

6-25-2018

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Victor Goldberg

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### Recommended Citation

Victor Goldberg (2018) "Remedies In The UCC: Some Critical Thoughts," *Barry Law Review*: Vol. 23 : Iss. 2 , Article 3.  
Available at: <https://lawpublications.barry.edu/barryrev/vol23/iss2/3>

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## REMEDIES IN THE UCC: SOME CRITICAL THOUGHTS

*Victor Goldberg\**

I thank the conference organizers and the law review for giving me the opportunity to vent some of my frustrations with the Uniform Commercial Code (UCC). I have expressed my concerns with the Code's overreliance on "custom and usage" elsewhere, and will not pursue that further here.<sup>1</sup> Nor will I bemoan the Code's invocation of good faith to undo the parties' balancing of flexibility and reliance.<sup>2</sup> I will confine my discussion to contract remedies. But I have to begin by noting one section I simply do not understand. Why on earth would the Code drafters in § 2-718(2)(b) have required restitution of nonrefundable deposits in excess of \$500? A standard that undid "unreasonable" deposits might conceivably make some sense, but a price fixed in 1965 (when the price level has increased more than 500%) is daft.

Let me begin with consequential damages. When I began teaching Contracts in the last century, it struck me as obvious that the right question to ask was with whom the parties would have assigned the responsibility for the damages. Upon reading § 2-715 Comment 2, I learned, much to my surprise, that the "tacit agreement" test for the recovery of consequential damages is rejected.<sup>3</sup> The commentary regarding the tacit agreement framing, summarized by Larry Garvin, is scathing.<sup>4</sup> Supporters of the Code's formulation ask: would reasonable business people have *contemplated the possibility*? If they somehow conclude that the contemplation threshold has been met, the plaintiff wins. The tacit agreement approach asks even if that threshold had been met, how would those same reasonable business people *allocate the risks*? Thus, both the supporters and critics make a tacit assumption about risk allocation. They just disagree on what that assumption is.

Heretofore, I had not bothered to read the next sentence in Comment 2: "Although the older rule at common law which made the seller liable for all consequential damages of which he had 'reason to know' in advance is followed . . . ." That is a rewriting of history. The 11th edition of Mayne's *Treatise on Contract Damages* (1946) asked: "Is mere knowledge or communication sufficient to impose

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\* Oberlin College B.A. 1963; Yale University PhD 1970. Jerome L. Greene Professor of Transactional Studies, Columbia University School of Law. I would like to thank participants in the conference for their helpful remarks.

1. See VICTOR P. GOLDBERG, FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE 162-88 (2006) (criticizing the decision in *Columbia Nitrogen v. Royster*, 451 F. 2d 3 (4th Cir. 1971)).

2. See *id.* at 101-41.

3. U.C.C. § 2-715 cmt. 2 (AM. LAW INST. & UNIF. LAW COMM'N 2017).

4. See Larry T. Garvin, *Globe Refining Co. v. Landa Cotton Oil Co. and the Dark Side of Reputation*, 12 NEV. L.J. 659 (2012).

liability?”<sup>5</sup> The answer was: NO. The rule changed abruptly in 1949 with Asquith, LJ’s opinion in *Victoria Laundry v. Newman*.<sup>6</sup> Asquith, like the Code authors, misstated the history, but he went a step further. Given the facts, the plaintiff would have lost; so he misstated the facts.<sup>7</sup>

There is some pretty good evidence that parties would assign the risk of consequential damages to the plaintiff. Disclaimers of consequential damages are routine. If most parties are contracting out of the default rule, then it is probably not a very good rule. The default rule will, however, sometimes come into play, notably when there is a battle of the forms. Why might the parties assign the risk to the plaintiff? As Coase pointed out in another context, both parties contribute to the harm.<sup>8</sup> The defendant controls the risk that something will go wrong, but the plaintiff controls the magnitude of the damages, were the risk to occur, both by post–incident (mitigation) and pre–incident behavior. If defendants are invariably held liable, the plaintiff’s incentives to control the costs are weakened. The defendant, in effect, would be providing insurance without some of the tools it might use to ameliorate the moral hazard and adverse selection problems. That insurance would be a cost of doing business, of course, and the defendants would have to cover that cost by charging higher rates to customers.<sup>9</sup>

