UCC Article 2, s. 2-708

Suppose a contract for sale of a widget (the "Widget") for a price of $1000 between Buyer and Seller. Further, suppose that it costs Seller $800 to manufacture the Widget. All other widgets (which are identical) similarly cost $800 to manufacture. Seller expects to make a profit of $200 on the sale of Widget to Buyer.

Case 1: Base Case

Buyer fails to take delivery of Widget, breaching the contract. Suppose that, at the time and place of the breach, the market price for that Widget is $1000. On these facts, the damage formula in s. 2-708(1) produces $0 in damages for Seller.

> Section 2-708(1):
>
> (1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender **[$1000]** and the unpaid contract price **[$1000]** together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.
>
> **UCP minus MP = MoD | $1000 - $1000 = $0**

Seller may, however, seek a damage recovery under s. 2-708(2) if Seller can show that the calculation in s. 2-708(1) is inadequate. When might this damage calculation amount be an inadequate measure of damages? Here, we will consider two cases: the case of a breach of a contract to purchase a standard good from a volume seller of standard goods; and, the anticipatory repudiation of a contract for a single specially manufactured good.

Case 2: Volume Seller Case

Suppose that Seller manufactures and sells a large volume of widgets each month: assume sales average 100 units per month. In the month in which Buyer breaches by failing to take delivery of the Widget, Seller's total sales of widgets falls to 99 units. In this scenario, it appears that the breach damaged Seller in the amount of $200—the amount of the profit on the lost sale. This is true because, but for the breach, Seller would have made a total profit on widget sales of $20,000. When the sale to Buyer was lost, the total profit on widget sales that month was reduced to $19,800.

Now, in a case such as this, it would be typical for Seller to resell the Widget because the Widget would be returned to the general inventory of widgets. Damages computed for a resale are calculated under s. 2-706. Assume a qualifying resale at the market price of $1000. There would be no damages based on the resale formula in s. 2-706. On these facts, Seller is indifferent between the formula in s. 2-708(1) and the formula under s. 2-706 because, in either case, damages are $0. Note that a calculation under s. 2-706 has the disadvantage of not containing an express alternative (as found in s. 2-708(2)) to recover lost profits.

Case 3: Single Good Contrast this lost volume situation with a case in which Seller has only a single specially made widget to sell each month. If, pursuant to s. 2-706, Seller is able to resell the Widget for $1000 when only Widget is available for sale (and no other widgets), Seller is compensated fully because no profit is lost. If only a single widget sale can take place, it does not matter whether that sale is to Buyer or to another substituted person. And, the damage formula in s. 2-708(1) gives the same result

(assuming a market price for the Widget of $1000). The case of the single widget would not be a case in which the formula in s. 2-708(1) was inadequate; there is no justification to resort to s. 2-708(2).

Given the above, in any particular case, a court must decide whether it is confronted with a lost volume seller situation as in Case 2, or with a single good type situation, as in Case 3.

> Professor Robert Harris, an early writer on the topic, captured the lost volume seller phenomenon in a definition which, with some modification, has been adopted by the majority of courts and commentators. Harris proposed that a seller who resells finished goods could qualify as a "lost volume seller" only if three conditions were satisfied: "(1) the person who bought the resold entity would have been solicited by plaintiff had there been no breach and resale; (2) the solicitation would have been successful; and (3) the plaintiff could have performed that additional contract." In essence, this definition requires the would-be lost volume seller to prove that sufficient demand existed such that she would have sold the equivalent of the contract goods to the resale purchaser in any event, and that she had the physical capacity to satisfy both contracts, either by manufacturing more goods or acquiring them from a supplier. The breach by the original buyer cannot have made performance of the resale contract possible. If this were the case -- if the buyer's repudiation enabled the seller to satisfy the resale buyer -- the seller did not really lose volume. The seller has simply substituted one sale for another, as the resale is a perfect replacement for the original contract.
>
> J. Breen, THE LOST VOLUME SELLER AND LOST PROFITS UNDER U.C.C. S 2-708(2): A CONCEPTUAL AND LINGUISTIC CRITIQUE, 50 U. Miami. L. Rev. 779, 794 (1996).

In addition to the conditions suggested by Professor Harris, courts and commentators have subsequently suggested a fourth criteria—that the seller must show that the additional sale would have been a profitable one. Id. at 796 and note 63.

The comparison of Case 2 with Case 3 illustrates the theory of when to award lost profits in a volume seller case. Prof. Breen's article explains how courts approach the question of whether or not a volume seller situation exists. You will sometimes hear a court or a commentator suggest that a volume seller situation exists when a Seller has an infinite or inexhaustible supply of inventory. This may be fine as a shorthand way of conveying the idea, but the real test is less stringent: did Seller have the excess capacity to make one additional sale.

Case law has firmly established that s. 2-708(2) allows for recovery of lost profit to a volume seller (though below it will be explained why this conclusion is problematic). See Neri v. Retail Marine Corp., 285 N.E.2d 311 (N.Y. 1972).

Quite apart from a lost volume seller case, the situation of partially completed goods provides another example in which lost profits might be awarded under s. 2-708(2).

