CHAPTER 7

REMEDIES FOR BREACH

The remedy for breach of contract is presumptively compensatory, or *substitutional* relief, in the form of a judgment awarding money damages to be paid to the aggrieved promisee, rather than *specific* relief, in the form of a court order directing the promisor to perform its promise. The following excerpt gives some historical background for this presumption.

''The common law courts did not generally grant specific relief for breach of contract. The usual form of relief at common law was substitutional, and the typical judgment declared that the plaintiff recover from the defendant a sum of money. . . . If the sum was not paid, a writ of execution was issued, empowering the sheriff to seize and sell so much of the defendant's property as was required to pay the plaintiff. . . .

''Promises were enforced in equity in a very different way. . . . Under the influence of canon law—for the early chancellors were usually clerics—decrees in equity came to take the form of the chancellor's personal command to the defendant to do or not to do something. The defendant that disobeyed could be punished not only for criminal contempt, at the instance of the court, but also for civil contempt, at the instance of the plaintiff. This put into the plaintiff's hands the extreme sanction of imprisonment, which might be supplemented by fines payable to the plaintiff and by sequestration of the defendant's goods. So it was said that equity acted *in personam,* against the person of the defendant, while the law acted *in rem,* against the defendant's property. But it did not follow that the chancellor stood ready to order every defaulting promisor to perform its promise. Equitable relief was confined to special cases by both historical and practical limitations.

''The most important historical limitation grew out of the circumstance that the chancellor had originally granted equitable relief in order to supply the deficiencies of the common law. Equitable remedies were therefore readily characterized as 'extraordinary.' When, during the long jurisdictional struggle between the two systems of courts, some means of accommodation was needed, an adequacy test was developed to prevent the chancellor from encroaching on the powers of the common law judges. Equity would stay its hand if the remedy of an award of damages at law was 'adequate.' To this test was added the gloss that damages were ordinarily adequate—a gloss encouraged by the philosophy of free enterprise with its confidence that a market economy ought to enable the injured party to arrange a substitute transaction. . . . So English courts came to regard money damages as the norm and specific relief as the deviation. Only for land, which English courts regarded with particular esteem, was a general exception made, on the ground that each parcel of land was 'unique' so money damages were inadequate. This strong preference of English courts for substitutional relief stands in sharp contrast to the preference of civil law systems, those derived from the Roman law, for specific relief.

"A second historical limitation, or group of limitations, is based on the concept that equitable relief is discretionary. Since the chancellor was to act according to 'conscience' (which prompted the notorious charge that his conscience might vary with the length of his foot), he might withhold relief if considerations of fairness or morality dictated. Gradually these equitable restrictions became more precise and hardened into rules. Some of the most renowned are embodied in equity's colorful maxims: 'one who seeks equity must do equity'; 'one who comes into equity must come with clean hands'; and 'equity aids the vigilant.' One of the most troublesome of these rules was the now discredited 'mutuality of remedy' rule, under which the injured party's right to specific relief depended on whether it would have been available to the other party, had the breach been on the other side. . . .

"Thus it came to be that, although the injured party can always claim damages for breach of contract, that party's right to specific relief as an alternative is much more limited. The historical development of parallel systems of law and equity may afford an adequate explanation for the reluctance of our courts to grant specific relief more widely, but it is scant justification for it. A more rational basis can today be found in the severity of the sanctions available for enforcement of equitable orders. Nevertheless, the modern trend is clearly in favor of the extension of specific relief at the expense of the traditional primacy of damages." See 3 *Farnsworth on Contracts* § 12.4 (2d ed. 1998).

We begin our discussion of modern remedies with specific relief. The initial case, *Campbell Soup*, was first encountered on p. 494 in the materials on unconscionability. The excerpt of the opinion below addresses Campbell's demand for specific performance of a contract for carrots from Wentz.

SECTION 1. SPECIFIC RELIEF

Campbell Soup Co. v. Wentz

United States Court of Appeals, Third Circuit, 1948.
172 F.2d 80.

■ GOODRICH, CIRCUIT JUDGE.[a] These are appeals from judgments of the District Court denying equitable relief to the buyer under a contract for the sale of carrots. The defendants in No. 9648 are the contract sellers. The

a. Herbert F. Goodrich (1889–1962) taught law for twenty-five years at Iowa, Michigan and Pennsylvania, where he also served as dean. Beginning in 1940 he served as judge on the United States Court of Appeals for the Third Circuit, and beginning in 1947 he served as director of the American Law Institute. His best-known book is a text on the conflict of laws.

defendant in No. 9649 is the second purchaser of part of the carrots which are the subject matter of the contract.

The transactions which raise the issues may be briefly summarized. On June 21, 1947, Campbell Soup Company (Campbell), a New Jersey corporation, entered into a written contract with George B. Wentz and Harry T. Wentz, who are Pennsylvania farmers, for delivery by the Wentzes to Campbell of all the Chantenay red cored carrots to be grown on fifteen acres of the Wentz farm during the 1947 season.

Where the contract was entered into does not appear. The contract provides, however, for delivery of the carrots at the Campbell plant in Camden, New Jersey. The prices specified in the contract ranged from $23 to $30 per ton according to the time of delivery. The contract price for January, 1948 was $30 a ton.

The Wentzes harvested approximately 100 tons of carrots from the fifteen acres covered by the contract. Early in January, 1948, they told a Campbell representative that they would not deliver their carrots at the contract price. The market price at that time was at least $90 per ton, and Chantenay red cored carrots were virtually unobtainable. The Wentzes then sold approximately 62 tons of their carrots to the defendant Lojeski, a neighboring farmer. Lojeski resold about 58 tons on the open market, approximately half to Campbell and the balance to other purchasers.

On January 9, 1948, Campbell, suspecting that Lojeski was selling it ''contract carrots,'' refused to purchase any more, and instituted these suits against the Wentz brothers and Lojeski to enjoin further sale of the contract carrots to others, and to compel specific performance of the contract. The trial court denied equitable relief. We agree with the result reached, but on a different ground from that relied upon by the District Court.

[The court said that the form of relief was for it to decide, as a federal court. Yet it noted that the federal rule on the point did not appear to differ from that of either state whose law might be applied—New Jersey or Pennsylvania.] A party may have specific performance of a contract for the sale of chattels if the legal remedy is inadequate. Inadequacy of the legal remedy is necessarily a matter to be determined by an examination of the facts in each particular instance.

We think that on the question of adequacy of the legal remedy the case is one appropriate for specific performance. It was expressly found that at the time of the trial it was ''virtually impossible to obtain Chantenay carrots in the open market.'' This Chantenay carrot is one which the plaintiff uses in large quantities, furnishing the seed to the growers with whom it makes contracts. It was not claimed that in nutritive value it is any better than other types of carrots. Its blunt shape makes it easier to handle in processing. And its color and texture differ from other varieties. The color is brighter than other carrots. The trial court found that the plaintiff failed to establish what proportion of its carrots is used for the production of soup stock and what proportion is used as identifiable physical ingredients in its soups. We do not think lack of proof on that point is material. It did appear that the plaintiff uses carrots in fifteen of its twenty-one soups. It also appeared that it uses these Chantenay carrots diced in some of them and that the appearance is uniform. The preservation of uniformity in appearance in a food article marketed throughout the country and sold under the manufacturer's name is a matter of considerable commercial significance and one which is properly considered in determining whether a substitute ingredient is just as good as the original.

The trial court concluded that the plaintiff had failed to establish that the carrots, "judged by objective standards," are unique goods. This we think is not a pure fact conclusion like a finding that Chantenay carrots are of uniform color. It is either a conclusion of law or of mixed fact and law and we are bound to exercise our independent judgment upon it. That the test for specific performance is not necessarily "objective" is shown by the many cases in which equity has given it to enforce contracts for articles—family heirlooms and the like—the value of which was personal to the plaintiff.

Judged by the general standards applicable to determining the adequacy of the legal remedy we think that on this point the case is a proper one for equitable relief. There is considerable authority, old and new, showing liberality in the granting of an equitable remedy. We see no reason why a court should be reluctant to grant specific relief when it can be given without supervision of the court or other time-consuming processes against one who has deliberately broken his agreement. Here the goods of the special type contracted for were unavailable on the open market, the plaintiff had contracted for them long ahead in anticipation of its needs, and had built up a general reputation for its products as part of which reputation uniform appearance was important. We think if this were all that was involved in the case specific performance should have been granted. . . .

The judgments will be affirmed.

NOTES

(1) *Inadequacy of Money Damages*. Why was a money damage award an inadequate remedy for Campbell? Campbell brought the action for specific performance after suspecting that it was buying from Lojeski "contract carrots" (that is, those very carrots that Wentz agreed to sell to Campbell) at an inflated price. But if it was getting the specific carrots for which it contracted, albeit at an inflated price, why wouldn't a monetary award equivalent to the excess of what was paid by Campbell suffice?

(2) *Incommensurability and Uncertainty*. The inadequacy of money damages is sometimes grounded in the belief that money offers no substitute for the promised performance, as when breach leads to the deprivation of a loved one's companionship or the loss of a firm's goodwill. Claimants also sometimes speak of money as being incommensurable with a specified performance, but more often the issue of inadequacy turns on uncertainty. When the performance would provide a "peculiar and unique value," money damages are often viewed as too speculative and therefore not compensatory. Again, Campbell's damages do not seem to have been beyond measure by reason of incommensurability or uncertainty. Its loss appears to have been simply the extra amount it had to pay for the very carrots for which it

contracted. Invoices and the contract could establish this difference with near certainty.

Professor Victor Goldberg has suggested that the uncertainty in the case was not the kind that relates to calculation of damages. Rather, the uncertainty revolved around Campbell not knowing in fact whether it was buying contract carrots or other carrots. Suspecting is not the same as knowing. Because it is difficult for buyers like Campbell to know whether Wentz and other growers report their output truthfully, Campbell may get fewer carrots or carrots of a lower quality than it contracted for with Wentz. Goldberg, *Framing Contract Law*, 217 (2006). How does injunctive relief—an order of specific performance—address this concern?

(3) *Cotton Crisis*. In 1973 there was a spectacular rise in the price of cotton on the American market. The causes were said to include large shipments to China, high water and flood conditions in the cotton belt, late plantings forced by heavy rains, and the devaluation of the dollar. In the early months of the year, before planting, a cotton farmer will make a ''forward'' sale contract for delivery to the buyer of all cotton to be raised and harvested on a specified tract at a fixed price per pound, without guarantee of quantity or quality. The farmer can then use this contract to finance the raising of the crop. Early in 1973, cotton farmers made such contracts to sell at a price roughly equal to the price on the market at that time, some 30 cents a pound. By the time the cotton had been raised and was ready for delivery, however, the market price had risen to about 80 cents a pound. The farmers felt, as one judge later put it, ''sick as an old hound dog who ate a rotten skunk.'' Many refused to perform the forward contracts that they had made at the lower price, and scores of lawsuits resulted throughout the cotton belt.[a]

If buyers of cotton asked you what remedies they have against recalcitrant farmers under enforceable contracts like that described at p. 1 above, what advice would you give about specific performance? Since buying substitute cotton on a risen market would simply cost more money, would not an award of damages be ''adequate to protect [their] expectation interest''? Cases denying specific performance of cotton contracts include Weathersby v. Gore, 556 F.2d 1247 (5th Cir.1977), and Duval & Co. v. Malcom, 214 S.E.2d 356 (Ga.1975).

But see Mitchell–Huntley Cotton Co., Inc. v. Waldrep, 377 F.Supp. 1215, 1219 (N.D.Ala.1974), where the court granted a declaratory judgment that a buyer who was ''in the business of buying cotton from producers and others and selling and delivering same to textile mills and others'' was entitled to specific performance of its contracts with farmers and enjoined the farmers from violating them. ''The cotton in question is unique and irreplaceable because of the scarcity of cotton.... The majority of all cotton to be produced in the United States in the 1973 crop year has been sold under contracts similar to those here at issue. There is no substantial carry-over of merchantable grades and classes of cotton from prior years in storage in the United States and there will be very little cotton available for purchase in the open market through the 1973 cotton season.'' Does it appear that the buyer's damage remedy was inadequate if, as the court found, ''a drastic shortage of cotton developed and the price for same on the open market had increased [from an original contract price of $.30 per pound] to an amount in excess of $.80 per pound''?

(4) *Question*. The contract in *Campbell* was governed by the Uniform Sales Act, the predecessor of Article 2 of the UCC. What are the standards for specific performance in Article 2? See UCC § 2–716.

a. This summary is taken largely from one of the cotton cases, Bolin Farms v. American Cotton Shippers Ass'n, 370 F.Supp. 1353 (W.D.La.1974).

Klein v. PepsiCo, Inc.

United States Court of Appeals, Fourth Circuit, 1988.
845 F.2d 76.

■ ERVIN, CIRCUIT JUDGE: This case turns on whether a contract was formed between Universal Jet Sales, Inc. (''UJS'') and PepsiCo, Inc., (''PepsiCo'') for the sale of a Gulfstream G–II corporate jet to UJS for resale to one Eugene V. Klein. If a contract was formed, the question remains whether the district court acted within his discretion by ordering specific performance of the contract. We believe the district court properly found that a contract was formed; however, we conclude that the remedy of specific performance is inappropriate. Accordingly, we affirm in part, reverse and remand in part.

I.

In March 1986, Klein began looking for a used corporate jet; specifically, he wanted a G–II. He contacted Patrick Janas, President of UJS, who provided information to Klein about several aircraft including the PepsiCo aircraft. Klein's pilot and mechanic, Mr. Sherman and Mr. Quaid, inspected the PepsiCo jet in New York. Mr. James Welsch served as the jet broker for PepsiCo.

Klein asked that the jet be flown to Arkansas for his personal inspection. On March 29, 1986, he inspected the jet. Mr. Rashid, PepsiCo Vice President for Asset Management and Corporate Service, accompanied the jet to Arkansas and met Mr. Klein. Janas also went to Arkansas. Klein gave Janas $200,000 as a deposit on the jet, and told Janas to offer $4.4 million for the aircraft.

On March 31, 1986, Janas telexed the $4.4 million offer to Welsch. The telex said the offer was subject to a factory inspection satisfactory to the purchaser, and a definitive contract. On April 1, PepsiCo counteroffered with a $4.7 million asking price. After some dickering, Welsch offered the jet for $4.6 million. Janas accepted the offer by telex on April 3. Janas then planned to sell the aircraft to Klein for $4.75 million. In Finding of Fact number 18 Judge Williams declared that a contract had been formed at this point.

Judge Williams ruled that a contract was evidenced by Janas' confirming telex which ''accepted'' PepsiCo's offer to sell the jet, and noted that a $100,000 down payment would be wired. The telex also asked for the proper name of the company selling the aircraft. See Finding of Fact number 22.

On April 3, Janas sent out copies of the Klein/UJS agreement and the UJS–PepsiCo agreement to the respective parties. Janas also sent a bill of sale to the escrow agent handling the deal on April 8. Mr. Rochoff, PepsiCo's corporate counsel, spoke with Janas about the standard contract sent by Janas to PepsiCo. He noted only that the delivery date should be changed.

On Monday, April 7, the aircraft was flown to Savannah, Georgia for the pre-purchase inspection. Quaid was present at the inspection for Klein.

Archie Walker, PepsiCo's chief of maintenance, was present for the seller. Walker and Quaid discussed a list of repairs to be made to the jet. Most of the problems were cured during the inspection. However, one cosmetic problem was to be corrected in New York, and there were cracks in the engine blades of the right engine.

On April 8, a boroscopic examination conducted by Aviall revealed eight to eleven cracks on the turbine blades. Walker told Rashid that the cost of repairing the blades would be between $25,000 to $28,000. Judge Williams found in Finding of Fact numbers 34 through 37 that PepsiCo, through Walker and Rashid, agreed to pay for the repair to the engine.

On April 9, the plane was returned to New York. Rashid wanted the plane grounded; however, it was sent to retrieve the stranded PepsiCo Chairman of the Board from Dulles airport that same evening. Donald Kendall, the Chairman, on April 10, called Rashid and asked that the jet be withdrawn from the market. Rashid called Welsch who effected the withdrawal. On the 11th Janas told Klein that PepsiCo refused to tender the aircraft. The deal was supposed to close on Friday, April 11.

On April 14, Klein telexed UJS demanding delivery of the aircraft. That same day, UJS telexed PepsiCo demanding delivery and expressing satisfaction with the pre-purchase inspection. On April 15, PepsiCo responded with a telex to UJS saying that it refused to negotiate further because discussions had not reached the point of agreement; in particular, Klein was not prepared to go forward with the deal.

Judge Williams, in a lengthy opinion, made numerous findings of fact. Such findings are reviewed only for clear error. Davis v. Food Lion, 792 F.2d 1274, 1277 (4th Cir.1986). If the findings are based on determinations of witness credibility, are consistent, and are corroborated by extrinsic evidence, they are virtually never clearly erroneous. Brown v. Baltimore and Ohio R. Co., 805 F.2d 1133, 1140 (4th Cir.1986).

Judge Williams' decision to grant specific performance is reviewed only for an abuse of discretion. Haythe v. May, 223 Va. 359, 288 S.E.2d 487 (1982); Horner v. Bourland, 724 F.2d 1142, 1144–45 (5th Cir.1984). Keeping these standards in mind, we now turn to the first issue, whether the district court clearly erred in finding that a contract arose between PepsiCo and UJS.

II.

PepsiCo argues forcefully that no contract was formed between it and UJS. The soft drink dealer argues first that the parties did not intend to be bound until a complete integration was written in final form. Until that definitive written contract existed, PepsiCo maintains that no contract existed. The company argues that the March 31 and April 1 telexes explicitly stated that no contract would exist until a written agreement was executed. Because no written agreement had been executed (PepsiCo had not signed the sales agreement sent by Janas to PepsiCo) the company argues that it had the right to withdraw from the negotiations. PepsiCo cites Reprosystem, B.V. v. SCM Corp., 727 F.2d 257, 262 (2d Cir.1984), cert.

denied, 469 U.S. 828 (1984) and Skycom Corp. v. Telstar Corp., 813 F.2d 810, 815–16 (7th Cir.1987) for the general proposition that either party can withdraw from negotiations for any reason.

Upon reviewing the facts, Judge Williams ruled that a contract was formed between the parties. He explains:

> A contract was formed between UJS and PepsiCo for the sale of the GII aircraft, Serial No. 170, for $4.6 million. The contract formation is based upon (1) UJS's April 3rd confirming telex; (2) the conduct of the parties, e.g., (a) PepsiCo's failure to communicate any objection to the terms of the April 3rd telex confirming the agreement reached between Welsch and Janas; (b) PepsiCo's directive to UJS to wire transfer a One Hundred Thousand Dollar ($100,000.00) down payment, which money was received by PepsiCo; (c) PepsiCo's communication with UJS that the Sales Agreement, which served to memorialize the contract, appeared ''fine''; (d) PepsiCo's execution of the Bill of Sale for the aircraft and its sending of the Bill of Sale to the escrow agent, as called for by Janas and in the Sales Agreement; (e) PepsiCo's sending the aircraft to Savannah, Georgia, for a prepurchase inspection as called for in both the April 3rd confirming telex and the Sales Agreement; and (f) admissions of PepsiCo, through Rashid, that UJS's offer to purchase the airplane was accepted.

Conclusion of Law number 6. Finally, Judge Williams expressly held that the intent to memorialize the contract in writing was not necessarily a condition to the existence of the contract itself. (Conclusion of Law number 8).

PepsiCo offers no reason as to why Judge Williams' findings on this issue are clearly erroneous. They merely disagree with his characterizations of the facts. This court may disagree with his characterization too, but that does not amount to a firm and definite conviction that a mistake has been committed. Anderson v. City of Bessemer City, N.C., 470 U.S. 564 (1985).

PepsiCo argues secondly, that no contract was formed because the condition of inspection satisfactory to the buyer had not been met. PepsiCo urges strongly that neither UJS nor Klein were willing to accept the aircraft ''as is,'' so the condition was unsatisfied. Judge Williams ruled that when PepsiCo agreed to make the repairs, the condition was satisfied. Furthermore, the court below ruled that the condition was excused by PepsiCo's refusal to tender the aircraft so that the buyer could express his dissatisfaction. [Conditions are discussed in Chapter 8 below.]

The district court's first ruling, that the condition was satisfied by PepsiCo's offers to pay for the repairs, resolves this issue. Judge Williams ruled that based on the conversations between Walker and Rashid, the seller had agreed to make the necessary repairs to market the plane. See Finding of Fact 34–37 at JA 89–90. Again, PepsiCo offers no suggestion that Judge Williams committed any error, much less clear error. Rather, PepsiCo urges its version of the facts on this court. Without more, the company loses.

Ultimately, then, a contract exists between PepsiCo and UJS for the sale of one G–II Gulfstream aircraft. Because PepsiCo failed to deliver the aircraft, the district court ordered relief in the form of specific performance. We now consider the appropriateness of the relief ordered.

III.

The Virginia Code § 8.2–716 [UCC § 2–716, as enacted in Virginia] permits a jilted buyer of goods to seek specific performance of the contract if the goods sought are unique, or in other proper circumstances. Judge Williams ruled that: 1) the G–II aircraft involved in this case is unique and 2) Klein's inability to cover with a comparable aircraft is strong evidence of ''other proper circumstances.'' Conclusions of Law No. 31 and No. 32. These conclusions are not supported in the record.

We note first that Virginia's adoption of the Uniform Commercial Code does not abrogate the maxim that specific performance is inappropriate where damages are recoverable and adequate. Griscom v. Childress, 183 Va. 42, 31 S.E.2d 309, 311 (1944). In this case Judge Williams repeatedly stated that money damages would make Klein whole. Klein argued that he wanted the plane to resell it for a profit. Finally, an increase in the cost of a replacement does not merit the remedy of specific performance. Hilmor Sales Co. v. Helen Neuschaefer Division of Supronics Corp., 6 U.C.C.Rep. Serv. 325 (N.Y.Sup.Ct.1969). There is no room in this case for the equitable remedy of specific performance.

Turning now to the specific rulings of the court below, Judge Williams explained that the aircraft was unique because only three comparable aircraft existed on the market. Therefore, Klein would have to go through considerable expense to find a replacement. Klein's expert testified that there were twenty-one other G–II's on the market, three of which were roughly comparable. Klein's chief pilot said that other G–II's could be purchased. Finally, we should note that UJS bought two G–II's which they offered to Klein after this deal fell through, and Klein made bids on two other G–II's after PepsiCo withdrew its aircraft from the market. Given these facts, we find it very difficult to support a ruling that the aircraft was so unique as to merit an order of specific performance.

Judge Williams ruled further that Klein's inability to cover his loss is an ''other proper circumstance'' favoring specific performance. Klein testified himself that he didn't purchase another G–II because prices had started to rise. Because of the price increase, he decided to purchase a G–III aircraft. As noted earlier, price increases alone are no reason to order specific performance. Because money damages would clearly be adequate in this case, and because the aircraft is not unique within the meaning of the Virginia Commercial Code, we reverse the grant of specific performance and remand the case to the district court for a trial on damages.

Affirmed in Part, Reserved and Remanded in Part.

NOTES

(1) In King Aircraft Sales v. Lane, 846 P.2d 550 (Wash.App.1993), the court upheld a decree of specific performance of a contract to sell two airplanes ''even

though the legal remedy of damages may have been available.'' The court distinguished *Klein* on the ground that prior to the adoption of the Code, Washington courts ''did not always require the absence of a legal remedy'' or that the goods be ''absolutely 'unique.' '' See also In re Bullett Jet Charter, 177 B.R. 593, 599 (Bankr.N.D.Ill.1995) (expert ''testified persuasively that there was no similar aircraft like it on the market'').

(2) *The Automobile Cases.* After the Second World War, a number of disappointed buyers sought specific performance of their contracts to buy scarce new automobiles from automobile dealers. Most buyers lost. A typical case is McCallister v. Patton, 215 S.W.2d 701 (Ark.1948), in which the buyer sought specific performance of a contract made on or about September 15, 1945, to buy a Ford super deluxe tudor sedan. (The war with Japan had ended on September 2, 1945). The buyer alleged that ''new Ford automobiles have been hard to obtain'' and that he had been ''unable to purchase an automobile at any other place or upon the open market of the description named.'' The Supreme Court of Arkansas held that his complaint was properly dismissed, taking ''judicial notice of the fact that large numbers of cars of the type mentioned in the alleged contract have been produced since 1945, and sold through both new and used car dealers in the open market. It is neither alleged nor contended that the car ordered has any special or peculiar qualities not commonly possessed by others of the same make so as to make it practically impossible to replace it in the market.''

For a rare case allowing specific performance, see Boeving v. Vandover, 218 S.W.2d 175 (Mo.App.1949), in which the dealer had attempted to impose the additional requirement of a trade-in upon the buyer. The trial court found that ''if [the buyer] lost his priority with [the seller] he would be forced to place his order with some other Buick Agency and await his turn, which might take from one to two years.'' Might the Arkansas court have reached a different decision if additional facts had been alleged? What facts?

Would UCC § 2–716 have changed the result in the *McCallister* case? For a Code case allowing specific performance of a contract for the sale of a Corvette Pace Car, produced in a limited edition of 6,000, see Sedmak v. Charlie's Chevrolet, Inc., 622 S.W.2d 694 (Mo.App.1981).

(3) *International Rules.* The common law's preference for damages over specific performance is not found in civil law countries. This difference resulted in an important compromise in the CISG. Article 46(1) provides that a buyer ''may *require* performance by the seller of his obligations,'' embodies the civil law approach. But this provision is undercut by article 28, which was added at the insistence of common law countries. It provides that even if a buyer is entitled to require performance, ''a court is not bound to enter judgment for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by the Convention.'' The significance of article 28 in an action brought in the United States was stated in Magellan International Corp. v. Salzgitter Handel, 76 F.Supp.2d 919 (N.D.Ill.1999) at 926: ''Simply put, that looks to the availability of such relief under the UCC,'' citing UCC § 2–716(1). What decision in *Klein* under the Convention? Can you think of any disadvantages of a rule that makes the availability of specific performance depend on where the action is brought? See generally J. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* 218–28 (3d ed. 1999).

Compare UNIDROIT Principles art. 7.2.2: ''Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance unless . . . the party entitled to performance may reasonably obtain performance from another source.'' What decision in *Klein* under the UNIDROIT Principles?

Morris v. Sparrow

Supreme Court of Arkansas, 1956.
225 Ark. 1019, 287 S.W.2d 583.

■ ROBINSON, JUSTICE. Appellee Archie Sparrow filed this suit for specific performance, seeking to compel appellant Morris to deliver possession of a certain horse, which Sparrow claims Morris agreed to give him as part consideration for work done by Sparrow. The appeal is from a decree requiring the delivery of the horse.

Morris owns a cattle ranch near Mountain View, Arkansas, and he also participates in rodeos. Sparrow is a cowboy, and is experienced in training horses; occasionally he takes part in rodeos. He lives in Florida; while at a rodeo in that state, he and Morris made an agreement that they would go to Morris' ranch in Arkansas and, later, the two would go to Canada. After arriving at the Morris ranch, they changed their plans and decided that, while Morris went to Canada, Sparrow would stay at the ranch and do the necessary work. The parties are in accord that Sparrow was to work 16 weeks for a money consideration of $400. But, Sparrow says that as an additional consideration he was to receive a brown horse called Keno, owned by Morris. However, Morris states that Sparrow was to get the horse only on condition that his work at the ranch was satisfactory, and that Sparrow failed to do a good job. Morris paid Sparrow the amount of money they agreed was due, but did not deliver the horse.

At the time Sparrow went to Morris' ranch, the horse in question was practically unbroken; but during his spare time, Sparrow trained the horse and, with a little additional training, he will be a first class roping horse.

First there is the issue of whether Sparrow can maintain, in equity, a suit to enforce, by specific performance, a contract for the delivery of personal property. Although it has been held that equity will not ordinarily enforce, by specific performance, a contract for the sale of chattels, it will do so where special and peculiar reasons exist which render it impossible for the injured party to obtain relief by way of damages in an action at law. . . . Certainly when one has made a roping horse out of a green, unbroken pony, such a horse would have a peculiar and unique value; if Sparrow is entitled to prevail, he has a right to the horse instead of its market value in dollars and cents.

