

Fall 2014

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### Recommended Citation

David Frisch, *The Compensation Myth and U.C.C. Section 2-713*, 80 Brook. L. Rev. (2014).

Available at: <https://brooklynworks.brooklaw.edu/blr/vol80/iss1/4>

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# The Compensation Myth and U.C.C. Section 2-713

*David Frisch*<sup>†</sup>

## INTRODUCTION

Writing twenty-five years ago, Professor Robert Childress argued quite persuasively that the market-price/contract-price formula in section 2-713 of the Uniform Commercial Code (Code or U.C.C.)<sup>1</sup> “is not a legitimate damage remedy for breach of contract” and ought to be repealed.<sup>2</sup> Since then, no single authoritative or canonical statement of the theory underlying section 2-713 has emerged. In their treatise, Professors James J. White and Robert S. Summers raise the idea that perhaps section 2-713 is best understood as a statutory liquidated damages clause,<sup>3</sup> or merely a relic of pre-Code law.<sup>4</sup> Professor

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<sup>1</sup> U.C.C. § 2-713 reads:

Section 2-713. Buyer’s Damages for Non-Delivery or Repudiation. (1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (2-715), but less expenses saved in consequence of the seller’s breach. (2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

U.C.C. § 2-713 (2013). The Code, in one form or another, is the law in all fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

<sup>2</sup> Robert Childress, *Buyer’s Remedies: The Danger of Section 2-713*, 72 NW. U. L. REV. 837, 853 (1978).

<sup>3</sup> JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 401 (5th ed. 1996). In her article on remedies, then-Professor and later Chief Justice of the Connecticut Supreme Court, Ellen Peters makes the same observation.

Perhaps it is misleading to think of the market-contract formula as a device for the measurement of damages . . . . An alternative way of looking at market-contract is to view this differential as a statutory liquidated damages clause, rather than as an effort to calculate actual losses. If it is useful in every case to hold the party in breach to some baseline liability, in order to encourage faithful adherence to contractual obligations, perhaps market fluctuations furnish as good a standard as any.

Roy Ryden Anderson adds that “[w]hatever the purpose of section 2-713, it clearly is not compensation.”<sup>5</sup>

This article seeks to bring greater discipline to the analysis of market damages by probing two basic assumptions that are routinely made in discussions of section 2-713: (1) that overcompensation concerns justify judicial interference with the buyer’s choice of remedy;<sup>6</sup> and (2) that the relevant market price, in all cases, is the market price that the aggrieved buyer would be required to pay if she wished to make a substitute purchase of goods elsewhere.<sup>7</sup>

In questioning these assumptions, this article does not question whether section 2-713 should continue to exist, nor does it suggest changes to the statutory text. Rather, it proposes a radical rethinking of the application of section 2-713 in several of its contexts. Although academic scholarship touching on the U.C.C. often concludes with a recommendation for the rewording or deletion of a particular section, this article does not seek to change the statutory path of the law for essentially two reasons.

First, the sudden disappearance of a frequently cited and extensively studied section of the U.C.C. may create a wide array of problems within the legal community. Judges, lawyers, and legal scholars would be left scratching their heads, searching for some rationale behind such an imperial and unnecessarily ambitious decision. In this alternative commercial

Ellen A. 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, 259 (1963).

<sup>4</sup> As White and Summers stated:

Since cover under 2-712 was not a recognized remedy under pre-Code law, it made sense under that law to say that the contract-market formula put buyer in the same position as performance would have *on the assumption that the buyer would purchase substitute goods*. If things worked right, the market price would approximate the cost of the substitute goods and buyer would be put “in the same position.” But under the Code, 2-712 does this job with greater precision, and 2-713 reigns over only those cases where the buyer does not purchase a substitute. Perhaps the drafters retained 2-713 not out of a belief in its appropriateness, but out of fear that they would be dismissed as iconoclasts had they proposed that the court in noncover cases simply award the buyer any economic loss proximately caused by seller’s breach . . . .

WHITE & SUMMERS, *supra* note 3, at 400-01.

<sup>5</sup> Roy Ryden Anderson, *Market Based Damages for Buyers Under the Uniform Commercial Code*, 6 REV. LITIG. 1, 6 (1987). Notwithstanding numerous detractors, section 2-713 does have its supporters. *See, e.g.*, David W. Carroll, *A Little Essay in Partial Defense of the Contract-Market Differential as a Remedy for Buyers*, 57 S. CAL. L. REV. 667 (1984) (arguing that the contract-market differential provides an adequate compensatory remedy in practically all cases of the seller’s breach). For more on the theoretical criticisms of section 2-713, see *infra* Parts III, IV.

<sup>6</sup> Roy Ryden Anderson, *Damage Remedies Under the Emerging Article 2—An Essay Against Freedom*, 34 HOUS. L. REV. 1065, 1103 (1997).

<sup>7</sup> GREGORY KLASS, *CONTRACT LAW IN THE USA* 225 (Kluwer Law International 2010).

law universe, a judge facing a case with an evident section 2-713 feature may stubbornly adhere to other cases with such a feature regardless of how the Code has changed. Of greater concern is the possibility that repeal may have an unforeseen impact on other sections of the U.C.C., which may negatively affect the Code's remedial system as a whole. If at all possible, statutory tinkering should be kept to a minimum.

Second, we are unlikely to see a drafting project to revise or amend Article 2 anytime soon. The political reality is that after an unsuccessful two-decade-long battle to draft and win approval of a new Article 2, it is improbable that the Uniform Law Commission (ULC) and the American Law Institute (ALI) leadership would be anxious to again take a drafting approach to ward off whatever threat of statutory obsolescence may currently exist under this Article.<sup>8</sup> Thus, a different strategy (i.e. one of interpretation) is required to help keep Article 2 responsive to twenty-first century commercial practices and guide courts toward the best results.

This article unfolds in four parts. Part I briefly surveys the basic features of the damages provisions of Article 2 of the Code, together with a bit of historical background. Part II, begins with a brief discussion of the generally accepted idea that, in a breach of contract context, a damages award is designed to achieve deterrence and full compensation for the promisee. Expectation damages are believed to accomplish these twin goals by giving precise incentives and awarding damages equal to the promisee's loss. This Part then demonstrates why, in general, it should not be expected that an award of a monetary nature will yield efficient results and that much of the theorizing that surrounds discussions of contract damages is based on the myth that the relevant market price is the price that the aggrieved buyer would have to pay if she wished to make a substitute purchase of goods from another source. Part III shifts to three issues concerning the application of section 2-713 and offers a nuanced analysis of these issues

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<sup>8</sup> See generally Updates, *88th ALI Annual Meeting May 16-18, 2011*, AMERICAN LAW INSTITUTE, <http://2011am.ali.org/updates.cfm> (last visited Aug. 18, 2014); Gordon Smith, *Withdrawing the 2003 Amendments to UCC Articles 2 and 2A*, THE CONGLOMERATE (May 17, 2011), <http://www.theconglomerate.org/2011/05/withdrawing-the-2003-amendments-to-ucc-articles-2-and-2a.html>. During the 1990s there were a variety of efforts to revise or amend Article 2 to better deal with modern commercial contracting. The two sponsors of the U.C.C. project—the ULC and the ALI—finally presented an Amended Article 2 to the states for adoption in 2003. After almost a decade, no state has adopted the amendments. In 2011, the sponsors withdrew their support and, hence, Amended Article 2 from the Official Text of the U.C.C., thereby bringing down the curtain on a long drafting project that has frustrated many and has probably satisfied no one.

that is grounded in realistic thinking about the contract liability system. Finally, in Part IV, this article debunks the conventional wisdom that the relevant market in which to determine the price component of the damages formula in section 2-713 is always the market in which the buyer is likely to go to make a substitute purchase (i.e., cover). In so doing, it suggests one significant consequence of an altered approach.

## I. THE DAMAGES RULES OF ARTICLE 2 OF THE UCC

Part 7 of Article 2 sets forth the ground rules by which aggrieved parties—both sellers and buyers—may recover damages for breach.<sup>9</sup> These ground rules are stated in terms of both the classification and measurement of damages. On the classification side, the Code draws substantive distinctions among incidental, consequential, punitive, and general or direct damages. The classification matters to sellers because they are generally allowed, under section 1-305, to recover only general and incidental damages, but not consequential or punitive damages.<sup>10</sup> The classification matters to buyers because consequential economic losses are subject to the “notice” or “foreseeability” requirement of *Hadley v. Baxendale*,<sup>11</sup> which limits liability for consequential damages to those losses that should have been contemplated by the contracting parties—or, as expressed in the Code, losses of which the parties had “reason to know.”<sup>12</sup> General and incidental damages are not expressly subject to such a requirement.

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<sup>9</sup> Since this article focuses on the buyer’s damages, it entirely ignores the possessory, see, e.g., U.C.C. § 2-716 (2013) (“Buyer’s Right to Specific Performance or Replevin”) and self-help goods-oriented remedies, see, e.g., *id.* § 2-608 (“Revocation of Acceptance in Whole or in Part”), that are sometimes available to plaintiffs. However, in this oversimplified overview of damages, seller’s damages are not ignored. In reality, the parallels between how the buyer’s and the seller’s damages are measured will help focus and organize the discussion that follows.

<sup>10</sup> Section 1-305 provides, in part, that “neither consequential or special damages nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law.” U.C.C. § 1-305 (alteration in original). The Comment states that the purpose is to make clear that “compensatory damages are limited to compensation” and that “[t]hey do not include consequential or special damages.” *Id.* § 1-305 cmt. 1. Section 2-715 makes special provision for buyers to recover consequential damages, not sellers. *Id.* § 2-715. Such a recovery by sellers may be possible, however, if the “lost profit” language of section 2-708(2) is liberally applied. *Id.* § 2-708(2). Another avenue for accomplishing the same result is for the seller to argue that the loss falls under the heading of incidental damages. A seller may recover incidental damages under section 2-710. *Id.* § 2-710.

<sup>11</sup> See *Hadley v. Baxendale*, (1854) 156 Eng. Rep. 145 (Exch. Div.) 149-52.

<sup>12</sup> See U.C.C. § 2-715(2)(a) (stating that consequential damages include “any loss resulting from general or particular requirements and needs of which the *seller at the time of contracting had reason to know*”) (emphasis added); *Cf. Baxendale*, 156 Eng. Rep. at 151.

As to both buyers and sellers, Article 2 sets forth numerous methods for calculating general damages, the choice of which typically turns on whether the aggrieved party retains finished goods. Under section 2-708(1), if the seller retains possession of the goods following the buyer's repudiation or wrongful rejection, the seller's damages will often be the difference between the market price at the time and place for tender and the unpaid contract price.<sup>13</sup> Section 2-713 provides a somewhat similar market price-contract price formula for buyers.<sup>14</sup>

It helps to appreciate some history here. In keeping with the legal realist agenda to protect and promote reasonable mercantile practices,<sup>15</sup> Karl Llewellyn, the chief reporter for the Code and the principal draftsman for Article 2, was particularly scornful of the market time and place basis for

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<sup>13</sup> The lost profits formula in section 2-708(2) will sometimes provide an alternative measure of damages. If the seller resells the goods following the buyer's breach, the measure would be the difference between the resale price and the contract price under section 2-706. This assumes that the seller has complied with the mandates of that section.

<sup>14</sup> For the complete text of section 2-713, see *supra* note 1. Under this section, the relevant temporal point for determining market price is "when the buyer learned of the breach." U.C.C. § 2-713. This changes the approach to market price taken by the Uniform Sales Act (USA), Article 2's statutory antecedent. The USA made relevant the market price as it existed when the goods "ought to have been delivered." U.S.A. § 67(3) (1908).

<sup>15</sup> The term "legal realism" has its genesis in an article by Karl Llewellyn. See Karl N. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431 (1930). Although realism was "neither a coherent intellectual movement nor a consistent or systematic jurisprudence," Horowitz explains that "above all, Realism is a continuation of the Progressive attack on the attempt of late-nineteenth-century Classical Legal Thought to create a sharp distinction between law and politics and to portray law as neutral, natural, and apolitical." MORTON J. HOROWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1870-1960: THE CRISIS OF LEGAL ORTHODOXY* 169-70 (Oxford University Press, Inc. 1992).

Llewellyn was one of the most influential figures in the realist assault on the conceptualism of the old order. See generally WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* (1973) (providing an interpretation of Llewellyn's thought and its development). He believed in finding the law in the commercial context that gave rise to the dispute. Accordingly, the judicial task was to discover this so-called "imminent law." Llewellyn accepted the view that:

Every fact-pattern of common life, so far as the legal order can take it in, carries within itself its appropriate, natural rules, its right law. This is a natural law which is real, not imaginary; it is not a creature of mere reason, but rests on the solid foundation of what reason can recognize in the nature of man and of the life conditions of the time and place; it is thus not eternal nor changeless nor everywhere the same, but is indwelling in the very circumstances of life. The highest task of law-giving consists in uncovering and implementing this immanent law.

KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 122 (1960) (quoting Levin Goldschmidt).

measuring damages.<sup>16</sup> Llewellyn was also concerned with the difficulties surrounding the seller's right of resale under the Uniform Sales Act (USA) section 60<sup>17</sup> and the fact that there was no corresponding statutory right of the buyer to "cover" or obtain goods elsewhere to make up for the seller's failure to deliver.<sup>18</sup> The Code cured these statutory deficiencies by including a spectrum of remedies afforded to both sellers and buyers.

When the buyer has accepted the goods, the recovery rule for general damages is "the loss resulting in the ordinary course of events . . . as determined in any manner which is reasonable."<sup>19</sup> However, for breach of warranty claims under section 2-714, the buyer's damages are based on "the difference . . . between the value of the goods accepted and the

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Litigation of a *hypothetical* market price in a[] *hypothetical* market is indeed always expensive and always uncertain; and as interpreted, the rule of "time and place where the goods *ought to have been* delivered" too commonly forces the issue to turn on a[] hypothetical market; and, too often, an unexpected ruling chooses a market on which counsel is not prepared; or even results in a reversal, in addition to giving inadequate damages.

REPORT AND SECOND DRAFT: THE REVISED UNIFORM SALES ACT (1941), *reprinted in* 1 ELIZABETH SLUSSER KELLY, UNIFORM COMMERCIAL CODE DRAFTS 523 (1984).

<sup>17</sup> USA section 60 permitted resale by the seller where (1) the goods were of a perishable nature, or (2) the seller had reserved the right to resell upon the buyer's default, or (3) the buyer had been in default for an unreasonable period of time. Following such a resale, the seller would recover damages "for any loss occasioned by the breach of the contract of sale." U.S.A. § 60. Notice that this provision provides no explicit formula to measure the damages recoverable by the seller following the resale. Under the Code, so long as the resale is conducted "in good faith and in a commercially reasonable manner, the seller may recover the difference between the resale price and the contract price" plus incidental damages. *See* U.C.C. § 2-706.

<sup>18</sup> Several early versions of what later became U.C.C. Article 2 were labeled the "Revised Uniform Sales Act (RUSA)." *See, e.g.*, REPORT AND SECOND DRAFT, *supra* note 16, at 269. In drafts of the RUSA, Llewellyn used the term "cover" to describe both the seller's right to resell and the buyer's right to purchase substitute goods. *See id.* at 522. Today the term is used only to describe the buyer's remedy. *See* U.C.C. § 2-712. In the following passage, Llewellyn explains how cover, for both buyers and sellers, reaffirms mercantile practice:

[The cover remedy] make[s] it possible, in transactions between professionals in the market, for the justified claimant, be he buyer or seller, to fix [h]is rig[h]ts with speed, after a breach, and then to *move*, with safety, in such manner as to get in fact the agreed benefit under the contract, or so much of it as is still available. . . . It not only steps up the certainties which the law can provide to help contractors, fitting into mercantile need and mercantile practice; but it also lays a foundation for cheaper and more adequate administration, at law, of the other remedies. . . . These sections incorporate the long standing practice of the English courts to give the aggrieved party reasonable time, on discovering breach, to cover himself in any reasonable way. Any litigation *after cover has actually been sought and had* is thus made to turn first on a fact easy to prove: to wit, what loss was actually suffered.

