 P.2d 433, 439 (1938) (continued delivery of milk reasonable since no commercially effective way existed to cease production by herd). The question of damages in *Northern Helex* was decided at 207 Ct. Cl. 862, 888-90, 524 F.2d 707, 721-22 (1975), *cert. denied*, 429 U.S. 866 (1976).

74. Under this Article the seller is given express power to complete manufacture or procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture.

U.C.C. § 2-704 comment 2 (1977).

75. *Id.*

76. *Id.*

77. *Id.*

78. 3 W. HAWKLAND, *supra* note 13, § 2-704.02, at 276; J. WHITE & R. SUMMERS, *supra* note 5, at 291.

White suggest the following starting point for making an intelligent choice under section 2-704.

Therefore, the first question which the lawyer should ask himself is what damages the seller may recover from the buyer if he ceases manufacturing at once and sues under 2-708(2) for his lost profit. Next, how do those damages compare with the damages the seller is likely to recover under 2-706 upon completion of the manufacture and the resale of the goods? To make these decisions correctly, one must make not only accurate legal analyses but also careful empirical judgments about the current and future market and about the seller's lost profit. One certainly should preserve all evidence which formed the bases for the decision and should document by letter or written memo when and why the decision to complete or not to complete was made.⁷⁹

All of this analysis rests on the proposition that, assuming the breach has left the seller at lost volume, the formula in section 2-708(2) allows the seller to recover its lost profit regardless whether it discontinues manufacture. If the seller discontinues manufacture, however, the formula allows an additional recovery of those costs in part performance that cannot be recouped. In any case in which the seller reasonably anticipates that it can resell the goods for an amount at least equal to the direct costs of manufacture, the decision to complete manufacture should be found reasonable because the seller meant to save the buyer the costs of part performance that had been incurred at the time of the breach. Even if the seller cannot recoup the costs incurred at the time of the breach by scrapping the goods, the seller can still mitigate its loss if it can resell the completed goods at a price in excess of the cost of completion. To return to the earlier hypothetical, at the time of the breach the seller had incurred \$6,000 of \$9,000 total direct costs. The contract price was \$10,000, and the seller would have made a profit of \$1,000, including reasonable overhead. If the seller discontinued manufacture, damages under section 2-708(2) would be \$7,000 (profit of \$1,000 plus costs reasonably incurred of \$6,000). If the seller completes manufacture of the goods and can resell them for \$4,000, a price in excess of the \$3,000 cost of completion, damages under section 2-708(2) would be only \$6,000 (a profit of \$1,000 plus \$9,000 costs reasonably incurred less \$4,000 proceeds of resale).⁸⁰

The picture at the time of breach is complicated by the fact that the incomplete goods will usually have some value, and their resale, if only as scrap, will recoup some of the seller's loss. In such situations a seller acts reasonably by completing manufacture only if the seller anticipates resale of the goods at a price at least equal to the costs of completion plus the scrap value of the partially manufactured goods. Thus, in the hypothetical, if the seller can scrap the partially manufactured goods for \$5,000, damage recov-

79. J. WHITE & R. SUMMERS, *supra* note 5, at 290.

80. Although courts and commentators agree that the language in § 2-708(2) referring to due credit for resale proceeds was intended to refer solely to the resale of partially manufactured goods following a discontinuance of their production, the provision clearly should apply to complete goods in this situation. *See infra* notes 148-55 and accompanying text.

ery under section 2-708(2) would total only \$2,000 (\$1,000 profit plus \$6,000 costs reasonably incurred less \$5,000 resale proceeds). The seller can mitigate these damages only by completing and reselling the goods at a price in excess of \$8,000 (the \$3,000 cost to complete plus the \$5,000 scrap value).⁸¹

Presumably section 2-704, which allows a seller either to complete or scrap contract goods in order to mitigate damages, applies both to a seller who has not begun manufacture, as well as to one who has. A narrow interpretation of the term "unfinished"⁸² cuts against this interpretation, but the underlying concept of the provision would make illogical a distinction between partially manufactured goods and those for which manufacture has not begun. Of course, the decisions that a seller must make under section 2-704(2) when manufacture has not yet begun will usually be much easier than the same decisions in situations in which the seller has incurred costs in partially manufacturing the goods.

In practice a seller's section 2-704(2) decisions are quite speculative and dependent both on the anticipated resale market for the completed goods and on how much of the expenses incurred in part performance the seller can recoup by discontinuing manufacture and scrapping the goods. The burden of proof that the seller acted unreasonably is on the buyer, and such a burden is not an easy one to carry.⁸³ The cases to date indicate that courts will generally uphold a seller's decision to discontinue manufacture following a buyer's breach absent clear proof of unreasonableness.⁸⁴ That the courts will uphold the decision is true especially when it appears questionable that a viable resale market existed for the goods.⁸⁵ In addition, the seller's decision is judged at the time it was reasonably made; hindsight that may prove the decision erroneous is immaterial,⁸⁶ even if the decision dramatically exacerbates damages. Thus, in one case, the seller completed manufacture of the goods in reasonable anticipation of reselling them, only to

81. Of course, this analysis assumes that the seller cannot better use its production capacity in performing other contracts rather than completing manufacture of the goods involved in the breached contract.

82. U.C.C. § 2-704(2) (1977).

83. *Id.* comment 2; see *Modern Mach. v. Flathead County*, 202 Mont. 140, 656 P.2d 206, 211, 36 U.C.C. Rep. Serv. (Callaghan) 395, 401 (1982).

84. See *Bead Chain Mfg. Co. v. Saxton Prods., Inc.*, 183 Conn. 266, 439 A.2d 314, 320, 31 U.C.C. Rep. Serv. (Callaghan) 91, 99-100 (1981); *Modern Mach. v. Flathead County*, 202 Mont. 140, 656 P.2d 206, 211, 36 U.C.C. Rep. Serv. (Callaghan) 395, 401 (1982); *E-Z Roll Hardware Mfg. Co. v. H & H Prods. & Finishing Corp.*, 4 U.C.C. Rep. Serv. (Callaghan) 1045, 1048 (N.Y. Sup. Ct. 1968); *Timber Access Indus. v. U.S. Plywood-Champion Papers, Inc.*, 263 Or. 509, 503 P.2d 482, 489-90, 11 U.C.C. Rep. Serv. (Callaghan) 994, 996 (1972); *Coast Trading Co. v. Parmac, Inc.*, 21 Wash. App. 896, 587 P.2d 1071, 1078-79, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1055-56 (1978).

85. See *Timber Access Indus. v. U.S. Plywood-Champion Papers, Inc.*, 263 Or. 509, 503 P.2d 482, 489-90, 11 U.C.C. Rep. Serv. (Callaghan) 994, 996 (1972); *Coast Trading Co. v. Parmac, Inc.*, 21 Wash. App. 896, 587 P.2d 1071, 1078, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1055 (1978).

86. The Code makes this position clear in U.C.C. § 2-704 comment 2 (1977). This approach is a departure from pre-Code law under the UNIF. SALES ACT § 64(4) (1906), which provided that a seller that guessed wrong and actually increased damages by completing manufacture bore the entire risk of that increase and could recover no greater damages than if it had discontinued the manufacture. See 3 W. HAWKLAND, *supra* note 13, § 2-704:02, at 275-76.

find that the market had dissolved and only a portion of the goods could be resold. The court properly allowed the seller the full unpaid contract price under section 2-709 for the unsold goods.⁸⁷

E. Other Cases; No Existing Market

Professors Summers and White suggest that a multitude of cases, other than those involving lost volume sellers of completed goods and incomplete or component goods sellers, may be subject to the profit formula of section 2-708(2).⁸⁸ The suggestion is wrong and, as noted by one commentator, no court has applied the provision to any such cases.⁸⁹ Summers and White specify two categorical examples.⁹⁰ The first involves a seller who resells the completed goods, but is unable to prove that lost volume resulted from the breach.⁹¹ Although this situation is discussed more fully below,⁹² its resolution should be that the seller must carry the burden of proof of its entitlement to damages, and failure to do so will restrict recovery. Much of the history of damage law is the story of aggrieved plaintiffs suffering from a similar plight.⁹³ The second situation involves a full capacity seller who, rather than reselling the goods, holds them past the time for a commercially reasonable resale.⁹⁴ Although the two scholars suggest that such a seller should receive a section 2-708(2) recovery, this Article has already concluded the contrary.⁹⁵

The profit formula should be available in only two categories of cases. First, the profit formula should be available to all component or incomplete goods sellers who have acted reasonably in not completing the goods. The second category consists of sellers of completed goods who are able to demonstrate that the buyer's breach caused lost volume.

A number of Code cases allow an aggrieved seller access to the profit formula upon a finding that no market exists for the goods. At first blush these holdings might indicate yet another category for the application of section 2-708(2). An examination of the facts in the cases and the analyses by the courts, however, shows that all of the cases involve situations of lost volume or incomplete goods. The courts often hold that, if the seller is a

87. *Foxco Indus. v. Fabric World, Inc.*, 595 F.2d 976, 983, 26 U.C.C. Rep. Serv. (Callaghan) 694, 701 (5th Cir. 1979).

88. J. WHITE & R. SUMMERS, *supra* note 5, at 278.

89. G. WALLACH, *supra* note 13, at 8-17.

90. J. WHITE & R. SUMMERS, *supra* note 5, at 279.

91. *Id.*

92. See *supra* text accompanying notes 178-209.

93. See Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1216 (1970) ("All in all, our system of legal remedies for breach of contract, heavily influenced by the economic philosophy of free enterprise, has shown a marked solicitude for men who do not keep their promises."); Speidel & Clay, *Seller's Recovery of Overhead Under UCC Section 2-708(2): Economic Cost Theory and Contract Remedial Policy*, 57 CORNELL L. REV. 681, 683-87 (1972) (since contract damages are compensatory rather than punitive, plaintiff must bear burden of showing actual damages).

94. J. WHITE & R. SUMMERS, *supra* note 5, at 279.

95. See *supra* text accompanying notes 41-52 (courts should continue to impose on plaintiffs duty to mitigate damages by prompt resale).

middleman or jobber who never takes possession of the goods, the seller has no available market in which to sell the goods.⁹⁶ In the same vein, the courts often hold that no market is available for a seller when the seller has not completed the goods.⁹⁷ The results in all of these cases are correct, but not solely for the reason given. In today's economy rare indeed is a situation in which absolutely no market exists for particular goods. Virtually everything can be resold at some price. Furthermore, the Code itself provides great flexibility for proving some value for use as the market price under section 2-708(1).⁹⁸ Thus, although there is a certain logic to the reasoning that the market formula, in situations in which market price cannot be shown, does not adequately compensate the seller as required by section 2-708(2),⁹⁹ such cases will actually occur quite infrequently. When the cases do come up, when the goods cannot be resold at a reasonable price, the seller should proceed, not under the profit formula, but for the full unpaid contract price under section 2-709.

F. *When the Market Formula Provides a Windfall*

In order to base a recovery on the profit formula, section 2-708(2) requires that the seller prove that the market formula will not provide adequate compensation. On the other hand, the Code does not prohibit a seller's using the market formula instead of section 2-708(2) to recover less than compensatory damages. Is the converse proposition true? Must an aggrieved seller use the profit formula if the market formula would provide the seller a windfall by placing it in a better position than it would have occupied had the buyer performed the contract?