Morris claims that the part of the agreement whereby Sparrow was to receive the horse was conditional, depending on Sparrow doing a good job, and that he did not do such a job. Both parties were in Chancery Court and the Chancellor had a better opportunity than this court to evaluate the testimony of the witnesses; we cannot say the Chancellor's finding in favor of Sparrow is against the preponderance of the evidence. . . .

Affirmed.

SPECIFIC PERFORMANCE AND INVESTMENT

Archie Sparrow spent his spare time training Keno to make it a first class roping horse. Surely he invested his time and effort in this way based on his expectation of receiving the horse at the end of the 16 week contract period. Would he have invested as much of his time and effort if he knew that instead of getting Keno he would only get money damages in the event that Chip Morris should break the contract? The answer depends on the *measure* of money damages, the topic of the next section. However, if he was assured of getting Keno through an award of specific performance he would have every reason to invest his energies as he did.

How does the availability of various remedies for breach affect the willingness of parties to invest resources in reliance on contracts? This question has been the central focus of an extensive literature over the past thirty years.[a] The standard conclusion is that parties will not invest sufficiently unless they expect to receive the full return of those investments. For example, if Morris can breach his contract with Sparrow and pay only a pittance then Sparrow will have greatly reduced incentives to invest in the horse. But if Morris is required specifically to perform (or pay money damages that take into account the value of Sparrow's investment) then Sparrow's incentive to underinvest goes away.

But is it possible to invest *too much*? When Sparrow invests as though he will get performance with certainty he takes no account of the possibility that performance may not be forthcoming. This issue returns us to the concept of efficient breach discussed in Chapter 1. There we observed that when a breaching promisor can fully compensate the promisee, breach may be Pareto efficient: the promisee can be left no worse off and the promisor better off by the breach. A failure to account for the likelihood of efficient breach when making investment decisions can lead parties to invest too much. After all, they may not get the goods, or other performance, they had counted on. Specific performance can encourage exactly this kind of disregard of the possibility of breach, leading parties to invest as though they are certain to receive performance: either the promisor will perform or the court will order specific performance.[b]

NOTES

(1) *Bargaining Around Court Orders*. As we shall see shortly, in our discussion of the Coase Theorem on p. 604, an order of specific performance does not necessarily imply that parties will actually perform. Disputants commonly reach

a. See Oliver Williamson, *Markets and Hierarchies* (1975); Benjamin Klein, Robert Crawford & Armen Alchian, Vertical Integration, Appropriable Rents, and the Competitive Contracting Process, 21 J. L. & Econ. 297 (1978); Oliver Hart & John Moore, Foundations of Incomplete Contracts, 66 Rev. Econ. Stud. 115 (1999).

b. The same is true for money damages that compensate promisees fully for their investments.

private settlements, even after receiving a court order. What does this suggest about the likelihood of overinvestment given specific performance?

(2) *Canned Tomatoes*. The Curtice Brothers Company, operator of a tomato canning business, sued James Catts and others for breach of contract and sought specific performance of Catts's promise to deliver "the entire product of certain land planted with tomatoes." In granting specific performance, the court emphasized the importance of Curtice Brothers' planning and investment.

"Complainants' factory has a capacity of about one million cans of tomatoes. The season for packing lasts about six weeks. The preparations made for this six weeks of active work must be carried out in all features to enable the business to succeed. These preparations are primarily based upon the capacity of the plant. Cans and other necessary equipments, including labor, must be provided and secured in advance with reference to the capacity of the plant during the packing period.... The condition which arises from the breach of the contracts is not merely a question of the factory being compelled to pay a higher price for the product. Losses sustained in that manner could, with some degree of accuracy, be estimated. The condition which occasions the irreparable injury by reason of the breaches of the contracts is the inability to procure at any price at the time needed and of the quality needed the necessary tomatoes to insure the successful operation of the plant.... The business and its needs are extraordinary in that the maintenance of all of the conditions prearranged to secure the pack are a necessity to insure the successful operation of the plant." Curtice Bros. Co. v. Catts, 66 A. 935, 936 (N.J.Ch. 1907).

What relationship might there be, if any, between the short packing season of only six weeks and protecting the investments of the business? Recall Alaska Packers' Ass'n v. Domenico on p. 325, where the court similarly made reference to the shortness of the packing season and the firm's investments.

(3) *Personal Service Contracts and Moral Hazard.* A court will not order specific performance of a contract to provide a service that is personal in nature. One concern is the difficulty of passing judgment on the quality of performance. A second concern is the undesirability of compelling the continuance of personal relations after disputes have arisen and confidence and loyalty have been shaken (and, in some instances, of imposing what might seem like involuntary servitude).

Catts, in the case above, sought to avoid specific performance by claiming that specific performance would amount to compelling personal services. The court held that Catts "may be restrained from selling the crop to others, and, if necessary, a receiver can be appointed to harvest the crop." The difficulties courts face in monitoring performance, along with the concern that a party compelled to perform by a judicial order may not have the best incentives to perform well, create the risk that individuals will take less than ideal actions knowing that they will not be made fully accountable for their actions, so-called "moral hazard." Appointing a receiver to perform the task may help, but is not a complete solution to the moral hazard problem. Can you see why?

(4) *Negative Injunctions.* Though courts are reluctant to compel performance of contracts to provide services that are personal in nature, they are quite willing to enjoin parties from other performances in appropriate circumstances. The classic case is Lumley v. Wagner, 42 Eng. Rep. 687, 693 (Ch. 1852), which arose out of a contract in which Johanna Wagner, an opera singer from the court of Prussia, agreed to sing exclusively for Benjamin Lumley, proprietor of Her Majesty's Theatre in London, for a period of three months. When Frederick Gye, proprietor of the Royal Italian Opera in London, persuaded Wagner to break her contract and sing at his theater, Lumley obtained an injunction restraining her from doing so. On

appeal, the Lord Chancellor upheld the injunction. "It is true that I have not the means of compelling her to sing, but she has no cause of complaint if I compel her to abstain from the commission of an act which she has bound herself not to do, and thus possibly cause her to fulfil her engagement."

As indicated above, a court will not grant an injunction unless the remedy in damages would be inadequate. This requirement is met if the employee's services are unique or extraordinary, either because of special skill that the employee possesses, as in Wagner's case, or because of special knowledge that the employee has acquired of the employer's business.

Injunctions are especially common in the world of sports, where the availability of such relief is enhanced by the belief that the requirement "that the player be an athlete of exceptional talent . . . is met prima facie in cases involving professional athletes." Nassau Sports v. Peters, 352 F.Supp. 870, 876 (E.D.N.Y.1972).

(5) *Clean Hands on the Playing Field.* The requirement that "one who comes into equity must come with clean hands" has come under special scrutiny in cases involving professional athletes. Thus in New York Football Giants, Inc. v. Los Angeles Chargers Football Club, Inc., 291 F.2d 471 (5th Cir.1961), it was held that the Giants, who had kept a contract with Charles Flowers secret so he could play as an amateur in the Sugar Bowl, lacked "clean hands" and could not have Flowers enjoined from playing with the Chargers. But see Houston Oilers v. Neely, 361 F.2d 36 (10th Cir.1966), in which the court said that "if the rule announced in [the *Flowers*] case was intended to apply to every instance in which a contract is entered into with a college football player before a post-season game with an understanding that it will be kept secret to permit that player to compete in the game, then we must respectfully disagree."

Laclede Gas Co. v. Amoco Oil Co.

United States Court of Appeals, Eighth Circuit, 1975.
522 F.2d 33.

■ ROSS, CIRCUIT JUDGE. The Laclede Gas Company (Laclede), a Missouri corporation, brought this diversity action alleging breach of contract against the Amoco Oil Company (Amoco), a Delaware corporation. It sought relief in the form of a mandatory injunction prohibiting the continuing breach or, in the alternative, damages. The district court held a bench trial on the issues of whether there was a valid, binding contract between the parties and whether, if there was such a contract, Amoco should be enjoined from breaching it. It then ruled that the "contract is invalid due to lack of mutuality" and denied the prayer for injunctive relief. The court made no decision regarding the requested damages. Laclede Gas Co. v. Amoco Oil Co., 385 F.Supp. 1332, 1336 (E.D.Mo.1974). This appeal followed, and we reverse the district court's judgment.

On September 21, 1970, Midwest Missouri Gas Company (now Laclede), and American Oil Company (now Amoco), the predecessors of the parties to this litigation, entered into a written agreement which was designed to provide central propane gas distribution systems to various residential developments in Jefferson County, Missouri, until such time as natural gas mains were extended into these areas. The agreement contemplated that as individual developments were planned the owners or developers would apply to Laclede for central propane gas systems. If Laclede determined that such a system was appropriate in any given development, it could request Amoco to supply the propane to that specific development. This request was made in the form of a supplemental form letter, as provided in the September 21 agreement; and if Amoco decided to supply the propane, it bound itself to do so by signing this supplemental form.

Once this supplemental form was signed the agreement placed certain duties on both Laclede and Amoco. Basically, Amoco was to "[i]nstall, own, maintain and operate . . . storage and vaporization facilities and any other facilities necessary to provide [it] with the capability of delivering to [Laclede] commercial propane gas suitable . . . for delivery by [Laclede] to its customers' facilities." Amoco's facilities were to be "adequate to provide a continuous supply of commercial propane gas at such times and in such volumes commensurate with [Laclede's] requirements for meeting the demands reasonably to be anticipated in each Development while this Agreement is in force." Amoco was deemed to be "the supplier," while Laclede was "the distributing utility."

For its part Laclede agreed to "[i]nstall, own, maintain and operate all distribution facilities" from a "point of delivery" which was defined to be "the outlet of [Amoco] header piping." Laclede also promised to pay Amoco "the Wood River Area Posted Price for propane plus four cents per gallon for all amounts of commercial propane gas delivered" to it under the agreement.

Since it was contemplated that the individual propane systems would eventually be converted to natural gas, one paragraph of the agreement provided that Laclede should give Amoco 30 days written notice of this event, after which the agreement would no longer be binding for the converted development.

Another paragraph gave Laclede the right to cancel the agreement. However, this right was expressed in the following language:

> This Agreement shall remain in effect for one (1) year following the first delivery of gas by [Amoco] to [Laclede] hereunder. Subject to termination as provided in Paragraph 11 hereof [dealing with conversions to natural gas], this Agreement shall automatically continue in effect for additional periods of one (1) year each unless [Laclede] shall, not less than 30 days prior to the expiration of the initial one (1) year period or any subsequent one (1) year period, give [Amoco] written notice of termination.

There was no provision under which Amoco could cancel the agreement.

For a time the parties operated satisfactorily under this agreement, and some 17 residential subdivisions were brought within it by supplemental letters. However, for various reasons, including conversion to natural gas, the number of developments under the agreement had shrunk to eight by the time of trial. These were all mobile home parks.

During the winter of 1972–73 Amoco experienced a shortage of propane and voluntarily placed all of its customers, including Laclede, on an 80% allocation basis, meaning that Laclede would receive only up to 80% of its previous requirements. Laclede objected to this and pushed Amoco to give it 100% of what the developments needed. Some conflict arose over this before the temporary shortage was alleviated.

Then, on April 3, 1973, Amoco notified Laclede that its Wood River Area Posted Price of propane had been increased by three cents per gallon. Laclede objected to this increase also and demanded a full explanation. None was forthcoming. Instead Amoco merely sent a letter dated May 14, 1973, informing Laclede that it was "terminating" the September 21, 1970, agreement effective May 31, 1973. It claimed it had the right to do this because "the Agreement lacks 'mutuality.' "[1]

The district court felt that the entire controversy turned on whether or not Laclede's right to "arbitrarily cancel the Agreement" without Amoco having a similar right rendered the contract void "for lack of mutuality" and it resolved this question in the affirmative. We disagree with this conclusion and hold that settled principles of contract law require a reversal.

I.

[The court held that Laclede's power to terminate did not make its promise illusory and that the agreement was an enforceable contract for Laclede's requirements for the subdivision. The district court, therefore, erred in holding that there was no binding contract.]

II.

Since he found that there was no binding contract, the district judge did not have to deal with the question of whether or not to grant the injunction prayed for by Laclede. He simply denied this relief because there was no contract. Laclede Gas Co. v. Amoco Oil Co., supra, 385 F.Supp. at 1336.

Generally the determination of whether or not to order specific performance of a contract lies within the sound discretion of the trial court. Landau v. St. Louis Public Service Co., 364 Mo. 1134, 273 S.W.2d 255, 259 (1954). However, this discretion is, in fact, quite limited; and it is said that when certain equitable rules have been met and the contract is fair and plain "specific performance goes as a matter of right." Miller v. Coffeen, 365 Mo. 204, 280 S.W.2d 100, 102 (1955), quoting, Berberet v. Myers, 240 Mo. 58, 77, 144 S.W. 824, 830 (1912). (Emphasis omitted.)

With this in mind we have carefully reviewed the very complete record on appeal and conclude that the trial court should grant the injunctive relief prayed. We are satisfied that this case falls within that category in which specific performance should be ordered as a matter of right. . . .

Amoco contends that four of the requirements for specific performance have not been met. Its claims are: (1) there is no mutuality of remedy in

1. While Amoco sought to repudiate the agreement, it resumed supplying propane to the subdivisions on February 1, 1974, under the mandatory allocation guidelines promulgated by the Federal Energy Administration under the Federal Mandatory Allocation Program for propane. It is agreed that this is now being done under the contract.

the contract; (2) the remedy of specific performance would be difficult for the court to administer without constant and long-continued supervision; (3) the contract is indefinite and uncertain; and (4) the remedy at law available to Laclede is adequate. The first three contentions have little or no merit and do not detain us for long.

There is simply no requirement in the law that both parties be mutually entitled to the remedy of specific performance in order that one of them be given that remedy by the court. . . .

While a court may refuse to grant specific performance where such a decree would require constant and long-continued court supervision, this is merely a discretionary rule of decision which is frequently ignored when the public interest is involved. . . .

Here the public interest in providing propane to the retail customers is manifest, while any supervision required will be far from onerous.

Section 370 of the Second Restatement of Contracts (1932) provides:

> Specific enforcement will not be decreed unless the terms of the contract are so expressed that the court can determine with reasonable certainty what is the duty of each party and the conditions under which performance is due.

We believe these criteria have been satisfied here. As discussed in part I of this opinion, as to all developments for which a supplemental agreement has been signed, Amoco is to supply all the propane which is reasonably foreseeably required, while Laclede is to purchase the required propane from Amoco and pay the contract price therefor. The parties have disagreed over what is meant by "Wood River Area Posted Price" in the agreement, but the district court can and should determine with reasonable certainty what the parties intended by this term and should mold its decree, if necessary accordingly.[2] Likewise, the fact that the agreement does not have a definite time of duration is not fatal since the evidence established that the last subdivision should be converted to natural gas in 10 to 15 years. This sets a reasonable time limit on performance and the district court can and should mold the final decree to reflect this testimony.

It is axiomatic that specific performance will not be ordered when the party claiming breach of contract has an adequate remedy at law. Jamison Coal & Coke Co. v. Goltra, 143 F.2d 889, 894 (8th Cir.), cert. denied, 323 U.S. 769 (1944). This is especially true when the contract involves personal property as distinguished from real estate.

However, in Missouri, as elsewhere, specific performance may be ordered even though personalty is involved in the "proper circumstances." Mo.Rev.Stat. § 400.2–716(1); Restatement of Contracts, supra, § 361. And a remedy at law adequate to defeat the grant of specific performance "must be as certain, prompt, complete, and efficient to attain the ends of justice as a decree of specific performance." National Marking Mach. Co. v. Triumph

2. The record indicates that Laclede has now accepted Amoco's interpretation and has agreed that "Wood River Area Posted Price" means Amoco's posted price for propane at its Wood River refinery.

Mfg. Co., 13 F.2d 6, 9 (8th Cir.1926). Accord, Snip v. City of Lamar, 239 Mo.App. 824, 201 S.W.2d 790, 798 (1947).

One of the leading Missouri cases allowing specific performance of a contract relating to personalty because the remedy at law was inadequate is Boeving v. Vandover, 240 Mo.App. 117, 218 S.W.2d 175, 178 (1949). In that case the plaintiff sought specific performance of a contract in which the defendant had promised to sell him an automobile. At that time (near the end of and shortly after World War II) new cars were hard to come by, and the court held that specific performance was a proper remedy since a new car "could not be obtained elsewhere except at considerable expense, trouble or loss, which cannot be estimated in advance."

We are satisfied that Laclede has brought itself within this practical approach taken by the Missouri courts. As Amoco points out, Laclede has propane immediately available to it under other contracts with other suppliers. And the evidence indicates that at the present time propane is readily available on the open market. However, this analysis ignores the fact that the contract involved in this lawsuit is for a long-term supply of propane to these subdivisions. The other two contracts under which Laclede obtains the gas will remain in force only until March 31, 1977, and April 1, 1981, respectively; and there is no assurance that Laclede will be able to receive any propane under them after that time. Also it is unclear as to whether or not Laclede can use the propane obtained under these contracts to supply the Jefferson County subdivisions, since they were originally entered into to provide Laclede with propane with which to "shave" its natural gas supply during peak demand periods.[3] Additionally, there was uncontradicted expert testimony that Laclede probably could not find another supplier of propane willing to enter into a long-term contract such as the Amoco agreement, given the uncertain future of worldwide energy supplies. And, even if Laclede could obtain supplies of propane for the affected developments through its present contracts or newly negotiated ones, it would still face considerable expense and trouble which cannot be estimated in advance in making arrangements for its distribution to the subdivisions.

Specific performance is the proper remedy in this situation, and it should be granted by the district court.[4] . . .

[Reversed and remanded.]

NOTES

(1) *The Code and Specific Performance.* Comments 1 and 2 to UCC § 2–716 say: "[W]ithout intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of

3. During periods of cold weather, when demand is high, Laclede does not receive enough natural gas to meet all this demand. It, therefore, adds propane to the natural gas it places in its distribution system. This practice is called "peak shaving."

4. In fashioning its decree the district court must take into account any relevant rules and regulations promulgated under the Federal Mandatory Allocation Program.

sale.... In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are 'unique' goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted 'in other proper circumstances'...."

In the case of a long-term output or requirements contract, might the difficulty of proving damages amount to "other proper circumstances" even if there is no "particular or peculiarly available source or market"? If Laclede were limited to damages, how would its damages be calculated under the Code? In Eastern Rolling Mill Co. v. Michlovitz, 145 A. 378 (Md.1929), a five-year output contract for scrap steel was broken by the seller in the first year. Part of the court's justification for ordering specific performance was that any estimate of damages "would be speculative and conjectured, and not, therefore, compensatory.... To substitute damages by guess for due performance of contract could only be because 'there's no equity stirring.' "

(2) *Another Form of Specific Relief.* In addition to the possibility of specific relief in the form of a decree of specific performance under UCC § 2–716(1), a buyer of goods may in some circumstances also obtain specific relief through an action to replevy the goods under UCC § 2–716(3).

A seller may in some circumstances obtain what amounts to specific relief through an action for the price under UCC § 2–709(1)(b). Can the seller do so if it can resell? What would you advise an aggrieved seller to do following breach in order to lay the foundation for a possible action for the price under this section?

NORTHERN DELAWARE INDUSTRIAL DEVELOPMENT CORP. v. E.W. BLISS CO., 245 A.2d 431 (Del.Ch.1968). Bliss, a general contractor, contracted to modernize the plant of the Phoenix Steel Corporation, for $27,500,000. [Phoenix was, along with Northern Delaware, a party to the contract and a plaintiff in the case.] The plant was spread over a 60–acre site. Work did not progress as rapidly as contemplated in the contract, and Phoenix sought an order to have Bliss put 300 more workers on the job, as required by the contract, to make up a full second shift during the period that one of Phoenix's mills had to be shut down because of the work. The court denied specific performance.

■ MARVEL, VICE CHANCELLOR.... It is not that a court of equity is without jurisdiction in a proper case to order the completion of an expressly designed and largely completed construction contract, particularly where the undertaking is tied in with a contract for the sale of land and the construction in question is largely finished.... The point is that a court of equity should not order specific performance of any building contract in a situation in which it would be impractical to carry out such an order, ... unless there are special circumstances or the public interest is directly involved.... I conclude that to grant specific performance ... would be inappropriate in view of the imprecision of the contract provision relied upon and the impracticability if not impossibility of effective enforcement by the Court of a mandatory order designed to keep a specific number of men on the job at the site of a steel mill which is undergoing extensive modernization and expansion. If plaintiffs have sustained loss as a result of actionable building delays ..., they may, at an appropriate time, resort to law for a fixing of their claimed damages. [On a motion for reargument, Phoenix argued that it sought only an order "directing the performance of a ministerial act, namely the hiring by defendant of more workers." The court denied the motion, relying on "the well established principle that performance of a contract for personal services, even of a unique nature, will not be affirmatively and directly enforced."]

NOTES

(1) *Distinctions.* Consider the remark of Chancellor Walworth in denying a decree of specific performance against an opera singer: "I am not aware that any officer of this court has that perfect knowledge of the Italian language, or possesses that exquisite sensibility in the auricular nerve, which is necessary to understand and to enjoy with a proper zest the peculiar beauties of the Italian opera, so fascinating to the fashionable world." De Rivafinoli v. Corsetti, 4 Paige Ch. 264, 270 (N.Y.1833). Is this point distinguishable from that in *Northern Delaware*?

Courts have shown increasing willingness to order specific performance of construction contracts. In most of these cases, however, the construction was to take place on the defendant's land with a conveyance or lease to follow. See, *e.g.*, Floyd v. Watson, 254 S.E.2d 687, 690 (W.Va.1979), where the court noted that the agreement "includes a provision for conveyance of land, and therefore specific performance is proper." Cf. City Stores Co. v. Ammerman, 266 F.Supp. 766 (D.D.C.1967), aff'd, 394 F.2d 950 (D.C.Cir.1968).

(2) *Specific Performance in Arbitration.* Suppose that Bliss and Phoenix had included in the construction contract the American Arbitration Association's arbitration clause, incorporating § R–45(a), quoted in Note 2, p. 28 above. Would the court have enforced an arbitral award granting the relief that it refused in the actual case? The New York Court of Appeals held that such an award was enforceable in Grayson–Robinson Stores, Inc. v. Iris Construction Corp., 168 N.E.2d 377 (N.Y.1960) (a 4–3 decision).

Walgreen Co. v. Sara Creek Property Co.

United States Court of Appeals, Seventh Circuit, 1992.
966 F.2d 273.

[For decades, Walgreen, a "discount" chain, had operated a pharmacy in the Southgate Mall in Milwaukee. Under its lease, the landlord, Sara Creek, promised not to lease space in the mall to another store operating a pharmacy. In 1990, fearful that its "anchor [largest] tenant" was about to close its store, Sara Creek informed Walgreen that it intended to buy out that tenant and install in its place a store operated by Phar–Mor, a "deep discount" chain that would contain a pharmacy. Its entrance was to be within a couple of hundred feet of Walgreen's. Walgreen sought an injunction against Sara Creek. After a hearing, the trial judge entered a permanent injunction against Sara Creek's letting the premises to Phar–Mor until Walgreen's lease expired. At the hearing Sara Creek's expert witnesses had testified that Walgreen's damages could be readily estimated, whereas Walgreen's employees had testified to the contrary, asserting among other reasons that those damages included intangibles such as good will. Sara Creek appealed.]

■ POSNER, CIRCUIT JUDGE. . . . Sara Creek reminds us that damages are the norm in breach of contract as in other cases. Many breaches, it points out, are "efficient" in the sense that they allow resources to be moved into a more valuable use. . . . Perhaps this is one—the value of Phar–Mor's occupancy of the anchor premises may exceed the cost to Walgreen of facing increased competition. If so, society will be better off if Walgreen is paid its damages, equal to that cost, and Phar–Mor is allowed to move in rather than being kept out by an injunction. That is why injunctions are not granted as a matter of course, but only when the plaintiff's damages remedy is inadequate. Northern Indiana Public Service Co. v. Carbon County Coal Co., 799 F.2d 265, 279 (7th Cir.1986). Walgreen's is not, Sara Creek argues; the projection of business losses due to increased competition is a routine exercise in calculation. Damages representing either the present value of lost future profits or (what should be the equivalent, . . . the diminution in the value of the leasehold) have either been awarded or deemed the proper remedy in a number of reported cases for breach of an exclusivity clause in a shopping-center lease. . . . Why, Sara Creek asks, should they not be adequate here?

The benefits of substituting an injunction for damages are twofold. First, it shifts the burden of determining the cost of the defendant's conduct from the court to the parties. If it is true that Walgreen's damages are smaller than the gain to Sara Creek from allowing a second pharmacy into the shopping mall, then there must be a price for dissolving the injunction that will make both parties better off. Thus, the effect of upholding the injunction would be to substitute for the costly processes of forensic fact determination the less costly processes of private negotiation. Second, a premise of our free-market system, and the lesson of experience here and abroad as well, is that prices and costs are more accurately determined by the market than by government. A battle of experts is a less reliable method of determining the actual cost to Walgreen of facing new competition than negotiations between Walgreen and Sara Creek over the price at which Walgreen would feel adequately compensated for having to face that competition.

That is the benefit side of injunctive relief but there is a cost side as well. Many injunctions require continuing supervision by the court, and that is costly. . . . Some injunctions are problematic because they impose costs on third parties. . . . A more subtle cost of injunctive relief arises from the situation that economists call "bilateral monopoly," in which two parties can deal only with each other: the situation that an injunction creates. . . . The sole seller of widgets selling to the sole buyer of that product would be an example. But so will be the situation confronting

Walgreen and Sara Creek if the injunction is upheld. Walgreen can ''sell'' its injunctive right only to Sara Creek, and Sara Creek can ''buy'' Walgreen's surrender of its right to enjoin the leasing of the anchor tenant's space to Phar–Mor only from Walgreen. The lack of alternatives in bilateral monopoly creates a bargaining range, and the costs of negotiating to a point within that range may be high. Suppose the cost to Walgreen of facing the competition of Phar–Mor at the Southgate Mall would be $1 million, and the benefit to Sara Creek of leasing to Phar–Mor would be $2 million. Then at any price between those figures for a waiver of Walgreen's injunctive right both parties would be better off, and we expect parties to bargain around a judicial assignment of legal rights if the assignment is inefficient. R.H. Coase, ''The Problem of Social Cost,'' 3 J. Law & Econ. 1 (1960). But each of the parties would like to engross as much of the bargaining range as possible—Walgreen to press the price toward $2 million, Sara Creek to depress it toward $1 million. With so much at stake, both parties will have an incentive to devote substantial resources of time and money to the negotiation process. The process may even break down, if one or both parties want to create for future use a reputation as a hard bargainer; and if it does break down, the injunction will have brought about an inefficient result. All these are in one form or another costs of the injunctive process that can be avoided by substituting damages.

The costs and benefits of the damages remedy are the mirror of those of the injunctive remedy. The damages remedy avoids the cost of continuing supervision and third-party effects, and the cost of bilateral monopoly as well. It imposes costs of its own, however, in the form of diminished accuracy in the determination of value, on the one hand, and of the parties' expenditures on preparing and presenting evidence of damages, and the time of the court in evaluating the evidence, on the other.

The weighing up of all these costs and benefits is the analytical procedure that is or at least should be employed by a judge asked to enter a permanent injunction, with the understanding that if the balance is even the injunction should be withheld. The judge is not required to explicate every detail of the analysis and he did not do so here, but as long as we are satisfied that his approach is broadly consistent with a proper analysis we shall affirm; and we are satisfied here. The determination of Walgreen's damages would have been costly in forensic resources and inescapably inaccurate. . . . The lease had ten years to run. So Walgreen would have had to project its sales revenues and costs over the next ten years, and then project the impact on those figures of Phar–Mor's competition, and then discount that impact to present value. All but the last step would have been fraught with uncertainty. . . .

Affirmed.

SPECIFIC PERFORMANCE, EFFICIENCY, AND THE COASE THEOREM

In the light of earlier discussions on efficient breach, p. 21 above, is specific performance an efficient remedy? Suppose that PepsiCo, after contracting to sell its jet to Klein for $4.75 million, gets an offer of $100,000 more from Gross, who has been searching for just such a jet. If Klein can compel PepsiCo to deliver the jet, it might be supposed that Gross, who values it more than Klein, would not end up with it. This, however, ignores two possibilities—resale and renegotiation.