REPORT AND SECOND DRAFT, *supra* note 16, at 522-23.

<sup>19</sup> U.C.C. § 2-714(1).

value they would have had if they had been as warranted,” except when “special circumstances show proximate damages of a different amount.”<sup>20</sup>

It may be helpful to make a general observation regarding Article 2’s remedial scheme. Stated boldly, it is exceptional among statutory regimes by not prescribing a general standard of recovery for the aggrieved party, but instead employing specific formulas for computing damages.<sup>21</sup> Ironically, other articles of the Code provide ample instances of damages provisions lacking such prescribed methods of calculation. Scattered throughout the Code are sections that provide simply for the recovery of “damages” with no guidance whatsoever on how those damages should be determined.<sup>22</sup>

In fact, Article 2’s damages rules may suffer from too much specificity. Perhaps it would be better to replace precise rules with a general standard of compensation, such as the standard found in U.C.C. section 1-305. Section 1-305 states in part: “The remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . .”<sup>23</sup> This might encourage courts to focus directly on the real-life facts of cases, combat the judicial manipulation of statutory language, and oblige judges to be more forthcoming about the reasons for their decisions. Moreover, even if we accept, *arguendo*, the proposition that the

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<sup>20</sup> *Id.* § 2-714(2).

<sup>21</sup> Interestingly, at least one commentator has taken the position that even more specificity is needed. See John A. Sebert, Jr., *Remedies under Article Two of the Uniform Commercial Code: An Agenda for Review*, 130 U. PA. L. REV. 360 (1981). Sebert’s analysis begins with the conclusion that “[t]he portion of article 2 that seems to evidence the most pervasive problems is part 7, which deals with remedies for breach.” *Id.* at 363. This is so, according to Sebert, “because the Code’s remedy provisions are not sufficiently specific to provide the necessary guidance to courts and litigants.” *Id.*

While it is tempting to think that making the rules even more specific would reduce the confusion and stem the tide of case law that continues to flow from the Article 2 provisions, this approach is unlikely to improve matters. Simply put, there is little reason to think that adding more provisions will ease the preoccupation of litigants and courts with issues of applicability and scope. Indeed, it seems far likelier that—to the extent that rules multiply and unanticipated situations continue to arise—disputes over which rule applies and how it applies in a given context will escalate.

<sup>22</sup> See, e.g., U.C.C. § 4-402 (“A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item.”); *id.* § 5-111(b) (“If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach . . . .”); *id.* § 7-203 (“A party to or purchaser for value in good faith of a document of title . . . relying in either case upon the description therein of the goods may recover from the issuer damages caused by the non-receipt or misdescription of the goods . . . .”); *id.* § 9-625(b) (“[A] person is liable for damages in the amount of any loss caused by a failure to comply with this article.”).

<sup>23</sup> *Id.* § 1-305.



specific measures in Article 2 are helpful, one may at least question whether it is healthy for courts to purport to be bound by them when in fact they are free under section 1-305 to disregard them entirely.<sup>24</sup>

Assuming, however, that the structure of Article 2 will not change in the foreseeable future, suggestions such as the foregoing are unlikely to bear much fruit. In light of practical approaches that courts can now take, let us turn first to the myth of overcompensation and its implications for section 2-713.

## II. THE FULL COMPENSATION PRINCIPLE AND THE MYTH OF OVERCOMPENSATION

### A. *The Full Compensation Principle*

Historically, the full compensation principle has been relied upon to ensure that contract remedies facilitate, rather than interfere with, the role of bilateral exchange in the voluntary transactions that allocate resources in a market economy. The mechanism on which courts have settled to implement this imperative is, in the common run of cases, to award damages in an amount sufficient to place the aggrieved party in as good a monetary position as she would have been had the contract been performed,<sup>25</sup> or as is frequently said, to give the aggrieved party "the benefit of the bargain."<sup>26</sup> Because of the difficulties in forcing people to continue a relationship they no longer wish to continue, the law of remedies permits the aggrieved party to compel the other party's performance through legal means only in those instances where damages are unsuitable.<sup>27</sup>

There is an obverse side to this normative coin. From the proposition that the central tenet of contract remedies is full compensation, it follows that it is not just instances of undercompensation that should be avoided. Because the distinct function of contract remedies is to improve economic outcomes by allocating assets to the higher value user, and because overcompensation would interfere with this economic outcome, overcompensation should be scrupulously avoided as well.

The theory of "efficient breach" offers a supporting economic justification for a remedial system premised on full

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<sup>24</sup> For more on this point, see *infra* notes 103-13 and accompanying text.

<sup>25</sup> See U.C.C. § 1-305; RESTATEMENT (SECOND) OF CONTRACTS § 344(a) (1981).

<sup>26</sup> RESTATEMENT (SECOND) OF CONTRACTS § 344(a) cmt. a (1981).

<sup>27</sup> See *id.* at 99-100.

compensation—not more, not less.<sup>28</sup> According to the theory, incentives for contract performance are efficient if they compel a promisor to balance the cost to him of performing against the losses to himself and to his counter-party that will result if he does not perform. This calculus would correctly encourage breach only if the value of the gain to the promisor exceeded the damage or loss to the non-breaching party. If, on the other hand, the promisor's liability for damages were greater than the benefit to be gained from breaching, presumably the promisor would elect to perform the contract instead.<sup>29</sup> The result, breach of performance, is defended on the ground that a Pareto superior<sup>30</sup> allocation of resources results because promisors are thereby encouraged to direct their efforts to the most valued use. Moreover, full compensation has the added benefit of encouraging reliance on contract rights because, breach or no breach, the promisee knows that she will receive the benefit of her bargain. If, however, aggrieved promisees were systematically undercompensated, promisors would not internalize the full value of performance to promisees and we would risk too much breach.<sup>31</sup> Of course, overcompensation would have just the opposite effect.<sup>32</sup>

The full compensation principle is not as firmly rooted in all legal systems. Consider, for example, the power of the parties to decide for themselves the amount or measure of

<sup>28</sup> See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 89-90 (2nd ed. 1977) (“If that loss is greater than the gain to the other party from completion, breach would be value-maximizing and should be encouraged.”); see generally *id.* at 118-90.

<sup>29</sup> For judicial expressions of this idea, see, e.g., *Patton v. Mid-Continent Sys.*, 841 F.2d 742, 750 (7th Cir. 1988) (“Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses.”); *Giampapa v. Am. Family Mut. Ins. Co.*, 64 P.3d 230, 251 (Colo. 2003) (“The theory of ‘efficient breach’ posits that the purpose of contract law is not to discourage all breaches. To the contrary, certain breaches, such as those where the breaching party's gains exceed the injured party's losses, are thought to be desirable.”).

<sup>30</sup> In a Pareto Efficiency paradigm, a Pareto superior outcome is one in which one party benefits to the detriment of none. “A change in the status quo is considered to be Pareto superior if it makes at least one person better off without making anyone else worse off.” ROBIN PAUL MALLOY, *LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE* 39 (West Publ'g Co. 1990) (emphasis omitted).

<sup>31</sup> See, e.g., William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 664 (1999) (“If the breaching party is not responsible for the non-breaching party's full losses, then there is an incentive to breach even when the breach would not be efficient.”).

<sup>32</sup> This notion accords remarkably with the historical unwillingness of courts to award punitive damages in breach of contract actions. See RESTATEMENT (SECOND) OF CONTRACTS § 355. *But see* Dodge, *supra* note 31, at 663 (“Allowing a party to breach a contract and pay damages is not as efficient as forcing that party, with the threat of punitive damages, to negotiate with the other party for a release from the contract.”).

damages in advance of any breach. In the U.S., this concept of stipulated or liquidated damages is subject to several restrictions.<sup>33</sup> “The most important restriction” is that if the sum of money chosen is unreasonably large, the clause is void as a penalty.<sup>34</sup> Such an approach is clearly consistent with the idea that the purpose of damages is to compensate the aggrieved party, not to deter or punish the party in breach.<sup>35</sup>

In sum, most courts and commentators accept the damages principle of full compensation as both fair and efficient. It is fair because, at least in theory, it provides an adequate performance substitute for the aggrieved party. Furthermore, it is efficient because of its incentive effects.

### *B. Challenging Two Assumptions of the Full Compensation Principle*

Let us now turn to two assumptions underlying the rhetoric of full compensation and its supporting economic justification, the doctrine of efficient breach. This article suggests that much of the theorizing that surrounds discussions of contract damages is grounded in myth. One myth is that promisors can and do internalize the costs of their breach as part of their decision-making process. The second myth is that full compensation of promisees, when attempted, is routinely achieved.

#### 1. The Myth that Contractual Choices are Premised on Accurate Damage Assessments

A realistic picture of the actual (rather than the assumed or asserted) decision-making behavior of contracting parties is a necessary but missing ingredient for addressing a wide range of questions regarding the full compensation principle. Unless the picture is sufficiently detailed and thoughtfully analyzed, it would be impossible to distinguish the effects of the law of damages from the effects of social, business, or other factors, including more general features of the law that bear on the collectability of judgment claims. For example, it is likely that the promisee’s potential ability to satisfy a judgment is sometimes a factor in the promisor’s decision whether or not to

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<sup>33</sup> See generally E. ALLAN FARNSWORTH, *CONTRACTS* 935-46 (2d ed. 1990).

<sup>34</sup> *Id.* at 935.

<sup>35</sup> However, not all countries prohibit contractual penalties. For a discussion of the full enforceability of penal clauses in France, subject to the discretionary moderating power of the judge, see James Beardsley, *Compelling Contract Performance in France*, 1 HASTINGS INT’L & COMP. L. REV. 93, 103-07 (1977).

breach. Even uninformed common sense shows more breaches to be probable, whether they be efficient or not, if the promisee is unlikely to satisfy a judgment through litigation.<sup>36</sup> As a result, most discussions of the positive case for the full compensation principle are unavoidably speculative. Nevertheless, “intuition” can provide at least a few suggestions for the real-world gap between the goals of the full compensation principle and attitudes towards contract performance.

First, the existing measures of damages cannot realistically be characterized as bedrock rules on which parties actually rely. There is empirical evidence to suggest that legal rules may be less relevant to the day-to-day practices of commercial transactors than one might guess.<sup>37</sup> Stewart Macaulay, in a famous and often-cited article, had this to say about the real world of commercial practice:

Contract planning and contract law, at best, stand at the margin of important long-term continuing business relations. Business people often do not plan, exhibit great care in drafting contracts, pay much attention to those that lawyers carefully draft, or honor a legal approach to business relationships. There are business cultures defining the risks assumed in bargains, and what should be done when things go wrong. People perform disadvantageous contracts today because often this gains credit that they can draw on in the future. People often renegotiate deals that have turned out badly for one or both sides. They recognize a range of excuses much broader than those accepted by most legal systems.<sup>38</sup>

Indeed, it is hard to imagine that any particular measure of damages is seriously considered by the parties or their lawyers prior to breach. In the real world, the dynamics of business contracting suggest that busy parties may proceed with little thought to even critical terms like price and delivery date, let alone damages. Many aspects of Article 2 are premised on the rough and tumble world of real-life contracting. In this respect,

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<sup>36</sup> See Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 4 (1996) (noting that “[t]he system by which money judgments are enforced is beginning to fail. The immediate cause is the deployment of legal structures that render potential defendants judgment proof”).

<sup>37</sup> See generally Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465 (1985).

<sup>38</sup> *Id.* at 467-68; see also Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 5 (1992) (suggesting that “it is a delusion to assume that commercial conduct is primarily controlled by what is ‘legal’”) (citing James J. White, *Contract Law in Modern Commercial Transactions, An Artifact of Twentieth Century Business Life?*, 22 WASHBURN L.J. 1, 19 (1982)); White, *supra* note 38, at 1-2 (conducting an empirical study of chemical and pharmaceutical companies and offering the “thesis that contract law is a much less significant determinant of commercial behavior in complex transactions than the typical law student, contracts professor, or lawyer dares believe”).

sections 2-204, 2-206, and 2-207 dispense with many of the common law formalities in contracting, making it unnecessary for a court to find the exact moment of formation, recognizing that parties may leave open one or more terms.<sup>39</sup>

Even if the promisor attempted to estimate the expected value of the damages he would be ordered to pay if suit is brought and make his decision accordingly, it is improbable that even the most legally savvy individual would be able to foresee all, or nearly all, of the contingencies and consequences of the breach. This conclusion is undeniable if courts are willing to permit the recovery of damages premised on post-breach events. For instance, in *Sinclair Refinery Co. v. Jenkins Petroleum Process Co.*, where Sinclair violated Jenkins's patent, the court allowed the subsequent (post-breach) use of the patent to be used as a factor in calculating respondent's damages.<sup>40</sup> Even if ex post data were off limits, it would often be the case that the promisor would not have an accurate picture of the factual underpinnings of the promisee's economic situation. With an inaccurate picture, the promisor's conclusion regarding the amount of damages that she would face is likely to be in error.

Consider, for example, what Professors Omri Ben-Shahar and Lisa Bernstein observed about lost profit claims:

When a breach occurs and expectation damages are sought, the expectation measure will often include lost profit. Lost profit is typically calculated on the basis of business information related to the promisee's operations, such as material and labor costs, inventory size, availability of alternative suppliers, the identity of her downstream contracting partners (customers), and, in the case of newer businesses her business plan.<sup>41</sup>

Their basic contention is that an aggrieved promisee may choose not to reveal these economic variables in order to keep sensitive business information confidential.<sup>42</sup> This choice means that expectation damages that are based on subjective, firm-specific information are likely to be under-compensatory. Therefore, the

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<sup>39</sup> See, e.g., U.C.C. § 2-305 (2013) ("Open Price Term"); *id.* § 2-309(1) ("The time for shipment or delivery . . . if not . . . agreed upon shall be a reasonable time.").

<sup>40</sup> *Sinclair Ref. Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 698 (1933) (referring to post-breach events and in elegant terms observing that "[e]xperience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect. We find no rule of law that sets a clasp upon its pages, and forbids us to look within"); see also, e.g., *Fishman v. Estate of Wirtz*, 807 F.2d 520, 552 (7th Cir. 1986) (stating that "we know of no case that suggests that a value based on expectation of gain is more relevant and reliable than one derived from actual gain").

<sup>41</sup> Omri Ben-Shahar & Lisa Bernstein, *The Secrecy Interest in Contract Law*, 109 YALE L.J. 1885, 1886 (2000).

<sup>42</sup> *Id.*

promisor has an excellent chance of settling at a figure under the actual lost profit. This, of course, assumes that the promisee still has the incentive to sue. The implicit corollary to this so-called “secrecy interest” of the promisee is that this information is not otherwise readily accessible to the promisor. How then can the promisor price his breach to determine whether it would be more efficient than performance? Taking these observations into consideration, it seems evident that he cannot.

## 2. The Myth that Expectation Damages Fully Protect Contractual Entitlements

This article now explores how a variety of aspects affect full compensation notions. It establishes the robust support for the idea that the aggrieved party is almost never put in the same position as it would have been had the contract been performed. It also shows that this failure to achieve the stated objective of contract remedies is a result of longstanding remedial judicial practices. In so doing, this section considers the high costs of litigation, the refusal of courts to award damages for non-pecuniary harms, the judicial treatment of interest and the value of money, the accepted burden of proof for actual damages, and the remedial rules of foreseeability and proportionality.