This problem can arise quite easily in any case in which the market value of the contract goods has declined dramatically subsequent to contracting. In the hypothetical considered above, the seller suffered \$2,000 in actual damages when it properly discontinued manufacturing the goods. It suffered a lost profit, including reasonable overhead, of \$1,000 and another \$1,000 in unrecovered costs when it salvaged the goods for only \$5,000 after having incurred \$6,000 of manufacturing costs. The market price at the time and

96. See *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 215, 28 U.C.C. Rep. Serv. (Callaghan) 1039, 1042 (5th Cir. 1980); *Neumiller Farms, Inc. v. Cornett*, 368 So. 2d 272, 275-76, 26 U.C.C. Rep. Serv. (Callaghan) 61, 66 (Ala. 1979); *Autonumerics, Inc. v. Bayer Indus.*, 141 Ariz. 181, 696 P.2d 1330, 1340, 39 U.C.C. Rep. Serv. (Callaghan) 802, 815 (Ct. App. 1984).

97. See *Unique Sys., Inc. v. Zotos Int'l, Inc.*, 622 F.2d 373, 378, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1348 (8th Cir. 1980); *Uchitel Co. v. Telephone Co.*, 646 P.2d 229, 236, 33 U.C.C. Rep. Serv. (Callaghan) 1678, 1682-83 (Alaska 1982); *Cesco Mfg. Corp. v. Norcross, Inc.*, 7 Mass. App. Ct. 837, 391 N.E.2d 270, 275, 27 U.C.C. Rep. Serv. (Callaghan) 126, 131-32 (1979); *Timber Access Indus. v. U.S. Plywood-Champion Papers, Inc.*, 263 Or. 509, 503 P.2d 482, 489, 11 U.C.C. Rep. Serv. (Callaghan) 994, 996 (1972); see also *Anchorage Centennial Dev. Co. v. Van Wormer & Rodrigues, Inc.*, 443 P.2d 596, 599, 5 U.C.C. Rep. Serv. (Callaghan) 811, 813 (Alaska 1968) (no market for made-to-order coins); *Detroit Power Screwdriver Co. v. Ladney*, 25 Mich. App. 478, 181 N.W.2d 828, 832-33, 8 U.C.C. Rep. Serv. (Callaghan) 504, 509 (1970) (no market for specialty item).

98. See Anderson, *supra* note 23, at 277-80, 283-86.

99. See U.C.C. § 2-708(2) (1977) (profit formula applies when market formula "inadequate to put the seller in as good a position as performance would have done").

place for tender, however, was \$7,500. Might the seller base its recovery on section 2-708(1) and recover the difference between the contract price and market price, \$2,500, thereby receiving a windfall of \$500? As discussed in the preceding section of this Article, the courts will probably avoid this problem by denying the seller access to the market formula if the goods are incomplete and the seller is not in a position to tender them.¹⁰⁰

If the goods have been completed, a more difficult situation arises since a true resale market exists for the completed goods. In the hypothetical if the seller is at lost volume, the actual economic loss is the profit, including reasonable overhead, of \$1,000. The market formula would produce a recovery of \$2,500. The seller might make the plausible argument that it should receive the greater recovery because nothing in the text of section 2-708(1) restricts use of the market formula and nothing in section 2-708(2) requires the seller to base its damages on the profit formula. In *Nobs Chemical, U.S.A., Inc. v. Koppers Co.*¹⁰¹ the Fifth Circuit found the argument intriguing, but nevertheless limited the seller's recovery to damages under section 2-708(2).¹⁰² The seller was a jobber or middleman who had never acquired the goods from its source of supply and thus clearly was left in a lost volume situation by the buyer's breach. The trial court had limited the seller's recovery to \$95,000 based on lost profits for the contract goods under section 2-708(2).¹⁰³ On appeal the seller sought to recover damages based on the market formula, which would have produced a recovery of between \$275,520 and \$319,600. The seller argued that the court should consider section 2-708(1) as a statutory liquidated damage provision accorded sellers as a matter of right. In affirming the judgment of the trial court and rejecting the arguments of the seller, the court pointed to section 1-106 of the Code, which directs that damage recoveries provide compensation and that windfall and penal damages be avoided.¹⁰⁴ The court also relied heavily on the commentary of Professors Summers and White, who had anticipated the problem before it arose in any reported decision.¹⁰⁵

Summers and White have concluded that the burden should be on the buyer to prove that the market formula will indeed provide a windfall recovery. They say:

We argue that the defendant is entitled to restrict the plaintiff to 2-708(2) only when defendant can prove that the measure of damages in 2-708(1) will overcompensate the plaintiff. We well understand that we

100. See *Capital Steel Co. v. Foster & Creighton Co.*, 264 Ark. 683, 574 S.W.2d 256, 258, 25 U.C.C. Rep. Serv. (Callaghan) 1349, 1352 (1978); cf. *supra* notes 96-97 and accompanying text (when goods are incomplete courts allow seller access to profit formula, saying no market exists for incomplete goods). Furthermore, the seller faces the risk that, should it be allowed access to the market formula, the court will put it in a worse position by making a deduction for expenses saved by not completing manufacture or assembly of the goods. See U.C.C. § 2-708(1) (1977).

101. 616 F.2d 212, 28 U.C.C. Rep. Serv. (Callaghan) 1039 (5th Cir. 1980).

102. *Id.* at 215, 28 U.C.C. Rep. Serv. (Callaghan) at 1042-43.

103. *Id.* at 214, 28 U.C.C. Rep. Serv. (Callaghan) at 1040.

104. *Id.* at 215, 28 U.C.C. Rep. Serv. (Callaghan) at 1042-43.

105. *Id.*

impose on defendant a heavy burden, for he must find this evidence largely through oral and documentary discovery of the opposing party's employees and business records. However, we believe it would place an undue burden on plaintiff-seller to require not only that he prove the market under 2-708(1) but that he also prove that 2-708(1) will not overcompensate him.¹⁰⁶

The Second Circuit, however, has recently taken the position that subsection (2) of section 2-708 need not be used to restrict windfalls under subsection (1). In a confusing opinion the court acknowledged that the market formula of section 2-708(1) rarely reflects a seller's actual economic loss and held that neither the language nor history of section 2-708(2) indicate that it should apply to cases involving a section 2-708(1) windfall.¹⁰⁷ The court's discussion did not address the question of whether the seller was left at lost volume as a result of the breach. The court did say that it was not convinced by the facts that the seller would be overcompensated by the market formula of section 2-708(1).¹⁰⁸ The court concluded that the market formula would provide the seller the benefit of its bargain.¹⁰⁹ The court reasoned that, by entering into an extended installment contract at a fixed price, the parties were speculating on the market price of aluminum.¹¹⁰ Because aluminum prices subsequently plunged, the seller had won its bet, and the market formula of section 2-708(1) would reflect the proper pay-off.¹¹¹

The court distinguished its decision from that of the Fifth Circuit in the *Nobs Chemical* case and reserved the question of whether it would have reached the same result in *Nobs Chemical*. The court considered the cases distinguishable because the seller in *Nobs Chemical* had contractually protected itself against market price fluctuation by immediately entering into a second fixed price contract for the purchase of the goods to be supplied under the first contract.¹¹² The court's reasoning is flawed by its failure to note that the fixed price of the breached contract is what protects the seller from the market price fluctuation. The contract guarantees to the seller the profit it would have made on the contract regardless of any decline in the market price. On the other hand, by entering into a fixed price contract, the seller relinquishes its ability to take advantage of a rise in the market price. A lost volume seller who receives the profit lost on the breached contract, plus incidentals, is fully compensated for the loss caused by the buyer's breach.¹¹³ Accordingly, no valid distinction exists between the Second Circuit case and the Fifth Circuit decision in *Nobs Chemical*. Furthermore, the Second Circuit's reasoning that windfall damages are permissible under sec-

106. J. WHITE & R. SUMMERS, *supra* note 5, at 282.

107. *Trans World Metals, Inc. v. Southwire Co.*, 769 F.2d 902, 908, 41 U.C.C. Rep. Serv. (Callaghan) 453, 460 (2d Cir. 1985).

108. *Id.*, 41 U.C.C. Rep. Serv. (Callaghan) at 461.

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. Of course, if the seller is not at lost volume its damages must be mitigated by a resale of the goods. See *supra* notes 40-52 and accompanying text.

tion 2-708(1) is directly in the teeth of section 1-106, which expressly prohibits penal damages.¹¹⁴

III. CALCULATION OF DAMAGES

A. *In General*

If a buyer's breach has left a seller with completed goods but in a lost volume situation, or with goods the manufacture or assembly of which has not been begun or completed, the seller may base its recovery on the profit formula of section 2-708(2). The formula provides for the following calculation:

$$\begin{array}{r}
 \text{Profit (including reasonable overhead)} \\
 + \text{ Incidental Damages} \\
 + \text{ Costs Reasonably Incurred} \\
 - \text{ Payments or Proceeds of Resale} \\
 = \text{ Total Damages Under Section 2-708(2)}
 \end{array}$$

Exactly what each element of the formula means and how one goes about proving the elements are unclear, and to date there is a dearth of helpful appellate level decisions.¹¹⁵

The basic component of the formula is the profit, including reasonable overhead. Any calculation of this amount must begin with the contract price of the breached contract. Usually, establishing the contract price will present no difficulty, and often the parties will stipulate the price at trial. Difficulties can arise, however, because the Code does not require an agreed contract price as a prerequisite for a valid contract.¹¹⁶ If the parties have

114. U.C.C. § 1-106 (1977).

115. In the words of Professors Summers and White:

So we await with anticipation the case that must even now be brewing somewhere in the court system which will pose a full-fledged disagreement between plaintiff's accountant and defendant's accountant which will give us some insight into how the courts should and will resolve disputes between the parties over the definitions of profit, overhead, due credit, etc.

J. WHITE & R. SUMMERS, *supra* note 5, at 288.

116. U.C.C. § 2-305 (1977) provides:

(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

- (a) nothing is said as to price; or
- (b) the price is left to be agreed by the parties and they fail to agree; or
- (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

not agreed upon a price, or means of determining the price, the court may fill the gap with a price that is reasonable at the time and place of delivery.¹¹⁷ If the market for the goods is unstable, however, determining a reasonable price may be a difficult matter. Other facts and circumstances of the particular case may exacerbate the problem. For example, if the contract price is based on the quantity ordered, as in a requirements contract, the seller must be able to prove at least the minimum quantity for which the buyer was obligated.¹¹⁸

Once the contract price is shown, the aggrieved seller is in a position to prove the remaining increments of the formula. The following sections discuss in turn these remaining damage increments. The seller may prove the profit, including reasonable overhead, by deducting from the contract price the variable or direct costs that the seller would have incurred in performing the contract. These variable costs should include not only the direct costs of producing the goods, but also other variable costs borne by the seller, such as costs of packing, labeling, and transporting the goods. A computation of the contract price less the total variable or direct expenses produces the profit figure, including reasonable overhead, contemplated by the formula.

