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## Should The Doctrine of Lost Volume Seller Be Retained? A Response to Professor Breen

Daniel W. Matthews

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# COMMENT

## Should The Doctrine of Lost Volume Seller Be Retained? A Response to Professor Breen

DANIEL W. MATTHEWS\*

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### I. INTRODUCTION

Damages to be awarded to a lost volume seller have been the subject of much debate. The question has periodically been wrestled with both judicially and academically. Differences of opinion focus on the proper measure of a volume seller's expectation interest, if such an interest exists, and whether damages should be based on some calculus of lost profit or market damages. Despite the attempt to codify and harmonize the Law Merchant, the law of sales under the Uniform Sales Act, the Uniform Commercial Code, and the collective understanding of those engaged in commerce, the debate over the proper measure of the seller's expectation interest has continued. In many instances, the con-

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tract price and market price differ to the extent that market-measured damages are sufficient to compensate the aggrieved seller.<sup>1</sup> However, in other instances, particularly in the case of fixed price goods, the contract price and market price may differ little or not at all. Using the market differential formula to calculate damages, the lack of disparity leaves the seller with nominal or no damages upon the buyer's breach.<sup>2</sup> So the debate ensues as to whether such a seller should be awarded lost profits in order to fulfill his expectation interest. One of the most discussed problems within this issue is that of the "lost volume seller."

Simply defined, a lost volume seller is one whose supply is, as a practical matter, unlimited in comparison to the demand for the product.<sup>3</sup> The problem arises where, upon the buyer's breach, the lost volume seller resells the goods intended for the first buyer to another buyer. The basis of the lost volume seller's claim is that but-for the buyer's breach, the seller could have realized a second sale, and earned an additional profit. Pursuant to the lost volume theory, the seller is permitted to claim lost profits unreduced by any profit made on the turnaround sale.

An obstacle to the permanent implantation of this doctrine is the literal and possibly uninformed reading of UCC § 2-708(2). Under section 2-708(2), a seller may seek lost profits from a breaching buyer so long as the market differential is inadequate to place the seller in the position he would have been had the original contract been performed.<sup>4</sup> The lost volume controversy centers upon the last clause of section 2-

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1. See U.C.C. § 2-708(1) (1994).

2. WILLIAM H. HENNING & GEORGE I. WALLACH, *THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE* ¶ 8.05[1][a] (1992).

3. See JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* §14-23, at 627 (3d ed. 1987). Defining a lost volume seller is an enormous debate in and of itself. Some commentators try to define a lost volume seller as simply a seller whose supply exceeds its demand such that the seller could have supplied both buyers. See, e.g., ROBERT A. HILMAN, ET AL., *COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE* ¶ 9.03[4], at 9-27 (1985). Others have added to this definition, stating that in order for a seller to have lost volume, he must show that the second sale would have been profitable. See *R.E. Davis Chem. Corp. v. Diasonics, Inc.*, 826 F.2d 678, 684 (7th Cir. 1987).

The "unlimited" supply requirement has troubled some commentators because no supplier literally has an unlimited supply of goods. See Comment, *A Theoretical Postscript: Microeconomics and the Lost-Volume Seller*, 24 CASE W. RES. L. REV. 712, 717 (1973). While I recognize that every seller's supply must necessarily be finite, I do not mean unlimited in a literal sense. Rather, when I say "unlimited," I mean "virtually unlimited."

4. U.C.C. § 2-708(2) (1994). This section reads:

If [market damages are] 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 . . . [with] due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

708(2), which obligates the seller to give "due credit for the payment and proceeds of resale" to the buyer.<sup>5</sup> If the lost volume seller resells the goods for the same price, the "due credit" language has been argued to preclude the seller from realizing two profits. However, notwithstanding the "due credit" language,<sup>6</sup> the lost volume seller concept has been overwhelmingly endorsed by commentators, beginning with a series of articles written by Professor Robert Harris in the early 1960s.<sup>7</sup> Brushing aside the "due credit" language as a drafting error, some proponents of the lost volume seller have thereby reconstrued section 2-708(2) to ignore the "due credit" language to specifically address the lost volume seller.<sup>8</sup>

Since 1972,<sup>9</sup> the courts have likewise embraced the lost volume concept by regularly and repeatedly awarding lost profits to volume sellers under section 2-708(2) despite the "due credit" language.<sup>10</sup> So over-

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5. *Id.*

6. See, e.g., 1 ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS §§ 2.6-9 (4th ed. 1992); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE §§ 7-9 to 7-10, 7-13 to 7-14 (4th ed. 1995); Roy Ryden Anderson, *Damages for Sellers Under the Code's Profit Formula*, 40 SW. L.J. 1021 (1986); Robert Childres & Robert K. Burgess, *Seller's Remedies: The Primacy of UCC 2-708(2)*, 48 N.Y.U. L. REV. 833 (1973); William L. Schlosser, *Construing UCC Section 2-708(2) to Apply to the Lost-Volume Seller*, 24 CASE W. RES. L. REV. 686 (1973) [hereinafter Schlosser, *Construing*]; William L. Schlosser, *Damages for the Lost-Volume Seller: Does an Efficient Formula Already Exist?*, 17 UCC L.J. 238 (1985) [hereinafter Schlosser, *Efficient Formula*]; John A. Seibert, Jr., *Remedies Under Article Two of the Uniform Commercial Code: An Agenda for Review*, 130 U. PA. L. REV. 360 (1981); Note, *Seller's Recovery of Lost Profits for Breach of a Sales Contract: Uniform Commercial Code Section 2-708(2)*, 11 WM. MITCHELL L. REV. 227 (1985). For commentary on the economics of the lost volume seller, see, e.g., Charles J. Goetz & Robert E. Scott, *Measuring Sellers' Damages: The Lost-Profits Puzzle*, 31 STAN. L. REV. 323 (1979); Victor P. Goldberg, *An Economic Analysis of the Lost-Volume Retail Seller*, 57 S. CAL. L. REV. 283 (1984); Comment, *A Theoretical Postscript: Microeconomics and the Lost-Volume Seller*, 24 CASE W. RES. L. REV. 712 (1973).

7. See Robert J. Harris, *A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared*, 18 STAN. L. REV. 66 (1965) [hereinafter Harris, *Seller's Damages*]; Robert J. Harris, *A General Theory for Measuring Seller's Damages for Total Breach of Contract*, 60 MICH. L. REV. 577 (1962); Robert J. Harris, *A Radical Restatement of the Law of Seller's Damages: Michigan Results Compared*, 61 MICH. L. REV. 849 (1963); Robert J. Harris, *A Radical Restatement of the Law of Seller's Damages: New York Results Compared*, 34 FORDHAM L. REV. 23 (1965); Robert J. Harris & Kenneth Graham, *A Radical Restatement of the Law of Seller's Damages: California Results Compared*, 18 STAN. L. REV. 553 (1966).