### *a. Interest and the Value of Money*

Whatever the historical reasons for its evolution, the muddled judicial and legislative responses to interest awards and the fluctuating value of money tend to undercut the normative goal of full compensation.<sup>43</sup> Although interest and monetary value are separate remedial concerns, for at least one reason that will soon be explained, their implications should be jointly considered.

Even if we make the unrealistic assumption that judgments are paid on the day they are rendered,<sup>44</sup> there

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<sup>43</sup> The story of interest begins in Biblical times, when it was viewed as suspicious at best and sinful at worst. For an overview of interest in its historical context, see Martin Oyos, Comment, *Prejudgment Interest in South Dakota*, 33 S.D. L. REV. 484, 485-88 (1988); see also John C. Keir & Robin C. Keir, *Opportunity Cost: A Measure of Prejudgment Interest*, 39 BUS. LAW. 129, 131 (1983) (noting that the “ancient and medieval prejudices against the charging of interest” influence the current approach to prejudgment interest).

<sup>44</sup> It is because this assumption does not accord with reality that judgment interest is granted by statute in all jurisdictions. See, e.g., 28 U.S.C. § 2516 (2000); VA. CODE ANN. § 6.2-302 (2010). Despite the indispensability of this ingredient to making the plaintiff whole, this article does not directly consider judgment interest or, for that matter, any of the

remains the often lengthy period between the date of breach and the date of judgment, as lawsuits are not filed immediately and litigation takes time. Without prejudgment interest, the aggrieved party is denied compensation for the lost opportunity to invest monies that became rightfully hers when the damages were incurred.<sup>45</sup> It is this focus on compensation that has led some courts to conclude that prejudgment interest is not really interest at all, but is instead a form of damages.<sup>46</sup> Although such a distinction may seem like mere semantics,<sup>47</sup> calling the award "damages" may have the beneficial effect of making statutory restrictions on prejudgment interest irrelevant.<sup>48</sup>

In a careful summary of the state of the law on the availability of prejudgment interest, Professor Michael S. Knoll states:

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practical difficulties encountered in collecting judgments. The question it seeks to answer is whether the judgment, if paid directly, fully compensates the promisee.

<sup>45</sup> CHARLES T. MCCORMICK, DAMAGES § 50 (1935) (prejudgment interest is "allowed by law as additional damages for loss of use of the money due as damages, during the lapse of time since the accrual of the claim"). Moreover, prejudgment interest provides a disincentive for defendant to delay litigation and prevents her from being unjustly enriched at the plaintiff's expense. The court in *In re Pago Pago Aircrash* of Jan. 30, 1974, 525 F. Supp. 1007 (C.D. Cal. 1981), put it this way:

An individual who must litigate to recover damages should be placed in the same position, when he recovers, as the individual who recovered the day he suffered an injury. Otherwise the [defendant] benefits from denying liability and continuing to litigate, while he retains the use of money to which the plaintiff is entitled, and the plaintiff is deprived of the benefit he should have derived from an immediate recovery.

*Id.* at 1014.

<sup>46</sup> See DAN B. DOBBS, LAW OF REMEDIES § 3.5 (1973) ("Sometimes courts emphasize the distinction between judgment and pre-judgment interest by saying that pre-judgment interest is really a form of *damages*, while judgment interest is interest as such, or interest *eo nomine*.").

<sup>47</sup> See, e.g., *The Manhattan*, 85 F.2d 427, 429 (3d Cir. 1936) (noting that "[t]he difference between loss and interest thus becomes little more than a difference in words").

<sup>48</sup> See, e.g., *Frank B. Bozzo, Inc., v. Elec. Weld Div. of the Fort Pitt Div. of Spang Indus.*, 498 A.2d 895 (Pa. Super. Ct. 1985). The Pennsylvania Superior Court was called upon to decide whether a buyer was entitled to have tacked on to its judgment, interest from the date on which the sales contract was breached. The seller contended that such recovery was unavailable where the amount of damages occasioned by the breach was, before judgment, neither liquidated nor ascertainable. The court disagreed. In its opinion, the award was not interest but rather "compensation for delay" measured by the legal rate of interest. *Id.* at 899. As such, it is an appropriate item of incidental damages under section 2-715. The court offered the illustration of a buyer unable to earn interest on money that had to be spent to meet the expenses incident to the seller's breach. *Id.* at 898. It is interesting to note that the New York Law Revision Commission objected to the inclusion of the phrase "damages from delay or otherwise resulting from the breach" in section 2-715 in order to prevent this form of delay damages from being classed as "incidental." See AM. LAW INST., NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 81 (1957) (at "Reason").

[T]he requirement that a losing defendant pay prejudgment interest to a successful plaintiff remains far from universal. Although a growing number of jurisdictions recognize a successful plaintiff's entitlement to prejudgment interest, other jurisdictions expressly bar recovery. Still other courts and statutes leave it to the discretion of the court whether to provide prejudgment interest. Frequently, within a jurisdiction, the availability of prejudgment interest depends on the source of the claim and the nature of the injury. For example, in California a successful plaintiff whose claim is for a certain amount (liquidated) or an amount capable of being made certain by calculation (clearly ascertainable) is entitled to prejudgment interest.<sup>49</sup>

In short, despite the premise that prejudgment interest is a necessary part of compensation, it is clear that the outcome of prejudgment interest analysis varies by jurisdiction and is not uniform, certain, or rational.<sup>50</sup> Moreover, consistency is also lacking on the issue of when to begin the prejudgment period. In a state such as Nevada, where interest starts to accrue when the summons and complaint are served, under-compensation is the inevitable result.<sup>51</sup>

Furthermore, under the present law, most courts award prejudgment interest based on a simple interest calculation.<sup>52</sup> However, to ensure that the plaintiff is fully compensated and that the defendant is not unduly enriched, interest needs to be compounded.<sup>53</sup> The financial effects of the choice of interest

<sup>49</sup> Michael S. Knoll, *A Primer on Prejudgment Interest*, 75 TEX. L. REV. 293, 297 (1996) (citations omitted).

<sup>50</sup> For example, in a jurisdiction that draws a distinction between liquidated or reasonably ascertainable damages and unliquidated damages, a court might permit prejudgment interest on an award to a buyer of market damages under U.C.C. section 2-713 or cover damages under U.C.C. section 2-712, yet deny that same buyer interest on lost profit damages under U.C.C. section 2-715. This type of inconsistency is indefensible. *See, e.g.*, *Funkhouser v. Preston Co.*, 290 U.S. 163, 168 (1933) ("It has been recognized that a distinction, in this respect, simply as between cases of liquidated and unliquidated damages, is not a sound one."); *Alaska v. Phillips*, 470 P.2d 266, 273 (Alaska 1970) ("[T]he liquidated-unliquidated common law distinction lacks a persuasive rationale.").

<sup>51</sup> *Compare* NEV. REV. STAT. § 17.130(2) (1987) ("[T]he judgment draws interest from the time of service of the summons and complaint . . ."), *with*, TEX. FIN. CODE ANN. § 304.005(a) (West 1999) ("[P]ostjudgment interest on a money judgment of a court in this state accrues during the period beginning on the date the judgment is rendered and ending on the date the judgment is satisfied.").

<sup>52</sup> DOBBS, *supra* note 46, at 354 (observing that simple interest appears to be the majority rule).

<sup>53</sup> *See* Knoll, *supra* note 49, at 306 (noting that "the difference between compound and simple interest is that with the former, interest earned in the past generates current interest, whereas with the latter, past interest never generates current interest"). Professor Knoll explains further:

Conceptually, the proper way to calculate prejudgment interest is to use the compound interest formulation. Compound interest is required because prejudgment interest is not paid to the plaintiff as it accrues, but is retained by the defendant until the judgment is enforced. Thus, each period the



computation can be significant. In fact, Professor Knoll in his article on prejudgment interest characterizes his suggestion that interest be compounded as, “if not the most significant, at least one of the most significant, in terms of dollars.”<sup>54</sup>

Even if interest were compounded, full compensation would still elude the plaintiff if the chosen rate were not appropriate. Whether the rate is unalterably fixed by statute<sup>55</sup> or is partially within the discretion of the judge or jury subject to a statutory ceiling,<sup>56</sup> the effects of the rate in terms of compensation are intertwined not only with the rate of return generally available to the plaintiff, but also the fluctuation in money values. Unless the rate is thoughtfully analyzed to address the former, and disengaged conceptually from the latter, the plaintiff would not be in the same position she would have been in if the damages were paid in full at the time of breach.

First, if the goal is to correctly calculate the rate of interest that the plaintiff could have earned, how can a rate fixed by statute be an accurate gauge? At times of low market interest rates, a statutory rate will overcompensate, and at times of high money costs, the same rate will undercompensate.<sup>57</sup> Fixed statutory rates also have the disadvantage that changes are subject to legislative priorities and time tables.<sup>58</sup> They are thus unresponsive to actual market variations.<sup>59</sup>

The second, and perhaps more important, complication to statutory or even market-based rates is that they fail to account for the loss in dollar value due to inflation. Although the law of damages assumes that a dollar’s buying power remains constant, one need only have a conversation with one’s grandparents to discover that this is quite clearly not the case. The point was well made by Lord Justice Omrod of the Court of Appeal in *William Cory & Son Ltd. v. Wingate Investments Ltd.*:<sup>60</sup>

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defendant’s obligation to the plaintiff increases. Compound interest accounts for this effect.

*Id.* at 307. Another way to think about the method of interest computation is to ask what type of interest arrangement would have been available to plaintiff, had she invested the amount of damages at the time of breach. Since most financial institutions commonly compound interest, this method is necessary to assure full compensation. *Id.*

<sup>54</sup> *Id.* at 308.

<sup>55</sup> See, e.g., TENN. CODE ANN. § 47-14-104 (2014).

<sup>56</sup> See, e.g., MINN. STAT. § 549.09 (2010).

<sup>57</sup> See John Y. Gotanda, *When Recessions Create Windfalls: The Problems of Using Domestic Law to Fix Interest Rates Under Article 78 CISG*, 13 VINDOBONA J. INT’L COM. L. & ARB. 229, 238-39 (2009).

<sup>58</sup> *Id.* at 231.

<sup>59</sup> *Id.* at 230.

<sup>60</sup> *William Cory & Son Ltd. v. Wingate Invs. (London Colney) Ltd.*, [1980] 17 Build. L.R. 114 (Eng.), 1980 WL 619053 (click “Official Transcript”).

It is clear that the defendants have had the use of this money ever since the date when they became liable to compensate the plaintiffs for breach of contract. It does not stop there. If the damages in this case are to be assessed at 1972 or 1973 pounds, the defendants will save an enormous amount because they will be able to pay a debt due in 1972 in 1980 pounds, which is not reasonable, equitable or just.<sup>61</sup>

Even if the prejudgment interest rate were tied to a market rate, this would have no effect on the compensation consequences of fluctuations in money value. A market rate is largely composed of two elements.<sup>62</sup> One is the “real interest rate,” or cost of money.<sup>63</sup> The other is compensation for erosion of money values caused by the lender’s anticipation of future inflation.<sup>64</sup> Thus, a market interest rate reflects an estimate of *future* inflation while prejudgment compensation should account for *past* inflation, so that application of the current rate is not the answer.<sup>65</sup> The Law Reform Commission of the Canadian Province of Manitoba, in its 1982 report, wisely recommended that courts multiply the real rate of interest by the time elapsed, to which the percentage change in an appropriate price index should be added to compensate for the lost purchasing power of money.<sup>66</sup>

Full acceptance of all this does not compel a particular approach. It compels only the abandonment of the fiction that the award of prejudgment interest ensures that the promisee will be in the same position she would have been in had the promisor paid an amount equal to the judgment at the time the breach or loss occurred.

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<sup>61</sup> *Id.* at 109.

<sup>62</sup> Rolando F. Peláez, *Higgledy-Piggledy Awards for Lost Earnings*, 36 JURIMETRICS J. 325, 326 n.7 (1996).

<sup>63</sup> *Real Interest Rate Definition*, INVESTOPEdia, <http://www.investopedia.com/terms/r/realinterestrate.asp> (last visited Nov. 14, 2014).

<sup>64</sup> Jay Kaplan, *Unit 6—Inflation and Economic Growth*, PRINCIPLES OF MACROECONOMICS (June 2002), <http://www.colorado.edu/economics/courses/econ2020/section6/section6-main.html>.

<sup>65</sup> As one commentator observed, the current rate is not even a reliable barometer of existing and future rates of inflation:

[C]entral bank and related rates of interest simply have not been, as Professor Waddams (and indeed other transatlantic writers) seem to suppose, so calculated as to compensate a lender for actual or prospective rates of inflation. Thus in 1974-75 in the United Kingdom with then current rates of inflation well in excess of 20 per cent., bank rates never rose above 12 3/4 per cent.

I. N. Duncan Wallace, *Inflation and Assessment of Construction Cost Damages*, 98 LAW Q. REV. 406, 409-10 (1982).

<sup>66</sup> See MANITOBA LAW REFORM COMM’N REPORT ON PREJUDGMENT COMPENSATION MONEY AWARDS, REPORT NO. 47, at 74-76 (Jan. 4, 1982), available at [http://manitobalawreform.ca/pubs/pdf/archives/47-full\\_report.pdf](http://manitobalawreform.ca/pubs/pdf/archives/47-full_report.pdf).

*b. The Price of Litigation and Associated Costs*

Under an expectation damages regime, the cost of litigation can be a deterrent to pursuing any recovery, which could in turn incentivize breach and disincentivize market participation. A major expense of the litigation system is its transaction costs. Evaluating the extent to which a promisee is compensated for the full cost of the breach requires consideration of not only the amount of damages awarded at the final stage of the litigation process, but also the costs of obtaining that award.<sup>67</sup> The general rule in the United States is that, in the absence of a statute or contractual provision to the contrary, the prevailing party in litigation is solely responsible for her attorneys' fees.<sup>68</sup> It should be noted that U.C.C. section 2-715, providing for the recovery of consequential damages, is not a statutory exception to this general rule.<sup>69</sup>

Whether the fee is an hourly rate, contingent fee, or some combination of the two, the amount is by no means trivial. As an example of what a contract plaintiff might expect to pay, consider the following explanation taken from one law firm's website:

When is a contingency fee a bad idea If you have a very strong case and you can afford to pay hourly for legal services, then a contingency fee may not be the best option. If you have a strong breach of contract claim for \$60,000, it may cost you \$5000 to litigate the case on an hourly basis and recover the money. If you can afford to pay the \$5000, this may be a better option than paying a \$20,000 contingency fee. When you do this, you are taking the risk of advancing the money, and you are taking the risk that you might pay for legal fees and still lose the case. If the case[] is strong, that [may] be a worthwhile risk to save money on attorney's fees.<sup>70</sup>

One can assume that this grim cost picture is not atypical. Even statutes or court rules that permit the prevailing party to recover her costs do not lessen the burden of litigation costs, as

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<sup>67</sup> For two reasons, this article ignores the real-world fact that most breach of contract cases are settled, not tried. The first is the lack of available data resulting from private nature of the settlement process. Second, settlement negotiations take place in the "shadow" of the law. See Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 997 (1979). One would, therefore, expect these private negotiations to be based on what would be a proper resolution at trial.

<sup>68</sup> See generally DOBBS, *supra* note 46, at § 3.10(3).

<sup>69</sup> See, e.g., *Ind. Glass Co. v. Ind. Mich. Power Co.*, 692 N.E.2d 886, 888 (Ind. Ct. App. 1998).