The formula additionally allows the seller to recover all expenses incurred in partially performing the contract and any incidental damages, as defined by section 2-710, resulting from the buyer's breach. Further, the seller must allow the buyer a credit for payments received from resale. This provision requires that a deduction be made for any amounts that the seller receives from a resale of partially manufactured goods as components or scrap.

B. *The Recovery of Overhead*

In non-Code cases the courts have disagreed on the question of whether indirect, fixed costs, commonly known as overhead, are deductible from the contract price in computing damages for lost profits. The courts often frame the question in terms of whether the aggrieved plaintiff is entitled to gross profits with no overhead deduction, or only net profits, which are gross profits with overhead deducted. The weight of authority suggests that overhead expense is not properly deductible in computing lost profits and that overhead is properly recoverable as damages. The cases holding to the contrary generally state no rationale except for the assertion that overhead is a cost incurred in doing business.¹¹⁹ Section 2-708(2) specifically affirms the weight of authority by providing that the seller's profit recovery should in-

117. *Id.* § 2-305(1).

118. *Chemetron Corp. v. McLouth Steel Corp.*, 522 F.2d 469, 472, 17 U.C.C. Rep. Serv. (Callaghan) 772, 776 (7th Cir. 1975); *see also Flood v. M.P. Clark, Inc.*, 335 F. Supp. 970, 971, 9 U.C.C. Rep. Serv. (Callaghan) 1226, 1227-28 (E.D. Pa. 1971) (in requirements contract damages should be based on buyer's actual requirements and not upon maximum amount for which seller could be obligated).

119. The cases are collected in R. DUNN, *RECOVERY OF DAMAGES FOR LOST PROFITS* § 6.5 (2d ed. 1981); *see also* Annotation, *Overhead Expense as Recoverable Element of Damages*, 3 A.L.R.3d 689, 697-702 (1965).

clude reasonable overhead.¹²⁰ The Code's provision for overhead is consistent with the basic theory of section 1-106 that recovery should put an aggrieved party in the position it would have occupied had the other party performed the contract.

Fixed overhead expense is not a proper deduction in computing lost profits because such expense exists regardless of the buyer's breach. By definition overhead expense is fixed in the sense that the seller continues to incur it despite the buyer's breach. Such items as administrative salaries, utilities, equipment depreciation, and taxes are common examples of overhead. These expenses are distinguishable from variable expenses, such as labor, materials, and transportation costs, which are directly attributable to the breached contract and which are expenses that a seller is saved as a result of the breach. In accounting terminology, which is often used in the reported decisions, overhead expense is often referred to as fixed or indirect costs. Expenses that are saved as a result of the buyer's breach are referred to as direct or variable costs.

The rationale for not deducting overhead in computing lost profits is simply that overhead is not an expense saved as a result of the buyer's breach. The rationale for allowing the seller to recover overhead expense as damages is equally clear. Since overhead expense is fixed, if the seller cannot recover as damages the proportionate part of the overhead that the breached contract would have borne, the seller's overhead will be allocated over the remainder of the seller's contracts, thereby reducing the profitability of those other contracts. Judge Staley, in his well-known opinion in *Vitex Manufacturing Corp. v. Caribtex Corp.*,¹²¹ succinctly explained the proposition:

By the very nature of this allocation process, as the number of transactions over which overhead can be spread becomes smaller, each transaction must bear a greater portion or allocate share of the fixed overhead cost. Suppose a company has fixed overhead of \$10,000 and engages in five similar transactions; then the receipts of each transaction would bear \$2,000 of overhead expense. If the company is now forced to spread this \$10,000 over only four transactions, then the overhead expense per transaction will rise to \$2,500, significantly reducing the profitability of the four remaining transactions.¹²²

The Code cases, with virtual unanimity, are in agreement with this reasoning.¹²³ The only case to the contrary allowed the seller to recover only over-

120. U.C.C. § 2-708(2) (1977).

121. 377 F.2d 795, 4 U.C.C. Rep. Serv. (Callaghan) 182 (3d Cir. 1967).

122. *Id.* at 799, 4 U.C.C. Rep. Serv. (Callaghan) at 186; see J. WHITE & R. SUMMERS, *supra* note 5, at 285 ("[A] contract with a theoretical net profit of zero may nevertheless carry a substantial economic benefit to the contracting party.").

123. *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 869-70, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1675-77 (1st Cir. 1982); *Automated Medical Laboratories, Inc., v. Armour Pharmaceutical Co.*, 629 F.2d 1118, 1125-26, 30 U.C.C. Rep. Serv. (Callaghan) 996, 1003-05 (5th Cir. 1980); *Unique Sys. v. Zotos Int'l, Inc.*, 622 F.2d 373, 379, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1350 (8th Cir. 1980); *Vitex Mfg. Corp. v. Caribtex Corp.*, 377 F.2d 795, 798, 4 U.C.C. Rep. Serv. (Callaghan) 182, 185 (3d Cir. 1967); *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 853-54, 26 U.C.C. Rep. Serv. (Callaghan) 406, 413-15 (E.D.N.Y.), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *Autonumerics, Inc. v. Bayer Indus.*,

head expense incurred up to the time of the buyer's breach.¹²⁴ The court's decision is incorrect. To compensate the seller fully for its loss, the court should have allowed the seller to recover the entire overhead that would have been allocated to the breached contract.

1. *Computation of Overhead*

Section 2-708(2) uses the phrase "profit (including reasonable overhead)."¹²⁵ Notice that this language does not provide for profit plus overhead, but rather carries the inference that the profit includes overhead. Overhead will virtually always be a tacit part of the seller's recovery of gross profits. The calculation of the profit portion of the section 2-708(2) formula, then, is contract price less variable expenses. The resulting gross profit figure will include the proportionate part of the fixed overhead costs attributable to the breached contract. This method of calculation is consistent with both the propositions that fixed overhead expenses are not expenses saved as a result of a contract breach and that the aggrieved seller is entitled to recover as damages that proportion of the overhead that the breached contract was to bear.

This method of calculation, contract price less variable expenses, is widely recognized by the reported decisions. Thus, in one case the court labeled the allocation of overhead as a tacit award of damages to the seller.¹²⁶ The court rejected the buyer's argument that, based on modern accounting principles, overhead is as much a cost of doing business as any other expense.¹²⁷ The court reasoned that the share of overhead allocable to a particular transaction should not be considered a cost for purposes of computing lost profits merely because those in business allocate such costs for planning purposes.¹²⁸

144 Ariz. 181, 696 P.2d 1330, 1339-40, 39 U.C.C. Rep. Serv. (Callaghan) 802, 814 (Ct. App. 1984); *Jericho Sash & Door Co. v. Building Erectors, Inc.*, 362 Mass. 871, 286 N.E.2d 343, 343-44, 10 U.C.C. Rep. Serv. (Callaghan) 1377, 1377-78 (1972); *Coast Trading Co. v. Parmac, Inc.*, 21 Wash. App. 896, 587 P.2d 1071, 1078-80, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1054-56 (1978); *cf.* RESTATEMENT (SECOND) OF CONTRACTS § 347 comment f (1982) (lost volume seller entitled to net profit).

124. *Industrial Circuits Co. v. Terminal Communications, Inc.*, 26 N.C. App. 536, 216 S.E.2d 919, 923, 17 U.C.C. Rep. Serv. (Callaghan) 996, 1000 (1975) (relying on North Carolina Supreme Court decision in *Perfecting Serv. Co. v. Product Dev. & Sales Co.*, 259 N.C. 400, 131 S.E.2d 9 (1963)).

125. U.C.C. § 2-708(2) (1977).

126. *Vitex Mfg. Corp. v. Caribtex Corp.*, 377 F.2d 795, 799, 4 U.C.C. Rep. Serv. (Callaghan) 182, 184-86 (3d Cir. 1967). The court stated:

First it must be recognized that the pro rata allocation of overhead costs is only an analytical construct. In a similar manner one could allocate a pro rata share of the company's advertising cost, taxes and/or charitable gifts. The point is that while these items all are paid from the proceeds of the business, they do not normally bear such a direct relationship to any individual transaction to be considered a cost in ascertaining lost profits.

Id., 4 U.C.C. Rep. Serv. (Callaghan) at 186.

127. *Id.* at 798-99, 4 U.C.C. Rep. Serv. (Callaghan) 185-86.

128. It is true that successful businessmen must set their prices at sufficient levels to recoup all their expenses, including overhead, and to gain profits. Thus, the price the businessman should charge on each transaction could be thought of as

Computing profit as contract price less variable expenses avoids the redundancy of the seller having to prove total costs, including overhead, to determine net profits and then adding back in overhead to determine gross profits. It would be most onerous to require the seller to prove every one of the fixed overhead costs, ranging from management salaries, utilities, and the like, to matters that may be quite difficult to calculate, such as equipment depreciation, and to matters that may vary by the month or year, such as charitable contributions. The simplified method of calculation also avoids having counsel for the buyer object at each opportunity that these fixed costs of doing business were unreasonably incurred. The true fact of the matter is that the reasonableness of particular overhead costs is of no relevance to the defendant buyer. A vice president of the seller may, because of nepotism, be paid an enormous salary that he or she in no sense earns. Although this salary will affect the overall profitability of the business, it has no direct effect on the profit that the seller would have earned on the breached contract.¹²⁹ In effect, had the buyer not breached the contract, the seller would have been able to use a portion of the gross profits from that contract to pay a portion of the relative's outrageous salary. The seller should be compensated for this loss.

Why then does section 2-708(2) use the term "reasonable overhead"? Despite the above analysis, this usage encourages a buyer to argue that the buyer may, indeed, attack the reasonableness of every item of the seller's fixed costs. Professor Hawkland has suggested that the purpose of the "enigmatic" phrase "reasonable overhead" is to prevent the seller from making an unreasonable allocation between fixed and variable cost categories.¹³⁰ For example, labor costs attributable to the breached contract exemplify variable costs that must be deducted to determine the seller's profit. What happens, however, if the seller, as a matter of internal operating policy, places all its labor force on fixed salary and, perhaps taking a page from the banking industry, gives each member of the force an administrative title? Obviously,

that price necessary to yield a pro rata portion of the company's fixed overhead, the direct costs associated with production, and a "clear" profit. Doubtless this type of calculation is used by businessmen and their accountants. However, because it is useful for planning purposes to allocate a portion of overhead to each transaction, it does not follow that this allocate share of fixed overhead should be considered a cost factor in the computation of lost profits on individual transactions.

Id. (citation omitted); see also *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 869-70, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1675-77 (1st Cir. 1982) (seller must deduct direct costs, which includes wages and benefits of workers on contract goods); *Automated Medical Laboratories, Inc. v. Armour Pharmaceutical Co.*, 629 F.2d 1118, 1125, 30 U.C.C. Rep. Serv. (Callaghan) 996, 1003-05 (5th Cir. 1980) (seller may recover gross profit, which includes overhead but not direct costs); *Jericho Sash & Door Co. v. Building Erectors, Inc.*, 362 Mass. 871, 286 N.E.2d 343, 344, 10 U.C.C. Rep. Serv. (Callaghan) 1377, 1378 (1972) ("profit (including reasonable overhead)" in statute is gross profit including fixed but not variable costs); *Coast Trading Co. v. Parmac, Inc.*, 21 Wash. App. 896, 587 P.2d 1071, 1079, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1054-56 (1978) (overhead not deductible in calculating lost profit).