Turning now to direct damages,<sup>10</sup> I will focus on three issues: (a) the relationship between market damages and cover; (b) damages for anticipatory repudiation; and (c) the lost volume seller. Some scholars perceive a conflict between the UCC remedies for a buyer’s breach.<sup>11</sup> Section 2–706 allows the seller to resell the goods (to cover) while § 2–708(1) gives the contract–market differential. The argument is that these might differ if, for example, the seller delays in reselling and the price has risen in the interim. The resale, it is argued, is the cover transaction and the seller would, in effect, have its cake and eat it too. White and Summers take this position: “We conclude that a seller should not be permitted to recover more under 2–708(1) than under 2–706. . . .”<sup>12</sup>

Rather than viewing cover as a separate remedy, I suggest it should instead be viewed as *evidence* of the contract–market differential. The persuasiveness of the evidence from a subsequent resale would depend on the temporal proximity; if the

5. JOHN D. MAYNE, *MAYNE’S TREATISE ON DAMAGES* 28 (W. G. Earengy ed., Sweet & Maxwell 11th ed., 1946).

6. *Victoria Laundry, Ltd. v. Newman Industries Ltd.* [1949] 2 KB 528 (Eng.).

7. See Victor P. Goldberg, *Victoria Laundry’s, Dirty Linen*, 2 *CRITERION J. ON INNOVATION* 523, 526 (2017).

8. R.H. Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1, 2 (1960).

9. See generally, VICTOR P. GOLDBERG, *RETHINKING CONTRACT LAW AND CONTRACT DESIGN* 87–115 (2015), for a more detailed version of my argument.

10. The line between direct and consequential damages is not as bright as one might hope; compare Goldberg, *RETHINKING CONTRACT LAW, PART I (Direct Damages)* with *RETHINKING CONTRACT LAW, PART II (Consequential Damages)*.

11. See JAMES J. WHITE & ROBERT S. SUMMERS *UNIFORM COMMERCIAL CODE* § 8–7, at 362 (6th ed. 2010); See also Melvin A. Eisenberg, *Conflicting Formulas for Measuring Expectation Damages*, 45 *ARIZ. ST. L.J.* 369, 399–400. For examples of judicial treatment, see *Coast Trading Co. v. Cudahy Co.*, 592 F.2d 1074, 1083 (9th Cir. 1979), *Tesoro Petroleum Corp. v. Holborn Oil Co.*, 547 N.Y.S.2d 1012, 1016–17 (N.Y. Sup. Ct. 1989), and *Eades Commodities, Co. v. Hoepfer*, 825 S.W.2d 34, 38 (Mo. App. Ct. 1992).

12. WHITE & SUMMERS, *supra* note 11, at 362.

seller were to resell promptly that would be good evidence of the market price. If the resale occurred three years later (as in *Peace River Seed Co–Operative, Ltd. v. Proseeds Marketing, Inc.*<sup>13</sup>), it would be terrible evidence. Nonetheless, at least one scholar, following White and Summers, has argued that the higher price three years later was the cover price, and the measured damages should have been adjusted accordingly.<sup>14</sup>