8. WHITE & SUMMERS, *supra* note 6, § 7-13, at 274-76.

9. See *Neri v. Retail Marine Corp.*, 285 N.E.2d 311 (N.Y. 1972).

10. See, e.g., *R.E. Davis Chem. Corp.*, 924 F.2d at 683; *Tri-State Petroleum Corp. v. Saber Energy, Inc.*, 845 F.2d 575, 580-81 (5th Cir. 1988); *Islamic Republic of Iran v. Boeing Co.*, 771 F.2d 1279, 1290 (9th Cir. 1985), *cert. dismissed*, 479 U.S. 957 (1986); *Teradyne, Inc. v. Teledyne Indus., Inc.*, 676 F.2d 865, 868-70 (1st Cir. 1982); *TCP Indus., Inc. v. Uniroyal, Inc.*, 661 F.2d 542 (6th Cir. 1981); *Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp.*, 466 F. Supp. 846 (E.D.N.Y.), *aff'd*, 614 F.2d 1289 (2d Cir. 1979); *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F.2d 251, 253-54 (4th Cir. 1974); *Comeq, Inc. v. Mitternacht Boiler Works, Inc.*, 456 So. 2d 264, 267-69 (Ala. 1984); *Autonumerics, Inc. v. Bayer Indus., Inc.*, 696 P.2d 1330, 1339-40 (Ariz. Ct. App. 1984); *National Controls, Inc. v. Commodore Business Machines, Inc.*, 209 Cal. Rptr.

whelming was the support for the lost volume seller that the issue of whether the lost volume seller should or should not receive lost profits seemed to be conclusively settled for over two decades.<sup>11</sup> In fact, most of the commentary and litigation on the lost volume issue in the past decade has centered not on whether the lost volume concept should exist, but rather upon the proper formula or measure of damages once the seller has been identified as a lost volume seller.<sup>12</sup>

Following years of dormancy, Professor John Breen recently resurrected the lost volume conceptual debate in an article wherein he swings a hefty academic attack on the lost volume seller doctrine and its attendant award of two profits.<sup>13</sup> In Professor Breen's view, the "due credit" language of section 2-708(2) should be read literally.<sup>14</sup> In support of his proposition, Professor Breen argues that the UCC's drafters included the "due credit" language specifically to preclude lost volume claims.<sup>15</sup> While Professor Breen admits that the lost volume concept may at first blush appear commonsensical, he nonetheless contends that a thorough analysis shows that the lost volume concept is flawed and repugnant to the rule of expectancy damages in that it overcompensates the seller.<sup>16</sup> My analysis is in response to Professor Breen's invitation to reexamine the lost volume debate. I respectfully dissent.

I take the position that the drafters did not say credit for the payments and proceeds of resale, but "due credit." In other words, "due credit" relates to "proper credit." That is, costs incurred in a sale saved by breach should be incorporated into the calculus of determining lost profit. Salvage value is one such cost. In other words, damages should reflect fair due credit to the breaching buyer as well as fair recovery for the seller. Having committed no wrong, the seller has had his lawfully contracted for profit wrongfully denied. It is the breach in the context of contractual rights and wrongs into which the law steps. In the philosophical approach of the Code, the law should fashion a remedy which puts the aggrieved party in as good a position as if the breaching party had performed.<sup>17</sup>

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636 (Cal. Ct. App. 1985); *Snyder v. Herbert Greenbaum and Assoc., Inc.*, 380 A.2d 618, 624-27 (Md. Ct. Spec. App. 1977).

11. Prior to 1996, the last commentary to seriously attack the validity of the lost volume seller occurred in 1973. See Morris G. Shanker, *The Case for a Literal Reading of UCC Section 2-708(2) (One Profit for the Reseller)*, 24 CASE W. RES. L. REV. 697 (1973).

12. See, e.g., Schlosser, *Efficient Formula*, *supra* note 6, at 244-61.

13. John M. Breen, *The Lost Volume Seller and Lost Profits Under U.C.C. § 2-708(2): A Conceptual and Linguistic Critique*, 50 U. MIAMI L. REV. 779 (1996).

14. Breen, *supra* note 13, at 786-89.

15. *Id.* at 844-46.

16. *Id.* at 785-86, 827-30.

17. U.C.C. § 1-106(1) (1994). Section 1-106(1) instructs courts that remedies "shall be

Like Professor Breen, I wish to read the Code literally and consistent with the realistic commercial milieu in which it was forged. Had the drafters intended to credit the breaching buyer with the proceeds of the aggrieved seller's resale, it is my position that they would have said so. Instead, the drafters spoke of "due credit," meaning credit given as appropriate under the factual circumstances. Hence, the various remedies available under the Code are all guided by the principle of fair remediation set down in UCC § 1-106's admonition to construe the law toward the end of putting aggrieved parties in as good a position as if there had been no breach.

The purpose of this article is to accept Professor Breen's offer to reopen the discussion of the lost volume seller started by Professor Harris over thirty years ago, and to close it. This article discusses both the etiology of the lost volume doctrine and whether the doctrine is conceptually valid. At the same time, this article addresses and responds to the questions and issues raised by Professor Breen's article. In particular, this article examines whether the lost volume seller suffers the economic harm of a lost profit to which the seller is entitled. Determining the calculation of damages is an accounting issue and beyond the scope of this article.

Part I of this article focuses on the Pre-Code case law that addressed lost volume cases with either common law principles or using the Uniform Sales Act. Part II of the article examines and discusses the legislative and drafting history behind section 2-708(2). Finally, Part III determines whether the lost volume doctrine is a rational, conceptually sound concept consistent with fairness and reasonable commercial expectancies.

## II. LOST VOLUME CASES AT COMMON LAW AND UNDER THE UNIFORM SALES ACT

### A. *The "Preference" for Market Measured Damages: Does It Exist?*

Since Professor Harris coined the term "lost volume seller" over thirty years ago, several commentators have written on the subject, the overwhelming majority of whom have written in its favor.<sup>18</sup> Surprisingly, in every article concerning lost volume, there has been very little discourse concerning the treatment of lost volume claims at common law and under the Uniform Sales Act. The discussion that has taken

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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 . . . " *Id.*

18. See *supra* note 7 and accompanying text.

place has been brief and often superficial.<sup>19</sup> Conclusions concerning the common law position have been inconsistent, with some claiming that the majority rule was to grant lost profits to lost volume sellers.<sup>20</sup> Conversely, others have argued that the majority of cases clearly denied lost profits to would be volume sellers.<sup>21</sup> Professor Breen, an advocate of this latter view, states that common law courts routinely denied lost profits to sellers, thereby limiting a seller's damages to the contract-market differential.<sup>22</sup> Furthermore, Professor Breen maintains that lost profit damages were so rare and unusual at common law that the lost volume concept could not have been the common law majority rule.<sup>23</sup>

While the majority of reported cases may have indicated a preference for market damages over lost profit, such a fact is irrelevant to the concept of the lost volume seller. In today's era of recognition and endorsement of the lost volume seller, the majority of courts still prefer market damages for sellers where appropriate.<sup>24</sup> This is true given that few sellers are able to meet the burden of proving lost volume seller status.<sup>25</sup> Therefore, the argument over whether common law courts preferred market damages over lost profits is not relevant to the issue being examined here. Instead, the argument should focus on the common law view pertaining to sellers who are lost volume sellers, not sellers in general.

As to the common law majority rule with regard to sellers who are lost volume sellers, Professor Breen claims that the common law courts rejected the two profit argument and preferred to award market damages instead.<sup>26</sup> An examination of the cases cited by Professor Breen reveals that while the cases strictly adhered to the market damages general rule,

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19. See, e.g., Goetz & Scott, *supra* note 6, at 330 (stating that common law courts were skeptical of lost volume claims and thus preferred market measured damages); Anderson, *supra* note 6, at 1025 (noting that the profit remedy was rarely applied at common law).

20. See, e.g., 1 DUNN, *supra* note 6, § 2.9, at 102 ("Even cases under the Uniform Sales Act and prior common law consistently permitted recovery of lost profits damages when a buyer from a reseller breached the contract of sale"); Schlosser, *Construing*, *supra* note 6, at 686-87 (citing Professor Corbin for the proposition that pre-Code contract law applied the lost volume concept).

21. See, e.g., Breen, *supra* note 13, at 856-57; Goetz & Scott, *supra* note 6, at 330.

22. Breen, *supra* note 13, at 856-57.

23. *Id.* at 856-57, 862.

24. 3 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES, § 2-708:04 (1994) (stating that market damages "usually will result in a recovery that equals the value of the seller's bargain").

25. See generally E. ALLAN FARNSWORTH, CONTRACTS § 12.10, at 890 & n.19 (1990). Professor Farnsworth notes that some suppliers attempt to reach an optimal volume whereby they will not enter additional contracts once this optimal volume is achieved. *Id.* For this reason, Professor Farnsworth notes that courts place the burden of proving lost volume on the aggrieved seller. *Id.* (citations omitted).