129. Professor Hawkland, by a series of cogent illustrations, has mathematically demonstrated this fact. See 3 W. HAWKLAND, *supra* note 13, § 2-708:04, at 331-38.

130. *Id.* at 337.

this practice would greatly increase the seller's fixed costs of doing business. May such a seller properly argue under section 2-708(2) that, because of its unique internal policies, it need make no deduction for labor costs in manufacturing the contract goods? Professor Hawkland correctly concludes not, stating that the seller's latitude in determining the nature of a particular cost is subject to a rule of reason.¹³¹

2. Variable Overhead Costs

Overhead costs are not always fixed. The costs can often vary with the individual facts of the particular case. Accountants sometimes use the phrase "variable overhead costs" to refer to such expenses.¹³²

If for any reason the buyer's breach enables the seller to save costs that normally would be fixed, such costs should be deducted in determining the seller's section 2-708(2) lost profit award. Professor Hawkland's example of fixed labor costs, discussed earlier, is a good example of such variable overhead costs. In an analogous case the seller, in computing its lost profit, omitted a deduction for the wages of employees who were to test the contract goods. The seller argued that the breach did not affect the wages paid to the testers. The court disagreed and held that the wages were not properly a part of overhead and, thus, the seller should have deducted them from the contract price.¹³³ The question of distinguishing between true overhead and variable overhead may often produce substantial disputes at trial.¹³⁴

A clearer example of a variable overhead cost is the cost of utilities to a seller whose manufacturing plant is normally shut down, but is reopened solely for the purpose of performing the breached contract. In such a case, the costs of utilities, normally fixed and indirect, become directly attributable to the breached contract. Such costs are thus variable overhead.¹³⁵

A more difficult situation arises when the seller goes out of business subsequent to the buyer's breach, thereby saving expenses, such as utilities cost or plant rental, that the seller would necessarily have incurred in performing the breached contract. Again, because of the particular situation, normally fixed expenses have become variable. The seller should not recover such

131. Reasonable overhead, then, means costs that reasonably are assigned to the fixed expense category. In this respect, some latitude must be given to the business judgment of the seller as to how costs should be allocated, but he must not be permitted to inflate his recovery under subsection 2-708(2) by unreasonably increasing his fixed expenses by including therein charges that clearly belong to the variable cost category.

Id.

132. R. DUNN, *supra* note 119, § 6.5, at 110 (2d ed. Supp. 1986); see *Roblin Hope Indus. v. J.A. Sullivan Corp.*, 11 Mass. App. Ct. 76, 413 N.E.2d 1134, 1136 (1980); see also *J. WHITE & R. SUMMERS*, *supra* note 5, at 285 ("no unanimity among accountants about what is overhead").

133. *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 870, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1676-77 (1st Cir. 1982).

134. *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 1342, 39 U.C.C. Rep. Serv. (Callaghan) 802, 817 (Ct. App. 1984).

135. See *Vitex Mfg. Corp. v. Caribtex Corp.*, 377 F.2d 795, 798, 4 U.C.C. Rep. Serv. (Callaghan) 182, 185 (3d Cir. 1967).

variable overhead expenses as damages; the expenses should be deducted from the price of the breached contract. The sparse pre-Code case law apparently endorsed this position.¹³⁶ No Code case to date has directly resolved the question, but the courts have indicated that they will follow the pre-Code rationale.¹³⁷

In short, there is logic to the proposition that a seller should not recover for overhead expenses that it did not incur. If the seller discontinues business, an overhead savings will often result. The situation becomes complicated, however, when the seller is actually driven out of business by the buyer's breach. This can happen when the buyer represents a significant percentage of the seller's business. If the seller is forced to shut down as a result of the buyer's breach, the seller may well save overhead expense yet at the same time suffer substantial economic loss from contracts it could have performed had it been able to continue in operation. Such losses, of course, represent consequential damages. The Code makes no provision for a seller's recovery of consequential damages, and the cases to date have denied such recovery.¹³⁸ On the other hand, a buyer who argues that it is not responsible for the seller's consequential loss, but at the same time seeks a deduction from the seller's damages for the overhead expenses that the seller saved by being forced to discontinue business, reminds one of the child who murders his parents and begs mercy of the court on the grounds that he is an orphan. The first case to address these questions directly will be an interesting one.

A final consideration in computing variable overhead expenses is that fixed costs for overhead can vary according to the seller's level of production. As production increases, more administrative staff may be necessary to support and supervise labor. Additional production may mean opening additional plants. If the buyer's breach causes a sufficiently significant decrease in the seller's level of production, some overhead may become a variable cost and should be treated as such.¹³⁹

136. See *French v. Pullman Motor Car Co.*, 242 Pa. 136, 88 A. 876, 877 (1913); see also Annotation, *Overhead Expense as Recoverable Element of Damages*, 3 A.L.R.3d 689 (1965).

137. In one case the court said:

Zotos argues, however, that a plaintiff who discontinues his business after a breach of contract is not entitled to recover overhead expenses which would have been incurred had the business continued. This may be the rule, but there is no proof in the record that Unique Systems, Inc., has ceased to exist. Apparently Zotos did not attempt to establish this fact at trial.

Unique Sys. v. Zotos Int'l, Inc., 622 F.2d 373, 379, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1350 (8th Cir. 1980). Similarly, another case disallowed overhead deduction because the trial court did not find any persuasive evidence that the breach caused a major work force reduction or a plant shutdown. *Coast Trading Co. v. Parmac, Inc.*, 21 Wash. App. 896, 587 P.2d 1071, 1080, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1056 (1978).

138. See *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 216, 28 U.C.C. Rep. Serv. (Callaghan) 1039, 1044-45 (5th Cir. 1980).

139. Thus, in one case the court said:

The allocation of overhead is particularly problematic because three centers remained open after the breach. . . . On remand, the court must examine Auto's 1975 records to determine actual overhead expenses for 1975. Because Auto closed three centers after the Armour breach, its overhead expenses in 1975 may very well have varied considerably from the expenses incurred in previous years.

C. Costs Reasonably Incurred

If a seller properly discontinues manufacturing contract goods following a buyer's breach, the seller may recover, in addition to the lost profit, the costs reasonably incurred in partially performing the contract.¹⁴⁰ Only by allowing a recovery of such costs can the aggrieved seller attain the position it would have occupied had the breached contract been performed. In our recurring hypothetical, we have a contract price of \$10,000 and total direct costs of \$9,000. Accordingly, the seller's profit including overhead would be \$1,000. Assume now that at the time of the buyer's breach the seller had incurred \$6,000 in direct costs of partially manufacturing the goods. Assuming further that the partially manufactured goods are valueless, the seller's damages obviously must account for the \$6,000 out-of-pocket expenses. Section 2-708(2) takes this factor into account by allowing the seller to recover costs reasonably incurred. Thus, in the hypothetical, the seller could recover a total of \$7,000.

Suppose the seller cannot or does not marshal the necessary proof at trial of what the total direct costs would have been in performing the breached contract. In such a case clearly the seller has failed to prove its profit. May the seller nevertheless recover the costs reasonably incurred in part performance? On the above facts, the seller would be asking for a \$6,000 rather than a \$7,000 recovery. The seller would argue that, on the facts in the record, the profit should be computed at zero and the costs reasonably incurred at \$6,000. Code section 1-106 directs courts to administer Code remedies liberally; thus no reason to deny the seller the \$6,000 recovery is apparent. This recovery would certainly be allowed if the record demonstrated that the seller's profit would actually have been zero, that is, if the seller's total direct

Automated Medical Laboratories, Inc. v. Armour Pharmaceutical Co., 629 F.2d 1118, 1126, 30 U.C.C. Rep. Serv. (Callaghan) 996, 1005 (5th Cir. 1980). These kinds of complications may explain the court's statement:

[T]he parties in this case interpret § 2-708(2) as entitling a seller to reasonable overhead as a component of lost profits. We accept this position of the parties in resolving their dispute. Because of the posture of the parties we take note of but we need not and specifically do not adopt the rule of *Vitex Manufacturing Corp. v. Caribtex Corp.*, 377 F.2d 795 [4 U.C.C. Rep. Serv. (Callaghan) 182] (3d Cir. 1967), to the effect that § 2-708(2) always entitles a seller to recover reasonable overhead expense as an element of the damage award. We defer resolution of that issue to the case in which it is presented to us as a disputed issue.

Id. at 1125 n.13, 30 U.C.C. Rep. Serv. (Callaghan) at 1004 n.13. In a similar vein, another court addresses the question of overhead varying according to the level of production negatively, saying:

One other matter with respect to computation of such damages must be noted. In view of our finding . . . that production by plaintiff of the 958.887 tons not accepted by the defendant would not have increased plaintiff's fixed costs beyond the level required for production of [steel] strand accepted by defendant, we hold that only plaintiff's variable costs of production should be considered in computation of the net lost profits to which we find plaintiff entitled.

Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp., 466 F. Supp. 846, 854, 26 U.C.C. Rep. Serv. (Callaghan) 406, 414-15 (E.D.N.Y.), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *see also* *Coast Trading Co. v. Parmac, Inc.*, 21 Wash. App. 896, 587 P.2d 1071, 1080, 25 U.C.C. Rep. Serv. (Callaghan) 1047, 1056 (1978) (overhead not affected by breach).

140. *See* U.C.C. § 2-708(2) (1977).

costs amounted to \$10,000, the contract price. The partial measure of recovery for expenses incurred in part performance is well established in contract damage law outside the Code.¹⁴¹

This measure of recovery, however, presents a real danger of overcompensating the plaintiff in cases in which full performance of the breached contract would have resulted in a loss to the seller. Assume in the above hypothetical that total direct costs of manufacture would have been \$12,000 and that, because the contract price was only \$10,000, the seller would have lost \$2,000 if the contract had been fully performed. To allow the seller a recovery of \$6,000 for costs reasonably incurred would place the seller in a better position than it would have occupied had the buyer performed the contract. The seller would escape the \$2,000 loss. Accordingly, if the buyer can show that the \$2,000 loss would have occurred, the court should reduce the seller's recovery by this amount. The recovery would then be \$4,000: the profit, a negative \$2,000, plus the costs reasonably incurred, \$6,000. Section 333 of the *Restatement of Contracts*, which allows for the recovery of expenses incurred in part performance, reaches this result.¹⁴² Judge Learned Hand said in a well-known case on point that the proposition is simply that the court will not knowingly allow a recovery of expenses incurred so as to place the plaintiff in a better position than it would have occupied had the contract been performed.¹⁴³ Although there are no Code cases directly on point, cases outside the Code¹⁴⁴ and the viewpoints of several respected commentators¹⁴⁵ give strong indication that the same result should obtain under section 2-708(2).