Acceptance of the cover–as–evidence formulation avoids a problem that has bedeviled some courts: what if the aggrieved party had entered into numerous contracts following the breach? Which, if any, is the cover contract? *Cargill, Inc. v. Stafford*<sup>15</sup> is an extreme example of a court’s confusion. The court was dealing with the question of the proper date for measuring damages following an anticipatory repudiation. The court concluded that the answer depended on whether the aggrieved party had a valid reason for not covering. Leave aside for the moment that this question made no sense. The court asserted: “The record contains scant, if any, evidence that Cargill covered the wheat.”<sup>16</sup> And again: “The record does not show that Cargill covered or attempted to cover. Nothing in the record shows the continued availability or nonavailability of substitute wheat.”<sup>17</sup> And so the case was remanded to determine whether Cargill had a valid reason for failing to cover. Think about it. Cargill was (and still is) a major player in a thick market. It engages in numerous wheat transactions every day. It makes no sense to identify any particular trade as the cover contract. Of course there was no evidence of Cargill covering or not covering. Neither lawyer should have thought it necessary to mention Cargill’s ongoing presence in the wheat market.

Well then, when should damages be measured if there is an anticipatory repudiation? Some courts and commentators distinguish between cases in which all performance would have been concluded before the decision and those in which some performance would have been due after the litigation had concluded. The Code (§ 2–723) is specific for the latter case:

If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (Section 2–708 or Section 2–713) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.<sup>18</sup>

White and Summers reason that the Code’s silence in the pre–litigation case meant that the opposite rule should apply—the rule would be the time performance

13. *Peace River Seed Coop., Ltd. v. Proseeds Mktg., Inc.* 322 P.3d 531, 533 (Or. 2014).

14. See Jennifer S. Martin, *Opportunistic Resales and the Uniform Commercial Code*, 2016 U. ILL. L. REV. 487, 525 (2016).

15. See generally *Cargill, Inc. v. Stafford*, 553 F.2d 1222 (10th Cir. 1977).

16. *Id.* at 1226.

17. *Id.* at 1227.

18. U.C.C. § 2–723 (AM. LAW INST. & UNIF. LAW COMM’N 2017).

was due. Thus, they claim, the date at which damages should be measured depends on whether or not all the performance was due before or after the court would render its decision.<sup>19</sup>

I prefer making the pre- and post-litigation rules the same to avoid the possibility that, in some instances, the parties might have the incentive to delay or accelerate the litigation. The choice, then, is between the price at the time at which the breach is accepted and the price at the time of performance. More precisely, that first choice is the forward price—the price at the time of the breach for goods to be delivered at the time of performance. The *expected value* of the price at the time of performance and the forward price at the time of the repudiation is the same. So, the choice should not matter too much as long as the rule is known beforehand.

The decisions go both ways. White and Summers enthusiastically endorse the opinion in *Hess Energy, Inc. v. Lightning Oil Co.*,<sup>20</sup> which measured damages at the time of performance:

In affirming Hess' jury verdict . . . the Fourth Circuit agrees with our interpretation and arguments . . . for the proposition that 2-713 measures the contract market difference at the time of delivery not at the time of repudiation in a repudiation case. Hurray for Judge Niemeyer.<sup>21</sup>

In *Cosden Oil & Chemical Co. v. Karl O. Helm Aktiengesellschaft*,<sup>22</sup> the court, after calling the problem “one of the most difficult interpretive problems of the Uniform Commercial Code,”<sup>23</sup> chose the time at which the repudiation was accepted (or a reasonable time thereafter).

Thomas Jackson used *Oloffson v. Coomer*<sup>24</sup> in developing his argument for the time of repudiation.<sup>25</sup> A farmer (Coomer) promised in April to sell 40,000 bushels of corn to a grain dealer for delivery in October and December. However, in June

19. See WHITE & SUMMERS, *supra* note 11, at 325 n.8. That was the position taken by the Second Circuit in *Trans World Metals, Inc. v. Southwire Co.*, 769 F.2d 902 (1985), in which the buyer repudiated a contract for the sale of 1,000 metric tons per month of aluminum:

We would accept Southwire's argument that the date Trans World learned of the repudiation would be the correct date on which to calculate the market price had this action been tried *before* the time for full performance under the contract. See N.Y.U.C.C. § 2-723(1) (market price at time aggrieved party learned of repudiation used to calculate damages in action for anticipatory repudiation that “comes to trial before time for performance with respect to some or all of the goods”). However, where damages are awarded *after* the time for full performance, as in this case, the calculation of damages under § 2-708(1) should reflect the actual market price at each successive date when tender was to have been made under the repudiated installment contract.