<sup>70</sup> Eric Parker, *Understanding Contingency Fees*, STOTIS & BAIRD CHARTERED (Mar. 6, 2009, 11:30 AM), [http://www.stotis-baird.com/library/index.php?option=com\\_content&task=view&id=69&Itemid=55](http://www.stotis-baird.com/library/index.php?option=com_content&task=view&id=69&Itemid=55).

these “costs” do not include attorneys’ fees.<sup>71</sup> Instead, they permit recovery of fees of the clerk of court, the marshal or sheriff, docket fees and like sums, which can vary from jurisdiction to jurisdiction.<sup>72</sup> Compared with outlays such as attorneys’ fees, recoverable costs tend to be small sums.<sup>73</sup>

From a compensation viewpoint, one problem with the contract law system is that courts are reluctant to permit recovery for non-pecuniary losses.<sup>74</sup> These are losses that are not susceptible to measurement in purely economic terms, such as mental suffering, inconvenience, loss of time, or humiliation.<sup>75</sup> One might take the position that two general categories of non-pecuniary damage claims may arise in breach of contract cases. First, there are claims for some type of psychological harm. These are the so-called “emotional distress” cases, regardless of what other descriptive label a court or litigant may choose to employ.<sup>76</sup> Perhaps the term “psychic harm” is the more appropriate characterization, and might better serve as a new and useful grouping of these cases, in which judges would strive for consistency and litigants would feel empowered to look for precedent. Instead, psychic harm currently does not seem to be a recognized category and is simply a feature common to many cases bearing different labels.

Second are the so-called claims for lost time. The distinguishing feature of these claims is their temporal, not psychic, nature. For some definite period of time, the aggrieved party has lost the opportunity to engage in an alternative activity—it is in this opportunistic sense that time has been lost. Thus, notwithstanding the old saying that “time is money,” the aggrieved party cannot expect to be compensated for what could be a considerable number of hours spent

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<sup>71</sup> See, e.g., FED. R. CIV. P. 54(d).

<sup>72</sup> See DOBBS, *supra* note 46, at § 3.10.

<sup>73</sup> *Id.*

<sup>74</sup> See John A. Sebert, Jr., *Punitive and Nonpecuniary Damages in Actions Based Upon Contract: Toward Achieving the Objective of Full Compensation*, 33 UCLA L. REV. 1565, 1571-72 (1986).

<sup>75</sup> See *id.* at 1578. (“Nonpecuniary losses, such as inconvenience, annoyance, and emotional distress, although likely real in many situations, are rarely recognized.” (internal citation omitted)). The most prominent exception involves the right of the aggrieved party to recover damages for emotional distress. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 353 (1981) (“Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result.”). Typically, emotional distress damages are only awarded in death and burial cases, in cases where the breach is accompanied by public embarrassment of the plaintiff or in cases where the breach results in physical harm to the plaintiff, as in contracts for medical services. See Sebert, at 1585; see also Douglas J. Whaley, *Paying for the Agony: the Recovery of Emotional Distress Damages in Contract Actions*, 26 SUFFOLK U. L. REV. 935 (1992).

<sup>76</sup> See Sebert, *supra* note 74, at 1568.

investigating and preparing for trial. Even in those instances where the economic value of the time lost is easily monetized (e.g., employees are diverted from their normal tasks to prepare as witnesses), the expense is not recoverable as an item of damages.

*c. The Problem of Measurement*

Frequently, courts have stated that if the plaintiff fails to prove his damages “with reasonable certainty,” all recovery is denied.<sup>77</sup> This all-or-nothing approach is notoriously draconian and is frequently criticized.<sup>78</sup> Yet, the rule against the recovery of speculative damages will no doubt continue to serve a legitimating function.<sup>79</sup> For example, courts have asserted that the profits lost by a new business are too speculative to permit their recovery.<sup>80</sup> This is especially true for those cases, such as

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<sup>77</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 352 (“Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty.”); DAN B. DOBBS, LAW OF REMEDIES § 3.1 (2d ed. 1993) (“When the plaintiff’s proof fails to show the amount of damages with adequate certainty, courts usually deny the damages claim if the case is the kind in which plaintiffs generally would be able to quantify damages.”). The only Code reference to this limitation appears in Comment 4 to section 2-715, which reads as follows:

The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

U.C.C. § 2-715 cmt. 4 (2013).

The effect of this reasonable certainty requirement is “to increase the injured party’s burden of persuasion well beyond the usual one of making out his case by the ‘preponderance or greater weight of the evidence.’” E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1210-11 (1970).

<sup>78</sup> See, e.g., Farnsworth, *supra* note 77, at 1214-15 (the certainty rule imposes “the Draconian choice of all or nothing” and “it is hard to defend a requirement that attempts to cope with the necessity for speculation by denying recovery altogether rather than by resorting to reasonable approximation”). Also, this rule has an ironic implication worth noting. Although its justification is to prevent overcompensation, it may, on occasion, do just the opposite. Once damages are proved with reasonable certainty, no discount rate is employed to take into account the reality that future financial projections always lack absolute certainty.

<sup>79</sup> In many respects, damages assessments in tort are much less exacting. Perhaps the most extreme example of an accepted damage assessment for which no certain metric exists is the pain and suffering award. See *Beagle v. Vasold*, 417 P.2d 673, 681 (Cal. 1966) (“Every case which has considered the issue [of pain and suffering] has emphasized the difficulty faced by a jury in attempting to measure in monetary terms compensation for injuries as subjective as pain. . .”).

<sup>80</sup> See DOBBS, *supra* note 46, at 154-55. Although proving probable losses is no easy matter for a business without a track record, according to at least some courts it may be possible to establish a sufficient factual basis for an award “with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like.” *AGF, Inc. v. Great Lakes Heat Treating Co.*, 555 N.E.2d 634, 638 (Ohio 1990) (quoting RESTATEMENT (SECOND) OF CONTRACTS

*MindGames Inc. v. W. Publ'g Co.*,<sup>81</sup> in which the business activity is in some way idiosyncratic. In *MindGames*, the plaintiff failed to establish the amount of lost future profits resulting from the defendant's failure to adequately promote a new board game invented by the plaintiff.<sup>82</sup> Moreover, the court went so far as to characterize the new business exemption as a "rule" that prevents recovery even where the evidence would otherwise be sufficient to project future profits.<sup>83</sup>

For this same reason of inherently uncertain proof, many courts have denied recovery for loss of goodwill.<sup>84</sup> Yet, try to tell a buyer of goods for resale that the market price-contract price formula puts her in as good a position as if the seller had performed when resold goods are being returned as defective by angry sub-buyers who are taking their business elsewhere. Notwithstanding this undeniably real loss to the buyer, it is not a liability concern for the seller. This serves to further illustrate why overcompensation is unlikely to present a realistic problem in a variety of cases.

#### d. *The Rules of Foreseeability and Proportionality*

Thus far, this article has identified some of the reasons why contract plaintiffs are routinely undercompensated

§ 352 cmt. b). The plaintiff's proof, however, was insufficient in *Great Lakes. Id.* Profits are even more difficult to prove in those cases where a new business is contemplated by the plaintiff, but the defendant's breach prevents its formation. *See, e.g., Coastland Corp. v. Third Nat'l Mortg. Co.*, 611 F.2d 969, 977-78 (4th Cir. 1979); Karilyn E. Kober, Comment, *A Case for Recovery: Damages for Lost Profits of an Unestablished Business*, 12 CREIGHTON L. REV. 1081 (1979).

<sup>81</sup> *MindGames, Inc. v. W. Publ'g Co.*, 218 F.3d 652 (7th Cir. 2000).

<sup>82</sup> *Id.* at 658-59.

<sup>83</sup> *Id.* at 654.

<sup>84</sup> Consider, for example, a party's loss of future profits due to customer dissatisfaction as a result of the breach. *See, e.g., Lifeguard Indus., Inc. v. Ambrose*, 42 B.R. 734, 740 (Bankr. S.D. Ohio 1983). *But see Delano Growers' Coop. Winery v. Supreme Wine Co.*, 473 N.E.2d 1066, 1077 (Mass. 1985). There, the Massachusetts Supreme Judicial Court stated that lost goodwill was a recoverable item of consequential damages under U.C.C. section 2-715 and concluded that the loss had been proved with sufficient specificity; *see also* Robert P. Barbarowicz, Comment, *Loss of Goodwill and Business Reputation as Recoverable Elements of Damages Under Uniform Commercial Code § 2-715—The Pennsylvania Experience*, 75 DICK. L. REV. 63 (1970). A reasonable definition of what is meant by goodwill is the following:

The good will of a business is the reasonable expectation of its continued profitable operation. Many factors are involved: the name of the firm, its reputation for doing business, the location, the number and character of its customers, the former success of the business, and many other elements which would be advantageous in the operation of the business. Good will is a property right which may be sold.

*Young v. Cooper*, 203 S.W.2d 376, 384 (Tenn. Ct. App. 1947), *quoted in Agric. Servs. Ass'n v. Ferry-Morse Seed Co.*, 551 F.2d 1057, 1071 (6th Cir. 1977).

without relying at all on the notorious rule of foreseeability laid down by the *Hadley* court.<sup>85</sup> But here is where it comes in to supplement the picture of under-compensation. For those readers who are unfamiliar with the facts in *Hadley*, they can be simply stated. A miller contracted with a carrier to deliver a broken crankshaft to the repair shop.<sup>86</sup> Unfortunately, the carrier was delayed and the miller was forced to shut down for the period of the delay.<sup>87</sup> The miller then sought to recover the profits lost during the delay.<sup>88</sup> The court stated:

Where two parties have made a contract, which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.<sup>89</sup>

One way in which courts and commentators have sought to operationalize the holding in *Hadley* is to distinguish between general or direct damages on the one hand and consequential or special damages on the other.<sup>90</sup> Although drawing this distinction can be a bit murky at times,<sup>91</sup> it is helpful to think of the former category as encompassing those losses that are tied directly to the value of what was promised and are not dependent upon the aggrieved party's particular circumstances or position. The harm is, therefore, presumed to be foreseeable and no specific proof of foreseeability is needed.<sup>92</sup> A good example is the cover damages formula in U.C.C. section 2-712.<sup>93</sup> A recovery under this section is directly related to the deficiency

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<sup>85</sup> *Hadley v. Baxendale*, [1854] 156 Eng. Rep. 145 (Ex.).

<sup>86</sup> *Id.* at 145.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*; See also RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981):

(1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made. (2) Loss may be foreseeable as a probable result of a breach because it follows from the breach (a) in the ordinary course of events, or (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.

For the U.C.C.'s formulation of the *Hadley* rule, see *supra* note 12.

<sup>90</sup> See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 351 cmt. b (1981).

<sup>91</sup> For a discussion of some competing meanings, see David W. Barnes & Deborah Zalesne, *The Shadow Code*, 56 S.C. L. REV. 93, 99-101 (2004); see also Jeffrey R. Cagle, et al., Comment, *The Classification of General and Special Damages for Pleading Purposes in Texas*, 51 BAYLOR L. REV. 629 (1999).

<sup>92</sup> See DOBBS, *supra* note 46, at § 12.1(1).

<sup>93</sup> U.C.C. § 2-712 (2013).

in the seller's performance (i.e., non-delivery) and has nothing to do with the specific buyer's situation.<sup>94</sup> This is not the case with consequential damages. Consider a buyer who anticipates reselling the goods at a profit. When the seller does not deliver, the buyer is unable to enter into anticipated resale contracts. She then sues the seller for lost profits under U.C.C. section 2-715(2)(a.). In order to obtain these lost profits, the buyer will have to show that the harm was foreseen or foreseeable, because not all buyers purchase goods for resale.<sup>95</sup> It would be unreasonable to expect sellers to make that assumption without knowing more about the buyer's situation or intention.

When it comes to recovering consequential damages, a great deal is at stake: these damages have the potential to greatly exceed direct damages and may be many times higher than the amount the aggrieved party agreed to pay for the breaching party's performance. In this legal environment, commercial parties can (and often do) seek to control their risk through clauses that limit or exclude liability for consequential damages.<sup>96</sup> The important lesson from *Hadley*, however, is that the aggrieved party may be foreclosed from recovering consequential damages even where there is no contractual provision alerting her to that fact.

Even in those cases where the foreseeability test is satisfied and no contractual provision precludes recovery of consequential damages,<sup>97</sup> there is no reason to believe that courts will award foreseeable damages in an unforeseeable amount. Although it is commonly asserted that the magnitude of the loss is not a disqualifying factor in the aggrieved party's

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<sup>94</sup> *See id.*

<sup>95</sup> Unlike general damages, consequential damages (e.g., lost profits) often compensate for a loss of value that the aggrieved party anticipated receiving from a third party. As one court explained:

[C]onsequential damages do not arise within the scope of the immediate buyer-seller transaction, but rather stem from losses incurred by the non-breaching party in its dealings, often with third parties, which were a proximate result of the breach, and which were reasonably foreseeable by the breaching party at the time of contracting.

*Petroleo Brasileiro, S.A., Petrobras v. Ameropan Oil Corp.*, 372 F. Supp. 503, 508 (E.D.N.Y. 1974).

<sup>96</sup> For example, U.C.C. section 2-719(3) expressly sanctions such a clause, provided it is not unconscionable.

<sup>97</sup> This article ignores the effect that the mitigation doctrine may have on the recovery rights of the aggrieved party because, at least in theory, the loss is a product of the aggrieved party's own inaction or neglect. *See* RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981) (setting forth the rule that "damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation"); *see also* U.C.C. § 2-715(2)(a) (precluding the recovery of consequential damages if those damages could have been prevented by "cover or otherwise").



recovery,<sup>98</sup> the behavior of courts and inconsistent statements of commentators leaves one baffled about the actual outcome in a given case.<sup>99</sup> Moreover, a rule against “disproportionate compensation” is now enshrined in the Restatement (Second) of Contracts.<sup>100</sup> The following illustration is provided to help us to understand what the drafters had in mind:

A, a retail hardware dealer, contracts to sell B an inexpensive lighting attachment, which, as A knows, B needs in order to use his tractor at night on his farm. A is delayed in obtaining the attachment and, since no substitute is available, B is unable to use the tractor at night during the delay. In an action by B against A for breach of contract, the court may, after taking into consideration such factors as the absence of an elaborate written contract and the extreme disproportion between B's loss of profits during the delay and the price of the attachment, exclude recovery for loss of profits.<sup>101</sup>

Therefore, each one of the analytical steps towards the recovery of consequential damages can be a complicated affair involving complicated decisions. Each step raises the possibility that the system will deny compensation when there has been a compensable loss.

High litigation costs, non-pecuniary damages, unavailable or inadequate prejudgment interest compensation, the problem of measurement, and the rules of foreseeability and proportionality all make the legal remedy of damages an unreasonable alternative to contract performance. Having identified these practical difficulties, the next section will lay bare the mythical belief that overcompensation concerns justify judicial negation of the buyer's choice of remedy.

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<sup>98</sup> See, e.g., E. ALLEN FARNSWORTH, *CONTRACTS* 825 (3d ed. 1999) (“The magnitude of the loss need not have been foreseeable, and a party is not disadvantaged by its failure to disclose the profits that it expected to make from the contract.”); *Barnard v. Compugraphic Corp.*, 667 P.2d 117, 120 (Wash. Ct. App. 1983) (holding that plaintiffs are not to be denied recovery because the amount of damage cannot be determined); *Wroth v. Tyler*, [1974] Ch. 30 at 61 (holding that a plaintiff “need show only a contemplation of circumstances which embrace the head or type of damage in question, and need not demonstrate a contemplation of the quantum of damages under that head or type”).