In cases involving recovery for expenses incurred on unprofitable contracts, the buyer should carry the burden of proof on any loss that the seller would have suffered. Pre-Code law also supports this position,¹⁴⁶ and the Code rejects any doctrine that the injured party must prove damages with mathematical precision.¹⁴⁷

141. See RESTATEMENT OF CONTRACTS § 333 (1932).

142. "If full performance would have resulted in a net loss to the plaintiff, the amount of this loss must be deducted, the burden of proof being on the defendant." *Id.* § 333(d).

143. *L. Albert & Son v. Armstrong Rubber Co.*, 178 F.2d 182, 191 (2d Cir. 1949), noted in Annotation, *Right to Recover, in Action for Breach of Contract, Expenditures Incurred in Preparation for Performance*, 17 A.L.R.2d 1300 (1951); see Fuller & Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 75-80 (1936).

144. *L. Albert & Sons v. Armstrong Rubber Co.*, 178 F.2d 182, 191 (2d Cir. 1949); *Hough v. Jay-Dee Realty & Inv., Inc.*, 401 S.W.2d 545, 550-51 (Mo. Ct. App. 1966); *Security Stove & Mfg. Co. v. American Ry. Express*, 227 Mo. App. 175, 51 S.W.2d 572, 576 (1932); *Reynolds Metals Co. v. Electric Smith Constr. & Equip. Co.*, 4 Wash. App. 695, 483 P.2d 880, 885 (1971); *Stolper Steel Prods. Corp. v. Behrens Mfg. Co.*, 10 Wis. 2d 478, 103 N.W.2d 683, 689 (1960).

145. J. WHITE & R. SUMMERS, *supra* note 5, at 282 n.79, 287 n.92; Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 274 (1963).

146. RESTATEMENT OF CONTRACTS § 333(d) (1932).

147. U.C.C. § 1-106 comment 1 (1977).

D. Due Credit for Payments or Proceeds of Resale

An irony regarding section 2-708(2) is that the section cannot be read literally and still properly be applied to lost volume sellers, the group to which the section is most often applicable. Section 2-708(2) concludes with the requirement that the breaching buyer receive "due credit for payments or proceeds of resale."¹⁴⁸ Taken on its face, this provision would require that the buyer obtain credit for the amount received by the lost volume seller upon resale of the goods. An illogical result follows: the seller is denied a profit it would have otherwise earned. The seller's damage recovery would be roughly that provided by section 2-706 or section 2-708(1),¹⁴⁹ both of which demonstrably do not compensate the lost volume seller.

The saving grace is that the drafting history of the provision makes clear that the drafters only intended the due credit clause to allow the seller to discontinue production and realize junk value on contract goods.¹⁵⁰ The due credit provision, then, applies only to the situation in which a seller, left at breach with partially manufactured goods, sells the incomplete goods as components or scrap. The cases¹⁵¹ and commentators¹⁵² have universally agreed with this interpretation of the provision.¹⁵³

148. *Id.* § 2-708(2).

149. See *National Controls, Inc. v. Commodore Business Machs., Inc.*, 163 Cal. App. 3d 688, 697-99, 209 Cal. Rptr. 636, 642-43, 40 U.C.C. Rep. Serv. (Callaghan) 12, 21 (1985); *Snyder v. Herbert Greenbaum & Assocs., Inc.*, 38 Md. App. 144, 380 A.2d 618, 625-26, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1114 (1977).

150. SUPPLEMENT NO. 1 TO THE 1952 OFFICIAL DRAFT OF TEXT AND COMMENTS OF THE UNIFORM COMMERCIAL CODE 14 (1955) [hereinafter SUPPLEMENT NO. 1]; see also *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 399 n.2, 285 N.E.2d 311, 314 n.2, 334 N.Y.S.2d 165, 169 n.2, 10 U.C.C. Rep. Serv. (Callaghan) 950, 954 n.2 (1972) (citing New York commentators).

151. *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 867-68, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1673-74 (1st Cir. 1982); *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F.2d 251, 253-54, 14 U.C.C. Rep. Serv. (Callaghan) 415, 416-18 (4th Cir. 1974); *National Controls, Inc. v. Commodore Business Machs., Inc.*, 163 Cal. App. 3d 688, 697-99, 209 Cal. Rptr. 636, 642-43, 40 U.C.C. Rep. Serv. (Callaghan) 12, 19-21 (1985); *Snyder v. Herbert Greenbaum & Assocs., Inc.*, 38 Md. App. 144, 380 A.2d 618, 625-26, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1113-16 (1977); *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 398-99, 285 N.E.2d 311, 314, 334 N.Y.S.2d 165, 169, 10 U.C.C. Rep. Serv. (Callaghan) 950, 954-55 (1972); see also *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 853-54, 26 U.C.C. Rep. Serv. (Callaghan) 406, 413-15 (E.D.N.Y.) (seller not required to offset profit from third-party sales against damages when not at lost volume), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *Comeq, Inc. v. Mitternight Boiler Works, Inc.*, 456 So. 2d 264, 267-69, 39 U.C.C. Rep. Serv. (Callaghan) 488, 492-94 (Ala. 1984) (middleman seller allowed lost profits); *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 1339-41, 39 U.C.C. Rep. Serv. (Callaghan) 802, 814-17 (Ct. App. 1984) (breaching buyer not to receive credit for resale proceeds when seller is lost volume seller); *Capital Steel Co. v. Foster & Creighton Co.*, 264 Ark. 683, 574 S.W.2d 256, 258-59, 25 U.C.C. Rep. Serv. (Callaghan) 1349, 1353 (1978) (seller may recover lost profits when buyer breaches during manufacture).

152. See J. WHITE & R. SUMMERS, *supra* note 5, at 277, 285; Harris, *Sales Act Results*, *supra* note 7, at 99.

153. *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 868, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1674 (1st Cir. 1982). One court fully explained the matter as follows:

Logically, lost volume status, which entitles the seller to the § 2-708(2) formula rather than the formula found in § 2-708(1), is inconsistent with a credit for the proceeds of resale. The whole concept of lost volume status is that the sale of the goods to the resale purchaser could have been made with other goods had

A possible exception to this interpretation, an exception that is nevertheless conceptually consistent with it, occurs when the seller completes manufacture solely for the buyer's account so as to mitigate damages as required in section 2-704(2). As previously demonstrated,¹⁵⁴ a seller with incomplete goods on hand may, on occasion, be able to mitigate its loss by reselling the goods, even at less than their total direct costs, if the seller can obtain a price in excess of the sum of the direct cost to complete the manufacture plus the amount it could receive by discontinuing manufacture and scrapping the goods.¹⁵⁵ A seller who reasonably takes such action should not prejudice its right to a recovery under the full section 2-708(2) formula, profit plus costs less due credit. A seller who takes this course of action should, given the general interpretation accorded the due credit provision, advise the buyer in advance that the seller's course of action in completing manufacture is solely for the buyer's account to mitigate the damages owed.

E. Incidental and Consequential Damages

Section 2-708(2) specifically provides for the seller's recovery of incidental damages. Section 2-710 defines incidental damages to include "any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach."¹⁵⁶ The cases have allowed sellers to recover a wide

there been no breach. In essence, the original sale and the second sale are independent events, becoming related only after breach, as the original sale goods are applied to the second sale. To require a credit for the proceeds of resale is to deny the essential element that entitles the lost volume seller to § 2-708(2) in the first place—the mutual independence of the contract and the resale.

Practically, if the "due credit" clause is applied to the lost volume seller, his measure of damages is not different from his recovery under § 2-708(1). Under § 2-708(1) he recovers the contract/market differential and the profit he makes on resale. If the "due credit" provision is applied, the seller recovers only the profit he makes on resale plus the difference between the resale price and the contract price, an almost identical measure to § 2-708(1). If the "due credit" clause is applied to the lost volume seller, the damage measure of "lost profits" is rendered nugatory, and he is not put in as good a position as if there had been performance.

The statutory history of the "due allowance—due credit" provision of § 2-708(2) indicates that it was added to § 2-708(2) to cover a particular class of sellers—the component parts assemblers/sellers. These are sellers who obtain the component parts for special assembly on behalf of the buyer, who find it useless to complete assembly after the buyer's breach. The "due credit" provision was intended to "clarify the privilege of the seller to realize junk value when it is manifestly useless to complete the operation of manufacture." Apparently, then, the "due credit" provision was intended to affect the rights of a particular class of sellers, which class does not include the "lost volume seller."

Snyder v. Herbert Greenbaum & Assocs., Inc., 38 Md. App. 144, 380 A.2d 618, 625-26, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1114-15 (1977) (footnotes omitted) (quoting SUPPLEMENT NO. 1, *supra* note 150, at 14).

154. See *supra* notes 70-87 and accompanying text.

155. Of course, such action by the seller will not mitigate its loss if it can better use its production capabilities to perform other contracts.

156. U.C.C. § 2-710 (1977).

variety of expenses incurred, including handling charges,¹⁵⁷ storage and moving charges,¹⁵⁸ finance charges,¹⁵⁹ and upkeep and insurance charges.¹⁶⁰

The typical lost volume seller situation rarely will incur incidental damages. A basic condition to a seller's ability to prove lost volume status is that the seller be able to show that it would have made the resale regardless of the buyer's breach. In such cases, however, many of the expenses normally recoverable by sellers as incidental damages, such as expenses of reselling or handling the goods, are incurred by the seller regardless of the buyer's breach; therefore, the expenses do not result from the breach as required by section 2-710. For this reason, lost volume sellers arguably have a narrower range of incidental damages than do other sellers.

The Code makes no provision for a seller's recovery of consequential damages. Section 1-106¹⁶¹ and the cases to date¹⁶² indicate that a seller is to be denied recovery for consequential loss. Nevertheless, some courts have apparently made an attempt to avoid the potential unfairness of this denial by adopting an expansive concept of incidental damages, labeling as incidentals items that might be more correctly regarded as examples of consequential loss. For example, in one case the court allowed the seller recovery for the loss of byproducts that the seller would have produced had the buyer not repudiated the contract and thereby prevented the seller from manufacturing the contract goods.¹⁶³ The court allowed the recovery without identifying any applicable provision of the Code.¹⁶⁴ The value of the byproducts was in no sense a charge, expense, or commission as provided in section 2-710. The same court, in an earlier opinion, had also allowed the recovery of finance charges incurred on the contract goods. The buyer argued that only the finance charges incurred subsequent to the contract breach could be regarded as incidental damages resulting from the breach under section 2-710. The court, however, disagreed.¹⁶⁵

157. *Great W. Sugar Co. v. Mrs. Allison's Cookie Co.*, 563 F. Supp. 430, 433, 36 U.C.C. Rep. Serv. (Callaghan) 164, 166 (E.D. Mo. 1983).

158. *Id.*; *Cesco Mfg. Corp. v. Norcross, Inc.*, 7 Mass. App. Ct. 837, 391 N.E.2d 270, 275, 27 U.C.C. Rep. Serv. (Callaghan) 126, 132 (1979); *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 400-01, 285 N.E.2d 311, 315, 334 N.Y.S.2d 165, 170, 10 U.C.C. Rep. Serv. (Callaghan) 950, 955 (1972); *Palmisciano v. Tarbox Motors*, 39 U.C.C. Rep. Serv. (Callaghan) 146, 151 (R.I. Super. Ct. 1984).