20. *Hess Energy, Inc. v. Lightning Oil Co.*, 338 F.3d 357 (4th Cir. 2003).

21. WHITE & SUMMERS, *supra* note 16, § 7-7, at 325-26.

22. *Cosden Oil & Chemical Co. v. Karl O. Helm Aktiengesellschaft*, 736 F.2d 1064 (5th Cir. 1984).

23. *Id.* at 1066.

24. See generally *Oloffson v. Coomer*, 296, N.E.2d 871 (Ill. App. Ct. 1973).

25. See Thomas H. Jackson, “*Anticipatory Repudiation*” *And The Temporal Element Of Contract Law: An Economic Inquiry Into Contract Damages In Cases Of Prospective Nonperformance*, 31 STAN. L. REV. 69, 81-94 (1978).

Coomer informed Oloffson that, because the season had been too wet, he would not be planting any corn. The contract price was about \$1.12, and the price for future delivery at that time was \$1.16. The market price rose substantially in the months after the repudiation. Oloffson ultimately purchased corn at much higher prices after the delivery dates had passed (\$1.35 and \$1.49) and argued that his damages should be based on those prices. The court held that, given the nature of the market, a commercially reasonable time to await performance was less than a day and used the forward price at the time of repudiation (\$1.16) when calculating damages.<sup>26</sup> Professor Jackson asserted that “contract law presumptively should adopt a general rule that an aggrieved buyer should cover at the forward price as of the date of the repudiation.”<sup>27</sup>

While this is essentially the same position I have taken, *Oloffson* does raise one issue. The court noted that Oloffson had argued that he had “adhered to a usage of trade that permitted his customers to cancel the contract for a future delivery of grain by making known to him a desire to cancel and paying to him the difference between the contract and market price on the day of cancellation.”<sup>28</sup> At first, this seems an odd point for Oloffson to make. Why should he care about the difference between the spot and forward price? His argument was that because Coomer had failed to give notice, Coomer could not take advantage of the usage and that damages should be measured by the price at the dates of performance (\$1.35 and \$1.49). That’s a non sequitur—why jump to this default rule? Regardless, the court rejected this argument because, it claimed, Coomer did not know of the alleged usage, and good faith required that Oloffson inform him of that usage. Absent the usage, the court then opted for the forward price at the time of the repudiation. Remarkably, White and Summers get this completely wrong. They reluctantly concede that “[t]he outcome of the case can be defended only on the ground that the contract was implicitly modified by the trade usage that prevailed in the corn market. . . .”<sup>29</sup> But, the court *rejected* the trade usage (spot price) and chose instead the forward price. The White and Summers preferred rule, price at the time of performance, wasn’t even in the running.

To call this a trade usage is an understatement. It was the rule of the National Grain and Feed Dealers Association (NGFDA): “cancel the defaulted portion of the contract at fair market value based on the close of the market the next business day.”<sup>30</sup> So, it appears that the standard rule in the grain trade is to use the *spot* price, not the *forward* price. In this instance, the difference between the spot and forward price is unimportant. For a storable commodity (wheat or corn), the spot price plus the expected costs of storage is a good approximation of the forward price.

26. *Oloffson*, 296 N.E.2d at 874. (“Since Coomer’s statement to Oloffson on June 3, 1970, was unequivocal and since ‘cover’ easily and immediately was available to Oloffson in the well-organized and easily accessible market for purchases of grain to be delivered in the future, it would be unreasonable for Oloffson on June 3, 1970, to have awaited Coomer’s performance....”).

27. Jackson, *supra* note 25, at 94.

28. *Oloffson*, 296 N.E.2d at 875.