If Klein compels PepsiCo to deliver the jet, Gross can still end up with the jet by buying it from Klein. If Klein sells the jet to Gross for $4.85 million, it will then be Klein who realizes the $100,000. If Klein cannot compel PepsiCo to deliver the jet, it will be PepsiCo that realizes the $100,000, less any liability to Klein. In both instances the jet goes to Gross, who values it most. In the rhetoric of modern economic theory this is known as an *allocatively efficient* outcome, which means simply that resources end up in the hands of those who value them most. In the first instance the cash surplus of the sale goes to Klein. In the second instance it goes to Pepsico. This movement of cash is normally treated as having no (allocative) efficiency consequences because parties are assumed to value cash in exactly the same way. Unlike the jet, the cash is no more valuable in Klein's hands than it is in Gross's hands or on PepsiCo's balance sheet. Klein is enriched in one case and PepsiCo in the other, and since the jet in either case goes to its highest-value user (Gross), it makes no difference from the point of view of efficiency whether it is Klein or PepsiCo who is made better off from the transaction, all else equal.

All else is seldom equal, of course. The cost of the transaction between Klein and Gross is unlikely to be exactly the same as the cost of the transaction between Pepsico and Gross. The costs include the costs to the parties of finding each other (search costs), negotiating over the terms (bargaining costs) and writing up their agreement ("ink" costs). These "transaction costs" may prohibit a direct exchange between Klein and Gross. If the transaction costs to Klein and Gross of completing a new contract are greater than the $100,000 surplus available from trading, then a trade between them will not happen.

Gross may yet end up with the jet even if Klein receives an order of specific performance. This is because it may be to the mutual advantage of Klein and PepsiCo to negotiate around the order of specific performance rather than for Klein to compel PepsiCo to perform. If Klein compels PepsiCo to perform and then does not find Gross, neither PepsiCo nor Klein will realize any of the $100,000 surplus. But if Klein negotiates with PepsiCo to release it from the contract so that PepsiCo can sell the jet to Gross, PepsiCo and Klein can share the $100,000. (Observe that, on this assumption, a rule of specific performance results in a sharing of the $100,000. The negotiations will determine the share that each gets, but since Gross gets the jet in any case, the efficiency of the rule does not turn on this.) There is, however, a cost to negotiating, and if it is assumed that PepsiCo and Klein would not think it worth their while to negotiate a release where only $100,000 is at stake, Gross will not end up with the jet in this way.

But if we assume that there are no costs to PepsiCo and Klein for bargaining with each other, then neither a specific performance rule nor a money damage rule—*any* money damage rule—is more efficient with regard to the allocation of resources. This provocative result is known as the Coase Theorem. The Coase Theorem states that when transaction costs are absent (or sufficiently small) and legal entitlements well-defined, parties will bargain to an allocatively efficient outcome under any remedy. That is, bargaining will result in the goods going to the party who values them the most, irrespective of the remedy provided by the court.

The Coase Theorem is often misread as suggesting that the remedies themselves have no efficiency implications. Nothing could be further from the truth. Professor Coase did not believe that transaction costs are typically absent.[a] He argued just the opposite: since transaction costs are always present, the remedy may indeed affect the allocation of goods. With regard to efficiency, then, much turns on the transaction costs associated with various remedial regimes. This insight has sparked a large literature attempting to characterize the circumstances wherein a transaction costs analysis would favor one type of remedy over another. These analyses focus on the costs of bargaining, search costs, the legal costs of determining damages, the monitoring costs of specific performance, etc., as well as the psychological costs and biases related to certain remedies. No general efficiency argument has been put forth in favor of a singly preferred remedy. Nor is one is not likely to appear. Perhaps this is as it should be. The value of Coase's insight is that it focuses our attention on the transaction costs of contracting and asks us to think about the desirability of particular remedies given these constraints.[b]

SECTION 2. MEASURING EXPECTATION

The usual remedy for breach of contract is an award of damages, typically based on the *expectation interest*. Recall from Chapter 1 that an award of expectation damages is a sum of money that will, to the extent that money can, put the promisee in the position he would have been in had the promise been performed. The promisee is then said to have received "the benefit of the bargain" or to have been "made whole."

Although this is an intuitive and simple principle, its practical implementation can be challenging. Unlike restitution damages (based on the *actual* benefit the promisee has conferred on the promisor) or reliance damages (based on the *actual* amount the promisee has expended in reliance on the promise), expectation damages poses a counterfactual

a. Ronald H. Coase, (1910–), professor emeritus at the University of Chicago Law School, first observed the salience of transaction costs in his early work on industrial organization. In "The Nature of the Firm," 4 *Economica* 386 (1937), Coase introduced transaction costs to explain why some firms contract for their needs in the market, while other firms expand their internal operations to satisfy their own needs, so-called "vertical integration." Later, he again used the idea of transaction costs to describe certain efficiency effects of legal rules in his famous article, "The Problem of Social Costs," 3 J.L. & Econ. 1 (1960). In 1991 Coase received the Nobel Prize in Economics principally for these two bodies of work.

b. The Coase Theorem makes no claims about distributive fairness, investment efficiency, or wealth effects that result from distinct assignments of legal entitlements.

difficulty: What value would the promisee have received had the breach not occurred? Finding a monetary equivalent to this value is straightforward in some instances, "as, for example, where the injured party has simply had to pay an additional amount to arrange a substitute transaction and can be adequately compensated by damages based on the amount." Restatement § 347 (Comment *a*). Similarly, where the promisee's expected advantage consists largely or exclusively of the realization of profit, as is the case for most commercially significant exchanges, the expectation interest can be expressed in money with some assurance. This is particularly true in well-defined or "thick" markets, where there are many buyers and sellers trading over particular goods.

In principle the expectation interest is based on that of the particular promisee at hand, quite without regard to that of the hypothetical reasonable promisee, and depends on the particular promisee's unique circumstances or those of its enterprise. Markets merely facilitate the identification of a promisee's expectation interest, either because the market approximates the promisee's interests well or because it allows the promisee to realize that interest through a substitute transaction.

More generally, Restatement § 347 looks to three broad factors in measuring a party's expectation interest:

> "(a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus
>
> (b) any other loss, including incidental or consequential loss, caused by the breach, *less*
>
> (c) any cost or other loss that he has avoided by not having to perform."

Consider these factors in turn. First, the breach may cause the injured party a loss by limiting or eliminating the expected return, or value, of performance itself. The difference between the value to the injured party of the performance that should have been received and the value to that party of what, if anything, was actually received is the injured party's *loss in value* (a).

Second, the breach may cause the injured party loss other than *loss in value,* such as physical harm to that party's person or property or expenses incurred in an attempt to salvage the transaction after breach. This residual category is the injured party's *other loss* (b).

Any breach, regardless of its seriousness, may result in *loss in value* (a) and in *other loss* (b). A serious breach may give the injured party a choice between continuing performance and stopping performance and treating the contract as terminated.

If the injured party chooses to stop performance and treat the contract as terminated, the breach may affect it in a third way. The breach may have a beneficial effect on the injured party by saving that party further expense that would have been incurred had performance continued. Moreover, the breach may have an additional effect on the injured party by allowing that party to avoid some loss by salvaging and reallocating some or all of the resources that it otherwise would have had to devote to performance of the contract. These savings are the injured party's *costs and other loss avoided* (c) and should be subtracted from any expectation damage award that a breaching promisor would have to pay.[a] Hence the general measure of damages is the sum of these factors, which can be expressed as a simple formula,

Damages = (a) *loss in value* + (b) *other loss* – (c) *cost and loss avoided*.

Hold aside *other loss* (b) for a moment and focus on the two remaining factors in the equation above—*loss in value* (a) and *cost and loss avoided* (c). Estimation of *loss in value* and *cost and loss avoided* pose different challenges depending on which party is in breach. In most agreements, one of the parties (say, a buyer) is simply required to pay money while the other party (say, a seller) is required to furnish goods, land, or services in return for a money payment. When the seller is the injured party, and the breach consists of the buyer's failure to pay, the difficulty largely lies in the determination of the seller's *cost and loss avoided,* since its *loss in value* is simply the amount of money that the buyer has failed to pay. When the seller is in breach, the difficulty lies in the determination of the buyer's *loss in value,* since its *cost and loss avoided* is simply the amount of money that it has not yet paid.

Now consider the *other loss* category, which consists mainly of incidental and consequential losses. ''Incidental losses include costs incurred in a reasonable effort, whether successful or not, to avoid loss, as where a party [*e.g*., a buyer] pays brokerage fees in arranging or attempting to arrange a substitute transaction.'' Restatement § 347 (Comment *c*). Typically, for a seller of goods, they include costs incurred in halting delivery and in transporting, housing and caring for goods after breach by the recipient. See, *e.g*., UCC § 2–710 (Seller's Incidental Damages). Consequential losses encompass, but are not limited to, harm to persons or property as a result of breach. As between the buyer and the seller, one might expect consequential losses to be suffered more likely by the former. The cases that follow illustrate these basic factors in practical application.

INTRODUCTION TO *VITEX*: LOST PROFITS AND FIXED COSTS

The venerated British economist John Maynard Keynes once famously quipped that ''in the long run we are all dead.'' *A Tract on Monetary Reform* (1923). The more prosaic distinction economists typically draw between the long run and the short run involves the variability of inputs used by firms in producing goods and services. Inputs, also called factors of production, include such things as raw materials, machinery, and labor.

a. It may help in understanding the distinction between *cost avoided* and *loss avoided* to imagine a contract for the sale of two products to be manufactured by the seller. Suppose that the buyer repudiates after the seller has manufactured one of the products. The saving that results when the seller stops production of the second product is the seller's *cost avoided.* The saving that results when the seller sells the first product to another buyer is the seller's *loss avoided.*

The short run is defined by economists as the period during which at least one input is fixed—that is, not variable. A factory is a common example of a short run fixed input. With enough time, or in the long run, new factories may be built and existing ones modified, but in the short run a factory is not variable.

The costs associated with fixed inputs are called, uninspiringly, fixed costs. Those costs must be borne before any goods can be produced. For example, a factory must be established before any goods can be manufactured. How then do these fixed costs relate to the profits expected from subsequent agreements to produce goods? This question is thoughtfully taken up in the next case. The opinion introduces the lost-profits measure of expectation damages. Lost profits are simply the profits that a firm would have earned had the breach not occurred. In commercial transactions, where parties are largely motivated by expected profits, lost profits are excellent approximations of the *expectation interest;* the connection between profits and expectancy is simple and direct. But there's often a devil in the details. Recall the observation above that when a seller is the injured party, the difficulty in determining damages lies largely in the estimation of its *cost and loss avoided* (c). How do fixed costs figure in this calculation?

Vitex Manufacturing Corp. v. Caribtex Corp.

United States Court of Appeals, Third Circuit, 1967.
377 F.2d 795.

■ STALEY, CHIEF JUDGE. This is an appeal by Caribtex Corporation from a judgment of the District Court of the Virgin Islands finding Caribtex in breach of a contract entered into with Vitex Manufacturing Company, Ltd., and awarding $21,114 plus interest to Vitex for loss of profits. The only substantial question raised by Caribtex is whether it was error for the district court, sitting without a jury, not to consider overhead as part of Vitex's costs in determining the amount of profits lost. We conclude that under the facts presented, the district court was not compelled to consider Vitex's overhead costs, and we will affirm the judgment.

Before discussing the details of the controversy between the parties, it will be helpful to briefly describe the peculiar legal setting in which this suit arose. At the time of the events in question, there were high tariff barriers to the importation of foreign wool products. However, under § 301 of the Tariff Act of 1930, 19 U.S.C.A. § 1301a, repealed but the provision continued under Revised Tariff Schedules, 19 U.S.C.A. § 1202, note 3(a)(i)(ii) (1965), if such goods were imported into the Virgin Islands and were processed in some manner so that their finished value exceeded their importation value by at least 50%, then the high tariffs to importation into the continental United States would be avoided. Even after the processing, the foreign wool enjoyed a price advantage over domestic products so that the business flourished. However, to keep the volume of this business at such levels that Congress would not be stirred to change the law, the Virgin Islands Legislature imposed ''quotas'' on persons engaging in processing, limiting their output. 33 V.I.C. § 504 (Supp.1966).

Vitex was engaged in the business of chemically shower-proofing imported cloth so that it could be imported duty-free into the United States. For this purpose, Vitex maintained a plant in the Virgin Islands and was entitled to process a specific quantity of material under the Virgin Islands quota system. Caribtex was in the business of importing cloth into the islands, securing its processing, and exporting it to the United States.

In the fall of 1963, Vitex found itself with an unused portion of its quota but no customers, and Vitex closed its plant. Caribtex acquired some Italian wool and subsequently negotiations for a processing contract were conducted between the principals of the respective companies in New York City. Though the record below is clouded with differing versions of the negotiations and the alleged final terms, the trial court found upon substantial evidence in the record that the parties did enter into a contract in which Vitex agreed to process 125,000 yards of Caribtex's woolen material at a price of 26 [25?] cents per yard.

Vitex proceeded to re-open its Virgin Islands plant, ordered the necessary chemicals, recalled its work force and made all the necessary preparations to perform its end of the bargain. However, no goods were forthcoming from Caribtex, despite repeated demands by Vitex, apparently because Caribtex was unsure that the processed wool would be entitled to duty-free treatment by the customs officials. Vitex subsequently brought this suit to recover the profits lost through Caribtex's breach.

Vitex alleged, and the trial court found, that its gross profits for processing said material under the contract would have been $31,250 and that its costs would have been $10,136, leaving Vitex's damages for loss of profits at $21,114. On appeal, Caribtex asserted numerous objections to the detailed computation of lost profits. While the record below is sometimes confusing, we conclude that the trial court had substantial evidence to support its findings on damages. It must be remembered that the difficulty in exactly ascertaining Vitex's costs is due to Caribtex's wrongful conduct in repudiating the contract before performance by Vitex. Caribtex will not be permitted to benefit by the uncertainty it has caused. Thus, since there was a sufficient basis in the record to support the trial court's determination of substantial damages, we will not set aside its judgment. Stentor Elec. Mfg. Co. v. Klaxon Co., 115 F.2d 268 (C.A.3, 1940), rev'd other grounds 313 U.S. 487 (1941); 5 Williston, Contracts § 1345 (rev. ed. 1937).

Caribtex first raised the issue at the oral argument of this appeal that the trial court erred by disregarding Vitex's overhead expenses in determining lost profits. In general, overhead ''. . . may be said to include broadly the continuous expenses of the business, irrespective of the outlay on a particular contract.'' Grand Trunk W.R.R. Co. v. H.W. Nelson Co., 116 F.2d 823, 839 (C.A.6, 1941). Such expenses would include executive and clerical salaries, property taxes, general administration expenses, etc.[1] Although Vitex did not expressly seek recovery for overhead, if a portion of these fixed expenses should be allocated as costs to the Caribtex contract, then under the judgment of the district court Vitex tacitly recovered these expenses as part of its damages for lost profits, and the damages should be

1. Caribtex could not be referring to overhead expenses as including labor costs and the like, because the trial judge did charge as costs all the expenses directly associated with the reactivation of Vitex's plant, and the actual processing of Caribtex's goods according to the terms of the contract.

reduced accordingly. Presumably, the portion to be allocated to costs would be a pro rata share of Vitex's annual overhead according to the volume of business Vitex would have done over the year if Caribtex had not breached the contract.

Although there is authority to the contrary, we feel that the better view is that normally, in a claim for lost profits, overhead should be treated as a part of gross profits and recoverable as damages, and should not be considered as part of the seller's costs. A number of cases hold that since overhead expenses are not affected by the performance of the particular contract, there should be no need to deduct them in computing lost profits. E.g., Oakland California Towel Co. v. Sivils, 52 Cal.App.2d 517, 520, 126 P.2d 651, 652 (1942); Jessup & Moore Paper Co. v. Bryant Paper Co., 297 Pa. 483, 147 A. 519, 524 (1929); Annot., 3 A.L.R.3d 689 (1965) (collecting cases on both sides of the controversy). The theory of these cases is that the seller is entitled to recover losses incurred and gains prevented in excess of savings made possible, Restatement, Contracts § 329 (made part of the law of the Virgin Islands, 1 V.I.C. § 4); since overhead is fixed and nonperformance of the contract produced no overhead cost savings, no deduction from profits should result.

The soundness of the rule is exemplified by this case. Before negotiations began between Vitex and Caribtex, Vitex had reached a lull in business activity and had closed its plant. If Vitex had entered into no other contracts for the rest of the year, the profitability of its operations would have been determined by deducting its production costs and overhead from gross receipts yielded in previous transactions. When this opportunity arose to process Caribtex's wool, the only additional expenses Vitex would incur would be those of re-opening its plant and the direct costs of processing, such as labor, chemicals and fuel oil. Overhead would have remained the same whether or not Vitex and Caribtex entered their contract and whether or not Vitex actually processed Caribtex's goods. Since this overhead remained constant, in no way attributable-to or affected-by the Caribtex contract, it would be improper to consider it as a cost of Vitex's performance to be deducted from the gross proceeds of the Caribtex contract.

However, Caribtex may argue that this view ignores modern accounting principles, and that overhead is as much a cost of production as other expenses. It is true that successful businessmen must set their prices at sufficient levels to recoup all their expenses, including overhead, and to gain profits. Thus, the price the businessman should charge on each transaction could be thought of as that price necessary to yield a pro rata portion of the company's fixed overhead, the direct costs associated with production, and a "clear" profit. Doubtless this type of calculation is used by businessmen and their accountants. Pacific Portland Cement Co. v. Food Mach. & Chem. Corp., 178 F.2d 541 (C.A.9, 1949). However, because it is useful for planning purposes to allocate a portion of overhead to each transaction, it does not follow that this allocate share of fixed overhead should be considered a cost factor in the computation of lost profits on individual transactions.

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

Secondly, even were we to recognize the allocation of overhead as proper in this case, we should uphold the tacit award of overhead expense to Vitex as a ''loss incurred.'' Conditioned Air Corp. v. Rock Island Motor Transit Co., 253 Iowa 961, 114 N.W.2d 304, cert. denied, 371 U.S. 825 (1962). By the very nature of this allocation process, as the number of transactions over which overhead can be spread becomes smaller, each transaction must bear a greater portion or allocate share of the fixed overhead cost. Suppose a company has fixed overhead of $10,000 and engages in five similar transactions; then the receipts of each transaction would bear $2000 of overhead expense. If the company is now forced to spread this $10,000 over only four transactions, then the overhead expense per transaction will rise to $2500, significantly reducing the profitability of the four remaining transactions. Thus, where the contract is between businessmen familiar with commercial practices, as here, the breaching party should reasonably foresee that his breach will not only cause a loss of ''clear'' profit, but also a loss in that the profitability of other transactions will be reduced. Resolute Ins. Co. v. Percy Jones, Inc., 198 F.2d 309 (C.A.10, 1952); Cf. In re Kellett Aircraft Corp., 191 F.2d 231 (C.A.3, 1951). Therefore, this loss is within the contemplation of ''losses caused and gains prevented,'' and overhead should be considered to a compensable item of damage.

Significantly, the Uniform Commercial Code, adopted in the Virgin Islands, 11A V.I.C. § 1–101 et seq., and in virtually every state today, provides for the recovery of overhead in circumstances similar to those presented here. Under 11A V.I.C. § 2–708, the seller's measure of damage for non-acceptance or repudiation is the difference between the contract price and the market price, but if this relief is inadequate to put the seller in as good position as if the contract had been fully performed, ''. . . then the measure of damages is the *profit (including reasonable overhead)* which the seller would have made from full performance by the buyer. . . .'' 11A V.I.C. § 2–708(2). (Emphasis added.) While this contract is not controlled by the Code, the Code is persuasive here because it embodies the foremost modern legal thought concerning commercial transactions. Indeed, it may overrule some of the cases denying recovery for overhead. E.g., Wilhelm Lubrication Co. v. Brattrud, 197 Minn. 626, 632, 268 N.W. 634, 636, 106 A.L.R. 1279 (1936).

Caribtex also argued that the contract should not be enforced because it was unconscionable. While Vitex was to make a large profit on the processing and Caribtex did bear the risk of failure to meet customs standards, the contract was freely entered-into, after much negotiation, between parties of apparently equal bargaining strength. This was not a contract of adhesion—Vitex was not the only processor in the Virgin

Islands and Caribtex's bargaining strength was evidenced by the successive and substantial price reductions it wrested from Vitex during the negotiations. Compare, Campbell Soup Co. v. Wentz, 172 F.2d 80 (C.A.3, 1948); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69, 75 A.L.R.2d 1 (1960).

The judgment of the district court will be affirmed.

NOTES

(1) *Cost and Loss Avoided*. In *Vitex*, the court observed that "since overhead is fixed and nonperformance of the contract produced no overhead cost savings, no deduction from profits should result." In terms of the damages formula above (*Damages* = (a) *loss in value* + (b) *other loss*—(c) *cost and loss avoided*), this means that the overhead to which the court referred was not a part of the third component. Are all overhead expenses fixed and unavoidable?

(2) *Profit at the Margin*. Profit is the difference between revenue earned and all expenditures required to generate that revenue. These expenditures include fixed and non-fixed costs. But to determine the lost profit from a particular contract, as the court sought to do in *Vitex*, one would look to *marginal* revenue and *marginal* cost—not to total revenue and total cost, or average revenue and average cost. The marginal revenue a party receives from a contract is the additional revenue resulting from that contract. (Often, but not always, that amount is the contract price.) The marginal cost of a contract is the cost of completing performance of that contract. Therefore, so far as the fixed costs of performing have been expended already, they are not part of the marginal cost of performing. Only the further expenditures required to perform the contract enter into marginal cost.

(3) *Overhead Costs*. The *Vitex* court relied on the marginal-cost logic above in reaching its conclusions regarding Vitex's overhead costs in the lost-profit calculation. But the court also said that "even were we to recognize the allocation of overhead as proper in this case, we should uphold the tacit award of overhead expense to Vitex as a 'loss incurred.' " Under which loss category—*i.e.*, *loss in value* (a), or *other loss* (b)—would this loss fall? Note that UCC § 2–708 gives little guidance as to how overhead is to be taken into account.

(4) *Sunk Costs*. Suppose that a firm leases a fleet of trucks for $500,000 in order to make delivery of goods as required by a large sale contract. If, following a breach by the buyer, the firm sublets the fleet for $400,000, then only $100,000 of this expenditure is "sunk." Sunk costs are those that cannot be avoided or recouped once they have been made. How much effort should a court require of an injured party to limit its losses to sunk costs alone?

Laredo Hides Co., Inc. v. H & H Meat Products Co., Inc.

Court of Civil Appeals of Texas, 1974.
513 S.W.2d 210.

■ BISSETT, JUSTICE. This is a breach of contract case. Laredo Hides Company, Inc., the buyer, sued H & H Meat Products Company, Inc., the seller, to recover damages for breach of a written contract for the sale of cattle hides. Trial was to the court without a jury. A take nothing judgment in favor of defendant was rendered. Plaintiff has appealed.

The controlling facts of the case are undisputed. H & H Meat Products Company, Inc. (H & H) is a meat processing and packing corporation, located in Mercedes, Texas. It sells cattle hides as a by-product of its business. Laredo Hides Company, Inc. (Laredo Hides) is a corporation, located in Laredo, Texas. It purchases cattle hides from various meat packers in the United States and ships them to tanneries in Mexico.

A written contract dated February 29, 1972, was executed whereby Laredo Hides agreed to buy H & H's entire cattle hide production during the period March through December, 1972.... [After two deliveries of hides, a $9,000 check sent by Laredo Hides to H & H in payment for the second shipment was delayed in the mail. Before it arrived, H & H gave Laredo Hides an ultimatum demanding payment within a few hours. When the demand was not met, H & H notified Laredo Hides on March 30, 1972, that H & H regarded this as a breach justifying cancellation of the contract and that it would deliver no more hides. In an omitted part of the opinion, the court held that H & H's precipitous action was unjustified, that its refusal to deliver more hides was itself a breach by repudiation of the contract that relieved Laredo Hides of tendering performance during the remaining months of the contract, and that the trial court's disposition of the case was error.]

Laredo Hides, on March 3, 1972, had contracted with a Mexican tannery for the sale of all the hides which it expected to purchase from H & H under the February 29, 1972, contract. Following the cancellation by H & H of the contract, Laredo Hides, in order to meet the requirements of its contract with the tannery, was forced to purchase hides on the open market in substitution for the hides which were to have been delivered to it under the contract with H & H.

H & H's total production during the months April through December, 1972, was 17,218 hides. Under the contract with H & H, the price was $9.75 per hide for bull, steer and heifer hides, and $9.75 per hide for cow hides if the shipment was under 5% cow hides. In the event the shipment was more than 5% cow hides, the price on the excess of cow hides over 5% was reduced to $7.50 per cow hide. The market price for hides steadily increased following the execution of the contract in question. By December 31, 1972, the average cost of bull hides was about $33.00 each and the average cost of cow, heifer and steer hides was about $22.00 each. The total additional cost to Laredo Hides of purchasing substitute hides from other suppliers was $142,254.48. The additional costs (transportation and handling charges) to Laredo Hides which resulted because of the purchases from third parties amounted to $3,448.95....

Since this case must be reversed, we now confront the issue of damages. The guidelines for determining a buyer's remedies in a case where there is a breach of a contract for the sale of goods by a seller are found in Chapter 2 of the Texas Business and Commerce Code [the Uniform Commercial Code, as enacted in Texas]. Among other remedies afforded by the Code, when there is a repudiation of the contract by the seller or a failure to make delivery of the goods under contract, the buyer may cover under § 2.711. He may have damages under § 2.712 "by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller'', and ''may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages'' provided by the chapter; or, he may, under § 2.713, have damages measured by ''the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages'' provided by the chapter.

Laredo Hides instituted suit in May, 1972, and filed its amended petition (its trial pleading) on October 24, 1972, when performance was still due by H & H under the contract. It prayed for specific performance, or in the alternative ''. . . damages at least in the amount of one hundred thousand dollars ($100,000), the same being the damages proximately caused by defendant's breach of the contract . . .'' There was never a trial amendment of this petition. There were no exceptions by H & H to Laredo Hides' pleadings. Trial commenced on February 28, 1973, was recessed on March 2, 1973, resumed on May 15, 1973, and ended May 16, 1973. Judgment was signed and rendered on August 6, 1973.

Laredo Hides offered uncontroverted evidence of the hide production of H & H from April to December, 1972. It also established the price for the same number of hides which it was forced to buy elsewhere. There was testimony that purchases had to be made periodically throughout 1972 since Laredo Hides had no storage facilities, and the hides would decompose if allowed to age. Furthermore, White, a C.P.A., testified as to statistical summaries which he made showing the cost of buying substitute hides. These summaries were made from invoices which are also in evidence. All of this evidence was admitted without objection. Clearly, Laredo Hides elected to pursue the remedy provided by § 2.712 of the Code, and by its pleadings and evidence brought itself within the purview of the ''cover'' provisions contained therein.

It is not necessary under § 2.712 that the buyer establish market price. Duesenberg and King, Sales and Bulk Transfers under the U.C.C. § 14.04 Matthew Bender (1974). Where the buyer complies with the requirements of § 2.712, his purchase is presumed proper and the burden of proof is on the seller to show that ''cover'' was not properly obtained. Spies, Sales, Performance and Remedies, 44 Tex.L.Rev. 629, 638 (1966). There was no evidence offered by H & H to negate this presumption or to ''establish expenses saved in consequence of the seller's breach'', as permitted by § 2.712.

The difference between the cover price and the contract price is shown to be $134,252.82 for steer hides and $8,001.66 for bull hides, or a total of $142,254.48. In addition, Laredo Hides offered evidence of increased transportation costs of $1,435.77, and increased handling charges of $2,013.18. These are clearly recoverable as incidental damages where the buyer elects to ''cover''. §§ 2.715(a); 2.712(b) . . . .

There is no evidence that Laredo Hides, in any manner, endeavored to increase its damages sustained when H & H refused to deliver any more hides to it. Laredo Hides, in purchasing the hides in substitution of the hides which should have been delivered under the contract, acted promptly and in a reasonable manner. The facts of this case regarding the issue of liability of H & H and the issues pertaining to damages suffered by Laredo Hides, have been fully and completely developed in the court below. The facts upon which judgment should have been rendered for Laredo Hides by the trial court are conclusively established. It, therefore, becomes the duty of this Court to render judgment which the trial court should have rendered. . . .

Applying the rules announced by the above cited cases and authorities to the instant case, we hold that the record does not support the findings of fact made by the trial judge and there is no legal justification for the conclusion of law reached by the court. Accordingly, the judgment of the trial court is reversed, and judgment is here rendered for Laredo Hides in the amount of $152,960.04, together with interest thereon at the rate of 6% per annum from August 6, 1973, the date judgment was rendered by the trial court, until paid.