159. *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 401, 285 N.E.2d 311, 315, 334 N.Y.S.2d 165, 170, 10 U.C.C. Rep. Serv. (Callaghan) 950, 955 (1972).

160. *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 216, 28 U.C.C. Rep. Serv. (Callaghan) 1039, 1044 (5th Cir. 1980); *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 401, 285 N.E.2d 311, 315, 334 N.Y.S.2d 165, 170, 10 U.C.C. Rep. Serv. (Callaghan) 950, 955 (1972).

161. *Id.* § 1-106(1) provides, in part, that "neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law."

162. *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 216, 28 U.C.C. Rep. Serv. (Callaghan) 1039, 1043 (5th Cir. 1980); *Petroleo Brasileiro, S.A. Petrobras v. Ameropan Oil Corp.*, 372 F. Supp. 503, 508, 14 U.C.C. Rep. Serv. (Callaghan) 661, 667 (E.D.N.Y. 1974).

163. *Wallace Steel, Inc. v. Ingersoll-Rand Co.*, 739 F.2d 112, 115, 38 U.C.C. Rep. Serv. (Callaghan) 1665, 1668 (2d Cir. 1984).

164. *Id.*

165. *Bulk Oil (U.S.A.), Inc. v. Sun Oil Trading Co.*, 697 F.2d 481, 484, 35 U.C.C. Rep. Serv. (Callaghan) 23, 28 (2d Cir. 1983).

F. Mitigation of Damages

Although the Code rarely addresses the matter, a basic principle of the law of damages is that an aggrieved party cannot recover for any loss that the party could have reasonably avoided. The Code has certainly not abolished this so-called duty to mitigate damages;¹⁶⁶ the duty permeates the Code through section 1-103, which preserves the applicability of the rules of law and equity unless the rules are specifically displaced by a Code provision.¹⁶⁷ The defendant buyer has the burden of proof to show that the seller has failed to act reasonably to minimize any loss.¹⁶⁸

This Article has previously discussed two examples of how a seller who attempts to bring action under section 2-708(2) may be found to have failed to mitigate damages. In the first instance, a full capacity seller, who has completed goods on hand, must account to the breaching buyer for the proceeds of any resale of the goods.¹⁶⁹ If a full capacity seller unreasonably fails to take advantage of an available resale, the seller will not recover for any damages that could have been avoided by the resale.¹⁷⁰ Second, mitigation duties exist under section 2-704(2) for sellers left with incomplete goods on hand at breach.¹⁷¹ Such sellers will not, for example, recover as damages any variable costs that could reasonably have been avoided by either completing the goods or by discontinuing their manufacture, depending on the facts and circumstances of the particular case.¹⁷²

The seller need only act reasonably in attempting to mitigate the loss. Thus, a court has held that a lost volume seller was not required to mitigate its loss by accepting a breaching buyer's offer to buy less expensive goods.¹⁷³ Because the buyer's offer was unreasonably conditioned upon the seller's surrender of its claim against the buyer for breach, the seller was not unreasonable in rejecting the offer.¹⁷⁴

A corollary in the law of damages to the duty to mitigate is the proposition that compensatory damages are measured at the least cost to the defendant.¹⁷⁵ Thus, in applying this principle one court held that because the buyer could have elected to honor the contract by either making all the lease

166. *Royal Store Fixture Co. v. Bucci*, 48 Pa. D. & C.2d 696, 703, 7 U.C.C. Rep. Serv. (Callaghan) 1193, 1198 (County Ct. 1969).

167. *TCP Indus. v. Uniroyal, Inc.*, 661 F.2d 542, 550, 32 U.C.C. Rep. Serv. (Callaghan) 369, 379 (6th Cir. 1981); *see also* U.C.C. §§ 2-704(2), -715(2)(a) (1977) (promoting damage mitigation).

168. *TCP Indus. v. Uniroyal, Inc.*, 661 F.2d 542, 550, 32 U.C.C. Rep. Serv. (Callaghan) 369, 379 (6th Cir. 1981).

169. *See Publiker Indus. v. Roman Ceramics Corp.*, 652 F.2d 340, 346, 32 U.C.C. Rep. Serv. (Callaghan) 449, 453 (3d Cir. 1981); *Snyder v. Herbert Greenbaum & Assocs., Inc.*, 38 Md. App. 144, 380 A.2d 618, 625, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1114 (1977).

170. *See Schiavi Mobile Homes, Inc. v. Girona*, 463 A.2d 722, 725, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1193 (Me. 1983); *supra* text accompanying notes 40-52.

171. *See supra* notes 70-87 and accompanying text.

172. *See Neumiller Farms, Inc. v. Cornett*, 368 So. 2d 272, 277, 26 U.C.C. Rep. Serv. (Callaghan) 61, 66 (Ala. 1979).

173. *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 870, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1677 (1st Cir. 1982); *see also* U.C.C. § 1-106 (1977).

174. *Teradyne*, 676 F.2d at 870, 33 U.C.C. Rep. Serv. (Callaghan) at 1677.

175. *RESTATEMENT OF CONTRACTS* § 329 comment a (1932) states:

payments on certain equipment or by exercising its option to purchase, calculation of the seller's lost profits should be based on the purchase option price and not on the larger amount of the total of eighty-four lease payments.¹⁷⁶ The court so held notwithstanding the fact that the breaching buyer had not exercised the purchase option.¹⁷⁷ As with the law of damages generally, mitigation requirements for aggrieved sellers under the Code will be as varied as the contracts the sellers enter.

IV. LITIGATION ASPECTS OF SECTION 2-708(2)

A. *Burdens of Pleading and Proof*

A claim for the profit lost on a breached contract under section 2-708(2) is one for general damages and not for special damages. In accordance with the basic law of damages, a recovery based on the profit formula need not be specially pled, and a general allegation of injury by breach of contract will suffice.¹⁷⁸ The point is worth making because the Code's profit formula, as a generally available remedy for aggrieved sellers, is new, and the courts historically are accustomed to dealing with lost profits as special damages. Thus, an occasional case incorrectly refers to an action under section 2-708(2) as a request for special damages.¹⁷⁹ When an action for lost profits takes the form of a claim for special damages it is because the claim is for general business losses not directly related to the breached contract. Such losses arise because of special circumstances of the plaintiff's situation and must be specially pled. A good example is the buyer's claim for lost profits as consequential damages under section 2-715(2)(a).¹⁸⁰ A section 2-708(2) claim, however, is not a claim for lost profits, but one for the particular profit lost naturally and necessarily as a result of the breach. The claim does not encompass unrelated and unanticipated transactions with third parties, or a loss of business generally, but arises naturally and necessarily as a result of the contract breach. Thus, a claimant need not specially plead section 2-708(2) lost profit. A claim for incidental damages under section 2-708(2) is,

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, at the least cost to the defendant and without charging him with harms that he had no sufficient reason to foresee when he made the contract. The various difficulties involved in this effort frequently make it impracticable to attain its purpose with any near approach to exactness. See also U.C.C. § 1-106 (1977) (remedies to be liberally administered to put aggrieved party in as good a position as if other party fully performed, but consequential, special, or penal damages not allowed).

176. *Uchitel Co. v. Telephone Co.*, 646 P.2d 229, 237, 33 U.C.C. Rep. Serv. (Callaghan) 1678, 1683 (Alaska 1982).

177. *Id.*

178. See *Hess Die Mold, Inc. v. American Plasti-Plate Corp.*, 653 S.W.2d 927, 929, 36 U.C.C. Rep. Serv. (Callaghan) 1632, 1633-34 (Tex. App.—Tyler 1983, no writ); *Tennell v. Esteve Cotton Co.*, 546 S.W.2d 346, 355, 21 U.C.C. Rep. Serv. (Callaghan) 978, 984 (Tex. Civ. App.—Amarillo 1976, writ ref'd n.r.e.); C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES 32-39 (1935).

179. *Great W. Sugar Co. v. Mrs. Allison's Cookie Co.*, 563 F. Supp. 430, 433, 36 U.C.C. Rep. Serv. (Callaghan) 164, 165 (E.D. Mo. 1983).

180. U.C.C. § 2-715(2)(a) (1977).

on the other hand, a claim for special damages; therefore, a claimant must specially plead such damages to avoid waiving the claim.¹⁸¹

Because the lost profit claim under section 2-708(2) involves damages that arise naturally and necessarily from the breach, foreseeability is not a factor in determining whether to award such damages. By contrast, a section 2-715(2)(a) claim for consequential damages does require foreseeability.¹⁸² On the rare occasion in which the courts have referred to the section 2-708(2) claim in terms of foreseeability or the contemplation of the parties, the courts have done so merely to note that the loss was foreseeable and within contemplation.¹⁸³

Despite the procedural requirements, however, good practice dictates alleging with particularity in the pleadings the bases for the claim for general damages. This practice may aid the trial court in understanding the gist of the cause of action and following the relevancy of the evidence being introduced. For example, the judge will better appreciate testimony about the ability of the seller to make unlimited sales of goods if the judge understands that the essence of the seller-plaintiff's claim is that the breach left the seller at lost volume.

Regardless of the burden of pleading, the seller must carry the burden of proving its entitlement to section 2-708(2) damages by showing that damages based on the market formula of subsection (1) do not place the seller in the same position it would have occupied had the buyer not breached the contract. The seller demonstrates the inadequacy of subsection (1) damages by showing either that it was left at lost volume or with incomplete goods as a result of the breach. The cases uniformly hold that a seller with completed goods must prove its lost volume status to recover under the profit formula.¹⁸⁴ A seller who does not complete manufacture of the goods must base a claim on the profit formula of section 2-708(2) because the courts will deny recovery on an action for the price under section 2-709,¹⁸⁵ on an action for damages based on the resale formula under section 2-706,¹⁸⁶ and on an action for damages based on the market formula under section 2-708(1).¹⁸⁷ The buyer has the burden of proof to show that the incomplete goods seller should reasonably have mitigated damages by completing manufacture of

181. See *Rodd v. W.H. King Drug Co.*, 30 N.C. App. 564, 228 S.E.2d 35, 37-38, 20 U.C.C. Rep. Serv. (Callaghan) 345, 348-49 (1976).

182. U.C.C. § 2-715(2)(a) (1977).

183. See *American Metal Climax, Inc. v. Essex Int'l, Inc.*, 16 U.C.C. Rep. Serv. (Callaghan) 101, 115 (S.D.N.Y. 1974); *Snyder v. Herbert Greenbaum & Assocs., Inc.*, 38 Md. App. 144, 380 A.2d 618, 624, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1112-13 (1977).

184. See *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F.2d 251, 253-54, 14 U.C.C. Rep. Serv. (Callaghan) 415, 418 (4th Cir. 1974); *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 1340, 39 U.C.C. Rep. Serv. (Callaghan) 802, 814 (Ct. App. 1984); *Snyder v. Herbert Greenbaum & Assocs., Inc.*, 38 Md. App. 144, 380 A.2d 618, 624, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1112 (1977).