Case 4: Incomplete Goods Case

Suppose a contract for sale of a widget (the "Widget") for $1000 between Buyer and Seller. Further suppose that it costs Seller $800 to manufacture the Widget. Seller expects to make a profit of $200 on this sale. Buyer tells Seller, in an anticipatory breach, to stop making the Widget at a time when Seller has incurred $600 in labor and materials on manufacturing the Widget. Consistent with the mitigation principle, Seller stops work. Seller is able to sell the partially completed Widget as scrap for $500. Suppose the market price for a comparable widget at the time and place for delivery has fallen to $900.

Under the damage formula in s. 2-708(1), Seller's damages would seem to be as follows: $100 (for the decline in market price) reduced by a credit of $200 for the savings realized by not completing the

Widget—i.e. no damages at all. Indeed, the formula makes it appear that Seller is better off due to the breach.

> Section 2-708(1):
>
> (1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender **[$900]** and the unpaid contract price **[$1000]** together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach **[$200]**.
>
> **[[UCP $1000 minus MP $900 = $100] minus ES $200 = --$100]**

Thus, the formula produces a result at odds with commercial reality by suggesting that Seller was better off by the breach.

Seller is, in fact, not better off. Seller lost a profit of $200 on the missed sale of the Widget. Further, Seller lost $100 on its sale of the partially completed Widget. The alternate calculation in s. 2-708(2) appears to make Seller whole. The calculation follows the wording of the statute:

> (2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer **[+$200]**, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred **[+$600]** and due credit for payments or proceeds of resale**[[--$500] = $300]**.

There is some doubt over whether Seller would even be entitled to use the damage formula in s. 2-708(1) with a partially completed Widget. Arguably, Seller should be entitled to market damages only if it was ready, willing and able to perform in the market by selling a completed Widget. This Seller could not do.

In the partially completed Widget scenario, Seller could not avail itself of s. 2-706 because Seller does not have a completed product to sell to another party. Similarly, Seller could not use s. 2-709 because that requires a failure to pay for the goods when due—and here that did not happen because of the anticipatory repudiation. Moreover, Seller must be able to deliver Widget to Buyer IF, pursuant to an action for the price, Buyer pays the price. There is a sale of scrap (which resulted in a loss), and no sale of an actual widget which results in a profit.

<u>Criticism of Awarding Lost Profits to a Volume Seller</u>

Some have criticized allowing a lost profit recovery under s. 2-708(2) for a "lost volume" seller. The first criticism is that allowing a recovery for lost profits for a lost volume seller allows a double recovery: the profit made on the resale and the "lost profit" from the breaching Buyer. Critics point out that Article 2 nowhere allows for the recovery of two profits from a sale of a single good. Comment 2 to s. 2-708(2) simply says:

> This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer.

In essence, the critics argue that, although the case law has determined that an "appropriate case" for lost profit recovery is a volume seller case, the language of the statute and Comment 2 neither limit

recovery of lost profits to volume seller cases nor sanction their award to lost volume sellers. The apparent double recovery seems at odds with the spirit of the mitigation principle.

Second, critics argue that the language of s. 2-708(2) itself presents a difficulty: while it awards lost profits in an "appropriate case", it also seems to require further adjustments which actually deny a double recovery in a lost volume seller case:

> Section 2-708(2):
>
> If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), **due allowance for costs reasonably incurred and due credit for payments or proceeds of resale**.

Critics of allowing the recovery of a lost profit in addition to the profit on the resale point out that the language of subpart (2) should deny the double recovery because due credit should be given for the payments or proceeds of resale. The way proponents of the "lost volume seller" attempt to address this problem with the statutory language is to suggest that the reference to payments or proceeds of resale should either be ignored or be limited to an anticipatory repudiation in an incomplete goods case (where the partially completed goods are sold for scrap).

Third, critics point out various conceptually odd results. Suppose that Buyer does not want the Widget. However, instead of breaching the contract, Buyer simply takes delivery of the Widget, pays for it and then resells Widget to a third party. In this alternative scenario, Seller does not obtain a double recovery. Why should it make a difference in outcome whether Buyer or Seller found the replacement purchaser for Widget?

Fourth, critics argue that the structure of Article 2 contemplates the primary seller remedy will be the resale of goods pursuant to s. 2-706. For example, note that Comment 2 to s. 2-706 suggests that s. 2-708 is used only when the circumstances for application of s. 2-706 have failed:

> Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him or her to that provided in section 2-708.

Allowing for a lost volume seller recovery under s. 2-708(2) has the effect of making this later section the primary avenue for recovery of damages by a seller, and not one to which the seller is merely "relegated."

Lastly, critics argue that, as a matter of economic theory, it is both difficult to identify a true lost volume seller situation and, if identified, to value the loss from the missed sale. For example, economic theory suggests a higher cost to manufacture the extra widget for sale, thus reducing the lost profit on the missed sale. The result is that awarding lost profits in a volume seller situation systematically overcompensate a seller for the buyer's breach. Some courts and commentators have tried to address this economic concern by suggesting that a seller must also show that its additional sale would be profitable (as noted above).

For these reasons, critics oppose the award of lost profits in a volume seller situation despite its almost universal endorsement by courts.