Reversed and rendered.

NOTES

(1) *What Is Cover?* Note that although Laredo Hides' contract with H & H was for a term of ten months, its substitute purchases were on the "spot" market. What statutory language justified the court in treating these purchases as cover? Compare McGinnis v. Wentworth Chevrolet Co., 668 P.2d 365 (Or.1983) (rental of car in lieu of purchase), and Cives Corp. v. Callier Steel Pipe & Tube, Inc., 482 A.2d 852 (Me.1984) (manufacture of goods in lieu of purchase). What result if the hides purchased on the spot market had been of a better quality than those that H & H had contracted to supply? See Martella v. Woods, 715 F.2d 410 (8th Cir.1983) (heifer buyer's purchase of better heifers), and Handicapped Children's Education Board v. Lukaszewski, 332 N.W.2d 774 (Wis.1983) (Board's hire of better-qualified teacher).

Would it make a difference if other hides of the quality contracted for were available on the spot market?

If Laredo Hides had been denied recovery under UCC § 2–712 (because the goods in the second transaction were held not to be "in substitution for those due from the seller"), then to what relief would it have been entitled?

(2) *Substitute Transactions: Goods.* Often, following breach, the injured party arranges a substitute transaction and claims damages based on that transaction rather than on one of the damage formulas set out earlier. Laredo Hides did that by arranging substitute purchases of hides and basing its damages on the cover price in those transactions under UCC § 2–712. The rule of that section is a Code innovation. It has no antecedent in prior law. (For comparable provisions, see CISG art. 75 and UNIDROIT Principles 7.4.5.) Had this case arisen before the enactment of the Code, Laredo Hides would have had to prove damages based on the difference between market price and contract price under the common law rule of Texas that was the antecedent of UCC § 2–713. What disadvantages would that have had for Laredo Hides?

In connection with the foregoing question, consider what the Supreme Court of Maine said in Williams v. Ubaldo, 670 A.2d 913 (Me.1996), a case involving the sale of a home. "The reports of professional appraisers have been accepted as evidence of the fair market value of real estate.... Evidence of the price resulting from a subsequent sale is also probative of a property's fair market value." Id. at 917.

(3) *Substitute Transactions: Services*. If an employee is fired in breach of a contract and does other work as a result of being freed from that contract, the employee's damages are based on the salary that would have been earned under the broken contract less that earned by doing the other work. In State ex rel. Schilling v. Baird, 222 N.W.2d 666, 670 (Wis.1974), Schilling, a deputy sheriff who was wrongfully suspended, argued that he was not required to deduct his earnings from other work because they were not made between midnight and eight in the morning, the shift to which he was assigned as a deputy. "With this conclusion the Court cannot agree. It lends itself to an almost absurd result. Under this interpretation all Schilling had to do was to refrain from getting a third shift job and could then earn as much as he wanted or was fortunate enough to earn and would not be required to deduct any of it."

Under the "collateral source" rule that prevails in some states, an employee's recovery in tort is reduced by sums received from a collateral source, such as unemployment compensation and similar benefits, in order to avoid double recovery. Courts in states with the rule have divided over whether an employee who sues in contract must deduct such sums. See 3 Farnsworth on Contracts § 12.9 n. 14 (2d ed.1998).

Sometimes it is no simple matter to decide whether another comparable opportunity accepted by the injured party after breach should be treated as a "substitute" in calculating damages. Often a seller or other supplier claims that a subsequent transaction *was not* a substitute in order to have not only the benefit of that transaction but also damages based on profits lost on the original transaction.

A person fired from a full-time job cannot expect to make gainful use of the released time and to have the gain disregarded in an action based on wrongful firing. That is so whether or not the old and new jobs are in the same line. Recall the wrongfully suspended deputy sheriff in Schilling, above.

Unlike sheriffs, schoolteachers, and stars of the stage, persons in the building trades commonly apply their personal services to the simultaneous performance of multiple contracts; and firms in those trades may not apply the personal service of any specified individual to a contract. Hence it is generally assumed that a person or firm can undertake a new repair or construction job while continuing work on jobs already booked, adding as necessary to the work force and the stock of tools and materials. On that assumption, earnings on a new job are not credited against a builder's claim for having been dismissed, wrongfully, from an "old" one. The breach has not resulted in "lost volume" for the builder.

(4) *Covering, the UCC*. Recall that in Klein's case he had bought a G–III jet after declining, on the ground of price, offers by UJS to sell him two G–IIs. Suppose that, instead, he had made a prompt purchase of another G–II, and had paid more than the contract price—say $250,000 more. Under UCC § 2–712 his "reasonable purchase of ... goods in substitution for those due from the seller" would have been "cover," entitling Klein to damages based on "the difference between the cost of cover and the contract price" (here $250,000).

Section 2–712 would have afforded Klein two advantages over UCC § 2–713. First, he would not have to prove market price, which would probably require expert witnesses, but could simply use his cover contract to show the cover price. Second, he could recover his actual additional cost of a substitute (here $250,000) rather than the hypothetical cost of a substitute (here $200,000) if he had obtained it on the market.

If the seller is the injured party, the Code accords a remedy analogous to that of cover for a buyer. Given that the goods concerned have been identified to the contract, Section 2–706 permits the seller to make a resale of the goods and to base damages on the resale price.

(5) *An ''Alternative Product'' Rule.* On occasion a seller of goods, in breach, has contested the buyer's claim of loss by contending that, aside from the contract in question, nothing would have averted the loss. The argument amounts to saying that a recovery of a claimant's lost expectation cannot be justified if, when the contract was made, that party could not have accomplished its purpose by dealing with someone else, and so lost no opportunity. One court has subscribed to that rule. Overstreet v. Norden Laboratories, 669 F.2d 1286 (6th Cir.1982). Norden Labs had supplied Dr. Overstreet with a vaccine for horses, said by him to have been ineffective. In an appeal by Norden, one issue was the trial court's instruction to a jury about damages. Norden persuaded two of the judges that it could limit its liability by showing that no effective vaccine had been available to Overstreet. One judge opposed that limitation, ascribing it to what he called an ''alternative product'' rule. A contrasting decision is that in Chatlos Systems v. National Cash Register [NCR] Corp., 670 F.2d 1304 (3d Cir.1982). NCR, having warranted the performance of its computer system, contended, in effect, that no other computer system in the same price range could have achieved the performance expected by the buyer of its system. The buyer presented testimony of the high value of a system that would serve the buyer as NCR had warranted that its system would. NCR sought to counter that valuation. It had gotten the witness to concede that the price of the high-value system would exceed by far the price paid to NCR for its system. Given that fact, NCR said, the testimony was like substituting a Rolls Royce for a Ford. The analogy did not move a majority of the court.

In Overstreet's case the court drew a different analogy. It said:

> ''Let us assume, as appears to be the case, that nothing will reverse or prevent baldness.... Suppose a warrantor, in good faith, represents to a man who is beginning to go bald that use of the warrantor's product will prevent the loss of his hair. The product fails to work and the man goes bald.... If in reliance on the warranty he gave away his assortment of wigs he could recover from the warrantor the cost of replacing them.... However, he could not recover for the loss of his hair. The breach simply had no effect on the presence or absence of the hair.''

Id. at 1296–97. Should the bald man recover for his lost expectation? The court thought not. It called its ruling a straightforward application of the requirement of causation.

PROBLEM

A Lucky Star. Star Paving subcontracted with Drennan to do for $15,000 the paving required under Drennan's contract to build a school for the Lancaster School District. Drennan wrongfully ordered Star to stop work at a time when it would have cost Star $5,000 to complete it. Luckily for Star, it was able at once to make a contract with the School District to finish the job at a price of $7,000. Star demands $10,000 ($15,000 minus $5,000) from Drennan. Drennan offers to pay $8,000 ($15,000 minus $7,000). Who is right? See Olds v. Mapes–Reeves Constr. Co., 58 N.E. 478 (Mass.1900). Would it make a difference if one or more terms of the second contract (*e.g.*, one about liability in the event of breach) were significantly different from those of the first?

R.E. Davis Chemical Corp. v. Diasonics, Inc.

United States Court of Appeals, Seventh Circuit, 1987.
826 F.2d 678.

■ CUDAHY, CIRCUIT JUDGE. Diasonics, Inc. appeals from the orders of the district court denying its motion for summary judgment and granting R.E. Davis Chemical Corp.'s summary judgment motion. Diasonics also appeals from the order dismissing its third-party complaint against Dr. Glen D. Dobbin and Dr. Galdino Valvassori. We affirm the dismissal of the third-party complaint, reverse the grant of summary judgment in favor of Davis and remand for further proceedings.

I.

Diasonics is a California corporation engaged in the business of manufacturing and selling medical diagnostic equipment. Davis is an Illinois corporation that contracted to purchase a piece of medical diagnostic equipment from Diasonics. On or about February 23, 1984, Davis and Diasonics entered into a written contract under which Davis agreed to purchase the equipment. Pursuant to this agreement, Davis paid Diasonics a $300,000 deposit on February 29, 1984. Prior to entering into its agreement with Diasonics, Davis had contracted with Dobbin and Valvassori to establish a medical facility where the equipment was to be used. Dobbin and Valvassori subsequently breached their contract with Davis. Davis then breached its contract with Diasonics; it refused to take delivery of the equipment or to pay the balance due under the agreement. Diasonics later resold the equipment to a third party for the same price at which it was to be sold to Davis.

Davis sued Diasonics, asking for restitution of its $300,000 down payment under section 2–718(2) of the Uniform Commercial Code (the "UCC" or the "Code") . . . . Diasonics counterclaimed. Diasonics did not deny that Davis was entitled to recover its $300,000 deposit less $500 as provided in section 2–718(2)(b). However, Diasonics claimed that it was entitled to an offset under section 2–718(3). Diasonics alleged that it was a "lost volume seller," and, as such, it lost the profit from one sale when Davis breached its contract. Diasonics' position was that, in order to be put in as good a position as it would have been in had Davis performed, it was entitled to recover its lost profit on its contract with Davis under section 2–708(2) of the UCC . . . .

Diasonics subsequently filed a third-party complaint against Dobbin and Valvassori, alleging that they tortiously interfered with its contract with Davis. Diasonics claimed that the doctors knew of the contract between Davis and Diasonics and also knew that, if they breached their contract with Davis, Davis would have no use for the equipment it had agreed to buy from Diasonics.

The district court dismissed Diasonics' third-party complaint for failure to state a claim upon which relief could be granted, finding that the complaint did not allege that the doctors intended to induce Davis to breach its contract with Diasonics. The court also entered summary judgment for Davis. The court held that lost volume sellers were not entitled to recover damages under 2–708(2) but rather were limited to recovering the difference between the resale price and the contract price along with incidental damages under section 2–706(1).... Davis was awarded $322,656, which represented Davis' down payment plus prejudgment interest less Diasonics' incidental damages. Diasonics appeals the district court's decision respecting its measure of damages as well as the dismissal of its third-party complaint.

II.

We consider first Diasonics' claim that the district court erred in holding that Diasonics was limited to the measure of damages provided in 2–706 and could not recover lost profits as a lost volume seller under 2–708(2). Surprisingly, given its importance, this issue has never been addressed by an Illinois court, nor, apparently, by any other court construing Illinois law. Thus, we must attempt to predict how the Illinois Supreme Court would resolve this issue if it were presented to it. Courts applying the laws of other states have unanimously adopted the position that a lost volume seller can recover its lost profits under 2–708(2). Contrary to the result reached by the district court, we conclude that the Illinois Supreme Court would follow these other cases and would allow a lost volume seller to recover its lost profit under 2–708(2).

We begin our analysis with 2–718(2) and (3). Under 2–718(2)(b), Davis is entitled to the return of its down payment less $500. Davis' right to restitution, however, is qualified under 2–718(3)(a) to the extent that Diasonics can establish a right to recover damages under any other provision of Article 2 of the UCC. Article 2 contains four provisions that concern the recovery of a seller's general damages (as opposed to its incidental or consequential damages): 2–706 (contract price less resale price); 2–708(1) (contract price less market price); 2–708(2) (profit); and 2–709 (price). The problem we face here is determining whether Diasonics' damages should be measured under 2–706 or 2–708(2). To answer this question, we need to engage in a detailed look at the language and structure of these various damage provisions.

The Code does not provide a great deal of guidance as to when a particular damage remedy is appropriate. The damage remedies provided under the Code are catalogued in section 2–703, but this section does not indicate that there is any hierarchy among the remedies. One method of approaching the damage sections is to conclude that 2–708 is relegated to a role inferior to that of 2–706 and 2–709 and that one can turn to 2–708 only after one has concluded that neither 2–706 nor 2–709 is applicable.[1] Under

1. Evidence to support this approach can be found in the language of the various damage sections and of the official comments to the UCC. See § 2–709(3) ("a seller who is held not entitled to the price under this Section shall nevertheless be awarded damages

this interpretation of the relationship between 2–706 and 2–708, if the goods have been resold, the seller can sue to recover damages measured by the difference between the contract price and the resale price under 2–706. The seller can turn to 2–708 only if it resells in a commercially unreasonable manner or if it cannot resell but an action for the price is inappropriate under 2–709. The district court adopted this reading of the Code's damage remedies and, accordingly, limited Diasonics to the measure of damages provided in 2–706 because it resold the equipment in a commercially reasonable manner.

The district court's interpretation of 2–706 and 2–708, however, creates its own problems of statutory construction. There is some suggestion in the Code that the "fact that plaintiff resold the goods [in a commercially reasonable manner] does *not* compel him to use the resale remedy of § 2–706 rather than the damage remedy of § 2–708." Harris, A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared, 18 Stan.L.Rev. 66, 101 n. 174 (1965) (emphasis in original). Official Comment 1 to 2–703, which catalogues the remedies available to a seller, states that these "remedies are essentially cumulative in nature" and that "[w]hether the pursuit of one remedy bars another depends entirely on the facts of the individual case." See also State of New York, Report of the Law Revision Comm'n for 1956, 396–97 (1956).[2]

for non-acceptance under the preceding section [§ 2–708]"); UCC Comment 7 to § 2–709 ("[i]f the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for non-acceptance [under § 2–708]"); UCC Comment 2 to § 2–706 ("[f]ailure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2–708"); UCC Comment 1 to § 2–704 (describes § 2–706 as the "primary remedy" available to a seller upon breach by the buyer); see also Commonwealth Edison Co. v. Decker Coal Co., 653 F.Supp. 841, 844 (N.D.Ill.1987) (statutory language and case law suggest that "§ 2–708 remedies are available only to a seller who is not entitled to the contract price" under § 2–709); Childres & Burgess, Seller's Remedies: The Primacy of UCC § 2–708(2), 48 N.Y.U.L.Rev. 833, 863–64 (1973). As one commentator has noted, 2–706 is the Code section drafted specifically to define the damage rights of aggrieved reselling sellers, and there is no suggestion within it that the profit formula of section 2–708(2) is in any way intended to qualify or be superior to it.

Shanker, The Case for a Literal Reading of UCC Section 2–708(2) (One Profit for the Reseller), 24 Case W.Res. 697, 699 (1973).

2. UCC Comment 2 to 2–708(2) also suggests that 2–708 has broader applicability than suggested by the district court. UCC Comment 2 provides:

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

The district court's restrictive interpretation of 2–708(2) was based in part on UCC Comment 1 to 2–704 which describes 2–706 as the aggrieved seller's primary remedy. The district court concluded that, if a lost volume seller could recover its lost profit under 2–708(2), every seller would attempt to recover damages under 2–708(2) and 2–706 would become the aggrieved seller's residuary remedy. This argument ignores the fact that to recover under 2–708(2), a seller must first establish its status as a lost volume seller. . . .

The district court also concluded that a lost volume seller cannot recover its lost profit under 2–708(2) because such a result would negate a seller's duty to mitigate damages. This position fails to recognize the fact that, by definition, a lost volume seller cannot mitigate damages through resale. Resale does not reduce a lost volume seller's damages because the breach has still resulted in its losing one sale and a corresponding profit. See Autonumerics, 144 Ariz. at 192, 696 P.2d at 1341.

Those courts that found that a lost volume seller can recover its lost profits under 2–708(2) implicitly rejected the position adopted by the district court; those courts started with the assumption that 2–708 applied to a lost volume seller without considering whether the seller was limited to the remedy provided under 2–706. None of those courts even suggested that a seller who resold goods in a commercially reasonable manner was limited to the damage formula provided under 2–706. We conclude that the Illinois Supreme Court, if presented with this question, would adopt the position of these other jurisdictions and would conclude that a reselling seller, such as Diasonics, is free to reject the damage formula prescribed in 2–706 and choose to proceed under 2–708.

Concluding that Diasonics is entitled to seek damages under 2–708, however, does not automatically result in Diasonics being awarded its lost profit. Two different measures of damages are provided in 2–708. Subsection 2–708(1) provides for a measure of damages calculated by subtracting the market price at the time and place for tender from the contract price.[3] The profit measure of damages, for which Diasonics is asking, is contained in 2–708(2). However, one applies 2–708(2) only if "the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done...." ... Diasonics claims that 2–708(1) does not provide an adequate measure of damages when the seller is a lost volume seller.[4] To understand Diasonics' argument, we need to define the concept of the lost volume seller. Those cases that have addressed this issue have defined a lost volume seller as one that has a predictable and finite number of customers and that has the capacity either to sell to all new buyers or to make the one additional sale represented by the resale after the breach. According to a number of courts and commentators, if the seller would have made the sale represented by the resale whether or not the breach occurred, damages measured by the difference between the contract price and market price cannot put the lost volume seller in as good a position as it would have been in had the buyer performed.[5] The breach effectively cost the seller a "profit," and the seller can only be made whole by awarding it damages in the amount of its "lost profit" under 2–708(2).

We agree with Diasonics' position that, under some circumstances, the measure of damages provided under 2–708(1) will not put a reselling seller in as good a position as it would have been in had the buyer performed

3. There is some debate in the commentaries about whether a seller who has resold the goods may ignore the measure of damages provided in 2–706 and elect to proceed under 2–708(1). Under some circumstances the contract-market price differential will result in overcompensating such a seller. See J. White & R. Summers, Handbook of the Law under the Uniform Commercial Code § 7–7, at 271–73 (2d ed. 1980); Sebert, Remedies under Article Two of the Uniform Commercial Code: An Agenda for Review, 130 U.Pa.L.Rev. 360, 380–83 (1981). We need not struggle with this question here because Diasonics has not sought to recover damages under 2–708(1).

4. This is also the position adopted by those courts that have held that a lost volume seller can recover its lost profits under 2–708(2)....

5. According to one commentator,

> Resale results in loss of volume only if three conditions are met: (1) the person who bought the resold entity would have been solicited by plaintiff had there been no breach and resale; (2) the solicitation would have been successful; and (3) the plaintiff could have performed that additional contract.

Harris, supra, at 82 (footnotes omitted).

because the breach resulted in the seller losing sales volume. However, we disagree with the definition of ''lost volume seller'' adopted by other courts. Courts awarding lost profits to a lost volume seller have focused on whether the seller had the capacity to supply the breached units in addition to what it actually sold. In reality, however, the relevant questions include, not only whether the seller could have produced the breached units in addition to its actual volume, but also whether it would have been profitable for the seller to produce both units. Goetz & Scott, Measuring Sellers' Damages: The Lost–Profits Puzzle, 31 Stan.L.Rev. 323, 332–33, 346–47 (1979). As one commentator has noted, under

> the economic law of diminishing returns or increasing marginal costs[,] ... as a seller's volume increases, then a point will inevitably be reached where the cost of selling each additional item diminishes the incremental return to the seller and eventually makes it entirely unprofitable to conclude the next sale.

Shanker, supra n. 1, at 705. Thus, under some conditions, awarding a lost volume seller its presumed lost profit will result in overcompensating the seller, and 2–708(2) would not take effect because the damage formula provided in 2–708(1) does place the seller in as good a position as if the buyer had performed. Therefore, on remand, Diasonics must establish, not only that it had the capacity to produce the breached unit in addition to the unit resold, but also that it would have been profitable for it to have produced and sold both. Diasonics carries the burden of establishing these facts because the burden of proof is generally on the party claiming injury to establish the amount of its damages; especially in a case such as this, the plaintiff has easiest access to the relevant data....[6]

One final problem with awarding a lost volume seller its lost profits was raised by the district court. This problem stems from the formulation of the measure of damages provided under 2–708(2) which is ''the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2–710), due allowance for costs reasonably incurred and due credit for payments or *proceeds of resale.*'' ... (emphasis added). The literal language of 2–708(2) requires that the proceeds from resale be credited against the amount of damages awarded which, in most cases, would result in the seller recovering nominal damages. In those cases in which the lost volume seller was awarded its lost profit as damages, the courts have circumvented this problem by concluding that this language only applies to proceeds realized from the resale of uncompleted goods for scrap. See, e.g., Neri [v. Retail Marine Corp., 30 N.Y.2d 393, 399 & n. 2, 334 N.Y.S.2d 165, 169 & n. 2, 285 N.E.2d 311, 314 & n. 2 (1972)]; *see also* J. White & R. Summers, Handbook of the Law under the Uniform Commercial Code § 7–13, at 285 (''courts should simply ignore the 'due credit' language in lost volume cases'') (footnote omitted). Although neither the

6. As some commentators have pointed out, the cost of calculating a loss of profit may be very high. Goetz & Scott, supra, at 353 (''the complexity of the lost-volume problem suggests that the information costs of exposing an overcompensatory rule are relatively high'').

text of 2–708(2) nor the official comments limit its application to resale of goods for scrap, there is evidence that the drafters of 2–708 seemed to have had this more limited application in mind when they proposed amending 2–708 to include the phrase "due credit for payments or proceeds of resale."[7] We conclude that the Illinois Supreme Court would adopt this more restrictive interpretation of this phrase rendering it inapplicable to this case.

We therefore reverse the grant of summary judgment in favor of Davis and remand with instructions that the district court calculate Diasonics' damages under 2–708(2) if Diasonics can establish, not only that it had the capacity to make the sale to Davis as well as the sale to the resale buyer, but also that it would have been profitable for it to make both sales. Of course, Diasonics, in addition, must show that it probably would have made the second sale absent the breach.

[In an omitted part of the opinion, the court went on to uphold dismissal of the third-party complaint.]

NOTES

(1) *Appeal after Remand.* On remand, after a three-day bench trial, the district judge concluded that Diasonics had adequately established damages for lost profits amounting to $453,050 and entered judgment for that sum less the $300,000 deposit retained by Diasonics. On appeal by Davis, the Court of Appeals upheld this conclusion as not clearly erroneous. "The evidence is undisputed that Diasonics possessed the capacity to manufacture one more MRI. Diasonics also demonstrated that it was . . . 'beating the bushes for all possible sales.' . . . Diasonics was still a young company struggling to acquire business in an extremely competitive market. . . . The mere fact that Diasonics was unable to specify the particular unit Davis contracted to buy and trace the exact resale buyer for that unit . . . should not foreclose it from recovering lost profits." R.E. Davis Chemical Corp. v. Diasonics, Inc., 924 F.2d 709, 711–12 (7th Cir.1991).

(2) *Lost Volume.* Many hundreds of pages of economic analysis have been devoted to the subject of sellers' claims of lost volume resulting from buyers' breaches. Two helpful sources are Robert Cooter & Melvin Eisenberg, Damages for Breach of Contract, 73 Cal.L.Rev. 1432, 1444–77 (1985); Goldberg, *Framing Contract Law* (2006).

In practice, the outcome may turn on who has the burden of proof on the issue of lost volume. Courts have generally placed the burden of proof on the seller. See Famous Knitwear Corp. v. Drug Fair, Inc., 493 F.2d 251 (4th Cir.1974). But in Islamic Republic of Iran v. Boeing Co., 771 F.2d 1279 (9th Cir.1985), the court rejected the argument that to take advantage of UCC § 2–708(2) a seller must prove that the market is one "in which supply exceeds demand." "We will not . . . impose rigid and complex burdens of proof on this section. . . . Most other jurisdictions have held that to qualify as a 'lost volume' seller under section 2–708(2), the seller needs to show only that it *could have* supplied both the breaching purchaser and the resale purchaser."

7. In explaining its recommendation that 2–708 be amended to include the requirement that due credit be given for resale, the Enlarged Editorial Board stated that its purpose was "to clarify the privilege of the seller to realize junk value when it is manifestly useless to complete the operation of manufacture." Supplement No. 1 to the 1952 Official Draft (1955), quoted in Harris, supra, at 98.

PROBLEM

A Paradox. How do you explain the following paradox? In order to justify allowing recovery for breach of a contract on which neither party appears to have relied, a court reasons that the injured party might have passed up the opportunity of making a similar alternative contract but should not be required to prove this. Then in calculating the injured party's damages, the court reasons that the injured party lost volume because it would not have passed up the opportunity of making a similar alternative contract but would have made both contracts. Judicial inconsistency?

LOSING CONTRACTS

If a lottery operator failed to deliver a purchased ticket, the purchaser could "get his money back whether or not he eventually would have won the lottery." Does this mean that an aggrieved party is generally entitled to restitution under a "losing contract"—even though that party would have sustained a loss had that contract been performed?

Consider the following as a possible solution. "In cases where the venture would have proved profitable to the promisee, there is no reason why he should not recover his expenses. On the other hand, on those occasions in which the performance would not have covered the promisee's outlay, such a result imposes the risk of the promisee's contract upon the promisor. We cannot agree that the promisor's default in performance should under this guise make him an insurer of the promisee's venture; yet it does not follow that the breach should not throw upon him the duty of showing that the value of the performance would in fact have been less than the promisee's outlay. It is often very hard to learn what the value of the performance would have been; and it is a common expedient, and a just one, in such situations to put the peril of the answer upon that party who by his wrong has made the issue relevant to the rights of the other. On principle therefore the proper solution would seem to be that the promisee may recover his outlay in preparation for the performance, subject to the privilege of the promisor to reduce it by as much as he can show that the promisee would have lost, if the contract had been performed." Learned Hand in L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182, 189 (2d Cir.1949).

The case just quoted from involved material delay by a seller of machines to be used by the buyer to reclaim old rubber during World War II. The buyer did not ask for loss of profits when the delay caused this speculative venture to fall through, but did claim expenses in reliance on the seller's promise to deliver on time, including the cost of laying foundations for the machines. It was this claim to which Hand spoke. For a defense of expectation-based recovery in such cases, see Andrew Kull, Restitution as a Remedy for Breach of Contract, 67 S. Cal.L.Rev. 1465 (1994); Henry Mather, Restitution as a Remedy for Breach of Contract: The Case of the Partially Performing Seller, 92 Yale L.J. 14 (1982).

UCC § 2–718(2) provides for some restitution when a party has pre-paid. Notice that this section applies to pre-paying buyers. What about a pre-delivering seller? See UCC § 2–709.

PROBLEM

Flour Markets. Buyer made a $500,000 payment on a contract for the sale of flour for a total price of $1,400,000. Seller broke the contract by failing to deliver the flour, although the market price of the flour had dropped to $1,100,000 by the time of delivery. Is Buyer entitled to restitution of $500,000 from Seller? See Bush v. Canfield, 2 Conn. 485 (1818).

United States v. Algernon Blair, Inc.

United States Court of Appeals, Fourth Circuit, 1973.
479 F.2d 638.

■ CRAVEN, CIRCUIT JUDGE. May a subcontractor, who justifiably ceases work under a contract because of the prime contractor's breach, recover in quantum meruit the value of labor and equipment already furnished pursuant to the contract irrespective of whether he would have been entitled to recover in a suit on the contract? We think so, and, for reasons to be stated, the decision of the district court will be reversed.

The subcontractor, Coastal Steel Erectors, Inc., brought this action under the provisions of the Miller Act, 40 U.S.C.A. § 270a et seq., in the name of the United States against Algernon Blair, Inc., and its surety, United States Fidelity and Guaranty Company. Blair had entered a contract with the United States for the construction of a naval hospital in Charleston County, South Carolina. Blair had then contracted with Coastal to perform certain steel erection and supply certain equipment in conjunction with Blair's contract with the United States. Coastal commenced performance of its obligations, supplying its own cranes for handling and placing steel. Blair refused to pay for crane rental, maintaining that it was not obligated to do so under the subcontract. Because of Blair's failure to make payments for crane rental, and after completion of approximately 28 percent of the subcontract, Coastal terminated its performance. Blair then proceeded to complete the job with a new subcontractor. Coastal brought this action to recover for labor and equipment furnished.