29. WHITE & SUMMERS, *supra* note 11, § 6.3

30. NGFA Grain Trade Rules, 28(A)(3).

While § 2–723 is the Code’s response to multi–year contracts, it is not particularly helpful. White and Summers recognize that “long–term contracts for the sale of commodities such as oil, gas, coal, nuclear fuel and the like do not have fixed quantities for remote time periods.”<sup>31</sup> What to do? “We think a court should be generous in listening to an aggrieved party’s expert testimony about projections.”<sup>32</sup> That does not give us much to go on.

Suppose that a buyer were to repudiate a twenty–year contract in year three. The agreement could have all sorts of bells and whistles. The contract could include a price adjustment mechanism (perhaps an index), or a gross inequity (or hardship) clause that would allow a disgruntled party to appeal to an arbitrator or court to reset the price. The contract might have a mechanism that would allow one of the parties to terminate the agreement under certain circumstances. Quantity need not be fixed. It could be determined by the buyer (requirements contract) or seller (output contract). The contract might include a take–or–pay or minimum quantity clause, and that might be modified with a makeup clause. Section 2–723 instructs the court to base damages on the “market price” at the date that the aggrieved party “learn[s] of the repudiation.” What is that price?

White and Summers suggest that the price at the time of the repudiation should be used for the remaining 17 years<sup>33</sup> and some courts—the Tenth Circuit in *Manchester Pipeline Corp. v. Peoples Natural Gas Co.*<sup>34</sup> and the Oklahoma Supreme Court in *Roye Realty & Developing, Inc. v. Arkla, Inc.*<sup>35</sup>—have taken the same position. But even if we accept the notion that the price would be constant for the entire period, it still does not take into account the many non–price aspects of the contract. The decisions tend to focus on the price of the product—the difference between the contract and market price. The relevant concern should be the change in the value of the contract at the time of the repudiation. I am not claiming that ascertaining that will be easy to do. But I am claiming that this is the appropriate conceptual framework. Dueling experts would undoubtedly disagree on future prices and quantities, and on the seller’s ability to mitigate by finding alternative buyers, as well as other aspects of the contract. Nonetheless, their concern would be the value of the contract, not just the price term.<sup>36</sup>

The take–or–pay contract is one type of long–term contract that has caused some confusion. In a take–or–pay, the buyer promises that it will pay the contract price for a certain quantity whether or not it actually takes anything. Suppose a 20–year contract that sets the take at 1,000 tons per year. In the first year, the buyer takes only 400 tons. What damages? While this is sometimes characterized as a breach by the

31. WHITE & SUMMERS, *supra* note 11, § 7–8.

32. WHITE & SUMMERS, *supra* note 11, § 7–8.

33. WHITE & SUMMERS, *supra* note 11, at 334 (qualifying this by accepting any price information that would become available in the period between repudiation and trial).

34. *Manchester Pipeline Corp. v. Peoples Nat. Gas. Co.*, a Div. of Internorth, 862 F.2d 1439, 1448 (10th Cir. 1988).

35. *Roye Realty & Developing, Inc. v. Arkla, Inc.*, 863 P.2d 1150 (Okla. 1993).

36. For an example of how much the expert valuations might diverge, see *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.*, 487 F.3d 89, 108 (2d. Cir. 2007) (plaintiff’s expert concluding that the damages exceeded \$500 million; defendant’s expert concluding that damages were zero).

buyer, it isn't. The buyer would simply owe the contract price multiplied by the 600-ton shortfall. The only breach would be the buyer's refusal to pay. What if the market collapsed and the buyer then repudiated the contract? The seller, which previously had to remain ready to perform for the ensuing 19 years would now be released from its obligation. It could mitigate by selling to others or (if continued production were not worthwhile) by ceasing to produce. The damages would be the difference between the future revenues had the contract been performed and the future revenues given the new market reality.<sup>37</sup>