<sup>99</sup> See, e.g., FARNSWORTH, *supra* note 33, at 250 (lost profit cannot be recovered “to the extent that it is extraordinary”); *Taylor & Gaskin, Inc. v. Chris-Craft Indus.*, 732 F.2d 1273, 1280 (6th Cir. 1984); *Victoria Laundry (Windsor) Ltd. v. Newman Indus. Ltd.*, [1949] 2 K.B. 528 (U.K.) (holding that, in regard to the buyer's lost profits on dyeing contracts, that even if a type of loss is reasonably foreseeable, the plaintiff can recover only that amount of loss that was reasonably foreseeable).

<sup>100</sup> Stated as: “(3) A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or ot[h]erwise if it concludes that in t[h]e circumstances justice so requires in order to avoid disproportionate compensation.” *RESTATEMENT (SECOND) OF CONTRACTS* § 351.

<sup>101</sup> *Id.* at § 351, illus. 18.

### III. THE FREEDOM TO CHOOSE THE MARKET MEASURE OF DAMAGES UNDER SECTION 2-713

From a compensation viewpoint, the problem with section 2-713 is not that it overcompensates or undercompensates aggrieved buyers. Its principle shortcoming, according to its critics, seems to be that the market price minus contract price formula lacks any relevant relation to the buyer's actual damages.<sup>102</sup> However, as discussed above, the contract liability system operates in such a manner that in the average run of cases, only a fraction of losses caused by actionable breach will ever be paid by the breacher. In fact, there are so many legal barriers to full compensation that only as an act of hyperbole can it be said that damages recovered in contract litigation put the injured party in as good a position as if the contract had been performed. The gap between the losses suffered and the contract liability system's contribution to paying these losses strongly suggests that we stop assuming that the traditional approach to expectation damages is a standard of perfect compensation. Instead, the buyer should have the option to choose her form of recovery. This section will look at three issues concerning the application of section 2-713 in a more realistic context.

#### A. *Should the Buyer's Actual Lost Profits be Permitted as a Defense to a Section 2-713 Claim?*

*Allied Cannery & Packers, Inc. v. Victor Packing Co.*, is a good example of one court's struggle with the question of whether a buyer should be awarded market damages even though that amount exceeded its lost profits.<sup>103</sup> In *Allied*, a packing company (Packer) contracted to sell raisins to an exporter (Exporter) at a fixed price.<sup>104</sup> Exporter had entered into two fixed-price resale contracts.<sup>105</sup> Before delivery, the raisin crop was adversely affected by rains, thus causing an increase in market price. Packer was unable to obtain raisins from its supplier and breached its contract with Exporter.<sup>106</sup> Exporter did not cover, but managed to have one of the resale contracts rescinded.<sup>107</sup> Although the other resale buyer demanded delivery,

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<sup>102</sup> See, e.g., Childres, *supra* note 2, at 837 (asserting that "section 2-713 fails because it is a hypothetical remedy; it lacks any relevant relation to damages actually suffered").

<sup>103</sup> *Allied Cannery & Packers, Inc. v. Victor Packing Co.*, 162 Cal. App. 3d 905, 912 (Ct. App. 1984).

<sup>104</sup> *Id.* at 907.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 908-09.

no suit was filed against Exporter, nor did Exporter ever pay any damages.<sup>108</sup> Thus, Exporter's "actual" loss was approximately \$4400, namely, its lost profits on the two resale contracts.<sup>109</sup> Exporter sued Packer for approximately \$150,000, which was the market-contract price differential under section 2-713.<sup>110</sup> The court limited Exporter's recovery to its expected resale profit of approximately \$4400.<sup>111</sup> In deciding this case, the court relied primarily on the policy, now expressed in U.C.C. section 1-305, that an award of damages should compensate for no more than the aggrieved party's actual loss.<sup>112</sup>

*Allied Cannery* supplies the conventional account for why market damages should be reduced to the buyer's lost profit: the general standard of compensation found in section 1-305 caps any recovery under the Code's more specific provisions.<sup>113</sup> Though there is undeniable power to this account, there is considerably more to this story.<sup>114</sup>

First, the fact that there is a considerable difference in amount between market damages and the profit the buyer would have earned on its resale contracts is a wholly inadequate basis for determining whether the buyer would realize a windfall if permitted to recover the former. When, for example, the buyer's litigation costs are factored in, it is quite possible that they may add an amount about equal to or even

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<sup>108</sup> *Id.* at 909.

<sup>109</sup> *Id.* at 909-10.

<sup>110</sup> *Id.* at 910.

<sup>111</sup> *Id.* at 915 & n.8.

<sup>112</sup> *Id.* at 915; U.C.C. § 1-305 (2013). The court's conclusion regarding an aggrieved buyer may apply with equal force to the disappointed seller. *See, e.g., Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 214-16 (5th Cir. 1980) (restricting seller to its recovery of lost profits under section 2-708(2) where seller's lost profits were less than its market damages).

<sup>113</sup> Another case limiting the buyer to its lost profit where the buyer had already contracted to sell the goods is *H-W-H Cattle Co., Inc. v. Schroeder*, 767 F.2d 437 (8th Cir. 1985). *But see TexPar Energy, Inc. v. Murphy Oil USA, Inc.*, 45 F.3d 1111 (7th Cir. 1995) (holding that the more specific measure of damages found in section 2-713 should prevail over the more general remedial policy expressed in section [1-305]). Professors Simon and Novack describe the competing judicial viewpoints on this issue as follows: "Strangely enough, each view has generally tended to disregard the arguments, and even the existence, of the opposing view. These two rival bodies of law, imposing in appearance, have passed each other like silent ships in the night." David Simon & Gerald A. Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395, 1397 (1979) (internal citation omitted).

<sup>114</sup> For one thing, even proponents of the position of the court in *Allied Cannery* would limit its application to situations where the buyer's resale purchaser will forego any claim it may have against the buyer. *See WHITE & SUMMERS, supra* note 3, at 413 (concluding that the buyer's damages should not be limited to the expected resale profit where the resale purchaser is likely to insist upon performance, "for in that case the buyer will be liable in damages to its own purchaser equal to the difference between the buyer's resale contract price and the market price").

greater than the dollar differences in recovery. In short, it makes no sense to speak in terms of compensation without data revealing the real costs (both economic and non-economic) of carrying out the litigation. The conclusion reached in *Allied Cannery* lacks any of this real data.<sup>115</sup> Thus, the court's ultimate determination fails to reach an outcome that effectively considers the real position of the injured party.

Moreover, even if the myth of overcompensation is not enough to compel the buyer's freedom of choice in this area, compensation law seeks to achieve other meaningful objectives that are not as elusive as establishing actual losses. Among these objectives are administrative efficiency and deterrence.<sup>116</sup> The market measure of damages achieves administrative efficiency because it will likely lower the cost of proof and reduce the time of lawyers, litigants, juries, and other third parties in the system. It achieves deterrence by facilitating the calculation of risks.<sup>117</sup> Sellers are discouraged from breaching their contracts in the face of a rising market, in all cases in which the buyer intends to resell, and from taking the chance that the buyer's damages will be small should the market drop. In the latter case, the buyer should be free to opt for a lost-profit recovery as an alternative to market damages.<sup>118</sup> This is

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<sup>115</sup> See *Allied Cannery & Packers*, 162 Cal. App. 3d at 915.

<sup>116</sup> Professors Simon and Novack have noted:

While it is generally recognized that the automatic invocation of market damages may sometimes overcompensate the plaintiff, a variety of arguments have been employed by commentators and courts to justify this result: the desirability of maintaining a uniform rule and of facilitating settlements; the public interest in encouraging contract performance and the proper functioning of the market; the prevention of defendant's unjust enrichment; the restoration of the very "value" promised to plaintiff; and the inherent difficulty and complexity of proving actual economic losses not encompassed within the contract terms.

Simon & Novack, *supra* note 113, at 1403 (citations omitted).

<sup>117</sup> Because this article has earlier questioned the factual underpinnings of the efficient breach doctrine, *see supra* note 28 and accompanying text, this article does not use a term that assumes that some breaches are efficient and others not. Instead, by using the term "deterrence," it treats all breaches equally and assumes that the adherence to contractual obligations is efficient and should be encouraged.

<sup>118</sup> Interestingly, Professors White and Summers recognize many of the adverse consequences of limiting damages but believe them to be outweighed by the idea of a lost-profit cap on the buyers-recovery.

We recognize that the prospect of a reduction in damages may have some impact upon a seller's willingness to perform, and may make the security of a buyer's expectations somewhat smaller than would otherwise be the case. Arguably, too, our position will unjustly enrich an occasional seller and may also make the trial more complicated. Even so, we think our overall position is more faithful to the idea that the contract plaintiff should recover only his lost expectancy.

not to say that these advantages will exist in every case. Rather, the advantages present in any given situation will depend on the particular characteristics of the contract, the market, and the parties. The aim here is to simply point out that overcompensation should not be an overriding concern and to identify some of the implications of this conclusion for the normative question of whether buyers should be free to have their damages measured under section 2-713.

*B. Should Post-Breach Events be Used to Limit the Buyer's Recovery Under Section 2-713?*

Another matter regarding the application of section 2-713 that warrants discussion is the effect of post-breach events on the buyer's right to choose a market-contract price measure of damages.<sup>119</sup> Consider, for example, the *Allied Cannery* case, but with changed facts: assume that Exporter had not yet entered into the resale contracts at the time of Packer's breach. Packer breaches on the delivery date, when the market price is above the contract price. Shortly thereafter, the market price falls dramatically to below the price at which Exporter and other wholesalers can sell raisins. If Packer had not breached, Exporter would have lost money on resale.

The foregoing hypothetical forces us to face directly the issue of whether post-breach circumstances should afford a ground for rejecting a specific Code-dictated measure of damages (here the difference between contract price and market price) in order to award a sum that presumably reflects the aggrieved party's actual loss. Under the conventional perception, overcompensation is assumed to be an ever-present risk that should be scrupulously taken into account when computing the plaintiff's damages. However, the preceding discussion indicates that this assumption may be false. Judges must consider this reality in choosing the desirable measure of damages. It is simply not enough to invoke a maxim or canon of statutory construction, as one court did, and say that section 2-713 trumps section 1-305 because it is the more specific provision.<sup>120</sup> To be

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WHITE & SUMMERS, *supra* note 3, at 414. This is but another example of the grip that the myth of full compensation has on the psyche of courts and commentators alike.

<sup>119</sup> Some courts have been all too willing to assume the propriety of deciding cases with ex post data. See *supra* note 40 and accompanying text.

<sup>120</sup> See *Tongish v. Thomas*, 840 P.2d 471, 474 (Kan. 1992) (“[B]ecause it appears impractical to make [§ 1-305] and [§ 2-713] harmonize in this factual situation, [§ 2-713] should prevail as the more specific statute according to rules of statutory construction.”).

convincing, any decision must be grounded in reason and policy, not on a premise that can be easily manipulated.<sup>121</sup>

In order to assess the merits of ignoring post-breach events, it is necessary to break down the general issue into two categories. These are: (1) the limiting effect, if any, of events that occur after suit has been filed, and (2) the limiting effect, if any, of events that occur post-breach, but before suit has been filed. This distinction is necessary because the latter context may invoke a policy concern that is not present in the former.

This part has suggested several potential advantages that awarding damages based on a straightforward application of section 2-713 may have over an approach that relies on section 1-305 to limit damages to some lesser amount. It has posited that actual overcompensation is unlikely and that recovery under section 2-713 does more to deter breach and promote administrative efficiency than would an award compelled by the variations of future shifts in the market. Once we recognize that the *Allied Cannery* court erred in its conclusion that the buyer's so-called actual loss should be determinative, it becomes apparent that permitting the buyer to choose to recover under section 2-713 without regard to events that occur after suit is filed is supported by those same considerations that generally justify freedom of choice. Moreover, if these later events were relevant, a principle of finality demands that there come a point when they would no longer be relevant. Exactly when would that point be reached? When judgment is entered? When the trial ends? At some earlier time? One is left to speculate.

Now consider the second temporal context in which later events may arguably be a potentially limiting factor in the buyer's choice of remedy. Suppose that in the *Allied Cannery* hypothetical, the dramatic fall in market price occurred before the buyer filed suit. In other words, instead of breathing a sigh of relief that the seller chose not to perform and pecuniary losses were avoided, the buyer ignores the post-breach event and

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<sup>121</sup> Indeed, Karl Llewellyn urged courts to decide cases in the Grand Style or the Style of Reason. For him, that meant statutes should be read and implemented "in accordance with their purpose and reason." KARL N. LLEWELLYN, *On the Current Recapture of the Grand Tradition*, in JURISPRUDENCE: REALISM IN THEORY AND PRACTICE 215, 217 (1962). Another indication of Llewellyn's belief that the underlying purposes of the Code and its sections should guide decisionmaking is his views on the canons of statutory construction. After noting that "there are two opposing canons on almost every point," he writes that "[p]lainly, to make any canon take hold in a particular instance, the construction contended for must be sold, essentially by means other than the use of the canon." Karl N. Llewellyn, *THE COMMON LAW TRADITION: DECIDING APPEALS*, app. at 521 (1960).

demands compensation under section 2-713. What may call for a different conclusion here regarding the application of that section is that the non-recoverable costs of litigation (e.g., attorney's fees) are essentially self-inflicted. After all, why file suit if there was no actual pecuniary loss at that time?<sup>122</sup>

Even in this situation we should be reluctant to impose restraints on market-based damages. Allowing recovery in such a situation might be seen by some as devoid of any normative component—or at least any normative component other than penalizing the seller for its breach. However, that view widely misses the mark. First, ignoring later events and their impact on the buyer's economic position fosters speedy and accurate judgments that would provide the predictability and certainty necessary for commercial transactions. Second, it would protect the buyer's right to receive the promised goods without conveying an unfair advantage to the seller who seeks to capitalize on a shifting market. The buyer should be entitled to the value of the seller's performance on the date set for that performance, regardless of what transpires afterwards.<sup>123</sup> In the hypothetical presented, it would seem wrong to excuse the seller's breach for the fortuitous reason that the buyer had not yet entered into resale contracts. More than a century ago, Sedgwick, in his treatise on damages, resisted whatever allure there might be for fixing compensation based on post-breach events. He argued for an award of market damages regardless of whether the buyer subsequently "keeps, sells, gives away, or destroys the goods."<sup>124</sup> Ignoring post-breach events in the

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<sup>122</sup> But how can we be sure that the buyer was able to, and did in fact, accurately assess its damages situation prior to filing suit? It may very well be that the facts indicating that there was no loss were first developed and came to light post-suit. In such a case it would be unfair to characterize the non-recoverable litigation costs as "self-inflicted."

<sup>123</sup> For an analogous situation, consider a buyer who covers at a price higher than the contract price at a time when it has entered into a "cost plus" contract to resell the goods. If the buyer can, therefore, pass its increased cost on to its sub-buyer should that deprive the buyer of its cover damages under section 2-712? According to at least one court the answer is no. *See KGM Harvesting Co. v. Fresh Network*, 42 Cal. Rptr. 2d 286, 376, 36 Cal. App. 4th 376, 389 (1995) (explaining that permitting the buyer to recover under section 2-712 "gives the buyer the benefit of its bargain. What the buyer chooses to do with that bargain is not relevant to the determination of damages under section 2[-]712").