The district court found that the subcontract required Blair to pay for crane use and that Blair's refusal to do so was such a material breach as to justify Coastal's terminating performance. This finding is not questioned on appeal. The court then found that under the contract the amount due Coastal, less what had already been paid, totaled approximately $37,000. Additionally, the court found Coastal would have lost more than $37,000 if it had completed performance. Holding that any amount due Coastal must be reduced by any loss it would have incurred by complete performance of the contract, the court denied recovery to Coastal. While the district court correctly stated the " 'normal' rule of contract damages," we think Coastal is entitled to recover in quantum meruit.

In United States for Use of Susi Contracting Co. v. Zara Contracting Co., 146 F.2d 606 (2d Cir.1944), a Miller Act action, the court was faced with a situation similar to that involved here—the prime contractor had unjustifiably breached a subcontract after partial performance by the subcontractor. The court stated:

> For it is an accepted principle of contract law, often applied in the case of construction contracts, that the promisee upon breach has the option to forego any suit on the contract and claim only the reasonable value of his performance.

146 F.2d at 610.... Quantum meruit recovery is not limited to an action against the prime contractor but may also be brought against the Miller Act surety, as in this case. Further, that the complaint is not clear in regard to the theory of a plaintiff's recovery does not preclude recovery under quantum meruit. Narragansett Improvement Co. v. United States, 290 F.2d 577 (1st Cir.1961). A plaintiff may join a claim for quantum meruit with a claim for damages from breach of contract.

In the present case, Coastal has, at its own expense, provided Blair with labor and the use of equipment. Blair, who breached the subcontract, has retained these benefits without having fully paid for them. On these facts, Coastal is entitled to restitution in quantum meruit.

> The "restitution interest," involving a combination of unjust impoverishment with unjust gain, presents the strongest case for relief. If, following Aristotle, we regard the purpose of justice as the maintenance of an equilibrium of goods among members of society, the restitution interest presents twice as strong a claim to judicial intervention as the reliance interest, since if A not only causes B to lose one unit but appropriates that unit to himself, the resulting discrepancy between A and B is not one unit but two.

Fuller & Perdue, The Reliance Interest in Contract Damages, 46 Yale L.J. 52, 56 (1936).

The impact of quantum meruit is to allow a promisee to recover the value of services he gave to the defendant irrespective of whether he would have lost money on the contract and been unable to recover in a suit on the contract. Scaduto v. Orlando, 381 F.2d 587, 595 (2d Cir.1967). The measure of recovery for quantum meruit is the reasonable value of the performance, Restatement of Contracts § 347 (1932); and recovery is undiminished by any loss which would have been incurred by complete performance. 12 Williston on Contracts § 1485, at 312 (3d ed. 1970). While the contract price may be evidence of reasonable value of the services, it does not measure the value of the performance or limit recovery. Rather, the standard for measuring the reasonable value of the services rendered is the amount for which such services could have been purchased from one in the plaintiff's position at the time and place the services were rendered.

Since the district court has not yet accurately determined the reasonable value of the labor and equipment use furnished by Coastal to Blair, the case must be remanded for those findings.[1] When the amount has been determined, judgment will be entered in favor of Coastal, less payments already made under the contract. Accordingly, for the reasons stated above, the decision of the district court is

Reversed and remanded with instructions.

NOTES

(1) *Measure of Restitution Interest.* What recovery for Builder under the losing contract according to *Algernon Blair?* What is the court's justification for measuring Coastal's restitution interest by ''the reasonable value of the performance''? Is this a proper measure of the ''benefits'' that Blair ''retained without having fully paid for''? How does it differ from Coastal's reliance interest? See Restatement § 371. The conclusion that ''the property owner is enriched by each stroke of the hammer or the paint brush'' is characterized as ''Pickwickian'' in Edwin Patterson, The Scope of Restitution and Unjust Enrichment, 1 Mo.L.Rev. 223, 230 (1936).

For a case allowing recovery for expenditures prior to the making of the contract, see Anglia Television Ltd. v. Reed, 3 All.E.R. 690 (Court of Appeal 1971). When an actor repudiated his contract to play the lead role for a studio, the studio abandoned the film and sued for expenditures including those incurred before contracting with him. Lord Denning explained that this sum was recoverable since ''it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken.'' Can such recovery be justified?

Of course a claimant that, like Coastal, asks for restitution must account for any benefits that it has received. In Coastal's case its benefits were ''what had already been paid,'' its progress payments. Accounting for a claimants benefits is not always so simple. In EarthInfo v. Hydrosphere Resource Consultants, 900 P.2d 113, 120–21 (Colo.1995), Hydrosphere sought restitution, having ''rescinded'' its software development contracts with Earthinfo because of the latter's ''substantial'' breach in suspending royalty payments. The court allowed restitution based on Earthinfo's profits during time the contract was in effect and then turned to Earthinfo's claim to the benefit it had conferred on Hydrosphere during that time. The Supreme Court of Colorado said that on remand the trial court ''must determine which part of the profit results from [Earthinfo's] own independent efforts and which part results from the benefits provided by [Hydrosphere]. . . . The allocation . . . may be affected by such factors as the seriousness of [Earthinfo's] wrongdoing and the extent to which [Hydrosphere's] contribution was at risk in the profit making enterprise.'' The burden of establishing the parties' relative contributions was on Earthinfo.

(2) *Contract Price as a Ceiling.* An injured party who has fully performed and then been refused payment can not recover more than the contract price. Should an injured party who has not fully performed be allowed to recover ''the reasonable value of the performance'' even if it exceeds the contract price? Using the contract price as a ceiling on recovery in such a case will not entirely avoid problems of measurement of the benefit conferred on the party in breach, since that benefit must, at least in principle, be measured before it can be known whether the ceiling has been reached. On the other hand, not using the contract price as a ceiling on

1. Under the view of the case taken by the district court it was unnecessary to precisely appraise the value of services and materials rendered; an approximation was thought to suffice because the hypothetical loss had the contract been fully performed was greater in amount.

recovery may result in a more generous recovery for part performance than would have been allowed for full performance.

For authority that the contract price is a ceiling, see Johnson v. Bovee, 574 P.2d 513 (Colo.App.1978). Cf. John T. Brady & Co. v. City of Stamford, 599 A.2d 370, 377 (Conn.1991), in which the court, through Peters, C.J., held that where "work on the project was 99 percent complete," restitution was precluded by the rule that after "full performance ... the appropriate measure of the value of the benefit conferred ... is the value that the parties themselves, in their contract, have assigned to that performance." For authority that it is not, see Southern Painting Co. v. United States, 222 F.2d 431 (10th Cir.1955).

PROBLEM

Kansas City to Atlantic City and Back. Security Stove in Kansas City had developed a furnace which it was anxious to exhibit at a trade association convention in Atlantic City, although it was not yet on the market. Since it was too late to ship it by freight, Security Stove made a contract for its shipment with Express Company, explaining its need, asking that it be shipped to arrive by October 8, and reminding Express Company of the urgency shortly before the date for shipment. Express Company picked up the shipment of 21 numbered packages, but the package containing the gas manifold, the most important part of the exhibit, was mislaid and did not arrive until the convention closed. Security Stove sues to recover from Express Company for express charges to Atlantic City, freight charges back to Kansas City, travel and hotel expenses and salaries for its employees who went to the convention to exhibit the furnace, and rental for the booth. What decision? See Security Stove & Mfg. Co. v. American Railway Express Co., 51 S.W.2d 572 (Mo.App.1932).

SECTION 3. LIMITATIONS ON DAMAGES

(A) AVOIDABILITY

In Virtue v. Bird, 84 Eng.Rep. 1000, 86 Eng.Rep. 200 (King's Bench 1678), a quaint case from three centuries ago, the plaintiff contracted to carry goods to Ipswich and to deliver them to a place to be appointed by the defendant. When the plaintiff arrived in Ipswich, however, "the defendant delayed by the space of six hours the appointment of the place; insomuch that his horses being so hot ... and standing in aperto aere, they died soon after." The court denied him recovery of this loss on the ground that "it was the plaintiff's folly to let the horses stand," for he "might have taken his horses out of the cart, or have laid down the [goods] any where in Ipswich."

Under an important limitation on expectation, an aggrieved promisee is not allowed to recover loss that it could reasonably have avoided. See Restatement § 350. Although it is sometimes said that the injured party is under a "duty" to mitigate damages, the injured party incurs no liability to the party in breach for a failure to mitigate. Recovery is the same regardless of whether the injured party takes steps in mitigation or not.

The injured party is simply precluded from recovering for loss that it could reasonably have avoided.

Where there is a market for goods, a buyer's damages are based on the assumption that the buyer could reasonably have avoided greater loss by obtaining substitute goods on the market. See UCC § 2–713, under which "the measure of damages . . . is the difference between the market price . . . and the contract price." See also CISG arts. 76(1), 77; UNIDROIT Principles arts. 7.4.6, 7.4.8.

For an example, recall that in *Klein,* p. 588 above, the court said that "money damages would clearly be adequate in this case" and remanded the case for a trial on damages. How should damages be calculated in such a trial? Recall that Klein "argued that he wanted the plane to resell it for a profit." Should Klein be allowed to recover the profit (say $500,000) he lost on that resale? This, along with return of his payments, would seem to give Klein his expectation by putting him in the position he would have been in had PepsiCo delivered the G–II jet. But if Klein could have realized the resale profit by obtaining a substitute G–II jet on the market for a somewhat enhanced price (say $200,000 more than the $4.75 million he was to pay PepsiCo), he could have put himself in that position for only $200,000.

Rockingham County v. Luten Bridge Co.

United States Circuit Court of Appeals, Fourth Circuit, 1929.
35 F.2d 301, 66 A.L.R. 735.

[Action at law, instituted in the district court, to recover an amount alleged to be due under a contract for the construction of a bridge in North Carolina. The contract was entered into by the Board of County Commissioners on January 7, 1924; but there was considerable public opposition to the building of the bridge, and on February 21, 1924, the board notified the plaintiff not to proceed any further under the contract, which it refused (unjustifiably, as the court found) to recognize as valid.[a] At that time plaintiff had expended about $1900 for labor done and material on the ground. Despite this notice from the county commissioners, plaintiff continued to build the bridge in accordance with the terms of the contract. The present action is brought to recover $18,301.07, the amount alleged to be due plaintiff for work done before November 3, 1924. The trial court directed a verdict for plaintiff for this sum. Defendant appealed.]

a. The vote of the commissioners had been three to two in favor of the contract, but on February 11 one of the commissioners who had voted in favor sent his resignation to the clerk, who immediately accepted it. Later the same day this commissioner attempted to withdraw his resignation, but the clerk ignored this and appointed another person to succeed him. The three commissioners who had voted in favor attended no further meetings, but the new commissioner together with the two who had voted against met frequently and, on February 21, unanimously adopted a resolution asserting that the contract was not valid and directing the clerk to so notify Luten, which he did. On April 7, the board passed a resolution reciting that it had been informed that one of its members was privately insisting that the bridge be built and repudiating this action by the member. In September it passed a resolution stating that it would pay no bills for the bridge.

■ PARKER, CIRCUIT JUDGE . . . . Coming, then, to the third question—i.e., as to the measure of plaintiff's recovery—we do not think that, after the county had given notice, while the contract was still executory, that it did not desire the bridge built and would not pay for it, plaintiff could proceed to build it and recover the contract price. It is true that the county had no right to rescind the contract, and the notice given plaintiff amounted to a breach on its part; but, after plaintiff had received notice of the breach, it was its duty to do nothing to increase the damages flowing therefrom. If A enters into a binding contract to build a house for B, B, of course, has no right to rescind the contract without A's consent. But if, before the house is built, he decides that he does not want it, and notifies A to that effect, A has no right to proceed with the building and thus pile up damages. His remedy is to treat the contract as broken when he receives the notice, and sue for the recovery of such damages as he may have sustained from the breach, including any profit which he would have realized upon performance, as well as any other losses which may have resulted to him. In the case at bar, the county decided not to build the road of which the bridge was to be a part, and did not build it. The bridge, built in the midst of the forest, is of no value to the county because of this change of circumstances. When, therefore, the county gave notice to the plaintiff that it would not proceed with the project, plaintiff should have desisted from further work. It had no right thus to pile up damages by proceeding with the erection of a useless bridge.

The contrary view was expressed by Lord Cockburn in Frost v. Knight, L.R. 7 Ex. 111, but, as pointed out by Prof. Williston (Williston on Contracts, vol. 3, p. 2347), it is not in harmony with the decisions in this country. The American rule and the reasons supporting it are well stated by Prof. Williston as follows:

"There is a line of cases running back to 1845 which holds that, after an absolute repudiation or refusal to perform by one party to a contract, the other party cannot continue to perform and recover damages based on full performance. This rule is only a particular application of the general rule of damages that a plaintiff cannot hold a defendant liable for damages which need not have been incurred; or, as it is often stated, the plaintiff must, so far as he can without loss to himself, mitigate the damages caused by the defendant's wrongful act. The application of this rule to the matter in question is obvious. If a man engages to have work done, and afterwards repudiates his contract before the work has been begun or when it has been only partially done, it is inflicting damage on the defendant without benefit to the plaintiff to allow the latter to insist on proceeding with the contract. The work may be useless to the defendant, and yet he would be forced to pay the full contract price. On the other hand, the plaintiff is interested only in the profit he will make out of the contract. If he receives this it is equally advantageous for him to use his time otherwise." . . .

Judgment reversed.

NOTE

The Code. Under UCC § 2–704(2), a seller that is to manufacture goods may proceed to complete their manufacture upon the buyer's repudiation, instead of halting manufacture and salvaging them while in process, "in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization." The seller that does so may then base recovery on the goods as completed, even if the "reasonable commercial judgment" turned out to be wrong. Is the manufacturer's situation in any way distinguishable from that of the Luten Bridge Co.?

PROBLEM

Walking Across the Brooklyn Bridge. In the Brooklyn Bridge hypothetical (p. 220 above), assume that on finishing the walk across the bridge B will have to spend $10 to take a taxi back to where A is waiting. If A attempts to revoke the $100 offer after B has taken only a few steps, can B recover $100 after continuing to walk across the bridge and spending the $10 on a taxi? See Restatement § 45(2). What do you think B should do when A attempts to revoke? What answer if A's offer had been to pay B $100 in return for B's *promise* to walk across the bridge? Is § 45(2) consistent with the principle of avoidability?

AVOIDABILITY UNDER CONTRACTS FOR THE SALE OF GOODS

It is one thing to say, as the court did in the *Luten Bridge* case, that the injured party cannot recover for cost that could have been avoided by simply *stopping performance*. It is another to take a second step and say that the injured party cannot recover for loss that could have been avoided by taking *affirmative steps* to arrange a substitute transaction. This second step is the basis for some of the most important rules governing damages for breach of contract for the sale of goods.

In a market economy, it is assumed that the injured party can generally arrange a substitute transaction and, under the principle of avoidability, is expected to do so. If the seller fails to deliver goods, the buyer can go into the market and "cover" by obtaining substitute goods, so that the buyer's damages should be based on the difference between a presumably greater price that the buyer will have to pay on the market and the lesser contract price. See UCC § 2–712. If the buyer fails to take and pay for goods, the seller can go into the market and resell to a substitute buyer, so that the seller's damages should be based on the difference between the presumably greater contract price and a lesser price it will receive on the market. See UCC § 2–706.

For the injured party that fails to take advantage of the availability of a substitute transaction on the market, the limitation of avoidability results in a formula based on the difference between the contract price and the market price at which it could have arranged a hypothetical substitute transaction. If, when the seller fails to deliver goods, the buyer fails to go into the market and "cover," its damages are based on "the difference between the market price . . . and the contract price." UCC § 2–713. If, when the buyer fails to take and pay for goods, the seller fails to go into the market and resell, its damages are based on "the difference between the market price . . . and the unpaid contract price." UCC § 2–708. On proof of market price, see UCC § 2–723, 2–724.

NOTE

Windfalls? The Code rules in this area have occasioned criticism on the ground that they sometimes seem to give the injured party a "windfall" by allowing that party to recover more than its actual loss, in disregard of the goal stated in UCC § 1–305(a) of putting that party "in as good a position as if the other party had fully performed."

Suppose, for example, that the injured party has arranged an actual substitute transaction for a price *more* favorable than the market price. Can the injured party recover damages based on market price even though those damages exceed that party's actual loss? Comment 5 to UCC § 2–713 suggests that a buyer cannot do so by explaining that the section "provides a remedy which is completely alternative to cover . . . and applies only when and to the extent that the buyer has not covered." See also UCC §§ 2–703, 2–711. But the Code nowhere suggests that a seller is subject to a similar restriction after a resale for more than market price. Should the Code be read as giving a "windfall" to a seller but not to a buyer? To neither? To both?

PROBLEMS

(1) *Klein Revisited.* In *Klein*, p. 588 above, suppose that Klein could have resold the G–II jet for $500,000 and that he could have bought one of the other similar G–II jets for $200,000 more than the contract price with PepsiCo.

If he promptly bought a G–III jet for $400,000 more than the contract price, how much could he recover?

If, after several inquiries, he promptly bought another G–II jet for $250,000 more than the contract price, how much could he recover?

If, after several inquiries, he promptly bought another G–II jet for $150,000 more than the contract price, how much could he recover?

(2) *Waiting for a Windfall?* Seller contracts to sell Buyer goods for $100,000. Buyer then makes a contract to resell the goods to another purchaser at $125,000. Seller fails to deliver. The market price of similar goods at and immediately after the delivery date is $110,000. Since Buyer's resale contract does not require delivery for six months, Buyer waits and does not go into the market for six months, by which time the market price has dropped to $90,000. How much should Buyer recover? Would $10,000 give Buyer a "windfall"? (Suppose that the market price had *risen* to $120,000 during Buyer's delay. How much should Buyer recover?) Is the applicable section UCC § 2–712 or 2–713?

Tongish v. Thomas

Supreme Court of Kansas, 1992.
840 P.2d 471.

[Dennis Tongish, a farmer, made a contract with the Decatur Coop Association under which he was to grow 116.8 acres of sunflower seeds, to be purchased by Coop at $13 per hundredweight for large seeds and $8 per hundredweight for small seeds, delivery to be in thirds by December 31, 1988, March 31, 1989, and May 31, 1989. Coop had a contract to deliver the seeds to Bambino Bean & Seed for the same price it paid Tongish plus a 55 cent per hundredweight handling fee, Coop's only anticipated profit. Owing to a short crop, bad weather, and other factors, the market price of sunflower seeds in January 1989 had risen to double that in the Tongish contract. Tongish notified Coop that he would make no more deliveries and sold the balance of his crop to Danny Thomas for about $20 per hundredweight or $14,714, which was $5,153 more than the Coop contract price. Coop sued Tongish and recovered $455 in damages, based on its loss of handling charges. Coop appealed and the Court of Appeals reversed for determination of damages based on market price under UCC § 2–713. Tongish appealed, arguing that under UCC § 1–106 the trial court was correct.]

■ MCFARLAND, JUSTICE: This case presents the narrow issue of whether damages arising from the nondelivery of contracted-for sunflower seeds should be computed on the basis of K.S.A. 84–1–106 or K.S.A. 84–2–713. . . . The analyses and rationale of the Court of Appeals utilized in resolving the issue are sound and we adopt the following portion thereof: . . .

"There is authority for appellee's position that K.S.A. 84–2–713 should not be applied in certain circumstances. In Allied Canners & Packers, Inc. v. Victor Packing Co., 162 Cal.App.3d 905, 209 Cal.Rptr. 60 (1984), Allied contracted to purchase 375,000 pounds of raisins from Victor for 29.75 cents per pound with a 4% discount. Allied then contracted to sell the raisins for 29.75 cents per pound expecting a profit of $4,462.50 from the 4% discount it received from Victor. 162 Cal.App.3d at 907–08 [209 Cal. Rptr. 60].

"Heavy rains damaged the raisin crop and Victor breached its contract, being unable to fulfill the requirement. The market price of raisins had risen to about 80 cents per pound. Allied's buyers agreed to rescind their contracts so Allied was not bound to supply them with raisins at a severe loss. Therefore, the actual loss to Allied was the $4,462.50 profit it expected, while the difference between the market price and the contract price was about $150,000. 162 Cal.App.3d at 908–09 [209 Cal.Rptr. 60].

"The California appellate court, in writing an exception, stated: 'It has been recognized that the use of the market-price contract-price formula under section 2–713 does not, absent pure accident, result in a damage award reflecting the buyer's actual loss. [Citations omitted.]' 162 Cal. App.3d at 912 [209 Cal.Rptr. 60]. The court indicated that section 2–713 may be more of a statutory liquidated damages clause and, therefore, conflicts with the goal of section 1–106. The court discussed that in situations where the buyer has made a resale contract for the goods, which the seller knows about, it may be appropriate to limit 2–713 damages to actual loss. However, the court cited a concern that a seller not be rewarded for a bad faith breach of contract. 162 Cal.App.3d at 912–14 [209 Cal.Rptr. 60].

"In *Allied,* the court determined that if the seller knew the buyer had a resale contract for the goods, and the seller did not breach the contract in bad faith, the buyer was limited to actual loss of damages under section 1–106. 162 Cal.App.3d at 915 [209 Cal.Rptr. 60].

"The similarities between the present case and *Allied* are that the buyer made a resale contract which the seller knew about. (Tongish knew the seeds eventually went to Bambino, although he may not have known the details of the deal.) However, in examining the breach itself, Victor could not deliver the raisins because its crop had been destroyed.... Victor had no raisins to sell to any buyer, while Tongish took advantage of the doubling price of sunflower seeds and sold to Danny Thomas. Although the trial court had no need to find whether Tongish breached the contract in bad faith, it did find there was no valid reason for the breach. Therefore, the nature of Tongish's breach was much different than Victor's in *Allied.*

"Section 2–713 and the theories behind it have a lengthy and somewhat controversial history. In 1963, it was suggested that 2–713 was a statutory liquidated damages clause and not really an effort to try and accurately predict what actual damages would be. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 259 (1963).

"In 1978, Robert Childres called for the repeal of section 2–713. Childres, Buyer's Remedies: The Danger of Section 2–713, 72 Nw.U.L.Rev. 837 (1978). Childres reflected that because the market price/contract price remedy 'has been the cornerstone of Anglo–American damages' that it has been so hard to see that this remedy 'makes no sense whatever when applied to real life situations.' 72 Nw.U.L.Rev. at 841–42.

"In 1979, David Simon and Gerald A. Novack wrote a fairly objective analysis of the two arguments about section 2–713 and stated:

'For over sixty years our courts have divided on the question of which measure of damages is appropriate for the supplier's breach of his delivery obligations. The majority view, reinforced by applicable codes, would award market damages even though in excess of plaintiff's loss. A persistent minority would reduce market damages to the plaintiff's loss, without regard to whether this creates a windfall for the defendant. Strangely enough, each view has generally tended to disregard the arguments, and even the existence, of the opposing view.' Simon and Novack, Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts, 92 Harv.L.Rev. 1395, 1397 (1979).

"Although the article discussed both sides of the issue, the authors came down on the side of market price/contract price as the preferred damages theory. The authors admit that market damages fly in the face 'of the familiar maxim that the purpose of contract damages is to make the injured party whole, not penalize the breaching party.' 92 Harv.L.Rev. at 1437. However, they argue that the market damages rule discourages the breach of contracts and encourages a more efficient market. 92 Harv.L.Rev. at 1437.

"The *Allied* decision in 1984, which relied on the articles cited above for its analysis to reject market price/contract price damages, has been sharply criticized. In Schneider, UCC § Section 2–713: A Defense of Buyers' Expectancy Damages, 22 Cal.W.L.Rev. 233, 266 (1986), the author stated that *Allied* 'adopted the most restrictive [position] on buyer's damages. This Article is intended to reverse that trend.' Schneider argued that by following section 1–106, 'the court ignored the clear language of section 2–713's compensation scheme to award expectation damages in accordance with the parties' allocation of risk as measured by the difference between contract price and market price on the date set for performance.' 22 Cal.W.L.Rev. at 264.

"Recently in Scott, The Case for Market Damages: Revisiting the Lost Profits Puzzle, 57 U.Chi.L.Rev. 1155, 1200 (1990), the *Allied* result was called 'unfortunate.' Scott argues that section 1–106 is 'entirely consistent' with the market damages remedy of 2–713. 57 U.Chi.L.Rev. at 1201. According to Scott, it is possible to harmonize sections 1–106 and 2–713. Scott states, 'Market damages measure the expectancy ex ante, and thus reflect the value of the option; lost profits, on the other hand, measure losses ex post, and thus only reflect the value of the completed exchange.' 57 U.Chi.L.Rev. at 1174. The author argues that if the nonbreaching party has laid off part of the market risk (like Coop did) the lost profits rule creates instability because the other party is now encouraged to breach the contract if the market fluctuates to its advantage. 57 U.Chi.L.Rev. at 1178.

"We are not persuaded that the lost profits view under *Allied* should be embraced. It is a minority rule that has received only nominal support. We believe the majority rule or the market damages remedy as contained in K.S.A. 84–2–713 is more reasoned and should be followed as the preferred measure of damages. While application of the rule may not reflect the actual loss to a buyer, it encourages a more efficient market and discourages the breach of contracts." Tongish v. Thomas, 16 Kan.App.2d at 811–17 [829 P.2d 916].

At first blush, the result reached herein appears unfair. However, closer scrutiny dissipates this impression. By the terms of the contract Coop was obligated to buy Tongish's large sunflower seeds at $13 per hundredweight whether or not it had a market for them. Had the price of sunflower seeds plummeted by delivery time, Coop's obligation to purchase at the agreed price was fixed. If loss of actual profit pursuant to K.S.A. 84–1–106(1) would be the measure of damages to be applied herein, it would enable Tongish to consider the Coop contract price of $13 per hundredweight plus 55 cents per hundredweight handling fee as the "floor" price for his seeds, take advantage of rapidly escalating prices, ignore his contractual obligation, and profitably sell to the highest bidder. Damages computed under K.S.A. 84–2–713 encourage the honoring of contracts and market stability. . . .

[Judgment of the Court of Appeals affirmed.]

NOTES

(1) *Questions.* If Coop had gone into the market after Tongish's repudiation and bought seeds to deliver to Bambino for $14,714, could it have recovered $5,153 from Tongish under UCC § 2–712? If Coop bought no seeds to deliver to Bambino and therefore had to pay damages to Bambino, could Coop recover those damages from Tongish? Note that Allied's buyers had agreed to rescind their contracts. Should the result in *Tongish* be different if Bambino had agreed to rescind its contract with Coop? Compare Iron Trade Products v. Wilkoff, p. 759 below, with H–W–H Cattle Co. v. Schroeder, 767 F.2d 437 (8th Cir.1985). Should the result in *Tongish* be different if Coop had protected itself by reserving the power to

cancel the contract with Bambino on breach by Tongish? See Farnsworth, Legal Remedies for Breach of Contract, 70 Colum.L.Rev. 1145, 1190 n. 189 (1970).

(2) *A Cautionary Note on Efficient Breach.* Recall the discussion of The Economics of Remedies at p. 20 above. It would be a mistake to assume that a seller like Tongish, who deals with a commodity that has a market, can often commit such a breach when there is a rise in the market.

If Tongish had not made his contract with Coop, he would, of course, have been free to take advantage of the risen market for sunflower seeks and sell his crop on the market, as he did to Thomas. But he had a contract with Coop. If we suppose that the contract price was $13 per hundredweight and that the risen market price was $20 per hundredweight, he would have gained an additional $7 per hundredweight by breaking his contract with Coop and selling on the risen market.

How much of that gain would be left after paying damages to Coop under the decision in *Tongish* to apply UCC § 2–713? How much of the gain would be left after paying damages to Coop under the decision in *Allied*? Can the difference in your answers be justified on the ground, noted by the court in *Tongish,* that "the nature of Tongish's breach" was much different than Victor's in *Allied*?

How can one explain the difference between a case such as *Naval Institute*, which seems to invite thoughts of efficient breach, and *Tongish*, which seems to discourage such thoughts?