26. Breen, *supra* note 13, at 862 & n.341.

the sellers in the cases are not in fact lost volume sellers.<sup>27</sup> I am, therefore, left unconvinced by Professor Breen's assertion that the lost volume doctrine flies in the face of establishing common law principles.

### B. Instances Where "Due Credit" was Given at Common Law

The discussion as to whether the proper measure of a seller's damages should be market measured or lost profit is of questionable significance. Arguably, the origin of the "due credit" may not pertain to the proper measure of damages, rather reflecting the drafters' concern over mitigation and the doctrine of avoidable consequences. The common law rule concerning substituted contracts was very simple. As a general rule, the injured party must deduct from his damages—give due credit to the breaching party—the gains made from subsequent contracts after breach.<sup>28</sup> This general rule, however, was subject to one very important exception and qualification. If the substituted contract would have been entered into regardless of the breach, then "due credit" for the second transaction should not be considered.<sup>29</sup> This rule was promulgated in the first Restatement of Contracts, which states that "[g]ains made by the

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27. See *id.* The first case cited by Professor Breen for his proposition, *W.R. Grace & Co. v. Nagle*, 275 F. 343 (2d Cir. 1921), involved a contract whereby the plaintiff agreed to turn steel slabs provided by the defendant into steel plates, and once finished, the plaintiff would sell the steel plates back to the defendant. Upon the defendant's failure to supply the remaining 400 slabs to the plaintiff for processing, the plaintiff sued. The Second Circuit awarded the plaintiff damages based on the contract-market differential. Because the defendant was the supplier of the slabs, the plaintiff did not have an unlimited supply of slabs to process into plates. Therefore, the plaintiff could not be a lost volume seller. Accordingly, Professor Breen's reliance upon the case is misplaced, as is his citation to *Garfield & Proctor Coal Co. v. New York, N. H. & H. R. Co.*, 143 N.E. 312 (Mass. 1924), which dealt with the issue of whether the seller should be limited to lost profits when the anticipated profits were considerably lower than the contract-market differential. This case is immaterial, since if market damages are adequate, the issue of lost profits is no longer an issue. The entire lost volume concept is premised on the fact that market damages for a volume seller are inadequate.

A third case cited for Professor Breen's position, *Kincaid v. Price*, 70 P. 153 (Colo. Ct. App. 1902), dealt with a buyer's breach of an output contract with the seller. To declare that a seller who contracts to sell his entire output is a potential lost volume seller is absurd. Because the seller's entire output is to go to the buyer, the seller *a fortiori* cannot qualify for the lost volume seller's unlimited supply requirement.

In two other cases cited by Breen, *Centennial Electric Co. v. Morse*, 116 N.E. 901 (Mass. 1917), and *Frederick v. Willoughby*, 116 S.W. 1109 (Mo. Ct. App. 1909), nothing in the facts show that either seller had a supply of goods greater than the demand for the product. The remaining cases are all automobile cases, which, along with the industry, speak for themselves. See *Charles St. Garage Co. v. Kaplan*, 45 N.E.2d 928 (Mass. 1942); *Babbitt v. Wides Motor Sales Corp.*, 192 N.Y.S.2d 21 (N.Y. App. Term 1959); *Lowas Garage Co. v. Scheer*, 199 N.Y.S. 748 (App. Term 1923); *Varley v. Belford*, 156 N.Y.S. 597 (App. Term 1916).

28. See generally RESTATEMENT OF CONTRACTS § 336 cmt. c (1932); RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. f, § 350 cmt. d (1981); 5 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1039, at 246-47, § 1041, at 256-60, § 1100, at 541-42 (1964).

29. See *id.*



injured party on other transactions after breach are never to be deducted from the damages that are otherwise recoverable unless such gains could not have been made had there been no breach."<sup>30</sup> Such a maxim was applicable to all types of contracts, including employment contracts,<sup>31</sup> construction contracts,<sup>32</sup> leases,<sup>33</sup> franchise agreements,<sup>34</sup> as well as sales. With regard to sales, the Restatement specifically adopts and endorses the lost volume concept by stating:

[s]pecific goods cannot be sold twice; therefore their market value obtainable on another sale is deducted. But manufacturing facilities can usually be expanded to meet all demands; therefore profit made on the manufacture and sale of a second article is not deducted. And the same is true in the case of a contract to sell a non-specific article, of which the supply in the market is not limited.<sup>35</sup>

Case law supports the Restatement's position. In fact, when faced with lost volume seller situations, common law courts and courts interpreting the Uniform Sales Act repeatedly cited the Restatement in awarding profits to volume sellers. For example, in *Wilhelm Lubrication Co. v. Bratrud*,<sup>36</sup> the Minnesota Supreme Court considered whether the plaintiff-seller's damages should be reduced by a subsequent contract to sell the subject matter goods to another buyer. Noting that the seller had a large supply of goods and many contracts similar to the one in the case, the court held that the subsequent sale of the goods was irrelevant to the seller's damages.<sup>37</sup> The court reasoned that the buyer's breach "merely mean[t] the loss of one sale and the profit that plaintiff would have received thereby."<sup>38</sup>

Likewise, in *Mossy Motors v. McRedmond*,<sup>39</sup> the Court of Appeal of Louisiana recognized the limits of the general rule that the subsequent

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30. RESTATEMENT OF CONTRACTS § 336 cmt. c (1932). See also 5 CORBIN, *supra* note 28, § 1041, at 256.

31. See *Canton-Hughes Pump Co. v. Llera*, 205 F. 209 (6th Cir. 1913); *Benziger v. Miller*, 50 Ala. 206 (1873); *Palm v. Planada Dev. Corp.*, 167 P. 381 (Cal. 1917); *Perry v. Simpson Waterproof Mfg. Co.*, 37 Conn. 520 (1871); *Maynard v. Royal Worcester Corset Co.*, 85 N.E. 877 (Mass. 1908); *Howard v. Daly*, 61 N.Y. 362 (1875). But see *Farmers' Fertilizer Co. v. Lillie*, 18 F.2d 197 (6th Cir. 1927) (holding that no credit should be given for second contract where the employee has been wrongfully discharged).

32. See *Ross v. Columbus Mining Co.*, 264 S.W. 1071 (Ky. 1924); *Sides v. Contemporary Homes, Inc.*, 311 S.W.2d 117 (Mo. Ct. App. 1958). See also *Grinnell Co. v. Voorhees*, 1 F.2d 693 (3d Cir. 1924) (applying the common law rule but arguably making the wrong decision).

33. See *Locks v. Wade*, 114 A.2d 875 (N.J. Super. Ct. App. Div. 1955).

34. See *Willred Co. v. Westmoreland Metal Mfg. Co.*, 200 F. Supp. 59 (E.D. Pa. 1961).

35. RESTATEMENT OF CONTRACTS § 336 cmt. c (1932).

36. 268 N.W. 634 (Minn. 1936).

37. *Bratrud*, 268 N.W. at 637.