<sup>124</sup> 3 THEODORE SEDGWICK, *A TREATISE ON THE MEASURE OF DAMAGES* § 855, at 1770 (9th ed. 1920). Simon and Novack offer an argument along these lines, developing a more elaborate, formalized version of a betting explanation:

[W]here both parties to a market transaction are . . . dealing with commodities of fluctuating value, the contract should be treated as equivalent to a bet which the parties are making against the future market price. Payment of market damages amounts to specific performance of the bet. Since a functioning futures market is predicated on a system of enforceable bets against the future, "specific performance" of those bets—through

calculation of damages has the advantages of deterring breach, and can provide finality and predictability to parties entering into a contract.

*C. Should a Buyer Who Purchased Replacement Goods be Permitted to Recover Contract/Market Damages Under Section 2-713?*

There has been persistent debate over whether an aggrieved buyer who has covered under section 2-712 by purchasing substitute goods elsewhere should be permitted to recover market-based damages in those situations where the applicable market price exceeds the cover price.<sup>125</sup> Consider, for example, a contract for the sale of 100 cases of widgets for a price of \$10.00 per case. At the time of the seller's failure to deliver, the market value of the widgets is \$11.00 per case, but it soon declines to \$10.50 per case. The aggrieved buyer purchases substitute widgets for the then market price of \$10.50, but chooses to sue to recover the difference between the contract price of \$10.00 and the market value of \$11.00 at the time she learned of the breach.

One view, put forward by Ellen Peters, is that the buyer has an unfettered choice between damages based on the

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payment of market damages—can be viewed as fundamental to the continued existence of the market itself.

Simon & Novack, *supra* note 113, at 1436-37.

<sup>125</sup> On the seller's side, the analogous case is one in which a seller who is not a "lost volume" seller seeks to recover damages measured by the contract-market differential under section 2-708(1) notwithstanding its resale to a third-party under section 2-706. On this issue, too, debate rages. For two examples of contrary viewpoints, see Peters, *supra* note 3, at 260 (concluding that the history of the UCC, including deletion of language prefacing a seller's right to recover damages for nonacceptance with "so far as any goods have not been resold," clarified that an aggrieved seller was not required to elect between damages under Section 2-706 and Section 2-708 and "indicates a purpose to safeguard alternative remedies") and WHITE & SUMMERS, *supra* note 3, at 478 ("We conclude that a seller should not be permitted to recover more under 2-708(1) than under 2-706, but we admit we are swimming upstream against a heavy current of implication which flows from the comments and the Code history.").

Another analogous case is that of an aggrieved lessee who elects to cover and then sues to recover more under a market-based measure. In this instance the drafters of Article 2A have spoken. Section 2A-519(1) provides that market-based damages are available only if "a lessee elects not to cover or a lessee elects to cover and the cover is by a lease agreement that for any reason does not qualify for treatment under [the cover provision], or is by purchase or otherwise." U.C.C. § 2A-519(1) (2013). If the contract is governed by the United Nations Convention on Contracts for the International Sale of Goods (the CISG) there can be no debate regarding the issue. The CISG makes it clear that an aggrieved party (buyer or seller) may only recover the difference between the contract price and the current price if she has not covered by purchase or resale. CISG art. 76(1) (2010).



cost of cover or on the market value of the goods.<sup>126</sup> In so concluding, she strives to achieve a parity of treatment for both buyers and sellers. The key U.C.C. provision for her is section 2-703, which provides a list of alternative remedies available to the seller, suggesting that the seller always has the choice of which remedy to pursue. Comment 1 reinforces this interpretation by providing: "This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach."<sup>127</sup> To put the strongest face on her position regarding the mandatory relevance of substitute transactions, Peters concludes her discussion with the following policy points:

A non-restrictive reading of the various remedies sections to preserve full options to use or to ignore substitute transactions as a measure of damages makes more sense . . . for a number of reasons. It preserves a parity of remedy for buyers and sellers. It is consistent with a number of other Code sections which frown on premature election of remedies. It is a good deal easier to administer, since it would be most difficult to ferret out from a reluctant complainant information about transactions sufficiently related to the contract in breach to qualify as cover or resale. Finally, preservation of the option encourages recourse to actual market substitutes, since it guarantees to the injured party that he will not lose all remedy in the event of an unusually favorable substitute contract. It is thus consistent with the Code's overall interest in keeping goods moving in commerce as rapidly as possible.<sup>128</sup>

Virtually all of the rival explanations for why a buyer who covers is deemed to have elected a remedy are exemplified by the explanation given by White and Summers. First, they point to Comment 5 to section 2-713, which expressly indicates that an election has occurred: "The present section provides a remedy which is *completely alternative* to cover under the preceding section and applies only *when and to the extent that the buyer has not covered*."<sup>129</sup>

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<sup>126</sup> Peters, *supra* note 3, at 260.

<sup>127</sup> U.C.C. § 2-703 cmt. 1. Similarly, section 2-711 lists the buyer's remedies following non-delivery by the seller, but its alternative wording suggests to Peters the strong possibility that it "requires damages to be measured by cover if cover has been effectuated." Peters, *supra* note 3, at 260. She ultimately rejects this conclusion for reasons of both policy and drafting history. *See id.*

<sup>128</sup> Peters, *supra* note 3, at 260-61.

<sup>129</sup> U.C.C. § 2-713 cmt. 5; WHITE & SUMMERS, *supra* note 3, at 410. Peters does not ignore this comment, but dismisses its import with the observation that "nothing supporting this position can be found in the text of section 2-713." Peters, *supra* note 3, at 260. Although the comments play an extremely prominent role in Code interpretation, Peters' statement reflects the view that courts and commentators ought to be particularly cautious about following a comment on a matter that does not appear

Next comes the familiar refrain about overcompensation or windfall concerns. Allowing the “higher damages of contract-market differential” they write, is “contrary to the general principle of Revised 1-305(a) and its predecessor, 1-106, (in as good a position as if the other party had performed and no more).”<sup>130</sup>

The interplay between overcompensation concerns and the now-moribund project to revise Article 2 provides a wonderful opportunity to see that the stridency with which these concerns is offered can cast a shadow over the statutory drafting process and deter more liberal grants of remedial options. At the outset, consider how the drafters decided to address the issue of election of remedies in a new section 2-701, which appeared for the first time in the December 1993 draft.<sup>131</sup> Subsection (e) of that section read as follows:

Except as otherwise provided in this Article or the agreement, the rights and remedies provided by this Article are cumulative. However, a court may deny a remedy if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.<sup>132</sup>

As Professor Anderson points out, this explicit statutory sanction of even insubstantial “overcompensation” was seen by many to be a radical departure from existing law and generated a firestorm of criticism.<sup>133</sup> At first, the Drafting Committee responded to this criticism by essentially ignoring it.<sup>134</sup>

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in the statutory text. In doing so, there is the real risk of carrying out policies that cannot be tied to any particular legislative judgment. This problem arises in many cases where the comments seem designed to function more as legislation than merely as a means of discerning the meaning of statutory language. This point was expressly recognized by the New York Law Revision Commission in its criticism of the comments: “A more serious objection arises from instances in which the [c]omments appear to qualify the text or to add further rules not supported by the text.” N. Y. STATE LAW REVISION COMM’N, REPORT OF THE LAW REVISION COMMISSION FOR 1956: REPORT RELATING TO THE UNIFORM COMMERCIAL CODE 26 (1956).

<sup>130</sup> WHITE & SUMMERS, *supra* note 3, at 410. In the cases under section 2-713 to date, the courts have found little difficulty with the issue. *See, e.g., Flood v. M.P. Clark, Inc.*, 335 F. Supp. 970 (E.D. Pa. 1971) (a buyer who elects to cover may not obtain market-based damages). Roy Anderson has summarized the extant case law as follows: “Over thirty years of case law under article 2 has demonstrated that both sellers and buyers do attempt to use market-based damages to achieve windfall recoveries. In reply, the courts have regularly . . . frustrate[d] these attempts.” Anderson, *supra* note 6, at 1072 (internal citations omitted).

<sup>131</sup> Drafts of Revised Article 2 dating back to 1996 are available online through the Uniform Law Commission website at <http://www.uniformlaws.org/Committee.aspx?title=Commercial%20Code%20Article%202,%20Sales,%20and%20Article%202A,%20Leases>. Older drafts are on file with the Commission. For a more detailed exposition of the relevant drafting history, see Anderson, *supra* note 6, at 1072-81. The summary in this article is drawn from that work.

<sup>132</sup> Proposed U.C.C. § 2-701(e) (Discussion Draft Dec. 1993).

<sup>133</sup> *See* Anderson, *supra* note 6, at 1076 (“The provision drew heated criticism, primarily from the ABA Task Force, largely on the bases that the provision conflicted

But an important point to appreciate about the Code revision and drafting processes is that criticism matters.<sup>135</sup> Thus, we see in the October 1, 1995 Discussion Draft a more traditional approach to remedial choice.<sup>136</sup> No longer was the term “substantial” used to modify overcompensation.<sup>137</sup> The accompanying reporter’s note goes on to explain that:

[T]he court, if requested by the defendant, may deny a particular choice when that remedy under the circumstances puts the aggrieved party in a better position than full performance would have done. In most cases, this will occur when the aggrieved party’s choice of damages based upon the difference between contract and market price substantially exceeds the profits that would have been made by full performance. Subsection (c) also rejects the view that the exercise of one remedy, such as resale by the seller, automatically precludes a subsequent choice to pursue another remedy, such as market damages. Again, the question is whether the choice exceeds the expectation principle.<sup>138</sup>

It seems the view that damages should be limited to actual compensation is the most important take away from the note, but the analysis is cursory and confusing at best. First, we are told that the court “may” deny a remedy that puts the aggrieved party in a better position. Why not “shall”? Second,

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with the compensation mandate . . . and that there is no historical antecedent in the law of contract for a ‘substantial’ overcompensation limitation.”)

<sup>134</sup> The Reporter’s notes in the very next discussion draft point out that:

Revised subsection (e) reinforces the idea that remedies are cumulative but then imposes a limitation that controls remedial choice throughout Part 7: A court, at the petition of the defendant, may deny or limit a remedy if under the circumstances it would put the aggrieved party “in a substantially better position than if the other party had fully performed.”

Proposed U.C.C. § 2-701 reporter’s note 4 (Discussion Draft July 29-Aug. 5 1994).

<sup>135</sup> In order for a Code project to be completely successful, universal enactment by the states is necessary. For that to happen there must be a compromise consensus among interested parties that grows from diversity of thought and experience. Consequently, informed and substantive critique of drafts is essential and taken seriously by drafting committees and reporters. For a small sampling of the commentary on the Code drafting and revision processes, see Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783 (1994).

<sup>136</sup> See generally Proposed U.C.C. § 2-703(c) (Discussion Draft Oct. 1, 1995).

<sup>137</sup> The new provision, now section 2-703(c), read as follows:

The rights and remedies provided in this chapter are cumulative, but a party may not recover more than once for the same injury. A court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a better position than if the other party had fully performed.

*Id.*

<sup>138</sup> *Id.* § 2-703 reporter’s note 4.

the note emphatically rejects the election of remedies doctrine. Market damages are not automatically unavailable if, for example, the seller resells. When would it be unavailable? Why would a seller who has resold ever choose market damages if the amount did not exceed the resale/contract price differential?<sup>139</sup>

Surprisingly, the term “substantially” reappeared in the November 1996 Discussion Draft without explanation.<sup>140</sup> The reason for the surprise is that the ABA Task Force was highly critical of the possibility that overcompensation may be permitted and it overtly threatened to lobby against a Revised Article 2 with such a provision when the draft was presented to the American Law Institute and American Bar Association for their approval.<sup>141</sup> In order to reduce objection, the Reporter undertook to prepare a Note summarizing the positions taken by the participants at the November 1996 meeting of the Drafting Committee and suggesting how section 2-803(c) should be applied.<sup>142</sup>

The attempted “fix” was not successful. Even with this Note, there was little support for section 2-803(c) and active opposition to this section and other aspects of Revised Article 2 continued.<sup>143</sup> As a result, the Drafting Committee was

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<sup>139</sup> Anderson, too, finds this Note confusing. See Anderson, *supra* note 6, at 1077 (“The Notes . . . acknowledge that problems of overcompensation would usually arise when a party attempts to have damages measured based on market price, but then confusingly suggested that the mere fact that the injured party had engaged in a true substitute transaction, such as resale of the goods, did not necessarily preclude its recovery of market-based damages.”).

<sup>140</sup> The section was changed to 2-803(c) and read as follows:

The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury. A **court** may deny or limit a remedy, if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.

Proposed U.C.C. § 2-803(c) (Discussion Draft Nov. 1, 1996) (emphasis in original). See Anderson, *supra* note 6, at 1078 (“No explanation for the reinclusion was given.”).

<sup>141</sup> See Anderson, *supra* note 6, at 1077 n.68.

<sup>142</sup> The significant features of this Note are discussed in Anderson, *supra* note 6, at 1079-81. At this point in the drafting process there were essentially three points of view regarding the merits of section 2-803(c):

Proponents of retaining the provision had emphasized the importance of maintaining the principle of free election of remedies. . . . Opponents of the provision had been a curious mix, about half expressing concern that section 2-803(c) would be used by courts to allow overcompensation, while the remainder expressed concern that courts would apply the provision to restrict plaintiffs to the smallest measurement regardless of the actual damages.

*Id.* at 1079.

<sup>143</sup> In a final attempt to address the concerns and reservations expressed, the Drafting Committee asked the Reporter to prepare a “Comment” to the section, which first appeared in the April 1997 Discussion Draft. This Comment turned out to be unpersuasive and did little to change minds. See *id.* at 1110-11 (noting that “[a]lthough

reconstituted with a new Reporter and Chair and the revision project was downgraded to a series of amendments,<sup>144</sup> thus bringing to an end the story of section 2-803(c). All that remained of the statutory product of the overcompensation debate was a new Comment 7 to amended section 2-713, which read as follows:

A buyer that has covered under Section 2-712 may not recover the contract price market price difference under this section, but instead must base the damages on those provided in Section 2-712. To award an additional amount because the buyer could show the market price was higher than the contract price would put the buyer in a better position than performance would have. Of course, the seller would bear the burden of proving that cover had the economic effect of limiting the buyer's actual loss to an amount less than the contract price-market price difference.<sup>145</sup>

The problem with this entire debate, as evidenced by the foregoing discussion of the Article 2 drafting project, is that it responds to the wrong question: "Under what circumstances, if any, should an aggrieved buyer or seller be overcompensated for the harm resulting from the other party's breach?"<sup>146</sup> The utility of this question depends upon the accuracy of its underlying premise, which is, of course, that ignoring an actual market transaction (cover or resale) in favor of market damages overcompensates. But as the reader must now appreciate, this premise overlooks the more realistic probability that an award that appears to overcompensate may not do so in practice, once the costs of litigation (both

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nothing new or particularly instructive is offered, there is the implicit assurance that nothing in section 2-803 is intended to restructure the application of article 2 damage remedies"). The Comment is reproduced in its entirety in *id.* at app. 1119.

<sup>144</sup> The course of events can be summarized as follows: Professor Speidel and Associate Reporter, Linda J. Rusch (Rusch served as an Associate Reporter from 1996-99), resigned in protest at the 1999 annual meeting of the Uniform Law Commission following a decision by its leadership to postpone a scheduled reading of the final draft of Revised Article 2 until July 2000. It was then that a new Reporter and Chair were appointed and the downgrading occurred. Eventually, Amended Article 2 received final approval at both the 2002 annual meeting of the Law Commission and the 2003 annual meeting of the American Law Institute.

<sup>145</sup> U.C.C. § 2-713 cmt. 7 (amended 2003). It is interesting to note that this Comment, presumably written by the new Reporter, Henry Gabriel, expresses a position that is inconsistent with the free election position that he had taken previously. See Henry Gabriel, *The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory*, 23 WAKE FOREST L. REV. 429, 449 (1988). It is reasonable to believe that he was under institutional pressure to appease opposing interest groups, particularly the ABA Task Force.