(3) *More Middlemen*. Coop acted like a middleman between Tongish and Bambino Bean & Seed. Coop's expected profit for this service was 55 cent per hundredweight handling fee, or about $455. But recall that there were two separate contracts: one between Coop and Tongish; the other between Coop and Bambino Bean & Seed. If Bambino Bean & Seed breached or renegotiated its contract with Coop, then Coop's damages from Tongish's breach would not have been $455. Should the damages available to Coop depend on what might have happened to Bambino? See Goldberg's *Framing Contract Law* 225 (2006) on the middleman's damages.

PROBLEM

Tongish Topsy–Turvy? Seller contracts to sell Buyer goods for $100,000. Seller then makes a contract to purchase the goods from a supplier for $90,000. The market price for similar goods then falls to $75,000, and Buyer repudiates the contract. (The market price then remains constant through the delivery date.) Seller has neither received the goods from its supplier nor resold them to another buyer. How much should Seller recover? Would $25,000 give Seller a "windfall"? Does UCC § 2–708(2) apply if a seller will be overcompensated by UCC § 2–708(1)? Compare Nobs Chemical, U.S.A., Inc. v. Koppers Co., Inc., 616 F.2d 212 (5th Cir.1980), with Trans World Metals, Inc. v. Southwire Co., 769 F.2d 902 (2d Cir.1985), and see Robert Scott, The Case for Market Damages: Revisiting the Lost Profits Puzzle, 57 U.Chi.L.Rev. 1155, 1175–79 (1990).

INTRODUCTION TO *PARKER v. TWENTIETH CENTURY FOX*

The application of the principle of avoidability to contracts of employment has proved particularly troublesome. In Gandell v. Pontigny, 171

Eng.Rep. 119 (1816), the court simply refused to apply the principle. A merchant was sued by his clerk, whom he had wrongfully discharged in the middle of a quarter. The clerk was allowed to recover the agreed compensation for the entire quarter, including the part when he had not worked, on Lord Ellenborough's reasoning that:

> Having served a part of the quarter and being willing to serve the residue, in contemplation of law he may be considered to have served the whole.

In Howard v. Daly, 61 N.Y. 362 (1875), a leading American case, Theodore W. Dwight[a] rejected this doctrine of "constructive service" as

> so wholly irreconcilable to that great and beneficent rule of law, that a person discharged from service must not remain idle, but must accept employment elsewhere if offered, that we cannot accept it.... The doctrine of "constructive service" is not only at war with principle but with the rules of political economy, as it encourages idleness and gives compensation to men who fold their arms and decline service, equal to those who perform with willing hands their stipulated amount of labor.

The case that follows is premised on rejection of the doctrine of constructive service and on applicability of the principle of avoidability.

Parker v. Twentieth Century–Fox Film Corp.

Supreme Court of California, 1970.
3 Cal.3d 176, 474 P.2d 689.

■ BURKE, JUSTICE. Defendant Twentieth Century–Fox Film Corporation appeals from a summary judgment granting to plaintiff the recovery of agreed compensation under a written contract for her services as an actress in a motion picture. As will appear, we have concluded that the trial court correctly ruled in plaintiff's favor and that the judgment should be affirmed.

Plaintiff is well known as an actress,[b] and in the contract between plaintiff and defendant is sometimes referred to as the "Artist." Under the contract, dated August 6, 1965, plaintiff was to play the female lead in defendant's contemplated production of a motion picture entitled "Bloomer Girl." The contract provided that defendant would pay plaintiff a minimum "guaranteed compensation" of $53,571.42 per week for 14 weeks commencing May 23, 1966, for a total of $750,000.[c] Prior to May 1966 defendant

a. Theodore W. Dwight (1822–1892) served as professor of law at Hamilton College, and then as professor of law and later as warden of the law school at Columbia from 1858 to 1891. His principal field was contracts. His method of teaching involved interrogation of his students on an assigned text, and it is reported that, "He could so cross-examine a dunce that the dunce would come off amazed at his own unconscious cerebration." From 1873 to 1875 he was a member of the New York Commission of Appeals, which had been created to help the Court of Appeals dispose of its backlog of undecided cases. It was said that his sixty-eight opinions were "monographs, exhausting the particular subject," and it was doubted "whether in any reports a greater amount of learning is anywhere condensed into an equal number of pages."

b. Mrs. Parker may be better known to the reader under her professional name, Shirley MacLaine.

c. According to the opinion in the Court of Appeal, "It is admitted that, under the contract ... the defendant was entitled to cancel the production, or to dispense with plaintiff's services, so long as it paid her the guaranteed compensation. Plaintiff's cause of action, therefore, is not actually for a breach of her employment contract by an unlawful discharge; rather it is for a recovery under the contract according to its terms. The par-decided not to produce the picture and by a letter dated April 4, 1966, it notified plaintiff of that decision and that it would not "comply with our obligations to you under" the written contract.

By the same letter and with the professed purpose "to avoid any damage to you," defendant instead offered to employ plaintiff as the leading actress in another film tentatively entitled "Big Country, Big Man" (hereinafter, "Big Country"). The compensation offered was identical, as were 31 of the 34 numbered provisions or articles of the original contract.[1] Unlike "Bloomer Girl," however, which was to have been a musical production, "Big Country" was a dramatic "western type" movie. "Bloomer Girl" was to have been filmed in California; "Big Country" was to be produced in Australia. Also, certain terms in the proffered contract varied from those of the original.[2] Plaintiff was given one week within which to accept; she did not and the offer lapsed. Plaintiff then commenced this action seeking recovery of the agreed guaranteed compensation.

The complaint sets forth two causes of action. The first is for money due under the contract; the second, based upon the same allegations as the

ties also are in agreement that defendant's alternative obligation to pay plaintiff $750,000 if it did not utilize her services in 'Bloomer Girl' was subject to an implied condition that she mitigate defendant's obligations by accepting other suitable employment." 81 Cal. Rptr. 221, 222 (Ct.App.1969). This agreement is consistent with the rule that if the party in breach has "the option of choosing between two alternatives at the time of breach, 'the measure of damages is the loss caused by reason of the promisor failing to perform the promise with the lesser value.'" Liberty Bank v. Talman Home Mortgage Corp., 877 F.2d 400, 407 (8th Cir. 1989). Under the "play or pay" contract, the studio could therefore choose liability under the "play" branch as to which the mitigation principle applied. For criticism of the case, see Goldberg, Bloomer Girl Revisited or How to Frame an Unmade Picture, 1998 Wis. L.Rev. 1051.

1. Among the identical provisions was the following found in the last paragraph of Article 2 of the original contract: "We [defendant] shall not be obligated to utilize your [plaintiff's] services in or in connection with the Photoplay hereunder, our sole obligation, subject to the terms and conditions of this Agreement, being to pay you the guaranteed compensation herein provided for."

2. Article 29 of the original contract specified that plaintiff approved the director already chosen for "Bloomer Girl" and that in case he failed to act as director plaintiff was to have approval rights of any substitute director. Article 31 provided that plaintiff was to have the right of approval of the "Bloomer Girl" dance director, and Article 32 gave her the right of approval of the screenplay.

Defendant's letter of April 4 to plaintiff, which contained both defendant's notice of breach of the "Bloomer Girl" contract and offer of the lead in "Big Country," eliminated or impaired each of those rights. It read in part as follows: The terms and conditions of our offer of employment are identical to those set forth in the "BLOOMER GIRL" Agreement, Articles 1 through 34 and Exhibit A to the Agreement, except as follows:

> "1. Article 31 of said Agreement will not be included in any contract of employment regarding 'BIG COUNTRY, BIG MAN' as it is not a musical and it thus will not need a dance director.
>
> "2. In the 'BLOOMER GIRL' agreement, in Articles 29 and 32, you were given certain director and screenplay approvals and you had preapproved certain matters. Since there simply is insufficient time to negotiate with you regarding your choice of director and regarding the screenplay and since you already expressed an interest in performing the role in 'BIG COUNTRY, BIG MAN,' we must exclude from our offer of employment in 'BIG COUNTRY, BIG MAN' any approval rights as are contained in said Articles 29 and 32; however, we shall consult with you respecting the director to be selected to direct the photoplay and will further consult with you with respect to the screenplay and any revisions or changes therein, provided, however, that if we fail to agree . . . the decision of . . . [defendant] with respect to the selection of a director and to revisions and changes in the said screenplay shall be binding upon the parties to said agreement."

first, is for damages resulting from defendant's breach of contract. Defendant in its answer admits the existence and validity of the contract, that plaintiff complied with all the conditions, covenants and promises and stood ready to complete the performance, and that defendant breached and "anticipatorily repudiated" the contract. It denies, however, that any money is due to plaintiff either under the contract or as a result of its breach, and pleads as an affirmative defense to both causes of action plaintiff's allegedly deliberate failure to mitigate damages, asserting that she unreasonably refused to accept its offer of the leading role in "Big Country."

Plaintiff moved for summary judgment under Code of Civil Procedure section 437c, the motion was granted, and summary judgment for $750,000 plus interest was entered in plaintiff's favor. This appeal by defendant followed. . . .

The general rule is that the measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service, less the amount which the employer affirmatively proves the employee has earned or with reasonable effort might have earned from other employment. . . . However, before projected earnings from other employment opportunities not sought or accepted by the discharged employee can be applied in mitigation, the employer must show that the other employment was comparable, or substantially similar, to that of which the employee has been deprived; the employee's rejection of or failure to seek other available employment of a different or inferior kind may not be resorted to in order to mitigate damages. . . .

In the present case defendant has raised no issue of *reasonableness of efforts* by plaintiff to obtain other employment; the sole issue is whether plaintiff's refusal of defendant's substitute offer of "Big Country" may be used in mitigation. Nor, if the "Big Country" offer was of employment different or inferior when compared with the original "Bloomer Girl" employment, is there an issue as to whether or not plaintiff acted reasonably in refusing the substitute offer. Despite defendant's arguments to the contrary, no case cited or which our research has discovered holds or suggests that reasonableness is an element of a wrongfully discharged employee's option to reject, or fail to seek different or inferior employment lest the possible earnings therefrom be charged against him in mitigation of damages.[3]

3. Instead, in each case the reasonableness referred to was that of the *efforts* of the employee to obtain other employment that was not different or inferior; his right to reject the latter was declared as an unqualified rule of law. Thus, Gonzales v. Internat. Assn. of Machinists, supra, 213 Cal.App.2d 817, 823–824, 29 Cal.Rptr. 190, 194, holds that the trial court correctly instructed the jury that plaintiff union member, a machinist, was required to make "such *efforts* as the average [member of his union] desiring employment would make at that particular time and place" (italics added); but, further, that the court *properly rejected* defendant's *offer of proof of* the *availability of other kinds of employment* at the same or higher pay than plaintiff usually received and all outside the jurisdiction of his union, as plaintiff could not be required to accept different employment or a nonunion job.

In Harris v. Nat. Union, etc., Cooks and Stewards, supra, 116 Cal.App.2d 759, 761, 254 P.2d 673, 676, the issues were stated to be, inter alia, whether comparable employment was open to each plaintiff employee, Applying the foregoing rules to the record in the present case, with all intendments in favor of the party opposing the summary judgment motion—here, defendant—it is clear that the trial court correctly ruled that plaintiff's failure to accept defendant's tendered substitute employment could not be applied in mitigation of damages because the offer of the "Big Country" lead was of employment both different and inferior, and that no factual dispute was presented on that issue. The mere circumstance that "Bloomer Girl" was to be a musical review calling upon plaintiff's talents as a dancer as well as an actress, and was to be produced in the City of Los Angeles, whereas "Big Country" was a straight dramatic role in a "Western Type" story taking place in an opal mine in Australia, demonstrates the difference in kind between the two employments; the female lead as a dramatic actress in a western style motion picture can by no stretch of imagination be considered the equivalent of or substantially similar to the lead in a song-and-dance production. Additionally, the substitute "Big Country" offer proposed to eliminate or impair the director and screenplay approvals accorded to plaintiff under the original "Bloomer Girl" contract (see fn. 2, ante), and thus constituted an offer of inferior employment. No expertise or judicial notice is required in order to hold that the deprivation or infringement of an employee's rights held under an original employment contract converts the available "other employment" relied upon by the employer to mitigate damages, into inferior employment which the employee need not seek or accept. (See Gonzales v. Internat. Assn. of Machinists, supra, 213 Cal.App.2d 817, 823–824, 29 Cal.Rptr. 190; and fn. 3, ante.) . . .

In view of the determination that defendant failed to present any facts showing the existence of a factual issue with respect to its sole defense—plaintiff's rejection of its substitute employment offer in mitigation of damages—we need not consider plaintiff's further contention that for various reasons, including the provisions of the original contract set forth in footnote 1, ante, plaintiff was excused from attempting to mitigate damages.

The judgment is affirmed.

■ SULLIVAN, ACTING CHIEF JUSTICE (dissenting). . . . Over the years the courts have employed various phrases to define the type of employment which the employee, upon his wrongful discharge, is under an obligation to accept. Thus in California alone it has been held that he must accept employment which is "substantially similar" . . .; "comparable employment" . . .; employment "in the same general line of the first employment" . . .; "equivalent to his prior position" . . .; "employment in a similar capacity" . . .; employment which is "not . . . of a different or inferior kind". . . .

For reasons which are unexplained, the majority . . . select from among the various judicial formulations which contain one particular phrase, "Not of a different or inferior kind," with which to analyze this case. I have

and if so whether each plaintiff made a *reasonable effort* to secure such employment. It was held that the trial court *properly sustained an objection to an offer to prove a custom of accepting a job in a lower rank* when work in the higher rank was not available, as "The duty of mitigation of damages . . . does not require the plaintiff 'to seek or to accept other employment of a different or inferior kind.' " (p. 764[5], 254 P.2d p. 676.)

discovered no historical or theoretical reason to adopt this phrase, which is simply a negative restatement of the affirmative standards set out in the above cases, as the exclusive standard. Indeed, its emergence is an example of the dubious phenomenon of the law responding not to rational judicial choice or changing social conditions, but to unrecognized changes in the language of opinions or legal treatises. However, the phrase is a serviceable one and my concern is not with its use as the standard but rather with what I consider its distortion.

The relevant language excuses acceptance only of employment which is of a *different kind*.... It has never been the law that the mere existence of *differences between two jobs in the same field* is sufficient, as a matter of law, to excuse an employee wrongfully discharged from one from accepting the other in order to mitigate damages. Such an approach would effectively eliminate any obligation of an employee to attempt to minimize damage arising from a wrongful discharge. The only alternative job offer an employee would be required to accept would be an offer of his former job by his former employer.

Although the majority appear to hold that there was a difference "in kind" between the employment offered plaintiff in "Bloomer Girl" and that offered in "Big Country", an examination of the opinion makes crystal clear that the majority merely point out differences between the two *films* (an obvious circumstance) and then apodictically assert that these constitute a difference in the *kind of employment.* The entire rationale of the majority boils down to this: that the "*mere circumstances*" that "Bloomer Girl" was to be a musical review while "Big Country" was a straight drama "demonstrates the difference in kind" since a female lead in a western is not "the equivalent of or substantially similar to" a lead in a musical. This is merely attempting to prove the proposition by repeating it. It shows that the vehicles for the display of the star's talents are different but it does not prove that her employment as a star in such vehicles is of necessity different *in kind* and either inferior or superior.

I believe that the approach taken by the majority (a superficial listing of differences with no attempt to assess their significance) may subvert a valuable legal doctrine.[4] The inquiry in cases such as this should not be whether differences between the two jobs exist (there will always be differences) but whether the differences which are present are substantial enough to constitute differences in the *kind* of employment or, alternatively, whether they render the substitute work employment of an *inferior kind*....

I remain convinced that the relevant question in such cases is whether or not a particular contract provision is so significant that its omission creates employment of an inferior kind. This question is, of course, inti-

4. The values of the doctrine of mitigation of damages in this context are that it minimizes the unnecessary personal and social (e.g., nonproductive use of labor, litigation) costs of contractual failure. If a wrongfully discharged employee can, through his own action and without suffering financial or psychological loss in the process, reduce the damages accruing from the breach of contract, the most sensible policy is to require him to do so. I fear the majority opinion will encourage precisely opposite conduct.

mately bound up in what I consider the ultimate issue: whether or not the employee acted reasonably. This will generally involve a factual inquiry to ascertain the importance of the particular contract term and a process of weighing the absence of that term against the countervailing advantages of the alternate employment. In the typical case, this will mean that summary judgment must be withheld. . . .

NOTES

(1) *Questions.* Would it have made a difference if the studio's offer of substitute employment had been conditioned on MacLaine's surrender of her rights under the old contract?

Who should bear the burden of proof on the issue of avoidability? In Delliponti v. DeAngelis, 681 A.2d 1261, 1265 (Pa.1996), the court placed the burden on the defendant employer and held that it had failed to meet that burden. Although the plaintiff, a municipal employee, testified only "that she made telephone inquiries regarding three job openings she read about in the newspaper but did not pursue any other jobs," the court concluded that the municipality's "assertion that there were unquestionably comparable jobs available does not establish that there were actual vacant positions available" to the employee.

(2) *"Honor and Respect."* Personal service contracts often involve considerations not common in the case of other kinds of contracts. "If the general counsel of a large corporation is wrongfully discharged, he is not required, in order to mitigate his damages, to take a job as a dishwasher. . . . Our case involves a contract to build a sewer. There is no suggestion that the contractor, a corporation rather than an individual, would have lost 'honor and respect' by taking steps to mitigate its damages. And we cannot imagine how any such steps could be thought to degrade or humiliate the corporation." S.A. Healy Co. v. Milwaukee Metropolitan Sewerage District, 50 F.3d 476, 481 (7th Cir.1995) (Posner, C.J.).

The court in *Parker* laid no stress on the fact that the offer of substitute employment came from the employer that had broken the contract in suit. Might this circumstance call "honor and respect" into question? Might the answer depend on the circumstances of the breach? In Voorhees v. Guyan Machinery Co., 446 S.E.2d 672, 679 (W.Va.1994), the court explained that "an offer of reemployment by an employer will not diminish the employee's recovery if the offer is not accepted if circumstances are such as to render further association between the parties offensive or degrading to the employee." The court went on to observe that the former employer's offer of reemployment came after it had caused the employee to lose his job with his new employer and after he had sued his former employer, and concluded that expecting him to return to work for his former employer "in such circumstances would be tantamount to expecting that Sulla and Gaius Marius might form a productive working relationship after Sulla's march on Rome."

(3) *An Equal–Opportunity Exception?* Does the avoidability principle apply even if the party in breach has an equal opportunity to reduce the damages by the same act? In Shea–S&M Ball v. Massman–Kiewit–Early, 606 F.2d 1245, 1249–50 (D.C.Cir.1979), one contractor sued another for damage caused by the other's failure to control groundwater and prevent a sewer from overflowing.[a] The Court of Appeals held that it was error for the trial court to conclude that the plaintiff "had not properly mitigated its damages by failing to build a dike. . . . 'The duty to

a. The first contractor was an intended beneficiary of the second contractor's contract with the owner, the Washington Metropolitan Area Transit Authority.

mitigate damages is not applicable where the party whose duty it is primarily to perform a contract has equal opportunity for performance and equal knowledge of the consequences of nonperformance.' " Here the defendant "had the primary responsibility for controlling its water runoff and had the same opportunity as [the plaintiff] to build a dike that would have prevented the damages." A few courts have taken a similar position, severely criticized in Cates v. Morgan Portable Building Corp., 780 F.2d 683, 689 (7th Cir.1985) (Posner, C.J.: position is "discordant with common law principles" by not preserving injured party's "incentive to consider a wide range of possible methods of mitigation of damages").

PROBLEMS

(1) *A Classic Problem.* First Bank repossessed a collection of classic automobiles together with thousands of rare parts no longer manufactured. It contracted to sell them to Frederick Simeone, a private collector of vintage automobiles, for $400,000. Because of legal problems arising from the repossession, First Bank refused Simeone's tender of the price and later, mistakenly thinking it was relieved of its obligation to Simeone because of a provision in their contract, sold the cars and parts to SMB, Inc., which resold them for $1,000,000. Simeone sued First Bank and recovered $2,600,000, based on expert testimony that the cars and parts were worth $3,000,000. First Bank appealed on the ground that Simeone "could have mitigated his damages by purchasing the vehicles and parts from SMB, Inc. at the increased price." What result on appeal? See Simeone v. First Bank National Assn., 73 F.3d 184 (8th Cir.1996).

(2) *Diasonics (Reprise).* Suppose that in *Diasonics*, p. 619 above, a company affiliated with Davis had offered to buy the equipment if Davis did not, so that Davis would not lose its deposit. What result if Diasonics had ignored the offer? See Schiavi Mobile Homes, Inc. v. Gironda, 463 A.2d 722 (Me.1983).

AVOIDABILITY AND THE COST OF REMEDY DEFECT

Cases of defective, as distinguished from merely incomplete, performance may raise difficult problems of avoidability. If the breach consists merely of incomplete performance, the injured party can usually arrange to have someone else complete the work at less than the loss in value to the injured party. The limitation of avoidability then has the effect of restricting the injured party to damages based on that lesser cost to complete the work rather than on the loss in value. Suppose, for example, that a builder breaks a contract to construct a factory by failing to finish the roof, making the factory, unusable. The owner cannot recover the relatively enormous loss resulting from the inability to use the factory but is relegated to the relatively small amount that it will cost to get another builder to finish the roof.

If the performance is defective rather than merely incomplete, however, trouble may arise. In that case, part of the cost to remedy the defect and complete performance as agreed will probably be the cost of undoing some of the work already done. The total cost to remedy the defect may then exceed the loss in value to the injured party so that an award based on that cost would to that extent be a windfall. The following case involves this situation.

Jacob & Youngs v. Kent

Court of Appeals of New York, 1921.
230 N.Y. 239, 129 N.E. 889, 23 A.L.R. 1429.

■ CARDOZO, J. The plaintiff built a country residence for the defendant at a cost of upwards of $77,000, and now sues to recover a balance of $3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that "all wrought iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture." The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.[a]

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's sub-contractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract—that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial ...

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the

a. The record on appeal indicates that, under the contract, payments were to be made monthly as the work progressed, on the certificate of the architect in an amount which "in his judgment" represented the amount due less 15% to be withheld. The specifications attached to the contract provided that where "any particular brand of manufactured article is specified, it is to be considered as a standard," and that a contractor "desiring to use another shall first make application in writing to the Architect ... and obtain their written approval of the change." The specifications made the architect's decision "as to the character of any material or labor furnished by the Contractor ... final and conclusive." Furthermore, "Any work furnished by the Contractor, the material or workmanship of which is defective or which is not fully in accordance with the drawings and specifications, in every respect, will be rejected and is to be immediately torn down, removed and remade or replaced in accordance with the drawings and specifications, whenever discovered.... The Owner will have the option at all times to allow the defective or improper work to stand and to receive from the Contractor a sum of money equivalent to the difference in value of the work as performed and as herein specified." Record p. 98–108. For the contract terms and much useful background, see Danzig, *The Capability Problem in Contract Law* 108–28 (1978).

exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof.[b] In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure (Spence v. Ham, supra). The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. "There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable" (Handy v. Bliss, 204 Mass. 513, 519, 90 N.E. 864. Cf. Foeller v. Heintz, 137 Wis. 169, 178, 118 N.W. 543; Oberlies v. Bullinger, 132 N.Y. 598, 601, 30 N.E. 999; 2 Williston on Contracts, sec. 805, p. 1541). The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

NOTES

(1) *Substantial Performance.* Kent promised to pay Jacob & Youngs if it built him a house as specified. Building the house as specified was therefore a condition of Jacob & Youngs' right to recover from Kent on that promise. In an omitted part of the opinion, Cardozo explains that Jacob & Youngs can recover from Kent on that promise in spite of the fact that it did not strictly fulfill that requirement. As to this, three judges dissent. This notion of substantial, as opposed to strict, performance, and the law of conditions in general, are taken up in Chapter 8. For present purposes, we are concerned only with the part of Cardozo's opinion in which he considers how much, if anything, should be deducted from that recovery as Kent's damages. (To remove the problem of substantial performance from the picture, assume that Kent had paid Jacob & Youngs in full and was suing for damages.)

b. In a brief per curiam opinion on a motion for reargument, the Court of Appeals later said that it "did not overlook the specification which provides that defective work shall be replaced" (see footnote a above). But for the promise to replace, as for the promise to install, the law "restricts the remedy to damages." 130 N.E. 933 (1921).

(2) *Relevance of Diminution in Value.* Diminution in market price is useful in fixing a lower limit for recovery, since the value of property to its owner is usually no less than the net price at which the owner could sell it. Similarly, cost to remedy the defect is useful in fixing an upper limit for recovery since, even if that cost is less than the loss in value to the owner, the lesser sum will enable the owner to complete and avoid any loss in value.

"An owner's recovery is not necessarily limited to diminution in value whenever that figure is less than the cost of repair. It is true that in a case where the cost of repair exceeds the damages under the value formula, an award under the cost of repair measure may place the owner in a better economic position than if the contract had been fully performed, since he could pocket the award and then sell the defective structure. On the other hand, it is possible that the owner will use the damage award for its intended purpose and turn the structure into the one originally envisioned. He may do this for a number of reasons, including personal esthetics or a hope for increased value in the future. If he does this his economic position will equal the one he would have been in had the contractor fully performed. The fact finder is the one in the best position to determine whether the owner will actually complete performance, or whether he is only interested in obtaining the best immediate economic position he can. In some cases, such as where the property is held solely for investment, the court may conclude as a matter of law that the damage award can not exceed the diminution in value. Where, however, the property has special significance to the owner and repair seems likely, the cost of repair may be appropriate even if it exceeds the diminution in value." Advanced, Inc. v. Wilks, 711 P.2d 524, 527 (Alaska 1985).

(3) *Proving Diminution in Value.* Do you agree that the "difference in value" to *Kent* "would be either nominal or nothing"? It may be that the difference between the *market price* of a house with Reading pipe and one with Cohoes pipe is zero, because buyers of houses consider the two kinds of pipe to be of equal value *to them.* But why should *Kent's* recovery be limited by this? "If a proud householder, who plans to live out his days in the home of his dreams, orders a new roof of red barrel tile and the roofer instead installs a purple one, money damages for the reduced value of his house may not be enough to offset the strident offense to aesthetic sensibilities, continuing over the life of the roof." Gory Associated Industries v. Jupiter Roofing & Sheet Metal, 358 So.2d 93, 95 (Fla.Ct.App.1978).

The problem of determining loss in value is most acute when, as in the principal case, there is great disparity between the minimum of diminution in market price and the maximum of cost to remedy the defect. Which better approximates loss in value? Although the opinion gives us no insight into why Kent might have specified Reading rather than some other brand of pipe, it does suggest one reason for the disparity between the maximum and minimum. Does that reason suggest which better approximates loss in value? (If a very large fraction of the disparity represents the cost of undoing and redoing the work, how large a fraction represents the loss in value to Kent?) Who should have the burden with respect to diminution in value?

One court has said that if the builder "thought that the cost of repairs was an unreasonable measure of damages given what it believed to be the relatively small decrease in value resulting from the breach, it clearly had the burden to present evidence from which the jury could find the diminution in value." Advanced, Inc. v. Wilks, at 526 (quoted in Note 2 above). But the builder could do this simply by presenting evidence of market price.

Another court has said that, as plaintiff, the owner "had the burden of producing evidence that afforded the jury a reasonable basis to measure" the owner's loss. But that court went on to say, "It is undisputed that homeowners are qualified to testify as to their personal opinion regarding the value, or diminution in value, of their properties." This is so even though the homeowner may rely in part on the cost of repairs in forming that opinion. The appropriate vehicle for challenging such an opinion is cross-examination. Tessmann v. Tiger Lee Constr. Co., 634 A.2d 870, 873 (Conn.1993).

Could Kent's lawyer have done more?

PROBLEMS

(1) *The Deep End.* Stephen Forsyth made a contract with Ruxley for a swimming pool on his estate. The price was $100,000, and the contract specified that the depth of the pool was to be 7 feet 9 inches at the deep end. However, Ruxley encountered unexpected rock and, after Forsyth had paid the price in full, he discovered that the pool was only 6 feet 6 inches deep at the deep end. (A depth of 5 feet 6 inches is considered safe for diving and, in any case, Forsyth had no plans to install a diving board.) To increase the depth to that required by the contract would involve demolishing and replacing the pool, with additional excavation, at a cost of $180,000, and Forsyth testified that he had no intention of having this done. Forsyth sued for damages based on the $180,000 cost. The jury awarded him $10,000 on an instruction that they could award damages for "loss of pleasure and amenity." Both parties appealed. What result? Ruxley Electronics & Construction, Ltd. v. Forsyth, [1995] 3 W.L.R. 118 (House of Lords).