My final concern is the so-called lost volume seller.<sup>38</sup> The basic issue in the lost volume cases is that if the buyer cancels an order (breaches), and the seller "mitigates" by selling the unit at the same price to another buyer, an award of the contract-market differential would result in zero damages. However, so goes the story, if the second buyer would have bought a unit from the seller anyway, the seller would have had two sales, not one. The seller would have lost the "profit" on the sale that got away. Making the seller whole would require that it be compensated for the profit it would have made, but for the breach.<sup>39</sup> That seems plausible. For White and Summers that remedy is "the recovery which all right-minded people would agree the lost volume seller should have."<sup>40</sup>

Nonetheless, I claim, all those "right-minded people" are wrong. By cancelling the order, the buyer, in effect, would be invoking an implied termination clause. The remedy would be the price the buyer would have to pay for termination (cancellation) if the contract were otherwise silent.<sup>41</sup> When framed this way, it becomes clear that the lost profits remedy misprices the buyer's option. I am not proposing a test in which we compare the proposed remedy to some idealized alternative (like efficiency). The standard I am applying is more forgiving—is the contract imposed by the court absurd? The lost profit remedy, I will argue, fails that test. When the parties have not set an explicit option price (perhaps as a nonrefundable deposit) and market conditions have not changed, the appropriate default rule should be zero damages.

While § 2-708(2) was meant to deal only with the exceptional case in which the normal remedies (§ 2-706 and § 2-708(1)) proved inadequate, some scholars have argued that it is, or should be, the dominant remedy. Childres and Burgess, for example, claimed:

37. "Take-or-pay" and "minimum quantity" contracts are basically the same. So, for example, in the casebook favorite, *Lake River v. Carborundum*, 769 F.2d 1284 (7th Cir. 1985), the shortfall at the end of the three-year period would not have been a breach, but the buyer's failure to pay would have been. Damages would have been the price multiplied by the shortfall. In Judge Posner's hypothetical in which he had the buyer repudiate the contract on the first day, damages would have not been the price times the quantity. *Lake River* would have been freed of its obligation to provide bagging services to Carborundum; its resources could instead be used for other purposes, mitigating the damages. For more on this, see generally Victor P. Goldberg, *Reckoning Contract Damages: Valuation Of The Contract As An Asset*, 75 WASH. & LEE L. REV. 301 (2018).

38. See Victor P. Goldberg, *Lost Volume Seller, R.I.P.*, (COLUM. L. & ECON., Working Paper No. 562, 2017).

39. U.C.C. § 2-708(2) (AM. LAW INST. & UNIF. LAW COMM'N 2017).

40. WHITE & SUMMERS, *supra* note 11, § 8-13.

41. For a similar argument, see generally Robert E. Scott & George G. Triantis, *Embedded Options and the Case Against Compensation in Contract Law*, 104 COLUM. L. REV. 1428 (2004).



[T]he lost-profit rule of 2–708(2) is no rule of last resort for the few cases that fail to fit the specific rules. It is the dominant damages rule or principle. . . . We think it probable that in the American economy of today and the foreseeable future, the overwhelming proportion of sales contracts should produce the 2–708(2) situation if repudiated by the buyer.<sup>42</sup>

Fortunately, that has not come to pass, but § 2–708(2) is still capable of real mischief.

The simple point is this: buyers would often be willing to pay a price for the option to terminate (or cancel), but that price bears no resemblance to the implicit option price of the lost profit remedy. Parties can price the option with nonrefundable deposits, progress payments, and other devices. Sadly, the law, with its skepticism regarding liquidated damages (and that unfortunate § 2–718(2) referred to in my opening paragraph) can sometimes get in the way.

Suppose a consumer orders a large consumer durable—a car, boat, or mobile home—and before delivery it cancels the order (breaches the contract).<sup>43</sup> Manufacturers pay retailers indirectly for retailing services; that price is the average price of retailing services the difference between the wholesale and retail price (the gross margin). If a car dealer had no difficulty getting additional units, the lost volume remedy would be the gross margin.<sup>44</sup> If lost profits were the remedy, the contract in effect says that the buyer promised to pay the gross margin (unknown to the buyer but probably around 10% of the contract price) for the option to buy the car for 90% of the sale price.