<sup>146</sup> See, e.g., Anderson, *supra* note 6, at 1117 (commenting on the "substantial overcompensation" limitation in Revised Section 2-803(c), he observes that "subsection (c) offers the court the discretion to overcompensate. Courts will undoubtedly be asked to entertain that discretion in cases in which plaintiffs, sellers or buyers, seek to use market-based damages to achieve windfall recoveries").

those that are measurable but not legally recoverable and those that are immeasurable) are taken into account.

The more meaningful question might be: “Is there a compelling reason, when overcompensation concerns are removed from the calculus, to require the aggrieved party who has engaged in a market transaction to elect that remedy over the general market price remedy?” The answer to that question is “No.” However, what about the argument that courts should be assigned the task of considering all costs of litigation and determining, in each case, whether overcompensation will really occur? The most serious problem with that approach is the enormous cost of effectuation. Determining “real” overcompensation requires a complex, fact-based adjudication should be rejected for that reason alone. It is with that in mind that we turn to the next section which will establish why an award of damages based on the difference between a hypothetical cover price and the contract price can, in reality, be transformed into a recovery for lost profits.

#### IV. AN ICONOCLASTIC VIEW OF MARKET PRICE: MUCH ADO ABOUT SOMETHING

Market price is a central concept to the application of section 2-713. It is a critical element of the statutory formula that measures both the buyer’s general damages and, if the buyer had already entered into a resale contract, the amount of its consequential damages under section 2-715(2).<sup>147</sup> Those consequential damages only exist if the buyer is, in turn, held liable to its sub-buyer under section 2-713 for the breach of the resale contract.<sup>148</sup> But there are apparent difficulties with any formula that relies on market price.

First, market price may vary at different times and places. Consequently, the drafters had to specify the relevant place and time at which to determine market price. They established the relevant place as “the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival”<sup>149</sup> and the relevant time as “when the buyer learned of the breach.”<sup>150</sup> What they neglected to do,

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<sup>147</sup> Since the buyer’s claim for consequential damages would be subject to section 2-715(2), it would have to show both an inability to cover and that the harm involved was foreseeable by the seller at the time the contract was made. U.C.C. § 2-715(2) (2013).

<sup>148</sup> *Id.* § 2-713.

<sup>149</sup> *Id.* § 2-713(2).

<sup>150</sup> *Id.* § 2-713(1).

however, was to provide us with a statutory designation (e.g., wholesale or retail) of the appropriate market.

The unchallenged assumption, by courts and commentators alike, is that the relevant market in which to determine price is the market in which the buyer is likely to go to make a substitute purchase (i.e., cover). This view of the relevant market is implicit in the geographic and temporal choices made by the drafters and is made explicit in the Comments: “The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief.”<sup>151</sup> The appropriateness of the cover market seems most compelling with respect to those buyers who intend to retain the good for their own personal use. After all, their ultimate interest is in turning cash into goods (\$ → goods). However, for buyers who intend to resell the goods, the cover market is less relevant, for what they care most about is converting cash into more cash (\$ → goods → \$\$). There is no statutory mandate that we treat dissimilar buyers in a similar way.<sup>152</sup> In fact, the jurisprudence and history of U.C.C. Article 2 as a realistic, fact-sensitive set of rules plainly contradicts that idea.

It was Llewellyn’s strong belief that to achieve “The Good, The True, The Beautiful in Commercial Law,”<sup>153</sup> its rules have to be informed by reality—they have to be grounded in fact-situations—with emphasis placed upon the circumstances of the overall setting of the transaction.<sup>154</sup> These considerations can be seen throughout Article 2 supporting, for example, the principles of unconscionability,<sup>155</sup> good faith,<sup>156</sup> and a provision mandating that every agreement be read to include any applicable usage of the particular trade.<sup>157</sup>

<sup>151</sup> *Id.* § 2-713 cmt. 1.

<sup>152</sup> Recall that it is not the purpose of this article to advocate for any substantive legal change that would require a revision to or an amendment of Article 2. Notwithstanding the statement in the Comment regarding the appropriate market, courts are free to adopt a “better” approach if one were offered. *See id.*

<sup>153</sup> Ingrid Michelsen Hillinger, *The Article 2 Merchant Rules: Karl Llewellyn’s Attempt to Achieve The Good, The True, The Beautiful in Commercial Law*, 73 GEO. L.J. 1141 (1985). The title of Professor Hillinger’s article is drawn from the words Llewellyn himself used as a title to a series of lectures. *See* K. N. Llewellyn, *On the Good, The True, The Beautiful, in Law*, 9 U. CHI. L. REV. 224 (1942). For Llewellyn, the quest for beautiful law meant that he had to create “a body of sales law which is clean, clear, guidesome, which it is almost impossible to misconstrue.” 1 STATE OF N.Y. LAW REVISION COMM’N, HEARINGS ON THE UNIFORM COMMERCIAL CODE 160 (1954).

<sup>154</sup> *See* Karl N. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431, 457-59 (1930); Karl N. Llewellyn, *Some Realism About Realism—Responding to Dean Pound*, 44 HARV. L. REV. 1222, 1237 (1931).

<sup>155</sup> U.C.C. § 2-302.

<sup>156</sup> *Id.* § 1-304.

<sup>157</sup> *Id.* § 1-303(c).

Another place where Llewellyn elevates commercial reality into the law is in section 2-509 (“Risk of Loss in the Absence of Breach”).<sup>158</sup> In pre-Code days the concept of title served as the jack-of-all-trades in sales law.<sup>159</sup> One had only to decide who had title and then the answers would neatly follow to such diverse questions as where the risk of loss lay, whether the seller could maintain an action for the price, whether the buyer could replevy the goods, and whether the seller’s or buyer’s creditors could levy on the goods.<sup>160</sup> But for Llewellyn, the neatness of such a singularity of issue was not worth its price:

The quarrel thus is, first, with the use of Title for purposes of decision as if the *location* of Title *were* determinable with certainty; and second, with the insistence on reaching for a single lump to solve all or most of the problems between seller and buyer—and even in regard to third parties.<sup>161</sup>

Thus, when the drafting of the Code began, Llewellyn was convinced that the time had come to scrap title as a means to resolve sales controversies.<sup>162</sup> The unpredictable application<sup>163</sup> and irrationality<sup>164</sup> of title led Llewellyn to fear that if its then-prominent role were enshrined in the Code, the effects would be intolerable. Making the most of his opportunity, Llewellyn boldly relegated title to backseat status in the Code. In its place are specific rules premised on considerations peculiar to the problem at hand. Take, for example, the default rules governing risk of loss. The several rules stated in section 2-509 are based on different methods of delivery and the character of the seller. By dealing with risk of loss in a number of settings, the risk is theoretically placed on the party in the best position to insure against loss or take the necessary steps to avoid it. Thus, we have a far more practical solution to the issue than the location of title approach of pre-Code law.

Perhaps the most significant set of provisions that illustrate Llewellyn’s realist tenet that legal rules must relate

<sup>158</sup> *Id.* § 2-509.

<sup>159</sup> See generally K. N. Llewellyn, *Through Title to Contract and a Bit Beyond*, 15 N.Y.U. L.Q. REV. 159 (1938).

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 166.

<sup>162</sup> *Id.* at 166-67.

<sup>163</sup> Llewellyn explained: “Nobody ever saw a chattel’s Title. Its location in Sales cases is not discovered, but created, often *ad hoc*.” *Id.* at 165.

<sup>164</sup> Referring to the concept of “title” or “property,” Llewellyn fancifully wrote: “when, in addition, ‘the property’ bounces around from party to party according to the issue, it begins to look as if ‘the property in the goods,’ as an issue-determiner, were in the mercantile cases, a farmer far from the dell, and none too well adjusted to the new environment.” K. N. Llewellyn, *Across Sales on Horseback*, 52 HARV. L. REV. 725, 733 (1939).



to the facts and circumstances of a given transaction are those that single out merchants for special treatment. Here, Llewellyn certainly intended to make rules more realistic or closer to the actual behavior of market participants. In a comment to the 1940 draft of the Uniform Sales Act, he wrote:

There are a considerable number of situations in Sales in which the practices, understandings, and needs between merchants are strikingly different from those where one of the parties or both stands outside the business course of dealing-as-a-business. A private buyer of furniture, for instance, can find the goods wholly unusable for him because of an error in color or finish, whereas the same defect could be readily adjusted with a dealer-buyer. The processes of negotiating adjustment are different. The speed of remedy required is different.<sup>165</sup>

Thus, Article 2 contains 13 provisions specifically tailored for merchants.<sup>166</sup> In some cases, merchant obligations are placed upon the merchant regardless of whether the other party qualifies as a merchant.<sup>167</sup> However, in others, the obligations are imposed in transactions “between merchants.”<sup>168</sup> Although one might quibble with the substance of Llewellyn’s status-based classification, no one has argued that the status of the parties should be irrelevant.<sup>169</sup>

But why should any classification-based structure of rules not take into account other distinctions that may exist with regard to the categories of buyers and sellers? Indeed, as early as the 1930s, Professor Nathan Isaacs wrote a series of articles critical of the “cash-and-carry” conceptualism of the Uniform Sales Act of 1906.<sup>170</sup> He was mindful that squeezing a single set of rules out of a stereotypical transaction had its advantages—but at what cost?<sup>171</sup> If the law of sales failed to

<sup>165</sup> REPORT AND SECOND DRAFT, *supra* note 16, at 178 (at “Comment On ‘Merchant’ Insert Into § 1”).

<sup>166</sup> A “merchant” is defined as “a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction.” U.C.C. § 2-104(1) (2013).

<sup>167</sup> *See, e.g., id.* § 2-205.

<sup>168</sup> *See, e.g., id.* § 2-201(2).

<sup>169</sup> For a suggested alternative to the merchant/non-merchant distinction see, *e.g.*, Hillinger, *supra* note 153, at 1184 (“In the abstract, then, Llewellyn’s Article 2 principle of discrimination seems sound, but his actual discrimination along merchant/nonmerchant lines is at least open to question. Today, the relevant principle of discrimination may be consumer/nonconsumer . . .”).

<sup>170</sup> *See* Nathan Isaacs, *The Industrial Purchaser and the Sales Act*, 34 COLUM. L. REV. 262, 262 (1934) (describing the type of sale envisioned by the Sales Act “as one by a dealer who is likely to be the maker, to a lay consumer. The picture is satisfied by the horseman who stops at the sadler’s door to buy a new saddle”); *see also* Nathan Isaacs, *Dealer-Purchaser*, 1 U. CIN. L. REV. 373 (1927).

<sup>171</sup> Isaacs suggested that the approach taken by the Uniform Sales Act was to be expected in an era of mass production. *See* Isaacs, *The Industrial Purchaser*, *supra*

track the differences that actually existed among market participants, he argued that we would see a “lack of plasticity or adjustability to time and circumstance, artificiality, inaccuracy, and occasional hardship.”<sup>172</sup> Isaacs’ interest in and insistence upon having the law conform to actual markets led him to suggest a refinement of sales law that would, at a minimum, take into account the different circumstances that surround transactions by a seller-manufacturer, consumer-purchaser, dealer-purchaser, and manufacturer-purchaser.<sup>173</sup>

Two things seem fairly obvious. First, that Llewellyn was quite familiar with the practical ideas on classification expressed by Isaacs in his articles.<sup>174</sup> Second, and perhaps more importantly, Llewellyn shared those ideas.<sup>175</sup> Like Isaacs, his skepticism about the merits of traditional legal distinctions or classification was pervasive. He was convinced that, if not drawn accurately enough, these distinctions would inevitably lead to partial, inconsistent, and incorrect analyses of contract problems.<sup>176</sup> He tended to regard the then-existing classification scheme of sales law as too “overbroad for intelligent use.”<sup>177</sup>

Now, consider the undetailed and imprecise concepts like “seller” and “buyer.” Within each there is neither guidance for the judge nor any substantive rules to create meaningful differences in the results of the cases. Yet, Llewellyn believed that there is a remarkable contrast among sellers who are

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note 170, at 262 (“This was an era of mass production in law as well as industry, in which jurisprudence was more concerned with supplying cheap, quick, easy, machine-made frameworks for all business transactions than with the fine adjustment of any one of these frameworks to serve the needs of carefully studied individualized situations.”).

<sup>172</sup> *Id.*

<sup>173</sup> See generally *id.*

<sup>174</sup> See Llewellyn, *Through Title*, *supra* note 159, at 159 (describing the scholarship produced by Isaacs as “the most challenging material on our [s]ales law which I have seen in print”). Moreover, Professor Wiseman suggests the possibility that Llewellyn got the idea for the titles of two of his articles (see Llewellyn, *Across Sales on Horseback*, *supra* note 164; K. N. Llewellyn, *The First Struggle to Unhorse Sales*, 52 HARV. L. REV. 873 (1939)) from the “horseman” and “saddle” picture of sales law painted by Isaacs. See Isaacs, *The Industrial Purchaser*, *supra* note 170, at 263; Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465, 477 n.43 (1987).

<sup>175</sup> See Wiseman, *supra* note 174, at 477 n.43.

<sup>176</sup> Llewellyn intimated this when he wrote:

The building of rules of law is by its very nature based on classification. Sound and wise building of law calls for sound and wise classification of the problem-situations. Such classification makes for justice-in-result[.]

K. N. Llewellyn, Memorandum Replying to the Report and Memorandum of Task Group 1 of the Special Committee of the Commerce and Industry Association of New York, Inc. on the Uniform Commercial Code (Aug. 16, 1954), *reprinted in* 1 STATE OF N.Y. LAW REVISION COMM’N, *supra* note 153, at 108.

<sup>177</sup> See Llewellyn, *Through Title*, *supra* note 159, at 160.

manufacturers, wholesalers, and large and small retailers.<sup>178</sup> He also drew similar distinctions among buyers who are consumers, dealers, and industrial buyers for use.<sup>179</sup> These subcategories are consistent with Llewellyn's commercial law conceptualism and are best seen in his fixation on expanding the scope of the legally relevant in the underlying transaction.<sup>180</sup>

Why is it, therefore, in light of Llewellyn's concern for commercial reality, that Article 2 fails to differentiate among these various subcategories of buyers and sellers?<sup>181</sup> Whether this statutory neglect of distinctions is the result of Llewellyn's assessment of the politics of legal change, a fear that he might be slicing doctrine a bit too thin, or perhaps some other cause, we have no way of knowing.<sup>182</sup> Whichever may be the cause, nothing would suggest that, in some instances, sales law would not be improved by recognizing the need for different treatment for buyers and sellers.

Against this background, a reasonable assumption is that Llewellyn probably would have agreed that the adoption of a single, uniform market price standard in all section 2-713 actions should be rejected as too inflexible and simplistic to adequately address the compensation objectives of buyers for use and buyers for resale. The importance of the intended use of property in the determination of market price or value has for some time been the subject of heated debate in legal areas other than sales. Perhaps

<sup>178</sup> *Id.*

<sup>179</sup> *Id.* at 160-61.

<sup>180</sup> As Professor Wiseman notes:

The logic of Llewellyn's jurisprudence and his views on sales law would lead to many more distinctions than simply that of merchant and nonmerchant. For example, it would call for the recognition of the differences in the needs, practices, and expectations of a merchant buyer for use from those of a merchant buyer for resale, the differences of a manufacturer from a distributor, and so on. And the logic of Llewellyn's jurisprudence might also be seen to require distinguishing between an automobile merchant and a grain merchant. In fact, one of the three indexes to Llewellyn's casebook on Sales is an index by commodity.