Would your answer be affected if Forsyth had testified that he planned to demolish and rebuild the pool if he recovered the $180,000? Would it be affected if it had been proved that Ruxley saved $50,000 by building the shallower pool?

(2) *The Thinned Blue Line.* Security Services contracted with Engulf & Devour, Inc., a multinational corporation, to provide twenty plainclothed guards for a price of $18,000, paid in advance, in order to prevent disruption by protestors at its annual meeting of shareholders. Because no protestors appeared at the meeting, the guards were not needed. However, Engulf & Devour later learned that Security Services provided only fourteen guards. Does Engulf & Devour have a claim for damages against Security Services?

Groves v. John Wunder Co.

Supreme Court of Minnesota, 1939.
205 Minn. 163, 286 N.W. 235.

■ STONE, J. Action for breach of contract. Plaintiff got judgment for a little over $15,000. Sorely disappointed by that sum, he appeals.

In August, 1927 S.J. Groves & Sons Company, a corporation (hereinafter mentioned simply as Groves), owned a tract of 24 acres of Minneapolis suburban real estate. It was served or easily could be reached by railroad trackage. It is zoned as heavy industrial property. But for lack of development of the neighborhood its principal value thus far may have been in the deposit of sand and gravel which it carried. The Groves company had a plant on the premises for excavating and screening the gravel. Nearby defendant owned and was operating a similar plant.

In August, 1927, Groves and defendant made the involved contract. For the most part it was a lease from Groves, as lessor, to defendant, as lessee; its term seven years. Defendant agreed to remove the sand and gravel and to leave the property "at a uniform grade, substantially the same as the grade now existing at the roadway . . . on said premises, and that in stripping the overburden . . . it will use said overburden for the purpose of maintaining and establishing said grade."

Under the contract defendant got the Groves screening plant. The transfer thereof and the right to remove the sand and gravel made the consideration moving from Groves to defendant, except that defendant incidentally got rid of Groves as a competitor. On defendant's part it paid Groves $105,000. So that from the outset, on Groves' part the contract was executed except for defendant's right to continue using the property for the stated term. (Defendant had a right to renewal which it did not exercise.)

Defendant breached the contract deliberately. It removed from the premises only "the richest and best of the gravel" and wholly failed, according to the findings, "to perform and comply with the terms, conditions, and provisions of said lease . . . with respect to the condition in which the surface of the demised premises was required to be left." Defendant surrendered the premises, not substantially at the grade required by the contract "nor at any uniform grade." Instead, the ground was "broken, rugged and uneven." Plaintiff sues as assignee and successor in right of Groves.

As the contract was construed below, the finding is that to complete its performance 288,495 cubic yards of overburden would need to be excavated, taken from the premises, and deposited elsewhere. The reasonable cost of doing that was found to be upwards of $60,000. But, if defendant had left the premises at the uniform grade required by the lease, the reasonable value of the property on the determinative date would have been only $12,160. The judgment was for that sum,[a] including interest, thereby nullifying plaintiff's claim that cost of completing the contract rather than difference in value of the land was the measure of damages. The gauge of damage adopted by the decision was the difference between the market value of plaintiff's land in the condition it was [in] when the contract was made and what it would have been if defendant had performed. The one question for us arises upon plaintiff's assertion that he was entitled, not to that difference in value, but to the reasonable cost to him of doing the work called for by the contract which defendant left undone.

1. Defendant's breach of contract was wilful. There was nothing of good faith about it. Hence, that the decision below handsomely rewards bad faith and deliberate breach of contract is obvious. That is not allowable. Here the rule is well settled, and has been since Elliott v. Caldwell, 43 Minn. 357, 45 N.W. 845, 9 L.R.A. 52, that, where the contractor wilfully and fraudulently varies from the terms of a construction contract, he cannot sue thereon and have the benefit of the equitable doctrine of

a. This was on the assumption that the land as it was left could not have been sold on the market.

substantial performance. That is the rule generally. See Annotation, ''Wilful or intentional variation by contractor from terms of contract in regard to material or work as affecting measure of damages,'' 6 A.L.R. 137.

Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 243, 244, 129 N.E. 889, 891, 23 A.L.R. 1429, is typical. It was a case of substantial performance of a building contract. (This case is distinctly the opposite.) Mr. Justice Cardozo, in the course of his opinion, stressed the distinguishing features. ''Nowhere,'' he said, ''will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract.'' Again, ''the willful transgressor must accept the penalty of his transgression.''

2. In reckoning damages for breach of a building or construction contract, the law aims to give the disappointed promisee, so far as money will do it, what he was promised. 9 Am.Jur. Building and Construction Contracts, sec. 152. It is so ruled by a long line of decisions in this state beginning with Carli v. Seymour, Sabin & Co., 26 Minn. 276, 3 N.W. 348, where the contract was for building a road. There was a breach. Plaintiff was held entitled to recover what it would cost to complete the grading as contemplated by the contract. For our other similar cases, see 2 Dunnell, Minn.Dig., 2 Ed. & Supp., secs. 2561, 2565.

Never before, so far as our decisions show, has it even been suggested that lack of value in the land furnished to the contractor who had bound himself to improve it [gave] any escape from the ordinary consequences of a breach of the contract. . . .

Even in case of substantial performance in good faith, the resulting defects being remediable, it is error to instruct that the measure of damage is ''the difference in value between the house as it was and as it would have been if constructed according to contract.'' The ''correct doctrine'' is that the cost of remedying the defect is the ''proper'' measure of damages. Snider v. Peters Home Building Co., 139 Minn. 413, 414, 416, 167 N.W. 108.

Value of the land (as distinguished from the value of the intended product of the contract, which ordinarily will be equivalent to its reasonable cost) is no proper part of any measure of damages for wilful breach of a building contract. The reason is plain.

The summit from which to reckon damages from trespass to real estate is its actual value at the moment. The owner's only right is to be compensated for the deterioration in value caused by the tort. That is all he has lost.[b] But not so if a contract to improve the same land has been breached by the contractor who refuses to do the work, especially where, as here, he has been paid in advance. The summit from which to reckon damages for that wrong is the hypothetical peak of accomplishment (not value) which would have been reached had the work been done as demanded by the contract.

b. So also in condemnation cases, where the owner loses nothing of promised contractual performance.

The owner's right to improve his property is not trammeled by its small value. It is his right to erect thereon structures which will reduce its value. If that be the result, it can be of no aid to any contractor who declines performance. As said long ago in Chamberlain v. Parker, 45 N.Y. 569, 572: ''A man may do what he will with his own, ... and if he chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it, it does not lie with a defendant who has been so employed and paid for building it, to say that his own performance would not be beneficial to the plaintiff.'' To the same effect is Restatement, Contracts, sec. 346, p. 576, Illustrations of Subsection (1), par. 4.

Suppose a contractor were suing the owner for breach of a grading contract such as this. Would any element of value, or lack of it, in the land have any relevance in reckoning damages? Of course not. The contractor would be compensated for what he had lost, i.e., his profit. Conversely, in such a case as this, the owner is entitled to compensation for what he has lost, that is, the work or structure which he has been promised, for which he has paid, and of which he has been deprived by the contractor's breach.

To diminish damages recoverable against him in proportion as there is presently small value in the land would favor the faithless contractor. It would also ignore and so defeat plaintiff's right to contract and build for the future. To justify such a course would require more of the prophetic vision than judges possess. This factor is important when the subject matter is trackage property in the margin of such an area of population and industry as that of the Twin Cities....

The genealogy of the error pervading the argument contra is easy to trace. It begins with Seely v. Alden, 61 Pa. 302, 100 Am.Dec. 642, a tort case for pollution of a stream. Resulting depreciation in value of plaintiff's premises, of course, was the measure of damages. About 40 years later, in Bigham v. Wabash–Pittsburg T. Ry., 223 Pa. 106, 72 A. 318, the measure of damages of the earlier tort case was used in one for breach of contract, without comment or explanation to show why....

It is at least interesting to note Morgan v. Gamble, 230 Pa. 165, 79 A. 410, decided two years after the *Bigham* case. The doctrine of substantial performance is there correctly stated, but plaintiff was denied its benefit because he had deliberately breached his building contract. It was held that: ''Where a building contractor agrees to lay an extra strong lead water pipe, and he substitutes therefor an iron pipe, he will be required to allow to the owners in a suit upon the contract, not the difference [in value] between the iron and lead pipes, but the cost of laying a lead pipe as provided in the agreement.''

To show how remote any factors of value were considered, it was also held that: ''Where a contractor of a building agrees to construct two gas lines, one for natural gas, and one for artificial gas, he will not be relieved from constructing both lines, because artificial gas was not in use in the town in which the building was being constructed.''

The objective of this contract of present importance was the improvement of real estate. That makes irrelevant the rules peculiar to damages to chattels, arising from tort or breach of contract.... In tort, the thing lost is money value, nothing more. But under a construction contract, the thing lost by a breach such as we have here is a physical structure or accomplishment, a promised and paid for alteration in land. That is the "injury" for which the law gives him compensation. Its only appropriate measure is the cost of performance.

It is suggested that because of little or no value in his land the owner may be unconscionably enriched by such a reckoning. The answer is that there can be no unconscionable enrichment, no advantage upon which the law will frown, when the result is but to give one party to a contract only what the other has promised; particularly where, as here, the delinquent has had full payment for the promised performance.

3. It is said by the Restatement, Contracts, sec. 346, Comment *b*: "Sometimes defects in a completed structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste. If no such waste is involved, the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance."

The "economic waste" declaimed against by the decisions applying that rule has nothing to do with the value in money of the real estate, or even with the product of the contract. The waste avoided is only that which would come from wrecking a physical structure, completed, or nearly so, under the contract. The cases applying that rule go no further. Illustrative are Buchholz v. Rosenberg, 163 Wis. 312, 156 N.W. 946; Burmeister v. Wolfgram, 175 Wis. 506, 185 N.W. 517. Absent such waste, as it is in this case, the rule of the Restatement, Contracts, sec. 346, is that "the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance." That means that defendants here are liable to plaintiff for the reasonable cost of doing what defendants promised to do and have wilfully declined to do.

It follows that there must be a new trial. The initial question will be as to the proper construction of the contract. Thus far the case has been considered from the standpoint of the construction adopted by plaintiff and acquiesced in, very likely for strategic reasons, by defendants. The question has not been argued here, so we intimate no opinion concerning it, but we put the question whether the contract required removal from the premises of any overburden. The requirement in that respect was that the overburden should be used for the purpose of "establishing and maintaining" the grade. A uniform slope and grade were doubtless required. But whether, if it could not be accomplished without removal and deposit elsewhere of large amounts of overburden, the contract required as a condition that the grade everywhere should be as low as the one recited as "now existing at the roadway" is a question for initial consideration below.

The judgment must be reversed with a new trial to follow.

So ordered.

■ [JUSTICE OLSON, dissenting in an opinion in which JUSTICE HOLT joined, urged that the diminished value rule be applied in the absence of evidence to show that the completed product was to satisfy the personal taste of the promisee, and denied that the wilfulness of the breach should affect the measure of damages.]

NOTES

(1) *Explanation.* In 1927, when the parties were bargaining over the terms of their contract, they would surely not knowingly have agreed to have Wunder assume such a burdensome task if it would have been of so slight a benefit to Groves. What is the explanation for the circumstances that, after seven years, Wunder's task was so burdensome and Groves's benefit was apparently so slight? That Wunder had underestimated the burden? That Groves had overestimated the benefit? That the cost of Wunder's performance had risen? That the amount of the benefit to Groves had fallen? That Wunder's performance would not have been so burdensome if it had done the restoration as the work progressed? That the actual benefit to Groves would have been greater than that reflected in the market price of the land? Some combination of these? Which of these possible explanations would justify the court's decision?

According to one critic, "not enforcing the contract would have given the defendant a windfall. But enforcing the contract gave the plaintiff an equal and opposite windfall, in the form of a cushion, which almost certainly the parties had not intended, against the impact of the Depression on land values." R. Posner, Economic Analysis of Law 121 (7th ed. 2007).

After the decision in Groves, Wunder paid Groves $55,000 to settle the claim. The land was left until 1951, when some grading was done on a portion at a cost of $6,000, and in 1953 this portion was sold for $45,000 to a buyer who planned to use it for a factory. Does this suggest anything about the proper measure of recovery?

(2) *"Wilfulness."* The court says that Wunder's "breach of contract was wilful." In H.P. Droher & Sons v. Toushin, 85 N.W.2d 273 (Minn.1957), the court distinguished *Groves* on the ground that, "The majority opinion is based, at least in part, on the fact that the breach of the contract was wilful and in bad faith". What does "wilful" mean in this context? Holmes said that for breach of contract "the measure of damages generally is the same, whatever the cause of the breach." Globe Refining Co. v. Landa Cotton Oil Co., 190 U.S. 540, 544 (1903). Is the *Groves* case an exception? If Wunder must pay over $47,000 more in damages if its breach is "wilful," is this not a penalty for "wilfulness"? Is that consistent with the goals of contract remedies?

PROBLEM

Advising Wunder. If you had been counsel for Wunder and had been asked by your client whether it should perform its promise to do the grading at a cost of $60,000 if the benefit to Groves would be under $13,000, what advice would you have given? If Wunder then refused to perform, would its breach be "wilful"?

Peevyhouse v. Garland Coal & Mining Co.

Supreme Court of Oklahoma, 1963.
1962 OK 267, 382 P.2d 109.

[In 1954 Willie and Lucille Peevyhouse leased their farm for five years to Garland Coal & Mining Co. to strip mine coal. In addition to the usual covenants, Garland agreed to perform specified restorative and remedial work at the end of the lease. It failed to do this work, which would have involved the moving of many thousands of cubic yards of dirt at a cost of about $29,000. Had the work been done, the market price of the farm would have been increased by only $300. The Peevyhouses sued for $25,000 in damages. The trial court gave judgment on a verdict for $5,000. Both parties appealed.]

■ JACKSON, JUSTICE. . . . On appeal, the issue is sharply drawn. Plaintiffs contend that the true measure of damages in this case is what it will cost plaintiffs to obtain performance of the work that was not done because of defendant's default. Defendant argues that the measure of damages is the cost of performance "limited, however, to the total difference in the market value before and after the work was performed". It appears that this precise question has not heretofore been presented to this court. . . .

Plaintiffs rely on Groves v. John Wunder Co., 205 Minn. 163, 286 N.W. 235, 123 A.L.R. 502. In that case, the Minnesota court, in a substantially similar situation, adopted the "cost of performance" rule as opposed to the "value" rule. The result was to authorize a jury to give plaintiff damages in the amount of $60,000, where the real estate concerned would have been worth only $12,160, even if the work contracted for had been done.

It may be observed that Groves v. John Wunder Co., supra, is the only case which has come to our attention in which the cost of performance rule has been followed under circumstances where the cost of performance greatly exceeded the diminution in value resulting from the breach of contract. Incidentally, it appears that this case was decided by a plurality rather than a majority of the members of the court. . . .

We do not think [that] either [the] analogy [of a "building and construction" or a "grading and excavation" contract] is strictly applicable to the case now before us. The primary purpose of the lease contract between plaintiffs and defendant was neither "building and construction" nor "grading and excavation". It was merely to accomplish the economical recovery and marketing of coal from the premises, to the profit of all parties. The special provisions of the lease contract pertaining to remedial work were incidental to the main object involved.

Even in the case of contracts that are unquestionably building and construction contracts, the authorities are not in agreement as to the factors to be considered in determining whether the cost of performance rule or the value rule should be applied. The American Law Institute's Restatement of the Law, Contracts, Volume 1, Sections 346(1)(a)(i) and (ii) submits the proposition that the cost of performance is the proper measure of damages "if this is possible and does not involve *unreasonable economic waste*"; and that the diminution in value caused by the breach is the proper measure "if construction and completion in accordance with the contract would involve *unreasonable economic waste*". (Emphasis supplied.) In an explanatory comment immediately following the text, the Restatement makes it clear that the "economic waste" referred to consists of the destruction of a substantially completed building or other structure. Of course no such destruction is involved in the case now before us.

On the other hand, in McCormick, Damages, Section 168, it is said with regard to building and construction contracts that ". . . in cases where the defect is one that can be repaired or cured without *undue expense*" the cost of performance is the proper measure of damages, but where ". . . the defect in material or construction is one that cannot be remedied without *an expenditure for reconstruction disproportionate to the end to be attained*" (emphasis supplied) the value rule should be followed. The same idea was expressed in Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 129 N.E. 889, 23 A.L.R. 1429, as follows: "The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value."

It thus appears that the prime consideration in the Restatement was "economic waste"; and that the prime consideration in McCormick, Damages, and in Jacob & Youngs, Inc. v. Kent, supra, was the relationship between the expense involved and the "end to be attained"—in other words, the "relative economic benefit". . . .

We . . . hold that where, in a coal mining lease, lessee agrees to perform certain remedial work on the premises concerned at the end of the lease period, and thereafter the contract is fully performed by both parties except that the remedial work is not done, the measure of damages in an action by lessor against lessee for damages for breach of contract is ordinarily the reasonable cost of performance of the work; however, where the contract provision breached was merely incidental to the main purpose in view, and where the economic benefit which would result to lessor by full performance of the work is grossly disproportionate to the cost of performance, the damages which lessor may recover are limited to the diminution in value resulting to the premises because of the non-performance. . . .

[Judgment reduced to $300 and affirmed (4–3).]

■ IRWIN, JUSTICE (dissenting). . . . Although the contract speaks for itself, there were several negotiations between the plaintiffs and defendant before the contract was executed. Defendant admitted in the trial of the action, that plaintiffs insisted that the above provisions be included in the contract and that they would not agree to the coal mining lease unless the above provisions were included. . . .

[I]n my opinion, the plaintiffs were entitled to specific performance of the contract and since defendant has failed to perform, the proper measure of damages should be the cost of performance. Any other measure of damage would be holding for naught the express provisions of the contract; would be taking from the plaintiffs the benefits of the contract and placing those benefits in defendant which has failed to perform its obligations; would be granting benefits to defendant without a resulting obligation; and would be completely rescinding the solemn obligation of the contract for the benefit of the defendant to the detriment of the plaintiffs by making an entirely new contract for the parties. . . .

NOTES

(1) Groves *and* Peevyhouse. Are *Groves* and *Peevyhouse* distinguishable? Is it clear that the loss in value to the Peevyhouses was not $5,000? Did Garland get a "windfall"? See E. Allan Farnsworth, Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract, 94 Yale L.J. 1339 (1985). What result in these cases under Restatement § 348(2)? For the background of *Peevyhouse*, see Judith Maute, *Peevyhouse v. Garland Coal Co.* Revisited: The Ballad of Willie and Lucille, 89 Nw.U.L.Rev. 1341 (1995).

Peevyhouse was reconsidered in Schneberger v. Apache Corp., 890 P.2d 847, 850, 854, 855 (Okl.1994), an action for breach of a contract to reduce water pollution that had been caused during the defendant's drilling operations. The plaintiffs argued "that recent statutory enactments and federal case law reflect a change in Oklahoma policy regarding protecting the environment from pollution caused by oil and gas drilling operations," and that this policy change "clearly indicates that the diminution in value rule established in *Peevyhouse* is outdated and . . . that the cost of remediation is the proper measure of damages for pollution caused by oil and gas operations." The Supreme Court of Oklahoma, however, adhered to *Peevyhouse*, noting that the parties to the contract "were free to specify in the contract what the measure of damages would be in the event of a breach," and that even if the court were to use the more generous measure, nothing would require "a plaintiff to apply the award to reclaiming the land."

(2) *"Economic Waste."* The first Restatement, we are told by the court in *Peevyhouse*, speaks of "economic waste" in the sense of destruction of a substantially completed structure. If Kent had been awarded damages measured by the cost to replace the pipe with Reading pipe, would he then have been required to replace it? Does it seem likely that he would have done so? In what sense is there "economic waste" if he is awarded damages measured by the cost to complete? See Comment *c* to Restatement § 348.

PROBLEM

Threatening Inefficient Performance. Suppose that the value to the Peevyhouses of having the land graded is $8,000, that the cost to Garland of grading it is $30,000, and that the parties are confident that a court will award $30,000 as damages for breach of contract by Garland. If Garland has not decided whether or not to grade the land and offers to split the $22,000 difference and pay the Peevyhouses $19,000 ($8,000 + $11,000), should the Peevyhouses accept? Suppose that Garland threatens to grade the land if they do not accept? Does this call into question the wisdom of a rule that would result in an award of $30,000 as damages? See Ian Ayres and Kristin Madison, Threatening Inefficient Performance of Injunctions and Contracts, 148 U.Pa.L.Rev. 45, 52–53 (1999) (noting that, as compared to litigation, "actual performance potentially saves attorney fees").

(B) FORESEEABILITY

Until the nineteenth century, judges left the assessment of damages for breach of contract largely to the discretion of the jury. It was no accident that the development of rules to curb this discretion, and the "outrageous and excessive" verdicts that resulted, coincided with the end of the industrial revolution and with a consequent solicitude for burgeoning enterprise. Hadley v. Baxendale is the leading case in this development.

Hadley v. Baxendale

Court of Exchequer, 1854.
9 Ex. 341, 156 Eng.Rep. 145.

[Plaintiffs, who operated a mill at Gloucester, sued defendants, who were common carriers, for damages for breach of a contract of carriage. The declaration contained two counts, but prior to the trial plaintiffs entered a *nolle prosequi* as to the first. In the second count plaintiffs alleged that they were forced to shut their mill down because the crank shaft of the steam engine, by which their mill was operated, became broken; that they arranged with W. Joyce & Co., of Greenwich, the manufacturers of the engine, to make a new shaft from the pattern of the old one; that they delivered the broken shaft to defendants who, in consideration of the payment of their charges, promised to use due care to deliver it to W. Joyce & Co. within a reasonable time but that defendants failed to do so; that by reason of defendants' negligence the completion of the new shaft and the reopening of plaintiffs' mill were delayed five days longer than would otherwise have been the case; and that during that period plaintiffs were compelled to pay wages and lost profits aggregating 300£ for which amount plaintiffs sought judgment. Defendants pleaded that they had paid 25£ into court in satisfaction of plaintiffs' claim; plaintiffs replied that this sum was insufficient for that purpose; and issue was joined upon this replication.]

At the trial before Crompton, J., at the last Gloucester Assizes, it appeared that the plaintiffs carried on an extensive business as millers at Gloucester; and that, on the 11th of May, their mill was stopped by a breakage of the crank shaft by which the mill was worked. The steam-engine was manufactured by Messrs. Joyce & Co., the engineers at Greenwich, and it became necessary to send the shaft as a pattern for a new one to Greenwich. The fracture was discovered on the 12th, and on the 13th the plaintiffs sent one of their servants to the office of the defendants, who are the well known carriers trading under the name of Pickford & Co., for the purpose of having the shaft carried to Greenwich. The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately; and in answer to the inquiry when the shaft would be taken, the answer was, that if it was sent up by twelve o'clock any day, it would be delivered at Greenwich on the following day. On the following day the shaft was taken by the defendants, before noon, for the purpose of being conveyed to Greenwich, and the sum of 2£ 4*s.* was paid for its carriage for the whole distance; at the same time the defendants' clerk was told that a special entry, if required, should be made to hasten its delivery. The delivery of the shaft at Greenwich was delayed by some neglect; and the consequence was, that the plaintiffs did not receive the new shaft for several days after they would otherwise have done, and the working of their mill was thereby delayed, and they thereby lost the profits they would otherwise have received.

On the part of the defendants, it was objected that these damages were too remote, and that the defendants were not liable with respect to them. The learned Judge left the case generally to the jury, who found a verdict with 25£ damages beyond the amount paid into Court.

Whateley, [for defendants], in last Michaelmas Term, obtained a rule nisi for a new trial, on the ground of misdirection. * * *

■ ALDERSON, B. We think that there ought to be a new trial in this case; but, in so doing, we deem it to be expedient and necessary to state explicitly the rule which the Judge, at the next trial, ought, in our opinion, to direct the jury to be governed by when they estimate the damages.

It is, indeed, of the last importance that we should do this; for, if the jury are left without any definite rule to guide them, it will, in such cases as these, manifestly lead to the greatest injustice. The Courts have done this on several occasions; and, in Blake v. Midland Railway Company, 21 L.J., Q.B. 237, the Court granted a new trial on this very ground, that the rule had not been definitely laid down to the jury by the learned judge at Nisi Prius.

''There are certain established rules,'' this Court says, in Alder v. Keighley, 15 M. & W. 117, ''according to which the jury ought to find.'' And the Court, in that case, adds: ''and here there is a clear rule, that the amount which would have been received if the contract had been kept is the measure of damages if the contract is broken.''

Now we think the proper rule in such a case as the present is this: Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them.

Now the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract. It is said, that other cases, such as breaches of contract in the nonpayment of money, or in the not making a good title to land, are to be treated as exceptions from this, and as governed by a conventional rule. But as, in such cases, both parties must be supposed to be cognizant of that well-known rule, these cases may, we think, be more properly classed under the rule above enunciated as to cases under known special circumstances, because there both parties may reasonably be presumed to contemplate the estimation of the amount of damages according to the conventional rule.

Now, in the present case if we are to apply the principles above laid down, we find that the only circumstances here communicated by the plaintiffs to the defendants at the time the contract was made, were, that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of that mill. But how do these circumstances show reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person? Suppose the plaintiffs had another shaft in their possession put up or putting up at the time, and that they only wished to send back the broken shaft to the engineer who made it; it is clear that this would be quite consistent with the above circumstances, and yet the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill. Or, again, suppose that, at the time of the delivery to the carrier, the machinery of the mill had been in other respects defective, then, also, the same results would follow. Here it is true that the shaft was actually sent back to serve as a model for a new one, and that the want of a new one was the only cause of the stoppage of the mill, and that the loss of profits really arose from not sending down the new shaft in proper time, and that this arose from the delay in delivering the broken one to serve as a model. But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would not, in all probability, have occurred; and these special circumstances were here never communicated by the plaintiffs to the defendants.

It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such cases occurring under ordinary circumstances, nor were the special circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants. The Judge ought, therefore, to have told the jury that, upon the facts then before him, they ought not to take the loss of profits into consideration at all in estimating the damages. There must therefore be a new trial in this case.

Rule absolute.

NOTES

(1) *Rule of* Hadley v. Baxendale. Do you think that in Hadley v. Baxendale the court applied the rule that it formulated correctly or incorrectly? Cf. Victoria

Laundry (Windsor) Ltd. v. Newman Industries Ltd., 2 K.B. 528, 537 (1949): "In considering the meaning and application of these rules, it is essential to bear clearly in mind the facts on which Hadley v. Baxendale proceeded. The head-note is definitely misleading in so far as it says that the defendant's clerk, who attended at the office, was told that the mill was stopped and that the shaft must be delivered immediately. The same allegation figures in the statement of facts which are said . . . to have 'appeared' at the trial before Crompton J. If the Court of Exchequer had accepted these facts as established, the court must, one would suppose, have decided the case the other way round. . . . But it is reasonably plain from Baron Alderson's judgment that the court rejected this evidence, for . . . he says: 'We find that the only circumstances here communicated by the plaintiffs to the defendants at the time when the contract was made were that the article to be carried was the broken shaft of a mill and that the plaintiffs were the millers of that mill.' . . ."

Hadley v. Baxendale has prompted much discussion. For criticism of the rule, see Barry Adler, The Questionable Ascent of *Hadley v. Baxendale,*, 51 Stan.L.Rev. 1547 (1999); Eisenberg, The Principle of *Hadley v. Baxendale,* 80 Calif.L.Rev. 563 (1992). For a thorough discussion of the background of the case, see Richard Danzig, *Hadley v. Baxendale:* A Study in the Industrialization of the Law, 4 J.Legal Stud. 249 (1975).

The common law rule laid down in Hadley v. Baxendale may be usefully contrasted with other the formulations of foreseeability in contracts, see Restatement § 351 and UCC § 2–715(2), as well as torts, see Restatement, Second, of Torts § 435.