185. See *Rowland Meledandi, Inc. v. Kohn*, 7 U.C.C. Rep. Serv. (Callaghan) 34, 35 (N.Y. Civ. Ct. 1969).

186. See *Anderson, Plunging the Depths*, *supra* note 11, at 421-24.

187. See *Anderson, supra* note 23, at 259-65.

the goods.¹⁸⁸

Professor Harris, who coined the term "lost volume," stated three elements of proof necessary for a showing of lost volume status: (1) the plaintiff would have solicited the purchaser of the resold goods regardless of any breach and resale; (2) the plaintiff's solicitation would have succeeded; and (3) the plaintiff would have been able to perform that additional contract.¹⁸⁹ Although one court apparently held that a mere showing that the seller was a retailer of goods was sufficient to show lost volume,¹⁹⁰ the court should have required more convincing proof of lost volume. Accordingly, another court denied a boat retailer recovery under section 2-708(2) because the retailer did not sufficiently prove its lost volume status. A salesman for the seller had testified at trial that the seller had an unlimited supply of the same type of boat as that which the buyer had agreed to purchase. The court found no other evidence in the record to substantiate this testimony.¹⁹¹ Instead, the court found testimony in the record that the seller told the buyer that the boat that was the subject of the purchase agreement was the only one available.¹⁹² The seller resold the contract boat at the same price that the breaching buyer had agreed to pay. On such conflicting evidence, the court upheld the trial court's ruling that the seller had suffered no damages.¹⁹³ The seller had simply failed to carry its burden of proof.

To carry the burden of proof of lost volume status, the bright line test is whether the seller would have made both the sale of the goods under the breached contract and the subsequent sale to a third party. This test is essentially the one proposed by Professor Harris¹⁹⁴ and recognized by a long and growing line of judicial decisions.¹⁹⁵ Thus, one court concluded that "to

188. "The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture." U.C.C. § 2-704 comment 2 (1977); see *supra* text accompanying note 76.

189. Harris, *Sales Act Results*, *supra* note 7, at 82. In their attack on the proposition that a lost volume seller should receive recovery under § 2-708(2), two commentators have argued, inter alia, that the seller must also prove that the performance of an additional contract would not increase its marginal costs above those that it would have incurred in performing the breached contract. Goetz & Scott, *supra* note 13, at 332-54. Professor Wallach's response to the point is the correct one: "This criticism may be accurate from an economist's perspective, but it asks too much of the law." G. WALLACH, *supra* note 13, at 8-18.

190. *Kaiserman v. Martin J. Ain, Ltd.*, 112 Misc. 2d 768, 768, 450 N.Y.S.2d 135, 135, 31 U.C.C. Rep. Serv. (Callaghan) 1374, 1374 (Sup. Ct. 1981).

191. *Lake Erie Boat Sales, Inc. v. Johnson*, 11 Ohio App. 3d 55, 463 N.E.2d 70, 73, 38 U.C.C. Rep. Serv. (Callaghan) 845, 849 (1983).

192. *Id.*

193. *Id.*

194. Harris, *Sales Act Results*, *supra* note 7, at 80-83.

195. See *Teradyne, Inc. v. Teledyne Indus.*, 676 F.2d 865, 868, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1674 (1st Cir. 1982); *TCP Indus. v. Uniroyal, Inc.*, 661 F.2d 542, 552, 32 U.C.C. Rep. Serv. (Callaghan) 369, 382 (6th Cir. 1981); *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F.2d 251, 254, 14 U.C.C. Rep. Serv. (Callaghan) 415, 418 (4th Cir. 1974); *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846, 853, 26 U.C.C. Rep. Serv. (Callaghan) 406, 413 (E.D.N.Y.), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *Comeq, Inc. v. Mitternacht Boiler Works, Inc.*, 456 So. 2d 264, 268, 39 U.C.C. Rep. Serv. (Callaghan) 488, 494 (Ala. 1984); *Autonumerics, Inc. v. Bayer Indus.*, 144 Ariz. 181, 696 P.2d 1330, 1340, 39 U.C.C. Rep. Serv. (Callaghan) 802, 815 (Ct. App. 1984); *National Controls, Inc. v. Commodore Business Machs., Inc.*, 163 Cal. App. 3d 688, 698-99, 209 Cal. Rptr. 636, 643, 40 U.C.C.

require proof of a market in which supply exceeds demand would be to require proof of a complex economic relationship that is not required" by section 2-708(2).¹⁹⁶ The court refused to "impose rigid and complex burdens of proof" and said that "to qualify as a 'lost volume' seller under § 2-708(2), the seller needs to show only that it *could have* supplied both the breaching purchaser and the resale purchaser."¹⁹⁷

The general standard of proof by which any plaintiff, including a seller seeking recovery under section 2-708(2), must prove entitlement to damages is by a preponderance of the evidence.¹⁹⁸ Section 1-201(8) of the Code defines the level of persuasion as follows: "'Burden of establishing' a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence."¹⁹⁹ The standard on appeal, whether the trier of fact was a judge or a jury, is whether the finding of fact was clearly erroneous.²⁰⁰

Burden of proof in its broadest sense designates the party who must ultimately establish by a preponderance of evidence the truth of the basic proposition.²⁰¹ In a narrower sense, burden of proof refers to an obligation resting on a party to go forward with the evidence to rebut an opponent's initial or prima facie proof. The reference is often to the burden of going forward with the evidence. The key distinction is that, in its broader sense, the burden of proof always rests on the same party. The burden of going forward with the evidence, in contrast, changes from party to party throughout a trial.²⁰² Proving actual lost volume status will be quite difficult in many

Rep. Serv. (Callaghan) 12, 19 (1985); *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 400, 285 N.E.2d 311, 315, 334 N.Y.S.2d 165, 170, 10 U.C.C. Rep. Serv. (Callaghan) 950, 955 (1972).

196. *Islamic Republic of Iran v. Boeing Co.*, 771 F.2d 1279, 1290, 41 U.C.C. Rep. Serv. (Callaghan) 1178, 1181 (9th Cir. 1985).

197. *Id.* (emphasis in original).

198. *Cf. Deutscher v. Long (In re Southern Indus. Banking Corp.)*, 36 Bankr. 1010, 1013, 38 U.C.C. Rep. Serv. (Callaghan) 531, 535 (E.D. Tenn. 1984) (burden of establishing signature); *Bickett v. W.R. Grace & Co.*, 12 U.C.C. Rep. Serv. (Callaghan) 629, 646 (W.D. Ky. 1972) (burden of establishing defect and causation in breach of warranty action); *Century Appliance Co. v. Groff*, 1 U.C.C. Rep. Serv. (Callaghan) 226, 228 (Pa. Ct. C.P. 1958) (burden of establishing unauthorized completion); *McCusker v. Fascione*, 117 R.I. 478, 368 A.2d 1220, 1224, 21 U.C.C. Rep. Serv. (Callaghan) 589, 590 (1977) (burden of establishing signature); *Virginia Nat'l Bank v. Holt*, 216 Va. 500, 219 S.E.2d 881, 882, 18 U.C.C. Rep. Serv. (Callaghan) 440, 440 (1975) (same).

199. U.C.C. § 1-201(8) (1977); *see Transammonia Export Corp. v. Conserve, Inc.*, 554 F.2d 719, 723, 22 U.C.C. Rep. Serv. (Callaghan) 301, 306 (5th Cir. 1977) (§ 1-201(8) burden is preponderance of the evidence); *I.S. Joseph v. Citrus Feed Co.*, 490 F.2d 185, 188 (5th Cir. 1974) (burden of establishing oral contract is preponderance of the evidence).

200. *Dangerfield v. Markel*, 278 N.W.2d 364, 368, 26 U.C.C. Rep. Serv. (Callaghan) 419, 424 (N.D. 1979) (citing *FED. R. CIV. P.* 52(8)); *see also Lake Erie Boat Sales, Inc. v. Johnson*, 11 Ohio App. 3d 55, 463 N.E.2d 70, 72, 38 U.C.C. Rep. Serv. (Callaghan) 845, 848 (1983) (reversal requires error that shocks the senses).

201. 29 AM. JUR. 2D *Evidence* §§ 123-124 (1967).

202. *FED. R. EVID.* 301 provides:

In all civil actions and proceedings not otherwise provided for by Act of Congress or by these rules, a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast.

cases; one commentator called it an almost impossible burden.²⁰³ The trial court can alleviate much of the difficulty by artfully manipulating the burden of going forward with the evidence. Although the ultimate burden must rest on the seller, once the seller has made a basic showing of lost volume status, the burden of going forward with the evidence should fall upon the buyer defendant. Indeed, the *Restatement (Second) of Contracts* supports this reasoning by placing the burden on the buyer of showing that the seller was not left at lost volume by the breach once the seller has made an initial showing of lost volume status.²⁰⁴

The practicalities of proving actual lost volume status have led commentators to urge a relaxation of the burden of proof for the seller.²⁰⁵ A perusal of the decisions under the Code to date indicates that sellers have had no great difficulty in proving their lost volume status by a preponderance of the evidence.²⁰⁶ In one case, the court acknowledged that the seller's actual status was a close question and noted that the ultimate determination on remand was for the trier of fact under all the facts and circumstances.²⁰⁷ The buyer may, of course, effectively counter evidence of the seller's lost volume status if the buyer can show either that the breach enabled the seller to make a resale that otherwise could not have been made,²⁰⁸ or that the seller unreasonably failed to mitigate damages by making such a sale.²⁰⁹

B. *Requisite Precision of the Damage Calculation*

To prove the amount of profit lost as a result of a breached contract, a seller must introduce evidence of the contract price and offset that amount with evidence of the direct costs of performing the contract.²¹⁰ If the seller encounters evidentiary problems in marshalling the proof necessary for this calculation, the problem likely will be with proving the actual direct costs that the seller did or would have incurred in performing the contract. The law of damages has always adopted a flexible attitude toward the degree of certainty that an aggrieved party must meet to prove damages, and the courts have long kept in mind that any uncertainty and inexactness is often attributable to the fact that the defendant's breach has made difficult proof

203. G. WALLACH, *supra* note 13, at 8-18.

204. RESTATEMENT (SECOND) OF CONTRACTS § 347 comment f, illustration 16, § 350 comment d (1982).

205. G. WALLACH, *supra* note 13, at 8-18; J. WHITE & R. SUMMERS, *supra* note 5, at 282.

206. See cases cited *supra* note 195.

207. TCP Indus. v. Uniroyal, Inc., 661 F.2d 542, 552, 32 U.C.C. Rep. Serv. (Callaghan) 369, 382 (6th Cir. 1981).

208. See Lake Erie Boat Sales, Inc. v. Johnson, 11 Ohio App. 3d 55, 463 N.E.2d 70, 72, 38 U.C.C. Rep. Serv. (Callaghan) 845, 849 (1983); see also Snyder v. Herbert Greenbaum & Assocs., Inc., 38 Md. App. 144, 380 A.2d 618, 625, 22 U.C.C. Rep. Serv. (Callaghan) 1104, 1113 (1977) (lost volume means sale to resale buyer could have been made regardless of breach); Neri v. Retail Marine Corp., 30 N.Y.2d 393, 285 N.E.2d 311, 314, 334 N.Y.S.2d 165, 169-70, 10 U.C.C. Rep. Serv. (Callaghan) 950, 955 (1972) (§ 2-708 recognizes lost volume situation); *supra* notes 24-33 and accompanying text.