38. *Id.*

39. 12 So. 2d 719 (La. Ct. App. 1943).

contract be used to deduct the seller's damages. In discussing the general rule the court stated,

[w]here it is applied in the case of a single article it may produce a fair result, but if applied in the case of a merchant which is regularly engaged in selling similar things, and where there is an unlimited supply and a limited market, surely it is easy to see that an unfair result would often be reached by its application.<sup>40</sup>

In addition to awarding lost profits to lost volume sellers, the Pre-Code courts also turned to the Restatement rule to justify the reduction of the sellers' damages by giving due credit to a buyer's subsequent sales contract. In such cases, the seller did not have an unlimited supply of goods, and thus could not qualify as a lost volume seller. An illustration of this proposition is *Ed S. Michelson, Inc. v. Nebraska Tire & Rubber Co.*<sup>41</sup> In *Michelson*, the plaintiff-seller sued the buyer for refusing to accept 10,000 tires. Upon repudiation, the plaintiff sold the tires to a substitute buyer for the same price as the original contract. Crucial to the outcome of the case was that the plaintiff was a middleman who had contracted with a supplier to purchase only 10,000 tires per month.<sup>42</sup> Thus, the plaintiff had only a limited supply and was not a lost volume seller. As such, the court limited the plaintiff's damages to one profit. The court reasoned that to award the plaintiff profits on the contract would be to award the plaintiff "two profits out of a contract that guaranteed it but one, and it would be very substantially better off because of the breach of the contract than it would have been had the contract been literally carried out."<sup>43</sup>

The *Michelson* case is an important illustration of the misapplication of the general rule. The error was compounded in *Berger Mfg. Co. v. Phillips Hotel Operating Co.*<sup>44</sup> In *Berger*, the plaintiff-seller claimed entitlement to lost profits despite a subsequent sale of the goods to a second buyer. In justifying the lost profit remedy, the plaintiff put forth the lost volume argument, contending that it had an unlimited supply of goods and, therefore, would have consummated the second contract anyway.<sup>45</sup> The court rejected the plaintiff's argument, noting that the plaintiff failed to cite any authority for its position.<sup>46</sup> In finding that the plaintiff was fully compensated by the resale, the court cited *Michelson* for the proposition that the plaintiff should not receive two profits for the

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40. *Id.* at 721.

41. 63 F.2d 597 (8th Cir. 1933).

42. *See id.* at 598.

43. *Id.* at 601.

44. 89 S.W.2d 703 (Mo. Ct. App. 1935).

45. *See id.* at 706.

46. *See id.*

sale of one article.<sup>47</sup> What the court failed to recognize was that the seller in *Michelson* had a limited supply of goods, whereas the seller's supply in *Berger* was unlimited. For this reason, the *Berger* decision should be regarded as an aberration, simply wrongfully decided based on blind adherence to the general rule of mitigation thereby ignoring the exception.

In terms of mitigation, the "due credit" language appears to make more sense. *Wilhelm Lubrication*, *Mossy Motors*, *Michelson*, and *Berger* are important to show that the issue of the lost volume seller is not solely one of market damages versus lost profits. Viewed in this context, the "due credit" language is arguably an expression of the general rule of mitigation with the failure to promulgate the exception. While one may argue *ad nauseam* as to exactly what the majority position may have been regarding the lost volume seller at common law, the Restatement, coupled with the above cases, provides ample support for the notion that Pre-Code case law was willing to endorse the doctrine.

### III. DRAFTING AND LEGISLATIVE HISTORY OF THE UCC

#### A. *Using the Drafting History to Give Meaning to the "Due Credit" Language*

The following provides an overview of the role that the drafting history of the UCC played in the lost volume debate. This analysis is not meant to be exhaustive of all arguments concerning the importance of the drafting history as it relates to the lost volume seller. Instead, this analysis is confined to the main focus in the lost volume debate, that is, the quest to discover the true meaning of the language "due allowance for costs reasonably incurred and due credit for payments and proceeds of resale."<sup>48</sup>

Both advocates and opponents of the lost volume seller doctrine point to the drafting history behind this particular phrase in order to promote and justify their respective positions. Advocates of the doctrine have used the drafting history to explain the "due credit" language in order to justify ignoring such language when applying section 2-708 to the lost volume seller.<sup>49</sup> In particular, the advocates point to the first appearance of the "due allowance" and "due credit" language of section 2-708 in the 1954 Recommendations of the Enlarged Editorial Board. This change in the text was accompanied by a comment explaining that

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47. *See id.*

48. U.C.C. § 2-708(2) (1994).

49. *See* WHITE & SUMMERS, *supra* note 6, § 7-13, at 275 ("Gross errors of the kind here committed by the drafters call for extraordinary solutions. . . . courts should simply ignore the 'due credit' language in lost volume cases."); Harris, *Seller's Damages*, *supra* note 7, at 99, 101.

"[t]he main purpose of the change is . . . to clarify the privilege of the seller to realize junk value when it is manifestly useless to complete the operation of manufacture."<sup>50</sup> This particular comment is critical because the advocates have used this piece of drafting history as ammunition for their cause in demonstrating that the "due credit" language was never intended to apply to lost volume situations.<sup>51</sup> Instead, in the proponents' eyes, the "due credit" language was only intended to address the scenario where the buyer's repudiation occurs while the seller is still in the process of manufacturing the goods.<sup>52</sup> In the advocates' opinion, the "due allowance" and "due credit" language of section 2-708 "works like a charm" when applied to a situation where the seller has unfinished goods.<sup>53</sup> Conversely, when finished and completed goods are involved, the "due allowance" and "due credit" language is senseless.<sup>54</sup> Therefore, the advocates have justified disregard of the "due credit" language based on the drafting history instead of solely basing their argument for ignoring the text to avoid absurd results.

In Professor Breen's view, the proponents are guilty of examining the drafting history through tinted glasses, placing a brief portion of the drafting history under a microscope, and thereby failing to see the big picture.<sup>55</sup> In support of his proposition, Professor Breen seeks to establish a more thorough analysis of the drafting history of Article 2. When viewing the drafting history as a whole, Professor Breen concludes that the drafters specifically drafted section 2-708 with the intention that it be applied literally to preclude lost volume claims.<sup>56</sup> In Breen's view, by focusing on a small part of the history of section 2-708 only, the advocates have failed to recognize the significance of other Code sections which may have an impact on the lost volume problem. In particular, Breen criticizes the advocates for ignoring the drafting history behind section 2-703.<sup>57</sup> Simply stated, section 2-703 is the index of the seller's

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50. Further Recommendations of the Enlarged Editorial Board for Amendments of Text and Answers to Certain Criticisms (1954) [hereinafter 1954 RECOMMENDATIONS].

51. See WHITE & SUMMERS, *supra* note 6, § 7-9, at 262-64 (quoting 1954 RECOMMENDATIONS, *supra* note 50, at 14); Sebert, *supra* note 6, at 394 n.146 (arguing that the accompanying reason to section 2-708(2) lends "some support in the drafting history of § 2-708(2) for ignoring the costs and proceeds language in the context of a lost volume seller."); Note, *Seller's Recovery of Lost Profits for Breach of a Sales Contract: Uniform Commercial Code Section 2-708(2)*, 11 WM. MITCHELL L. REV. 227, 239, 245-47 (contending that the legislative history indicates that a literal reading of section 2-708(2) is not intended to apply to lost volume sellers but is only applicable to a components seller who ceases manufacture after breach).

52. See sources cited *supra* note 51.

53. WHITE & SUMMERS, *supra* note 6, § 7-13, at 401.

54. See sources cited *supra* note 51.

55. See Breen, *supra* note 1, at 818, 844.

56. See *id.* at 844-45.

57. See *id.* at 870, 882.

remedies, informing the seller which remedies are available, and directing the seller to a specific remedial section. Under earlier drafts of section 2-703(e) and its precursors, as a precondition to seeking relief under section 2-708 for either market damages or profit, the seller must not have resold the goods.<sup>58</sup> If the goods were resold, then the seller was limited to a remedy under section 2-706, under which the seller's damages are measured by the contract price-resale price differential. Given that the lost volume seller makes a resale, Breen argues that the drafters clearly intended that the lost volume seller not enjoy the benefits of the section 2-708 remedy.<sup>59</sup> Accordingly, because the reselling seller's damages are to be limited to the contract-resale differential, Breen contends the drafters demonstrated their intent that the lost volume seller was to be fully compensated with only one profit.<sup>60</sup>

Another reason for the importance of section 2-703(e) is that, in Breen's opinion, the advocates have failed to recognize its significance in formulating a mistaken assumption that the "due allowance" and "due credit" language is merely a clarification to be applied only when dealing with unfinished goods.<sup>61</sup> Consequently, the advocates argue that the "due allowance" and "due credit" language is meaningless and should be disregarded in the context of finished goods.<sup>62</sup> Breen concedes that the "due allowance" and "due credit" language was intended to be a clarification that section 2-708(2) afford a lost profit remedy to sellers of unfinished products. However, Breen's main criticism of the advocates' position is that the necessary corollary of this clarification is that "due allowance" and "due credit" have no bearing on awarding lost profits to sellers of finished goods, namely, lost volume sellers. Breen explains that the advocates have failed to recognize that, pursuant to section 2-703(e), the seller who makes a resale was not entitled to the profit remedy in the first place.<sup>63</sup> Therefore, in Breen's opinion, the addition of the "due allowance" and "due credit" language was intended to be an exception to the general rule that the profit remedy and resale were to be mutually exclusive.<sup>64</sup> Moreover, Breen argues that had the drafters intended the profit remedy to be available to those sellers who resell finished goods, the drafters most certainly would have said so.<sup>65</sup>

That there be no resale of the goods as a condition to application of

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58. *See id.* at 870-75.