If, however, the dealer could not get more units (perhaps because it was a “hot” car that the manufacturer had on allocation), then there would not be any lost volume, and the seller would be restricted to the contract–market price differential—which would be zero. In effect, the lost volume profit rule sets the option price at the gross margin in normal times, but as the market gets tighter (as the dealer’s chances of obtaining an additional car from the manufacturer diminish) the lost volume measure (option price) falls. There is no good economic reason for such a result. Indeed, it is perverse. Other things equal, the tighter the market, the greater the option price should be. The lost volume remedy sets the option price high when the market is slack and low when it is tight, the opposite of what a rational dealer would do.

42. Robert Childres & Robert K. Burgess, *Seller's Remedies: The Primacy of UCC 2-708(2)*, 48 N.Y.U. L. Rev. 833, 881–82 (1973); see also John A. Seibert, Jr., *Remedies Under Article Two of the Uniform Commercial Code: An Agenda for Review*, 130 U. PA. L. REV. 360, 366 (1981) (“Although this profit plus overhead recovery may have been seen by the Code’s drafters as a provision that would apply only infrequently, it is now recognized that, at least in theory, this will be the appropriate measure of damages in a substantial majority of cases involving merchant sellers.”) and Roy Ryden Anderson, *Damages For Sellers Under The Code’s Profit Formula*, 40 SW. L.J. 1021, 1063. (“Under the Code’s scheme the profit formula of section 2–708(2) is truly the dominant damage remedy for aggrieved sellers who suffer a breach prior to the time that the buyer accepts the goods. The formula applies to most commercial sellers because such sellers are usually left in a lost volume situation by a buyer’s breach.”).

43. See, e.g., *Neri v. Retail Marine Corp.*, 285 N.E.2d 311 (1972) Many contracts casebooks include it to illustrate the lost volume seller problem.

44. See U.C.C. § 2–708, cmt. 2, (AM. LAW INST. & UNIF. LAW COMM’N 2017).

The intuitive appeal of the lost volume remedy in the retail context is that the gross margin is a rough approximation of the average price of retailing services. That intuition does not carry over to the manufacturer context. There, the loss would be the difference between the contract price and the seller's "but-for" costs. So, if, a seller were in an R&D intensive industry, the "lost profits" could be a very large fraction of the contract price. For example in *Teradyne, Inc. v. Teledyne Industries, Inc.*,<sup>45</sup> the contract price was about \$98,000 for a product with a substantial R&D component. All the parties, including the court, presumed that the lost volume remedy was appropriate and their only issue was whether some labor costs should be treated as fixed or variable. The variable costs were about \$22,000. Thus, the contract that the court created said in effect that the buyer was willing to pay \$76,000 for the option to buy the goods for \$22,000. No one asked the simple question: why on earth would it do something that stupid? Are there any circumstances in which a buyer would be willing to enter into such an arrangement? Yes, some. If the seller relied on this particular buyer (say in a long-term coal contract) or if the item were highly customized with little market value if the buyer were to cancel, a high cancellation fee (option price) would be plausible. Of course, in neither of these cases would the seller expect to be able to sell to this buyer and another. The seller would not be a lost volume seller. Once we make the contract structure explicit—an option price that was over 70% of the contract price—it is clear that no "right-minded person" would have voluntarily entered into such a contract.