Wiseman, *supra* note 174, at 506 n.183 (internal citation omitted).

<sup>181</sup> An implicit differentiation may on occasion result from Llewellyn's decision to make any applicable usage of trade a component part of the parties' agreement. For the Code's definition of "agreement," see U.C.C. § 1-201(b)(3) (2013).

<sup>182</sup> See Wiseman, *supra* note 174, at 506 n.183 (commenting on Llewellyn's failure to discuss these distinctions at any time during the drafting of Article 2, she states that "[w]hether it was pragmatic political wisdom or a decision that such discussion would carry atomization of legal rules too far is difficult to know"). We do know, however, that Llewellyn was resigned to the reality that many highly desirable legal changes would not work themselves into Article 2. Maybe he just tired of legal skirmishes. He once remarked that he was "ashamed of [the Code] in some ways; there are so many pieces that I could make a little better; there are so many beautiful ideas I tried to get in that would have been good for the law, but I was voted down." Karl Llewellyn, *Why a Commercial Code?*, 22 TENN. L. REV. 779, 784 (1953).

the most significant of these areas is the attempt to establish a use-theory of value for application in bankruptcy.

Valuations of property (both real and personal) occur in bankruptcy for reasons that are both too numerous and complex to detail here.<sup>183</sup> However, two examples should suffice to illustrate that the contexts in which these valuations are required are diverse and implicate numerous sections and chapters of the Bankruptcy Code. Consider first, relief from the automatic stay that goes into effect upon commencement of a bankruptcy case and stays all creditor actions against the debtor or property of the estate.<sup>184</sup> One ground for obtaining relief from the stay as it pertains to particular property is for a party in interest (e.g., a secured party) to establish that the “debtor does not have an equity in such property.”<sup>185</sup> It is impossible to determine whether the debtor has any “equity” in property unless one knows the property’s value.

A second example of when a valuation of property is necessary is when it comes time to classify the claim(s) of a secured creditor under section 506(a). That section states that a claim is secured to the extent of the collateral’s value and is unsecured as to any deficiency. Thus, an under-secured debt is split into a secured and unsecured claim, thereby reflecting the reality that the extent of a security interest is necessarily limited by the value of the collateral. Clearly, then, the court must value the collateral to determine the creditor’s cram down, voting and other rights that depend for their application upon whether a claim is secured or unsecured.<sup>186</sup>

Given the importance of assessing value in bankruptcy, a court is faced with the predicament of having to choose between competing valuation standards.<sup>187</sup> Up until 2005, the Bankruptcy Code was relatively silent on the issue. Its only guidance came from section 506(a), which stated that value “shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor’s interest.”<sup>188</sup> This statement and

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<sup>183</sup> For a list of some of these reasons, see David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63, 65-70 (1991).

<sup>184</sup> See 11 U.S.C. § 362(d) (2012).

<sup>185</sup> *Id.*

<sup>186</sup> Many of these rights are covered in Carlson, *supra* note 183, at 67-70.

<sup>187</sup> *Id.* at 64 (“Because valuations are not verifiable propositions, it is impossible to say as an objective matter whether valuation standards must adhere to ‘liquidation’ versus ‘going concern’ value, or between ‘use’ or ‘exchange’ value, or whether valuation should be *ex ante* or *ex post* transaction costs.”).

<sup>188</sup> 11 U.S.C. § 506(a).

its legislative history suggest that courts will have to determine the relevant valuation standard on a case-by-case basis and that a valuation at one time for one purpose would not be binding at a later time for another purpose.<sup>189</sup> Then, in 2005, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act, Congress added a new paragraph to section 506(a), which establishes that the applicable standard of valuation as to an individual debtor in a Chapter 7 or 13 shall be “replacement value.”<sup>190</sup>

Even if one grants the wisdom of the Court and Congress in setting the proper valuation standard for Chapters 7 and 13 individuals, it is simply implausible to believe that the serious ambiguity that surrounds the concept of value has been finally removed from bankruptcy practice. Difficulties remain with the analysis in those cases within the scope of section 506(a)(2),<sup>191</sup> but the problems are far greater when no statutory basis exists. Courts are faced with the choice of either liquidation or going concern value. In making this choice, courts have tended to associate the former value with liquidation cases and the latter value in reorganization cases.<sup>192</sup> Such an approach has the virtue of uniformity of application and is consistent with section 506(a), which requires consideration of how the property is being used.<sup>193</sup>

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<sup>189</sup> See S. REP. NO. 95-989, at 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854; H.R. REP. NO. 95-595, at 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312.

<sup>190</sup> Section 506(a)(2) reads as follows:

If the debtor is an individual in a case under chapter 7 or 13, [the value of] personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

11 U.S.C. § 506(a)(2). This section has as its source the Supreme Court’s decision in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997). In that case, the Chapter 13 debtors proposed to retain the collateral (a truck) for use in a freight-hauling business. Their Chapter 13 plan proposed to cram down the secured party by paying the present value of the collateral in 58 monthly installments. The debtors argued that the standard for valuing the truck should be foreclosure value. The Court disagreed and held that a replacement value applied.

<sup>191</sup> Section 506(a)(2) does not settle the valuation issue, since it says nothing as to the choice between replacement at retail cost, replacement at wholesale cost, or replacement at a cost indicated in a widely distributed publication of price quotations, such as Bluebook.

<sup>192</sup> See Carlson, *supra* note 183, at 76.

<sup>193</sup> See, e.g., *id.* (“Very frequently, courts choose going concern value in reorganization cases and choose liquidation value in liquidation cases.”); see also Isaac M. Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C. L. REV. 925, 939 (1980) (arguing that “[i]t is incongruous to value a business that is being reorganized on the basis of the price its assets could fetch on a

In the end, the valuation theorist must rest his claims on the idea that value is necessarily a function of the purpose of the exercise and the anticipated use of the property. Thus, it is of no small import that such a theorist recognize that if there is no fixed meaning of the term “value” generally, what reason is there to believe that there should be a unitary concept of “value” in the field of damages that fails to give effect to its purpose and the situation at hand. This translates to nothing more than making a determination of value relevant to practical concerns.

Returning to section 2-713, one question that has been uniformly ignored entails the market price component of its damages formula. The question is, which market? To answer this question, Comment 1 states that “[t]he general baseline adopted in [section 2-713] uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief.”<sup>194</sup> But this conventional market definition can lead to ambiguity and confusion when a contrast is drawn between two basic categories of buyers: there are those buyers who buy for use or consumption and those buyers who buy for resale. It is important to differentiate between these two categories. With regard to those buyers who purchase for use, not for sale, there is little reason to be skeptical of an approach that looks to the price in the relevant cover market. To the extent that section 2-713 is designed to reflect a hypothetical universe in which the buyer purchases substitute goods, there can be no other market that makes even remote sense.

Quite a different possibility emerges when the buyer is some sort of middleman who intends to resell the goods. The consequence of middleman status is that two markets compete for attention: there is the market in which the buyer buys and the market in which it resells. Assume for example, that the seller breaches a contract to supply goods at \$8,000 to a wholesaler or middleman buyer. The market price at the time the buyer learns of the breach, in the wholesale market in which he normally buys, is \$10,000. On that same date, the higher retail market price in the buyer’s selling market is \$15,000. All academic commentary and case law assumes that

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piecemeal liquidation when the entire theory of the reorganization is that the debtor is being preserved as a going concern”). Of course, as with any other legal proposition, there are those who would dissent from the commonly accepted wisdom. *See, e.g., In re T.H.B. Corp.*, 85 B.R. 192, 196 (Bankr. D. Mass. 1988) (noting that “[t]he fact that the debtor is a going concern is no reason to value the collateral under the going concern standard unless it appears likely that the secured party will actually receive that value from its collateral through a pending sale”).

<sup>194</sup> U.C.C. § 2-713, cmt. 1 (2013).

the relevant market price for purposes of section 2-713 is \$10,000 and asks whether the buyer should be permitted to recover a total of \$9,000 (consequential damages for the lost resale contract added to the buyer's market damages).<sup>195</sup> The standard answer to this question is that only consequential damages may be recovered.<sup>196</sup>

More subtly, we might realize that if the market price that matters for purposes of section 2-713 is the price at which the goods could be sold by the buyer, the preceding issue would no longer concern us. Even more subtly, this approach to market price would have the effect of transforming what are now perceived to be consequential damages recoverable under section 2-715 to general or direct damages recoverable under section 2-713.<sup>197</sup> By this process of redefinition, damage claims that were previously denied would potentially become

<sup>195</sup> Of course the claim for consequential damages assumes an inability to cover and that the loss was foreseeable by the seller at the time of contracting. See U.C.C. § 2-715.

<sup>196</sup> The following hypothetical (from which the above figures are borrowed) appears in a former edition of the White and Summers treatise is typical:

Assume for example, that a buyer sues wholesaler for nondelivery of a shipment of fiberglass skis [sic] under section 2-713. He might ask for the market-contract differential (assume it is \$10,000-\$8,000) plus consequential damages[,] which are lost resale profits. If he could resell the shipment of skis [sic] at \$15,000 but he cannot cover, his lost profits will be \$7,000 (\$15,000-\$8,000). Should a court allow a recovery of \$9,000 (the market-contract differential plus lost profits)? First, 2-715(2)(a) requires cover if it is at all reasonable, and that principle would eliminate profits in most cases. Secondly, in the unusual case where cover is impossible the court should award only \$7,000 since that amount will put the wholesaler in the same position he would have been in if the manufacturer had sent the skis [sic]. If a court gives the buyer the market-contract differential of \$2,000 under 2-713, then the "loss resulting" from the wholesaler's inability to resell under 2-715(2)(a) is only \$5,000.

JAMES J. WHITE & ROBERT S. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 394-95 n.91 (2d ed. 1980); see also Childres, *supra* note 2, at 843-44 ("When *B* cannot get the contract or comparable goods, may he then get the section 2-713, market price-contract price differential remedy or measure of damages? And may this come 'together with any . . . consequential damages . . .'? . . . Consequentials he should recover, within tolerable standards, but not 'together with' anything."). The same conclusion was reached in *M. K. Metals, Inc. v. Container Recovery Corp.*, 645 F.2d 583, 590-91 (8th Cir. 1981) (agreeing with White and Summers that the buyer should recover only lost profits because "to allow damages on both of appellant's theories would amount to double recovery").

<sup>197</sup> Although the distinction between consequential damages and general or direct damages can at times be muddled and difficult to draw, it seems clear enough that, at least under the Code, the latter category is encompassed by the formulae of sections 2-712, 2-713 and 2-714, and the former category results from losses that fall outside these sections and are not delineated as incidental damages under section 2-715(1). Lost profits on a contemplated resale is the most common type of economic-loss claim that is viewed as consequential damages. See, e.g., *Upjohn Co. v. Rachele Labs., Inc.* 661 F.2d 1105 (6th Cir. 1981).

recoverable today. The reasons for this are several, but one stands out as the most significant.<sup>198</sup>

Consequential damages within the scope of section 2-715(2) are limited to those “which could not reasonably be prevented by cover or otherwise.”<sup>199</sup> There is, however, no mitigation requirement that would bar a buyer from a recovery under section 2-713 merely because she decided not to take advantage of an available cover option.<sup>200</sup> Therefore, a court inclined to take the approach suggested here to the determination of market price might well give an aggrieved buyer its consequential damages without regard to whether the lost profit could have been minimized by reasonable steps taken to replace the promised goods.

This idea, that lost resale profits should be measured through the medium of market price, not only tends to bring the buyer closer to full compensation, it avoids what may be a number of potentially difficult issues. Gone would be the need to determine and allocate overhead expenses that would otherwise have to be deducted from the anticipated resale price if the buyer seeks his expected profit directly under section 2-715(2). Gone, too, would be the issues of whether there was a replacement market for the goods and whether it would have made good sense for the buyer to enter into that market.

These practical benefits aside, it is simply implausible to maintain that an award of damages based on the difference between a hypothetical cover price and the contract price is not

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<sup>198</sup> For losses that fall outside the sections that govern general damage, section 2-715(2)(a) limits liability by requiring general or particular requirements or needs of the buyer that the seller had reason to know of at the time of contracting. Recovery of lost profits under the rubric of section 2-713 would not require such a showing. However, such a change in statutory focus is unlikely to alter the outcome of many cases. Presumably, “a seller of a commodity to a wholesaler usually has reason to foresee that his failure to deliver the commodity as agreed will probably cause the wholesaler to lose a reasonable profit on it.” RESTATEMENT (SECOND) OF CONTRACTS § 351 cmt. b (1981). A “foreseeability” test would, therefore, in this situation, have little effect.

Recovery under section 2-713 might also make inapplicable a generally worded clause limiting or excluding consequential damages under section 2-719(3). However, one suspects that this consequence of shifting the buyer’s recovery from section 2-715 to section 2-713 would be short-lived. Sellers would soon learn to redraft clauses to address this change.

<sup>199</sup> U.C.C. § 2-715(2)(a).

<sup>200</sup> Professor Wallach explains as follows:

An expectation interest, traditionally labeled the “benefit of the bargain,” is created once a contract has been formed. The buyer is entitled to the benefit of that expectation, even if he chooses not to pursue the goods with which that expectation is associated once the seller has repudiated the contract and failed to deliver conforming goods.



in reality a recovery for lost profits. If the relevant market price for purposes of section 2-713 is the cost of cover, then the wholesale buyer is forced to recover one component of its lost profit under that section and the remainder of its lost profit under section 2-715(2)(a). Ultimately, a switch to resale market price under section 2-713 eliminates this bifurcated recovery and assigns to one section the task of dealing with two parts of a total loss that share a common essence.<sup>201</sup>

## CONCLUSION

A major assumption exists in the economic and contracts literature that when one party breaches a contract, the normal remedy of expectation damages will be sufficient to place the aggrieved party in as good a position as it would have been in if the contract had been performed. That is, the aggrieved party's expectations ("the benefit of its bargain") are both a ceiling, above which damages should not be awarded, and a floor, which sets the minimum that the injured party should receive. One purpose of this article has been to debunk the validity and universality of this assumption. Given the real-world transactions costs associated with enforcing contractual obligations and the numerous legal limitations on damage recoveries, routine undercompensation is the likely norm.

Why does a proper understanding of the myth and the reality of the contracts compensation system matter? This article has attempted to show that there are several significant consequences that follow from a full appreciation of the fundamental gulf between the harm caused by a person who breaks her promise and the compensation received by her victim. First, on the theoretical level, debunking the compensation myth forces a reconsideration of the fundamental premise underlying the theory of "efficient breach" and the extent to which allocative efficiency is achieved by contract law. Second, on a practical level, the insights offered in this article raise questions about the present legal approaches to the assessment of market-based damages under Article 2 of the U.C.C.—approaches that seem to concentrate on the risk of

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<sup>201</sup> It is for this reason that the conclusion reached herein regarding the question of mitigation should not necessarily apply when recovery is sought under section 2-715(2)(a) for a loss that does not share the essence of market-based damages. Because the buyer in essence owns the right to the seller's performance and the right to profit from the fluctuation of market price or market price arbitrage, no attempt at mitigation should be required.

overcompensation and give little recognition to administrative efficiency and other remedial values.

In presenting a more realistic understanding of compensation to the application of U.C.C. section 2-713, in particular to those issues that bear on the buyer's right to choose this measure of damages, this article hopes to promote a more nuanced and better integrated perception of these issues. To the extent that current judicial solutions to many of the section 2-713 issues stem from misperception of the compensation system, and to the extent that the misperception can be corrected, it is hoped that the change in perception discussed here will lead to a change in the application of some of the Code's remedial provisions.