59. *See id.* at 870.

60. *See id.*

61. *Id.* at 882.

62. *See* notes 51-54 and accompanying text.

63. *See* Breen, *supra* note 13, at 882.

64. *See id.* at 882.

65. *See id.* at 881.

section 2-708 was eliminated in the 1956 Recommendations and is not part of the current Code.<sup>66</sup> The stated reason for the elimination of the no resale language was to dispel concerns over election of remedies particularly between section 2-706 and section 2-708.<sup>67</sup> In acknowledging that the advocates could argue that the elimination of the no resale condition demonstrates a willingness of the drafters to open the door to section 2-708 for lost volume sellers of finished goods, Breen attempts to refute this argument by claiming that the elimination of the no resale language had nothing to do with lost volume claims.<sup>68</sup> In support of his proposition, Breen asserts that the no resale condition was deleted over the concerns raised by Professor John Honnold's analysis of section 2-703.<sup>69</sup> Breen argues that Honnold's main concern was that the seller could be precluded from any relief, if, for instance, the seller failed to comply with one of the requirements of section 2-706. Comment 2 of section 2-706 stated that if there was an improper resale of the goods, for example, for failing to notify the breaching buyer or failing to identify the goods to the contract, then the seller's damages should be measured under section 2-708. Given that the seller has made a resale, the no resale condition of section 2-703(e) to application of section 2-708 was internally inconsistent with Comment 2 of section 2-706. Thus, Honnold recommended the elimination of the no resale condition in order to harmonize Comment 2 of section 2-706 and section 2-703(e). According to Breen, Honnold's only concern was that the seller who improperly resells the goods under section 2-706 should at least be afforded market measured damages, prescribed in section 2-708(1).<sup>70</sup> Honnold's silence concerning the lost profit remedy led Breen to infer that the deletion of the no resale language was not meant to allow the lost volume seller to freely elect to have his damages measured by section 2-708(2). Rather, Breen stresses that the logical inference is that the no resale condition be retained in lost volume situations. Thus, according to Breen, the deletion of the no resale condition prohibits the advocates of the lost volume seller from arguing in good faith "that the drafters were in fact attempting to remove the last 'linguistic impediment' to lost volume claims."<sup>71</sup>

#### B. *The Overemphasis of the Drafting History to Solve the Lost Volume Problem*

In support for his criticism of the lost volume seller, Breen chas-

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66. See *id.* at 887.

67. See *id.* at 887-88, 894.

68. See *id.* at 888.

69. See *id.* at 895-97.

70. See *id.* at 895.

71. *Id.* at 897.

tises the advocates for having their reasoning clouded by their belief that the lost volume seller *ought* to receive two profits.<sup>72</sup> In particular, Breen argues that this faulty reasoning is most evident in the advocates' attempt to justify their view by focusing on the limited drafting history which, when viewed alone, appears to support their proposition.<sup>73</sup> Nonetheless, Breen is equally guilty by leaving the reader unconvinced that his view of the drafting history dispels any doubt that the drafters specifically intended to preclude lost volume claims. Breen's emphasis on the interrelation between sections 2-703(e) and 2-708 is at best circumstantial. For instance, his own analysis of the drafting history notes Professor Honnold's concern over the inconsistency between section 2-703(e) and Comment 2 of section 2-706.<sup>74</sup> This shows, if anything, that Article 2 is not a perfect instrument and that inconsistencies are inevitable. Hence, Breen's judgment, like that of the advocates, may be equally clouded by the preconceived notion that the lost volume seller *ought not* to receive two profits.

In all the evidence presented by the advocates and the opponents of the lost volume seller, there seems to be mere *inference* that the lost volume doctrine should or should not be endorsed. In no way does any of the evidence allude *directly* to the lost volume concept. For instance, Breen infers from the drafting history that since the no resale condition of section 2-703(e) precluded application of the section 2-708 profit remedy, the drafters must have specifically intended to limit lost volume claims.<sup>75</sup> If the drafters' true intent was to preclude lost volume claims, then this section certainly would have been a strange way of expressing it. It seems inconceivable that the drafters could have so strongly opposed lost volume claims yet have failed to provide any direct comment to that effect. Furthermore, the advocates have likewise referred to the "due credit" comment language to infer that such language not apply where the seller resells finished goods.<sup>76</sup> What remains as fact is that neither the advocates nor the opponents have provided the "smoking gun" that would bring the debate to a clear and convincing end. Therefore, it seems equally plausible that the drafters *never contemplated* the lost volume seller.<sup>77</sup>

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72. See *id.* at 878-79.

73. See *id.* at 880.

74. See *id.* at 895.

75. See *id.* at 882-83.

76. See sources cited *supra* note 51.

77. See also, STEWART MACAULEY ET AL., *CONTRACTS: LAW IN ACTION* 72-74 (1995). The authors give an excellent overview of the drafting history of section 2-708(2). With regard to the addition of the "due credit" language, the authors propose the following explanation:

Why wasn't this unfortunate change spotted and revoked? One can only guess, but a guess might be suggested by the fact that a blizzard of changes were proposed by

Support for the above proposition appears in the various writings of the Code's principal drafter and chief architect, Karl Llewellyn. In fact, Llewellyn admitted quite candidly that "[b]orderline, doubtful, or uncontemplated cases are inevitable."<sup>78</sup> For this reason, there is no indication that Llewellyn intended the Code to be applied as rigidly and as literally as Breen would seem to suggest. Because the Code was intended to be semi-permanent legislation, with revisions coming every thirty to fifty years, Llewellyn's idea was that the Code, in order to be effective, needed to grant flexibility for judges to tailor decisions in accordance with changing technological and economic conditions.<sup>79</sup> In his book on Llewellyn, William Twining argues that Llewellyn Code philosophy was a response to the Continental Codes of the 19th Century, which, when drafted, were believed to instill social change, but were too rigidly constructed such that they ended up as barriers to change.<sup>80</sup> In response, Llewellyn specifically drafted Article 1 to reflect his own philosophy of the Code.<sup>81</sup> Indeed, Article 1 is quite unique in that section 1-102(1) makes liberal, as opposed to literal, construction mandatory.<sup>82</sup> To assure uniformity despite mandatory liberal interpretation, Llewellyn believed that each statute should display on its face its underlying policies and purposes. By doing so, the courts would avoid giving the statute a "wooden and literal meaning."<sup>83</sup> Thus, Llewellyn foresaw that when future courts faced with situations "utterly unanticipated" by the statute could use the statute's underlying purposes and policies to make "sense . . . of [the statute] in the light of the new situation."<sup>84</sup>

Having determined that Llewellyn intended the Code to be interpreted in accordance with its underlying policies, the next step is to determine the underlying policies behind section 2-708(2). In section 2-

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the New York Law Revision Commission around this time and that also at this time the legislature of New York rejected the Code in a form without these changes. New York's rejection and the Commission's proposals precipitated a crisis resolved only through extended and intermittently fierce debates. In this circumstance, § 2-708(2), which had been approved by the N.Y. Law Revision Commission and which had so little pretension to do anything beyond restating 'standard law,' *probably received little attention.*

*Id.* at 74 (emphasis added).

78. WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* 322 (1973) (quoting Karl N. Llewellyn Papers § (J)(VI)(I)(e), at 5 (1944)).

79. *See id.* at 305.

80. *See id.*

81. *See generally* John L. Gedid, *U.C.C. Methodology: Taking a Realistic Look at the Code*, 29 WM. & MARY L. REV. 341, 378-83 (1988).

82. U.C.C. § 1-102(1) (1994). Section 1-102(1) states that "[t]his Act shall be liberally construed and applied to promote its underlying purposes and policies." *Id.*

83. Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed*, 3 VAND. L. REV. 395, 400 (1950).

84. *Id.* at 400.



708's accompanying Comment 2, the drafters make a vague reference that the profit remedy should be awarded "in all appropriate cases" in the case of fixed or standard priced goods.<sup>85</sup> While it is unclear whether the drafters of the Comment were specifically addressing lost volume sellers, it clearly demonstrates that market measured damages are inadequate in the case of standard priced goods. What the drafters failed to articulate is an understanding of how to calculate the lost profit, leaving that aspect of the lost volume problem unanswered. Therefore, it is necessary to look elsewhere in the Code for applicable policy and purpose considerations.

Of particular guidance is section 1-106, which reflects Llewellyn's view that remedial statutes be "liberally administered."<sup>86</sup> Section 1-106 emphasizes that, in liberally construing remedial statutes, one should not lose sight of the Code's policy to "put [the aggrieved party] in as good a position as if the other party had fully performed."<sup>87</sup> While the application of section 1-106 appears simple on its face, the practical utilization of the section has been much harder, because both sides of the lost volume seller debate have used section 1-106 to support their own positions. That is, the advocates point to section 1-106 to justify their belief that the lost volume seller is undercompensated by section 2-708(2) because, had the buyer fully performed, the seller would have enjoyed two profits.<sup>88</sup> Conversely, critics of the lost volume doctrine contend that a literal reading of section 2-708(2) is consistent with the normative principle of section 1-106 in that the lost volume seller would be overcompensated by anything more than one profit.<sup>89</sup> In the final analysis, however, since the lost volume seller was unanticipated by the drafters, section 1-106 indicates the debate should be less concerned with the Code's drafting history. Instead, the battle should be a dispute over the conceptual validity of the lost volume seller. This is particularly important given the recent actions of the Permanent Editorial Board concerning the revision of Article 2, which forms the discussion of the following subsection.

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85. U.C.C. § 2-708 cmt. 2 (1994). Comment 2 states that § 2-708(2) is "designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods." *Id.*

86. U.C.C. § 1-106(1) (1994).

87. *Id.*

88. See, e.g., RAY D. HENSON, *THE LAW OF SALES* § 7.04, at 285 (1985) (stating that "a straightforward reading of [section 1-106] . . . should solve most problems [of lost volume] without undue difficulty").

89. See Breen, *supra* note 13, at 910-11.

C. *Current Revision of Article 2: Is Professor Breen's Discussion of the Original Drafting Rendered Moot?*

1. THE RECOMMENDATIONS OF THE STUDY GROUP AND TASK FORCE

In 1988, the Permanent Editorial Board assigned a Study Group to make an appraisal of Article 2.<sup>90</sup> In its revisions and recommendations to Article 2 published in 1990, the Study Group concluded that the "due allowance" and "due credit" language should be scrapped.<sup>91</sup> Regarding section 2-708(2), the Study Group concluded, "[t]his measure of damages, because it focuses only on lost profits, *should not contain* the language, now in § 2-708(2), 'due allowance for costs reasonably incurred and due credit for payments and proceeds of resale.'"<sup>92</sup> In 1991, the Task Force assembled by the American Bar Association examined the Study Group's Preliminary Report and agreed with the Study Group's recommendation that the "due credit" language be dropped in the next revision of Article 2.<sup>93</sup>

Although Breen addresses this recommendation of the Study Group, he is quick to downplay its significance. Noting that the Study Group gave little explanation for its recommendation, Breen criticizes the Study Group for merely assuming, based on the great weight of authority of case law, that the lost volume doctrine is valid.<sup>94</sup> In Breen's opinion, if the Study Group were only aware of the drafting history of section 2-708(2), they would understand that the intent of the original drafters in utilizing the "due credit" language was to preclude lost volume claims.<sup>95</sup> As demonstrated earlier, Breen has not shown in a clear and convincing way that this is true. However, even supposing Breen is correct in his view of the drafting history, this has nothing to do with whether the drafters were *right* (or thorough). The very purpose of the Permanent Editorial Board is to revise the inadequacies of the Code in order to align the Code with what the law should be, given the ever changing legal and commercial climate. Attitudes and views change from generation to generation, and something which may have been right for an older generation may not be right for successive generations. It is upon this premise that the Permanent Editorial Board has every right to change a particular section of the Code which they find absurd or unfit. Because the "due credit" language seems destined for extinc-

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90. See PEB Study Group Uniform Commercial Code, Article 2 - Preliminary Report (1990).

91. See Note, *An Appraisal of the March 1, 1990, Preliminary Report of the Uniform Commercial Code Article 2 Study Group*, 16 DEL. J. CORP. L. 981, 1221 (1991).

92. *Id.*

93. See *id.* at 1224.

94. See Breen, *supra* note 13, at 902.

95. See *id.* at 902-03.

tion, the focus of the debate should zoom in on the conceptual validity of the lost volume concept itself. Only then may we determine whether the actions of the Permanent Editorial Board are justified.

## 2. THE AUGUST 1994 AND SUBSEQUENT REVISIONS OF ARTICLE 2

After analyzing the finding of the Study Group and the Task Force, the National Conference of Commissioners on Uniform State Laws, in August 1994, gave the first reading of the revised Article 2.<sup>96</sup> The revised version of section 2-708(2), now renumbered 2-708(b), reads as follows:

(b) Subject to Section 2-701(e), a seller may recover damages measured by other than market price including:

(1) lost profits, including reasonable overhead, resulting from the breach determined in any reasonable manner, together with incidental and consequential damages under Section 2-710, less expenses avoided as a result of the buyer's breach; and

(2) reasonable expenditures made in preparing for or performing the contract if, after the breach, the seller is unable to obtain reimbursement by salvage, resale, or other reasonable measures.<sup>97</sup>

If adopted, the revised section 2-708(b) will no longer be subject to dispute over the proper meaning of the legislative intent, let alone the words "due credit."

In addition to the revision of section 2-708, the revision of section 2-701 is also especially noteworthy. Section 2-701(c), which addresses remedies in general, is a virtual restatement of section 1-106, mandating the liberal interpretation of the remedial statutes.<sup>98</sup> In its proposed form, section 2-701(c) states:

(c) The remedies provided by this article must be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. If those remedies fail to place the aggrieved party in the position, the court may award damages measured by the loss resulting in the ordinary course of events from the breach as determined in any manner which is reasonable.<sup>99</sup>

Since August 1994, Article 2 has undergone several more revisions, none of which has substantially changed either section 2-708(b) or section 2-701 of the August 1994 draft.<sup>100</sup> These more recent revisions

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96. Richard E. Speidel & James J. White, *The Emerging Article 2: Remedies for Breach of the Contract for Sale*, C965 A.L.I.-A.B.A. 33, 35 (1994).

97. *Id.* at 50.

98. *Id.* at 47.

99. *Id.*

100. At the time of compiling this article, the latest draft of Article 2, dated January 24, 1997, renumbered sections 2-708(b) and 2-701(c) of the August 1994 draft to sections 2-821(b) and 2-

show that section 1-106 is destined to supremacy over all specific remedial statutes. As already stated, this section has been used by advocates and opponents alike to support their respective positions. Hence, it is time to analyze in what position the seller would be had the buyer fully performed—whether it be one profit, two profits, or somewhere in between.