Ironically, courts and commentators that claim to be troubled by the possible punitive aspects of a liquidated damages clause would routinely apply § 2-708(2), notwithstanding the fact that the lost profits remedy is often more punitive. Two cases will illustrate this point. In *R.E. Davis Chemical Corp. v. Disonics, Inc.*,<sup>46</sup> the buyer cancelled an order for an MRI machine. There was a non-refundable deposit of \$300,000.<sup>47</sup> The buyer sued for the return of the deposit, and Disonics counterclaimed for its lost profits. The court granted the return of the deposit (citing § 2-718(2)(b)) but held that Disonics could be a lost volume seller. The court remanded to determine whether Disonics could have produced the second unit profitably; on remand it found that Disonics could and that the lost volume damages were in excess of \$450,000. For my purposes, the significant point is that the court was comfortable with the notion that the \$300,000 down payment would be an unenforceable penalty, but a \$450,000 lost profits award would not be.

Even more bizarre was *Rodriguez v. Learjet*.<sup>48</sup> Learjet sold an airplane for future delivery with the contract calling for a series of progress payments when certain milestones were reached. The buyer made the first payment of \$250,000, canceled the order shortly thereafter, and then asked for the return of the payment. The payment was, it asserted, a penalty. Lear subsequently sold the jet to another customer for a "profit" of \$1,887,464. Here is where it gets weird. To show that the liquidated damages were not unreasonable, Learjet argued that it was a lost volume

45. *Teradyne, Inc. v. Teledyne Indus., Inc.*, 676 F.2d 865 (1st Cir. 1982).

46. *R.E. Davis Chemical Corp. v. Disonics, Inc.*, 826 F.2d 678 (7th Cir. 1987).

47. *Id.* (ignoring the fact that the deposit was non-refundable. The full payment terms are in the contract, a copy of which is available from the author).

48. *Rodriguez v. Learjet, Inc.*, 946 P.2d 1010 (Kan. Ct. App. 1997).

seller. If the lost volume profits were greater than the liquidated damages, then the liquidated damages would be reasonable, and the \$250,000 would not be a penalty. The court concluded that Learjet's lost volume profits were the \$1.8+ million profit that it received in the subsequent sale. Since \$1.8 million is greater than \$250,000, there was no penalty. (The court says nothing about why Learjet preferred \$250,000; my presumption is that it was more interested in establishing the legality of its progress payments than in making a one-time killing.) My point is that the court considered the \$250,000 payment to be at least problematic while suggesting that an award seven times that would be just fine.

I could go on with more illustrations,<sup>49</sup> but I think this is enough to make my point. Awarding lost volume profits fixes an implied option price, one that has perverse effects, setting the price high when the market is slack and low when it is tight. More generally, the implied option price is simply unrelated to any plausible function. And to make matters even worse, courts will overrule explicit options as penalties to replace them with the implicit lost-volume option price (that might be even bigger).

There remains a puzzle. Why is it that so many "right-thinking people" have been thinking about it the wrong way for so long? How, for example, could the implied option price in *Teledyne* be so absurdly high and yet neither the lawyers nor the judge even noticed the absurdity? Part of the explanation, I believe, is the view that canceling an order (breaching a contract) is a wrong to be redressed. Rather, the question should be framed as a matter of pricing the buyer's termination option. In the absence of an explicit option price, the default rule should set the price at zero.

Suppose that all my criticisms of the Code are correct. What can be done? The last attempt to rewrite the Code collapsed and I doubt that anyone would dare revive that effort. That leaves interpretation. I feel fairly confident that my concerns with §§ 2-706, 2-708(1) and 2-723 can be adequately handled. Indeed, White and Summers suggest that their interpretation of the conflict between § 2-706 and § 2-708(1) is contestable.<sup>50</sup> And, as noted above, their view is that § 2-723 is not really capable of dealing with the repudiation of long-term contracts. I am a bit less sanguine about § 2-708(2), although I have suggested elsewhere a number of possible arguments.<sup>51</sup> The most persuasive for me is the canon of interpretation that language should not produce an absurd result.

49. See Goldberg, *The Lost Volume Seller*, *supra* note 38.

50. WHITE & SUMMERS, *supra* note 11, at 421 ("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.")

51. See Goldberg, *The Last Volume Seller*, *supra* note 38.