209. See Schiavi Mobile Homes, Inc. v. Girona, 463 A.2d 722, 726, 36 U.C.C. Rep. Serv. (Callaghan) 1190, 1194 (Me. 1983).

210. Royal Store Fixture Co. v. Bucci, 48 Pa. D. & C.2d 696, 702, 7 U.C.C. Rep. Serv. (Callaghan) 1193, 1198 (Pa. County Ct. 1969).

of the costs that the seller would have incurred.²¹¹

The Code's policy concerning the required precision for damage calculation is consistent with this traditional view and with the Code's own general view that courts should liberally construe Code provisions in order to promote the purposes and policies underlying the Code.²¹² Section 1-106 provides that "[r]emedies 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"²¹³ Although the courts never allow damage recoveries based on mere conjecture or speculation,²¹⁴ the courts, in allowing recoveries for lost profits under section 2-708(2), have consistently followed the policy reflected in comment 1 to section 1-106 by rejecting any rule of mathematical precision in calculating damages.²¹⁵

211. See C. MCCORMICK, *supra* note 178, at 102-17.

212. See U.C.C. § 1-102 (1977).

213. *Id.* § 1-106.

214. Palmisciano v. Tarbox Motors, 39 U.C.C. Rep. Serv. (Callaghan) 146, 151 (R.I. Super. Ct. 1984).

215. Teradyne, Inc. v. Teledyne Indus., 676 F.2d 865, 870, 33 U.C.C. Rep. Serv. (Callaghan) 1669, 1677 (1st Cir. 1982) (damages need be proven only with definiteness and accuracy permitted by facts); Automated Medical Laboratories, Inc. v. Armour Pharmaceutical Co., 629 F.2d 1118, 1126, 30 U.C.C. Rep. Serv. (Callaghan) 996, 1005 (5th Cir. 1980) (seller need prove lost profit with reasonable, not mathematical, certainty); Unique Sys. v. Zotos Int'l, Inc., 622 F.2d 373, 378, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1349 (8th Cir. 1980) (in new venture situation seller need prove amount of damages with reasonable degree of certainty; earnings history not required); Nobs Chem., U.S.A., Inc. v. Koppers Co., 616 F.2d 212, 217, 28 U.C.C. Rep. Serv. (Callaghan) 1039, 1045 (5th Cir. 1980) (damages need be proven with reasonable certainty, not with exactness); Vitex Mfg. Corp. v. Caribtex Corp., 377 F.2d 795, 798, 4 U.C.C. Rep. Serv. (Callaghan) 182, 184 (3d Cir. 1967) (difficulty in determining amount of costs often arises because of buyer's repudiation before complete performance, ambiguities should be decided against buyer); American Metal Climax, Inc. v. Essex Int'l, Inc., 16 U.C.C. Rep. Serv. (Callaghan) 101, 115 (S.D.N.Y. 1974) (rational basis for determining lost profit required for new venture); Distribu-Dor, Inc. v. Karandanis, 11 Cal. App. 3d 463, 470, 90 Cal. Rptr. 231, 236, 8 U.C.C. Rep. Serv. (Callaghan) 36, 42 (1970) (lesser standard of certainty required for proving amount of damage than required for proving fact of damage); Bead Chain Mfg. Co. v. Saxton Prods., Inc., 183 Conn. 266, 439 A.2d 314, 321, 31 U.C.C. Rep. Serv. (Callaghan) 91, 100 (1981) (proof of damages need only be presented with reasonable certainty; buyer has no right to complain since difficulty in proof is due to its breach; remedies should be liberally construed); Jericho Sash & Door Co. v. Building Erectors, Inc., 362 Mass. 871, 286 N.E.2d 343, 344, 10 U.C.C. Rep. Serv. (Callaghan) 1377, 1378 (1972) (damages need only be proved with precision and accuracy permitted by facts and are at best approximate); Rowland Meledandi, Inc. v. Kohn, 7 U.C.C. Rep. Serv. (Callaghan) 34, 35 (N.Y. Civ. Ct. 1969) (difficulty in proving amount of damage will not relieve buyer unless damages easily ascertainable and seller fails to prove them); Paramount Lithographic Plate Serv., Inc. v. Hughes Printing Co., 2 Pa. D. & C.3d 677, 694-95, 22 U.C.C. Rep. Serv. (Callaghan) 1129, 1140 (Ct. C.P.) (only reasonable estimate of lost profit with definiteness and accuracy permitted by facts required; breaching buyer may not complain of lack of precision in calculation), *aff'd mem.*, 249 Pa. Super. 625, 377 A.2d 1001 (1977). Judge Peters, a noted commercial law scholar writing for the Connecticut Supreme Court, assessed one situation as follows:

Viewing the evidence in this light, we cannot say that the trial court erred in its determination of the amount of profits and overhead attributable to the contract in breach. With regard to the loss of profits, Bead's president testified, without objection, about the elements he considered in pricing the job for Saxton. Under the Code, it is not fatal that his cost and price estimates about the actual production run were necessarily theoretical, since Saxton's breach made it impossible to go forward with the production that would have made historically accurate figures available. Our cases have, in fact, long acknowledged that opinion testimony is relevant evidence of loss of earnings and of good

Nevertheless, courts have denied sellers' recovery for lost profit under section 2-708(2) when the sellers failed to introduce any evidence as to costs.²¹⁶ One case has even upheld the trial court's denial of a recovery for overhead because the seller did not carry its burden of proof as to the amount of such loss.²¹⁷ The court did not explain its decision. The conclusion is hard to understand because the recovery of overhead is usually not proved directly, but arises tacitly as part of a general recovery for gross profits.²¹⁸

As discussed earlier, the lost profit formula under section 2-708(2) is not a remedy for general business losses, but is only a recovery for the profit lost on the particular breached contract. The seller need only show its contract price and the direct costs it would have incurred on that particular contract. If the seller can show that it could have performed the contract, it is of no importance that the seller's business is new and unestablished. In this regard, comment 2 to section 2-708 states, "[i]t is not necessary to a recovery of 'profit' to show a history of earnings, especially if a new venture is involved."²¹⁹ An occasional case misses the point and apparently applies a stricter standard to new businesses under section 2-708(2).²²⁰ To date, however, no case has denied a seller recovery under section 2-708(2) because the business was new, unestablished, or lacking in prior earnings history.

The courts have been laudably patient with sellers who had definite section 2-708(2) claims, but marshalled the claims with varying degrees of incoherence. Thus, in one instance in which the seller's attorney fervently argued the case under everything but the applicable UCC provisions, the court reframed the evidence in the record within the Code's provisions, determined that the seller was entitled to a lost profit recovery under section 2-708(2), and upheld the trial court's award.²²¹ Unfortunately for the seller,

will. There is no reason why lost profits cannot be similarly established. Bead's president based his estimates on his experienced view of the equipment that would be required, the difficulty of maintaining production, and the time required for the job. Having taken account of these and related factors, he built a 20 percent profit into the contract price of \$13.95 per thousand units. The award of \$3000 lost profits on a contract for 5,000,000 units at a total contract price of approximately \$70,000 was therefore well within the supporting evidence.

Bead Chain Mfg. Co. v. Saxton Prods., Inc., 183 Conn. 266, 439 A.2d 314, 321, 31 U.C.C. Rep. Serv. (Callaghan) 91, 100-01 (1981) (citations omitted). Similarly, in another case the court upheld the trial court's "conservative estimate" of lost profit based on the evidence available in the record. Unique Sys. v. Zotos Int'l, Inc., 622 F.2d 373, 379, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1349 (8th Cir. 1980).

216. See Royal Store Fixture Co. v. Bucci, 48 Pa. D. & C.2d 696, 701-03, 7 U.C.C. Rep. Serv. (Callaghan) 1193, 1198 (Pa. County Ct. 1969); Rowland Meledandi, Inc. v. Kohn, 7 U.C.C. Rep. Serv. (Callaghan) 34, 35 (N.Y. Civ. Ct. 1969).

217. Copymate Mktg., Ltd. v. Modern Merchandising, Inc., 34 Wash. App. 300, 660 P.2d 332, 333, 36 U.C.C. Rep. Serv. (Callaghan) 161, 164 (1983).

218. See *supra* text immediately following note 118.

219. U.C.C. § 2-708 comment 2 (1977).

220. See Unique Sys. v. Zotos Int'l, Inc., 622 F.2d 373, 378, 28 U.C.C. Rep. Serv. (Callaghan) 1340, 1349 (8th Cir. 1980); see also American Metal Climax, Inc. v. Essex Int'l, Inc., 16 U.C.C. Rep. Serv. (Callaghan) 101, 115 (S.D.N.Y. 1974) (rational basis for determining lost profit required for new venture).

221. Bead Chain Mfg. Co. v. Saxton Prods., Inc., 183 Conn. 266, 439 A.2d 314, 320, 31 U.C.C. Rep. Serv. (Callaghan) 91, 99 (1981).

the evidence indicated that, had the seller properly presented the case under section 2-708(2), the seller's award would have been much larger.²²² Similarly, in another case, the court upheld damages of \$4,285, which had been requested by the seller and awarded by the trial court. In its opinion the court noted that, had the action been properly framed under section 2-708(2), the damage award would have been in excess of \$6,000.²²³ Even the most helpful of courts, however, can do only so much. Thus, in another case a seller of incomplete goods was properly denied an action for the price and then was denied recovery altogether when it introduced no evidence upon which the court could calculate damages under section 2-708(2).²²⁴

V. CONCLUSION

Under the Code's scheme the profit formula of section 2-708(2) is truly the dominant damage remedy for aggrieved sellers who suffer a breach prior to the time that the buyer accepts the goods. The formula applies to most commercial sellers because such sellers are usually left in a lost volume situation by a buyer's breach. The profit formula also applies in all cases in which a seller properly decides not to complete manufacture of the goods after the buyer breaches the contract. The courts have come to allow the profit formula as a matter of course in all lost volume and incomplete goods cases. Further, the courts have properly taken a relaxed attitude toward the burden of proof that the seller must carry to establish either lost volume status or the propriety of a decision to discontinue manufacture of the goods under the guidelines of section 2-704. Accordingly, as the trial bar becomes more familiar with the mechanics of proving damages under section 2-708(2), the profit formula promises to become the most widely used of sellers' damage remedial alternatives under the Uniform Commercial Code.

222. *Id.* at 320-21, 31 U.C.C. Rep. Serv. (Callaghan) at 99-101.

223. *Chicago Roller Skate Mfg. Co. v. Sokol Mfg. Co.*, 185 Neb. 515, 177 N.W.2d 25, 27, 7 U.C.C. Rep. Serv. (Callaghan) 804, 806 (1970).

224. *Rowland Meledandi, Inc. v. Kohn*, 7 U.C.C. Rep. Serv. (Callaghan) 34, 35 (N.Y. Civ. Ct. 1969).