#### IV. CONCEPTUAL ANALYSIS OF THE LOST VOLUME SELLER

##### A. *Responses to the Arguments Against the Lost Volume Seller*

###### 1. THE MITIGATION ARGUMENT

One argument used to discredit the lost volume seller concept is that it is repugnant to the seller's duty to mitigate damages. In one of the earliest articles to raise objections to the lost volume seller, Professor Morris Shanker voiced his concern that adoption of the lost volume theory undermines the importance of the duty to mitigate damages under the Code.<sup>101</sup> Shanker's conclusion was based upon his premise that, since most sellers have a supply greater than the demand, nearly every seller could qualify as a lost volume seller.<sup>102</sup> As a result, nearly every buyer, upon a breach, is left with no hope of mitigation. In Shanker's opinion, the lost volume concept effectively destroys the mitigation of damages principle, one of the fundamental maxims of contract remedies.<sup>103</sup>

Shanker is not alone in his concerns over the potential negative effects of the lost volume concept on mitigation principles. In fact, in the modern lost volume era, it appears that the mitigation argument has been the only argument used successfully in court to counter a lost volume claim. This is precisely the argument the Superior Court of Pennsylvania employed in 1992 to deny a lost volume claim in *Northeastern Vending Co. v. P.D.O., Inc.*<sup>104</sup> *Northeastern* involved a breach of a lease arrangement and, as such, was outside the scope of Article 2. Rather than confront the awkward language of section 2-708, the court addressed the express acceptance of the lost volume theory embodied in

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803(a), respectively. Although some language from the August 1994 draft was omitted in the January 1997 draft, we believe that the sections remain substantively the same. In the accompanying comment to section 2-821 of the January 1997 draft, the revisors stated that no effort was made to resolve the lost volume seller issue. However, the drafters indicated that recovery for lost volume "is still possible under the flexible standards of [§ 2-821(b)]." The January 1997 draft is available on the internet at <<http://www.law.upenn.edu/library/ulc/ucc2/text18.htm>>.

101. See Shanker, *supra* note 12, at 700-01.

102. See *id.* at 701.

103. See *id.*

104. 606 A.2d 936 (Pa. Super. Ct. 1992).

the second Restatement of Contracts.<sup>105</sup> Despite the Restatement's clear endorsement of the lost volume seller and explanation why mitigation should have no bearing in such situations, the court nevertheless rejected the lost volume theory because it "erodes the duty to mitigate."<sup>106</sup> The court further contended that the lost volume theory would encourage the seller to remain idle, thereby doing nothing to minimize damages.<sup>107</sup>

The *Northeastern* court's concern over the potential idleness of the lost volume seller is completely unwarranted. The lost volume seller, by definition, does not remain idle. Rather, in order to make a lost volume claim, the seller must *actively* pursue a second contract. Therefore, to contend that the theory of lost volume encourages the seller to do nothing is without merit. Moreover, to claim that the lost volume concept is inconsistent with mitigation is to countenance a lack of understanding when mitigation is to be applicable. As already discussed in Part I.B, *supra*, as a general rule, the nonbreaching party has a duty to mitigate its damages by entering into a similar contract. However, the important qualification to this rule is that if the subsequent contract would have been made regardless of the breach, then that contract is not taken into consideration to minimize the damages. This is exactly the rule articulated by the second Restatement of Contracts and which the *Northeastern* court chose to ignore. The philosophical heart of the lost volume theory is that the seller would have generated a second sale irrespective of the buyer's breach. It follows that the lost volume seller cannot possibly mitigate damages. For this reason, the majority of both courts and commentators have recognized the illegitimacy of the mitigation argument.<sup>108</sup> More fatal to this view, even Professor Breen admits that the mitigation argument is invalid because the definition of the lost volume seller makes mitigation impossible.<sup>109</sup>

## 2. THE "DIMINISHED CAPACITY" ARGUMENT

In an early treatise on contract remedies, Professor Samuel Williston expressed doubt about awarding two profits to a lost volume seller. In making a resale of the goods, Williston argued that the seller "diminishes his capacity to make other sales of his product."<sup>110</sup> Because the second sale plunges into the seller's market, thereby reducing it by one customer, the "diminished capacity" argument holds that the award of

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105. *See id.* at 938.

106. *Id.*

107. *See id.*

108. *See, e.g.*, 1 DUNN, *supra* note 6, § 2.9 (pocket part 1996), at 25; ROBERT J. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 177, at 536 (1970); Anderson, *supra* note 6, at 1055.

109. Breen, *supra* note 13, at 820-21.

110. 3 SAMUEL WILLISTON, WILLISTON ON SALES § 583a (1961).

two profits for the sale of one set of goods overcompensates the seller. This same reasoning was the basis of the holding in *A. Lenobel, Inc. v. Senif*,<sup>111</sup> arguably the case which best articulated an attack on the lost volume theory. In *A. Lenobel*, the court reasoned that if the buyer would have assigned his contract or accepted the goods and resold them to another buyer in the same market, this action would have depleted the seller's prospects for an additional sale.<sup>112</sup> In such a case, the court noted that the seller would have been limited to one profit. Therefore, the court believed it was justified in limiting the seller's damages to one profit.<sup>113</sup>

The "diminished capacity" argument is arguably a "red herring" debate, since its application appears to have validity concerning a seller who is not a lost volume seller. The lost volume seller in its purest form would have a potentially extensive market for its goods. This is especially true in the modern global economy where a seller could supply customers both domestically and internationally. Such was not the case for a car dealer in a small town in New York in the 1930s, as it was for the seller in *A. Lenobel*. In that instance, the buyer could have bought the car and resold it in competition with the seller, thereby significantly reducing the seller's already small market. In this context, the "diminished capacity" argument carries its most weight. To understand this is to realize that if a buyer's actions could significantly impact the seller's prospects, then that seller is *a fortiori* not a lost volume seller. In its purest form, the lost volume seller could have thousands of prospects, the loss of one of which would be negligible at best.

### 3. THE COUNTER-HYPOTHETICAL

The "diminished capacity" argument, first recognized in *A. Lenobel*, was again used in 1973 by Professor Shanker to attack the lost volume seller.<sup>114</sup> Although Shanker used this theoretical situation for his flawed mitigation argument, Professor Breen has resurrected this scenario, in what he deems the "counter-hypothetical," in yet another context.<sup>115</sup> In Breen's opinion, the counter-hypothetical succeeds to rebut the lost volume theory for reasons not fully articulated by either Shanker or *A. Lenobel*.

The main force of Breen's argument is that the seller's expectation interest in the profit from the second sale is unprotected.<sup>116</sup> As illustra-

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111. 300 N.Y.S. 226 (N.Y. App. Div. 1937).

112. *Id.* at 229.

113. *Id.* at 230-31.

114. See Shanker, *supra* note 12, at 701-02.

115. Breen, *supra* note 13, at 818-19.

116. See *id.* at 823-27.

tion, Breen points to the basis of the lost volume seller's claimed expectation interest—that is, the lost volume seller contends that he expected to sell the goods, plus a second set of the goods to an additional buyer. Breen cautions that the seller's expectation must only be measured at the time of entering a valid contract. It is the valid contract that protects the seller's expectation. Breen explains that at the time of entering into the original contract with the breaching buyer, the seller merely has a protectable expectation in this contract and the hope of entering a similar contract with another customer in the future. Thus, at the time of entering into the first contract, the seller has no protectable expectation of a second sale in the post-contractual market, since the seller has yet to make the contract for resale. Because the resale occurs after repudiation of the original contract, in awarding lost profits to the seller, courts apply the seller's expectation upon resale retroactively, relating back to the formation of the original contract. Thus, Breen concludes, "the seller's expectation of an additional sale is a *post hoc* expectation, which is an oxymoron."<sup>117</sup> Breen argues that this thesis is the real point of the counter-hypothetical. That is, the value of the counter-hypothetical is that it shows the seller to have no protectable interest in the future market.<sup>118</sup>

Breen is correct in his premise that the lost volume seller, at the time of entering into the original contract, has a protected expectation in one profit and an unprotected expectation or hope to make similar contracts in the future. The main flaw with Breen's reasoning, however, is that the lost volume seller's expectation in the second sale is always unprotected. The lost volume seller's expectation in the second sale is unprotected until the seller enters into the second contract. At that time, the seller has a protectable expectation in the original contract, and a separate and distinct protectable expectation in the second sale. There is nothing retroactive in the application of the seller's expectation interest in the second sale. Contrary to Breen's assertion, the lost volume seller is not claiming a protectable interest in two transactions at the time of the original sale. Conversely, the lost volume seller claims an expectation in two contracts entered into at different intervals. Thus, the argument over the lost volume seller is not whether the seller has a protectable expectation in the post-contractual market, but whether, after the second sale is consummated, the expectation on the second sale should be used to *reduce* the expectation interest on the original sale.

A separate problem with the validity of the counter-hypothetical centers upon the difference between breach and performance. Whether

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117. *Id.* at 824.

118. *See id.* at 827.

the buyer assigns his rights under the contract or buys the goods and attempts a resale, the buyer in such a situation is nonetheless *performing* the contract. This is completely unlike a flat breach of contract. The significance of the counter-hypothetical is to show that buyers who contract with lost volume sellers have a better way to handle the situation than to breach. As a practical matter, attorneys who counsel these buyers should advise them of this option when the buyer is considering repudiating the contract.

*B. Revisiting the Lost Volume Problem: New Arguments for the Lost Volume Seller*

The vulnerability of Professor Breen's view that the lost volume seller should receive only one profit is best demonstrated in a hypothetical situation where Breen's view will produce extremely unfair results. For example, suppose Boeing contracts to sell ten jets to United Airlines. Shortly after entering into the contract, United decides that it would rather buy ten jets of comparable quality from McDonnell-Douglas, one of Boeing's chief competitors. Because United knows that Boeing is a lost volume seller who will quickly resell the ten jets to another airline, United realizes that, under Breen's view, Boeing will have no recourse, other than nominal damages, against it upon breach. Therefore, United repudiates its contract with Boeing and contracts with McDonnell-Douglas to buy the ten jets. Subsequently, Boeing resells the ten jets to American Airlines at the price the jets were to be sold to United. At the time United breached, Boeing was already negotiating the deal with American and had the capacity to supply both airlines with the jets. According to Breen, Boeing should be limited to the contract price-resell price differential, which in this case is nothing, plus incidental damages. Because Boeing had nearly closed its deal with American at the time of United's breach, Boeing's expenses in locating a substitute buyer are minimal, leaving Boeing with little or no incidental damages.

The inequitable result of Breen's view is highlighted by the fact that Boeing is left with nominal damages while losing not only a sale and profit, but also a sale to one of its competitors. The effect of Breen's position is to devalue contracts with lost volume sellers to a degree that they are rendered worthless. Because such a buyer will be liable only for nominal damages, the buyer is encouraged in many instances to breach. Effectively, the buyer in such a case has voidable contract rights. As a matter of public policy, courts should consider fashioning contract remedies in order to discourage breach of con-



tract.<sup>119</sup> Of course, there are instances where the breaching party may make an "efficient breach" by paying damages to the aggrieved party and then entering into another contract. However, the theory is premised upon the condition that the breaching party pay damages to make the aggrieved party whole. In Breen's view, the buyer essentially pays no damages to the aggrieved seller in order to contract more favorably. Therefore, Breen's view is inconsistent even with the theory of efficient breach.

## V. CONCLUSION

Professor Breen's article has reopened the lost volume seller debate, posing new questions and analyzing the problem from a variety of perspectives. Although Breen makes several plausible arguments against the lost volume theory and raises issues not yet examined, I am not convinced that the lost volume theory should be wholly abandoned. The emphasis that both the proponents and Breen place on the drafting history of Article 2 in deciding the lost volume debate is near trivial. Neither side has provided direct evidence that the Code's drafters considered the lost volume problem when drafting Article 2. Moreover, the next revision of Article 2, eliminating the "due allowance" and "due credit" language, should redirect the lost volume debate away from linguistic interpretation and towards the important issue—the conceptual validity of the lost volume seller and the fundamental policy behind damages.

With regard to the conceptual validity of the lost volume seller, Breen has simply not demonstrated that limiting the lost volume seller's damages to one profit is wise and consistent with the Code's policy of placing the aggrieved party in the same position had the breaching party fully performed. The counter-hypothetical is ineffective in demonstrating that the seller's expectation in a second profit is unprotected. Breen's conclusion is clouded by the mistaken assumption that the seller seeks to establish his expectation interest in two profits at the time of entering the original contract. Rather, the lost volume seller claims that he has two separate and distinct expectations—one profit at the time of entering each respective contract. By focusing upon the seller's unprotected expectation, Breen's argument misses the real question: whether the first expectation should be reduced by giving "due credit" for proceeds on the second contract.

The conceptual analysis of the lost volume seller needs to go beyond a discussion of the counter-hypothetical. The most critical flaw

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119. See *Tongish v. Thomas*, 840 P.2d 471, 476 (Kan. 1992) (holding that a court should fashion a remedy in a way that will discourage breach of contract).

in Breen's position is the failure to justify the inequitable and absurd results which would result if lost volume sellers are limited to one profit. In the most egregious circumstance, the abandonment of the lost volume theory will permit a buyer to breach a contract with a lost volume seller and make a contract with a competing seller while incurring little or no liability. One can hardly imagine Breen arguing in good faith that the lost volume seller has not been damaged in this situation.

The lasting effect and importance of Breen's article is that certain sub-issues within the lost volume debate should be revisited. However, the debate should be about whether the lost volume remedy should or should not exist. Instead, the impact of Breen's article is in raising concerns over the definition and identification of lost volume seller situations. In examining the article, Breen arguably makes a good case that the lost volume seller may be over applied. Take, for example, *Neri v. Retail Marine Corp.*,<sup>120</sup> the seminal case for the lost volume doctrine, the facts of which Breen uses in hypothetical situations throughout his article. The problem with *Neri* is that the buyer was an average consumer as opposed to a merchant. The defendant in *Neri* had to repudiate the contract because he had to be hospitalized and required surgery. It is easy to empathize with such a non-culpable breaching buyer. However, it is important to remember that the breaching buyer, except in cases of commercial impracticability, is never entirely without fault. One might argue that the average consumer who breaches a contract with a lost volume seller is unlucky in that he did not deal with a non-volume seller. In such an instance, awarding a lost profit to a big commercial seller against the average consumer seems unjust.<sup>121</sup> As a practical matter, however, Sears is unlikely to waste its time suing the average consumer for breach of contract to purchase a washing machine. Even if one concludes that the lost volume theory is unjust with regard to the average consumer, such a conclusion has absolutely no bearing on lost volume claims where the buyer is a merchant.

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120. 285 N.E.2d 311 (N.Y. 1972).

121. In Stewart Macauley's casebook, *Contracts: Law in Action*, the authors ponder whether a lost volume case should be decided differently if the buyer is a merchant or an average consumer. MACAULEY ET AL., *supra* note 77, at 77-78. The authors make note of interviews two University of Washington law students conducted with several car dealers. *Id.* at 78. Most of the dealers interviewed responded that they did not know that they could sue a breaching customer for lost profit. *Id.* The students observed that

[a]ll the dealers we talked to thought that the idea of recovering lost profits was, from a practical standpoint, "ludicrous." As one dealer put it: "Realistically, how long could a dealer who sues customers for lost profits last in a competitive market? Once the word got out, such a reputation would drive customers away."

*Id.* See also Melvin A. Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 797-82 (1982) (arguing that lost volume should only apply where the buyer is a merchant and not a consumer).