(2) *Limitation of Risk.* "The rule of Hadley v. Baxendale is an attempt to restrict the promisor's liability for breach of promise to those consequences, the risk of which he knew about, or must be taken to have known about, when he made the contract. The scope of damage for breach of contract is much narrower than the 'proximate consequence' rule which prevails in actions to recover for a tort. If we may assume that the defaulting promisor is usually an *entrepreneur,* a business man who has undertaken a risky enterprise, the law here manifests a policy to encourage the *entrepreneur* by reducing the extent of his risk below that amount of damage which, it might be plausibly argued, the promisee has actually been caused to suffer." Edwin Patterson, The Apportionment of Business Risks Through Legal Devices, 24 Colum.L.Rev. 335, 342 (1924).

In British Columbia Saw Mill Co. v. Nettleship, L.R. 3 C.P. 499 (1868), Willes, J., criticized the result reached in an old case "said to have been decided two centuries ago where a man going to be married to an heiress, his horse having cast a shoe on the journey, employed a blacksmith to replace it, who did the work so unskilfully that the horse was lamed, and the rider not arriving in time, the lady married another; and the blacksmith was held liable for the loss of the marriage." But cf. Coppola v. Kraushaar, 92 N.Y.S. 436 (App.Div.1905), in which a disappointed suitor whose betrothed broke their engagement after their wedding was delayed sued to recover five hundred dollars, expended uselessly on the wedding, from the defendant, whose failure to deliver two gowns, ordered for the bride, had caused the postponement of the wedding. "Before the defendant can be held to these alleged damages . . . I think that the parties must have had in contemplation that the wedding would never occur if the defendant failed to furnish the 'two dresses' on the day before the appointed time. . . . While such a disappointment would naturally be keen to any prospective bride, it was hardly to be contemplated, in the absence of specific warning, that she would forever refuse to wed if those 'two dresses' were not forthcoming before the day set for the ceremony. The damages are too remote."

(3) *Allocation of Risk*. Restatement § 351(3) confronts the problem of risk by stating that a court may limit damages even for foreseeable loss "if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation." In Sundance Cruises Corp. v. American Bureau of Shipping, 7 F.3d 1077, 1084 (2d Cir.1993), the court held that a shipowner was "not entitled to rely on a classification certificate as a guarantee to the owner that the vessel is soundly constructed." The court reasoned that "the great disparity between the fee charged ($85,000) by ABS for its services and the damages sought by Sundance ($264,000,-000) is strong evidence that such a result was not intended by the parties. Citing Restatement § 351, the court concluded 'that the small fees charged could not have been intended to cover the risk of such liability; the ship classification industry could not continue to exist under such terms.' " See Larry Garvin, Disproportionality and the Law of Consequential Damages: Default Theory and Cognitive Reality, 59 Ohio St. L.J. 339 (1998).

(4) *Consequential Damages*. Damages that, in Baron Alderson's words, would not be considered as "arising naturally," but only as a result of "the special circumstances under which the contract was actually made," are often called "consequential" damages. The Code has given special significance to this term by providing in UCC § 2–712(2) for buyer's recovery of "any incidental or consequential damages" while providing in UCC § 2–708(1) for seller's recovery of only "any incidental damages." In addition, UCC § 2–715 refers to both "incidental" and "consequential" damages "resulting from seller's breach," while UCC § 2–710 speaks only of "incidental damages to an aggrieved seller." Can you justify such a distinction between buyers and sellers?

Courts have read the Code as precluding recovery by sellers of consequential damages, a reading that has resulted in attempts by sellers to characterize claims such as those for additional interest costs resulting from breach as "incidental" rather than "consequential" and therefore allowable under UCC § 2–710. In St. Paul Structural Steel Co. v. ABI Contracting, Inc., 364 N.W.2d 83 (N.D.1985), the court accepted a seller's argument that "interest payments incurred as a result of a buyer's breach of a sales agreement do constitute incidental damages."

Disputes over the meaning of "consequential" also arise when the contract contains a provision precluding recovery of "consequential damages." For a case involving such a clause, see Reynolds Metals Co. v. Westinghouse Electric Corp., 758 F.2d 1073 (5th Cir.1985) (where seller of transformer failed to provide competent engineer to install it, buyer was limited to "difference-in-value losses" based on fee that competent engineer would have charged and could not recover consequential damages for cost of repairing damage to transformer caused by breach).

(5) *Availability of Cover*. Courts have often assumed that in our market economy there is ordinarily a market on which an injured buyer can cover. They have therefore concluded that losses resulting from the buyer's inability to cover do not follow from the breach in the ordinary course and are foreseeable by the seller only if the seller was aware of facts making the buyer's inability to cover foreseeable. See Marcus & Co. v. K.L.G. Baking Co., 3 A.2d 627 (N.J.1939). Does UCC § 2–715(2)(a) dispense with the requirement that the buyer's inability to cover be foreseeable?

DELCHI CARRIER SPA v. ROTOREX CORP., 71 F.3d 1024 (2d Cir.1995). [Rotorex, a New York corporation, agreed to supply compressors to Delchi, an Italian manufacturer of air conditioners, in three shipments.

While the second shipment was en route, Delchi discovered that the first shipment had both higher power consumption and lower cooling capacity than the contract required. Delchi asked Rotorex to supply conforming compressors and, when Rotorex refused, Delchi cancelled the contract and sought another source. Delchi sued Rotorex seeking incidental and consequential damages. From a $1,248,332 judgment for Delchi, both parties appealed.]

■ WINTER, CIRCUIT JUDGE . . . . [T]he instant matter is governed by the CISG, . . . a self-executing agreement between the United States and other signatories, including Italy. Because there is virtually no caselaw under the Convention, we look to its language and to "the general principles" upon which it is based. See CISG art. 7(2). The Convention directs that its interpretation be informed by its "international character and . . . the need to promote uniformity in its application and the observance of good faith in international trade." See CISG art. 7(1) . . . . Caselaw interpreting analogous provisions of Article 2 of the Uniform Commercial Code ("UCC") may also inform a court where the language of the relevant CISG provisions tracks that of the UCC . . . .

The CISG [art. 74] provides

> Damages for breach of contract . . . may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.

Rotorex contends . . . that the district court improperly awarded lost profits for unfilled orders from Delchi affiliates in Europe and from sales agents within Italy. We disagree. The CISG requires that damages by limited by the familiar principle of foreseeability established in Hadley v. Baxendale . . . . However, it was objectively foreseeable that Delchi would take orders for . . . sales based on the number of compressors it had ordered and expected to have ready for the season . . . .

On its cross-appeal, Delchi challenges the district court's denial of various consequential and incidental damages . . . on the ground that . . . an award would constitute a double recovery for Delchi. We disagree. . . . The expenses incurred by Delchi for shipping, customs, and related matters for the two returned shipments of Rotorex compressors, including storage expenses for the second shipment at Genoa, [along with the] unreimbursed tooling expenses and the cost of useless insulation and tubing materials . . . are legitimate [incidental and] consequential damages that in no way duplicate lost profits damages.

The labor expense incurred as a result of the production line shutdown . . . is also a reasonably foreseeable result of delivering nonconforming compressors for installation in air conditioners . . . . Whether Delchi's labor costs during this four-day period are variable or fixed costs is in large measure a fact question that we cannot answer because we lack factual findings by the district court. We therefore remand to the district court on this issue . . . .

[Affirmed in part and reversed and remanded in part.]

NOTES

(1) *''Possible'' or ''Probable''?* Judge Winter explains that cases under the Code may ''inform a court where the language of the relevant CISG provisions tracks that of the UCC.'' The relevant CISG provision speaks of ''a *possible* consequence of the breach.'' Do you find this language in the Code? Recall that in Hadley v. Baxendale Baron Alderson spoke of ''the *probable* result of the breach,'' language that has been carried over into Restatement § 351(1), which speaks of ''a *probable* result of the breach.'' Is the difference between ''possible'' and ''probable'' significant? See also UNIDROIT Principles 7.4.4 (''likely'').

(2) *Buyer for Resale.* The court's decision on Delchi's ''lost profits for unfilled orders'' is not surprising. If a seller knows it is selling to a buyer for resale, loss of such profits is generally regarded as foreseeable. Loss of profits on future contracts is another matter.

Nevertheless, Hendricks, an import agent, overcame this obstacle under a contract to buy garments from Daewoo, a Korean manufacturer. As Daewoo knew, Hendricks needed the garments for resale to Champion, a wholesaler of sporting apparel, with whom Hendricks had developed a continuing relationship. The garments had serious defects (''too risky to market''), and Champion terminated its relationship with Hendricks. Hendricks sued Daewoo for damages including its loss of future Champion contracts and had judgment based on a $375,000 jury verdict. Daewoo appealed. As to foreseeability, the court said: ''We think that a rational jury could conclude in these circumstances that Daewoo could have foreseen that a nonconforming tender, as severe and pervasive as the present evidence demonstrates, probably would cause Hendricks, in the ordinary course of events, to lose future Champion contracts.'' Hendricks & Associates v. Daewoo Corp., 923 F.2d 209, 215 (1st Cir.1991). For the court's disposition of the case, see Note 1, p. 673 below.

PROBLEM

Sweetening a Damage Claim. Federal contracted to sell 75,000 tons of sugar to Czarnikow, to be delivered directly to Czarnikow's customers. In the contracts that Czarnikow then made in turn with its customers, it provided that the sugar was to be ''Federal'' brand, but this provision was not known to Federal. (Recall that in *Tongish*, p. 633 above, the court noted that ''Tongish knew the seeds eventually went to Bambino, although he may not have known the details of the deal.'') When the sugar delivered by Federal turned out to be defective, Czarnikow spent $340,000 in the settlement of claims and the defense of law suits brought by its customers, an amount that was inflated because Czarnikow's obligations to them could not be met by delivery of sugar from other suppliers, which it might have obtained on the market. Is Federal liable for $340,000? Czarnikow–Rionda Co. v. Federal Sugar Refining Co., 173 N.E. 913 (N.Y.1930).

Assuming that Federal is liable for $340,000, could Czarnikow recover an additional $100,000 by showing that it had lost this much in profits when its volume dropped because it was deprived of $340,000 in capital? See Lewis v. Mobil Oil Corp., 438 F.2d 500 (8th Cir.1971).

Might these questions be answered differently under Article 2 of the UCC and the CISG?

Kenford Co. v. County of Erie

Court of Appeals of New York, 1989.
73 N.Y.2d 312, 537 N.E.2d 176.

■ MOLLEN, JUDGE. This appeal arises out of breach of contract litigation spanning 18 years and involving the proposed construction and operation of a domed stadium facility in the County of Erie. The issue is whether the plaintiff Kenford Company, Inc. (Kenford) is entitled to recover damages against the defendant County of Erie (County) for the loss of anticipated appreciation in the value of the land which Kenford owned in the periphery of the proposed stadium site. Under the circumstances of this case, we conclude that Kenford is not entitled to recovery on this claim since there is no evidence to support a determination that the parties contemplated, prior to or at the time of the contract, assumption by the County of liability for these damages.

By way of background, the County of Erie adopted enabling legislation in May 1968 authorizing it to finance and construct a domed sports stadium in the vicinity of the City of Buffalo. The County, simultaneously, adopted a resolution authorizing a $50 million bond resolution for the purpose of financing the construction of the proposed stadium.... Kenford, through its president and sole shareholder, Edward H. Cottrell, submitted an offer ... to donate to the County the land upon which the stadium was to be built, in exchange for which the County was to permit ... the management company of Dome Stadium, Inc. (DSI), to lease or manage the proposed stadium facility.

In June 1969, the County adopted a resolution accepting Kenford's ... offer, after which the parties engaged in contract negotiations. During this period of time, Cottrell, as agent for Kenford, exercised his options on several parcels of land located in the Town of Lancaster. On August 8, 1969, the County, Kenford and DSI executed a contract which provided, in pertinent part, that Kenford would donate 178 acres of land located in the Town of Lancaster to the County for use in construction of the stadium and necessary access roadways. In consideration therefor, the County agreed to commence construction of the stadium within 12 months. The County also agreed to negotiate a 40–year lease with DSI for the operation of the facility which was to provide, inter alia, that the County would receive, as its consideration, lease revenues of not less than $63.75 million over the 40–year term to be comprised of (1) all tax revenues received by the County generated by the operation of the stadium site area; (2) rental payments from DSI; and (3) increased real property taxes resulting from increased assessments and other tax revenues received from or generated by "the peripheral lands and development thereof". The term "peripheral lands" was defined as "those lands presently owned, contracted for or hereinafter acquired by Edward H. Cottrell or Kenford, and located within the area of the Town of Lancaster". If a mutually satisfactory lease could not be agreed upon within three months of the contract signing, the County and DSI were to execute a 20–year management agreement which was annexed to the contract.[1]

[When the County learned] that the proposed project would cost approximately $72 million which was $22 million in excess of the County's prior bond resolution [it terminated the contract and] Kenford and DSI instituted the instant breach of contract action and sought specific performance thereof, or, in the alternative, damages in the amount of $90 million.[2] . . . [A damage trial] resulted in a jury award to Kenford in the sum of $18 million for its lost appreciation in the value on its property located on the periphery of the proposed stadium site and an award of over $6 million in out-of-pocket expenses. DSI was awarded $25.6 million in lost profits under the parties' 20–year management contract.

On appeal, the Appellate Division, while affirming the major portion of the $6 million jury award for Kenford's mitigation and reliance damages, reversed the award to DSI for loss of profits as well as a portion of the award to Kenford for out-of-pocket expenses and directed a new trial on the damage award for loss of anticipated appreciation in the value of Kenford's peripheral lands.... On this latter point, the majority of the Appellate Division determined that Kenford's loss of land appreciation was both a foreseeable and certain damage for which it was entitled to recover. The majority, however, found that the award was based upon improper appraisal evidence [and remanded].... Two Justices dissented ... and took the position that these damages were not foreseeable and, in any event, were inherently speculative and, therefore, not recoverable.

DSI subsequently sought review of the Appellate Division's dismissal of its breach of contract claim against the County. This court, addressing itself solely to the denial of DSI's right to recover its loss of profits under the 20–year management contract, affirmed that portion of the Appellate Division's decision. Therein, we determined that those damages were not recoverable on the twofold basis that the County's liability for DSI's loss of profits was not in the contemplation of the parties at the time of the execution of the contract and, secondly, the damages were too speculative and, thus, did not satisfy the legal requirements of proof with reasonable certainty....

[On retrial on the issue of damages for Kenford's loss of anticipated land appreciation, the jury awarded Kenford the sum of $6.5 million. The Appellate Division affirmed, and the County appealed, raising the issue whether Kenford was entitled to recover damages for lost anticipated appreciation in the value of its peripheral lands.]

It is well established that in actions for breach of contract, the nonbreaching party may recover general damages which are the natural and probable consequence of the breach. "[In] order to impose on the defaulting party a further liability than for damages [which] naturally and directly [flow from the breach], i.e., in the ordinary course of things, arising from a breach of contract, such unusual or extraordinary damages must

1. Despite extensive negotiations, the County and DSI never agreed upon a satisfactory 40–year lease agreement.

2. The plaintiffs were later granted permission to increase the ad damnum clause to $495 million....

have been brought within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting'' (Chapman v. Fargo, 223 N.Y. 32, 36, 119 N.E.76); see also Czarnikow Rionda Co. v. Federal Sugar Ref. Co., 255 N.Y 33, 173 N.E. 913; . . . Hadley v. Baxendale, 9 Exch. 341, 156 Eng. Rep. 145. . . . In determining the reasonable contemplation of the parties, the nature, purpose and particular circumstances of the contract known by the parties should be considered . . . as well as ''what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made'' (Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. 540, 544 [Holmes, J.]) . . . .

In the case before us, it is beyond dispute that at the time the contract was executed, all parties thereto harbored an expectation and anticipation that the proposed domed stadium facility would bring about an economic boom in the County and would result in increased land values and increased property taxes. This expectation is evidenced by the terms of the provision of the parties' contract requiring the County and DSI to undertake negotiations of a lease which would provide for specified revenues to be derived from, inter alia, the increased taxes on the peripheral lands. We cannot conclude, however, that this hope or expectation of increased property values and taxes necessarily or logically leads to the conclusion that the parties contemplated that the County would assume liability for Kenford's loss of anticipated appreciation in the value of its peripheral lands if the stadium were not built. On this point, our decision in the prior appeal regarding DSI's right to recover damages for lost profits under the 20–year management contract is particularly instructive: ''Initially, the proof does not satisfy the requirement that liability for loss of profits over a 20–year period was in the contemplation of the parties at the time of the execution of the basic contract or at the time of its breach. . . . Indeed, the provisions in the contract providing remedy for a default do not suggest or provide for such a heavy responsibility on the part of the County. In the absence of any provision for such an eventuality, *the commonsense rule to apply is to consider what the parties would have concluded had they considered the subject.* The evidence here fails to demonstrate that liability for loss of profits over the length of the contract would have been in the contemplation of the parties at the relevant time'' ([Kenford Co. v. County of Erie,] 67 N.Y.2d 257, 262, 493 N.E.2d 234 [emphasis added]).

Similarly, there is no provision in the contract between Kenford and the County, nor is there any evidence in the record to demonstrate that the parties, at any relevant time, reasonably contemplated or would have contemplated that the County was undertaking a contractual responsibility for the lack of appreciation in the value of Kenford's peripheral lands in the event the stadium was not built. This conclusion is buttressed by the fact that Kenford was under no contractual obligation to the County to acquire or maintain ownership of any land surrounding the 178 acres it was required to donate to the County. Although the County was aware that Kenford had acquired and intended to further acquire peripheral lands, this knowledge, in and of itself, is insufficient, as a matter of law, to impose liability on the County for the loss of anticipated appreciation in the value of those lands since the County never contemplated at the time of the contract's execution that it assumed legal responsibility for these damages upon a breach of the contract.... [In] Hadley v. Baxendale, 9 Exch. 341, 156 Eng. Rep. 145, supra [the common carrier was not liable for the loss of profits at the plaintiffs' flour mill since the carrier, who knew that the mill was closed, was not aware that the mill's continued operation was dependent solely on prompt delivery of the mill's broken shaft].

Undoubtedly, Kenford purchased the peripheral lands in question with the hope of benefiting from the expected appreciation in the value of those lands once the stadium was completed and became operational. In doing so, Kenford voluntarily and knowingly assumed the risk that, if the stadium were not built, its expectations of financial gain would be unrealized. There is no indication that either Kenford or the County reasonably contemplated at the time of the contract that this risk was assumed, either wholly or partially, by the County. To hold otherwise would lead to the irrational conclusion that the County, in addition to promising to build the domed stadium, provided a guarantee that if for any reason the stadium were not built, Kenford would still receive all the hoped for financial benefits from the peripheral lands it anticipated to receive upon the completion of the stadium. According to Kenford's version of the facts, Kenford was to realize all of its anticipated gains with or without the stadium. Clearly, such a result is illogical and without any basis whatsoever in the record.

Thus, the constant refrain which flows throughout the legion of breach of contract cases dating back to the leading case of Hadley v. Baxendale (9 Exch. 341, 156 Eng. Rep. 145, supra) provides that damages which may be recovered by a party for breach of contract are restricted to those damages which were reasonably foreseen or contemplated by the parties during their negotiations or at the time the contract was executed. The evident purpose of this well-accepted principle of contract law is to limit the liability for unassumed risks of one entering into a contract and, thus, diminish the risk of business enterprise.... In the case before us, although Kenford obviously anticipated and expected that it would reap financial benefits from an anticipated dramatic increase in the value of its peripheral lands upon the completion of the proposed domed stadium facility, these expectations did not ripen or translate into cognizable breach of contract damages since there is no indication whatsoever that the County reasonably contemplated at any relevant time that it was to assume liability for Kenford's unfulfilled land appreciation expectations in the event that the stadium was not built. Thus, under the principles set forth in Hadley v. Baxendale (supra) and its progeny of cases in this State ... Kenford is not entitled to recovery, as a matter of law, for its lost appreciation in the value of its peripheral lands caused by the County's breach of the parties' contract.

[Reversed and] award for loss of anticipated profits from appreciation in the value of peripheral lands stricken.

NOTES

(1) *Limitation of Risk (Reprise).* Note the court's quotation from Globe Refining Co. v. Landa Cotton Oil Co. In that case Holmes laid down a "tacit agreement"

test, declaring that "the extent of liability . . . should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind. . . . [It] depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made. . . . [M]ere notice to a seller of some interest or probable action of the buyer is not enough."

This test has not generally found favor. According to Comment 2 to UCC § 2–715, "The 'tacit agreement' test for the recovery of consequential damages is rejected." What does *Kenford's* use of the test show about the attitude of the New York Court of Appeals toward limitation of risk?

(2) *Jury Instructions.* Because the issue of foreseeability is often one for the jury, it is of interest to see how judges instruct juries on the issue. In Redgrave v. Boston Symphony Orchestra, Inc., 602 F.Supp. 1189 (D.Mass.1985), the actress Vanessa Redgrave sued the Boston Symphony Orchestra for breach of a contract under which she was to appear as narrator in the Orchestra's centenary performances of Stravinsky's opera-oratorio Oedipus Rex, claiming, among other things, damages for harm to her professional career. She alleged that the Orchestra had cancelled the performances in retaliation for her public expressions on political issues, and the Orchestra argued that it had done so because Redgrave's statements in support for the Palestine Liberation Organization caused it to fear a disruption of the performances. Here is the judge's instruction on the issue of foreseeability.[a]

> Damages are allowed for consequential harm to her professional career only if the harm was a foreseeable consequence within the contemplation of the parties to the contract when it was made.
>
> By the phrase "harm that is a foreseeable consequence within the contemplation of the parties" we mean harm of a kind within one or more of the following groups:
>
> (1) harm of a kind that was referred to in communications between the parties while they were negotiating at or before the time the contract was made; (2) any other harm of a kind foreseeable as sufficiently likely to result from cancellation that it would have been taken into account in the exercise of reasonable care in assessing the possible costs and benefits of the proposed contract and in deciding whether or not to enter into the contract. The test of foreseeable harm is an objective one based on what a party to the contract, at the time of making the contract, knew or had reason to foresee or had reason to know or ought to have known would be harm which could result from the breach of the contract. To be within the contemplation of the parties, the harm must be of a kind that either was foreseen or else was foreseeable by a reasonable person in the position of the party now being sued, taking into account the facts and circumstances that party or its agents knew, as well other facts and circumstances, if any, which a reasonable person in that position would have known through the exercise of reasonable care. Thus, in order to find that consequential harm was within the contemplation of both parties in this case, you must find that BSO's agents knew or should have known, when the contract was made, that there was a substantial likelihood that a cancellation would be likely to cause Vanessa Redgrave to lose other professional work.

a. The judge was Robert E. Keeton, an author of a leading textbook on insurance, R. Keeton & A. Widiss, *Insurance Law* (1988).

> The plaintiffs have the burden of proving by a preponderance of the evidence that the harm was a foreseeable consequence within the contemplation of the parties. You are not allowed to speculate on this question.

The jury found that harm to Redgrave's professional career was foreseeable and awarded $100,000 in consequential damages. The trial judge concluded that this award was supported by the evidence but that, on principles analogous to the law of defamation, Redgrave could not recover for such harm on the facts of the case. Therefore, he limited Redgrave's recovery to $27,500, the amount she was to be paid for the performances less expenses that she would have incurred to perform the contract. The Court of Appeals held that it was error so to limit damages but concluded that, though the quoted instruction was "appropriate," Redgrave's evidence was sufficient to support only some $12,000 in consequential damages. Redgrave v. Boston Symphony Orchestra, Inc., 855 F.2d 888 (1st Cir.1988).

PROBLEM

Cold Steel. In September, Torrington, the successful bidder with the New York State Department of Transportation on a highway reconstruction job in northern New York, made a subcontract with Fort Pitt for the structural steel to be used for a bridge, "Delivery to be mutually agreed upon." In November, Torrington advised that it would need the steel the following June, and Fort Pitt replied that it was tentatively scheduling delivery accordingly. In January, however, Fort Pitt advised that it could not meet the June date. When most of the steel did not arrive until mid-September, this delayed the pouring of the concrete until the end of October when there was danger of freezing. To mitigate damages, Torrington had the concrete poured on a crash basis in a single day, which entailed additional costs including overtime pay and extra equipment. Torrington sued Fort Pitt for damages based on these additional costs.

Fort Pitt argued that when it made the contract in September it was advised that the total work was to be completed in two years and could not reasonably have anticipated that Torrington would so expedite the work that steel delivery would be called for within a year. It claimed that, under Hadley v. Baxendale, whatever knowledge it received after the contract was made cannot expand its liability. Torrington, on the other hand, argued that Fort Pitt should be charged with whatever knowledge it had in November when the June delivery date was agreed upon, and Fort Pitt, as an experienced bridge fabricator, must have then realized that any delay beyond August would jeopardize the pouring of the concrete and force postponement of the work until spring.

Is Fort Pitt or Torrington right? See Spang Industries, Inc. v. Aetna Casualty & Surety Co., 512 F.2d 365 (2d Cir.1975).

SENTIMENTAL VALUE

In Mieske v. Bartell Drug Co., 593 P.2d 1308 (Wash.1979), the court said this in connection with a claim for damages caused by the loss of a home-movie record of a couple's wedding and later family life. "The fact that damages are difficult to ascertain and measure does not diminish the loss to the person whose property has been destroyed. . . . The problem is to establish the value to the owner. . . . Recognizing that value to the owner encompasses a subjective element, the rule has been established that compensation for sentimental or fanciful values will not be allowed. . . .

"What is sentimental value? The broad dictionary definition is that sentimental refers to being 'governed by feeling, sensibility or emotional idealism. . . .' Webster's Third New International Dictionary (1963). Obviously that is not the exclusion contemplated by the statement that sentimental value is not to be compensated. If it were, no one would recover for the wrongful death of a spouse or a child. Rather, the type of sentiment which is not compensable is that which relates to 'indulging in feeling to an unwarranted extent' or being 'affectedly or mawkishly emotional . . .' Webster's Third New International Dictionary (1963).

"Under these rules, the court's damages instruction was correct. In essence it allowed recovery for the actual or intrinsic value to the plaintiffs but denied recovery for any unusual sentimental value of the film to the plaintiffs or a fanciful price which plaintiffs, for their own special reasons, might place thereon."

Was the value of Keno to Archie Sparrow in Morris v. Sparrow, p. 593 above, sentimental or something else?

EMOTIONAL DISTRESS

Courts have been reluctant to allow damages for emotional distress resulting from breach of contract. See Restatement § 353. Sometimes emotional distress is not foreseeable, and, even if it is foreseeable, the resulting damages are often particularly difficult to establish and to measure. See Goldberg, Emotional Distress Damages and Breach of Contract: A New Approach, 20 U.C.Davis L.Rev. 57 (1986).

Furthermore, some courts have likened the award to damages for emotional distress to the award of punitive damages. In Brown v. Fritz, 699 P.2d 1371, 1374–75 (Idaho 1985), for example, the court overturned an award of $15,000 for the emotional distress of a home buyer when she discovered that the sellers had fraudulently represented the property. When the buyer learned that the sellers had previously sold part of the property to another and that the sewage system malfunctioned, causing raw sewage to accumulate beneath the house, she resold the property and "suffered severe emotional distress which manifested itself in physical symptoms, including the need for substantial hospitalization."

The court noted that in a decision five years earlier it had said that "the commercial nature of the contract" was relevant but not decisive, indicating a distinction between commercial contracts and " 'non-commercial' contracts, such as to perform a caesarean section, to bury a body, or to deliver a bride's trousseau." The court also noted that in a decision two years earlier it had said that punitive damages "should be awarded only in the most unusual and compelling circumstances" and "will be sustained on appeal only when it is shown that the defendant acted in a manner that was 'an extreme deviation from reasonable standards of conduct, and that the act was performed by the defendant with an understanding of or disregard for its likely consequences.' "

The home buyer's emotional distress "resulted from the negotiations for and the consummation of a contract to convey real property" and not "from an 'independent' tort involving a physical or a constructive contact between two parties who were not in a contractual relationship." Observing "the close parallel between allowable damages for breach of contract under the terminology of 'emotional distress' and for punitive damages," the court held that "when damages are sought for breach of a contractual relationship, there can be no recovery for emotional distress suffered by the plaintiff. If the conduct of a defendant has been sufficiently outrageous, we view the proper remedy to be in the realm of punitive damages."

NOTES

(1) *The Case of the "Whole Damned Business."* Blummer Lamm employed the Shingletons, undertakers, to inter her husband in a vault guaranteed to be watertight. About three months later, during a heavy rain, the vault rose above the ground, and the Shingletons undertook to reinter the body. They raised the vault in Lamm's presence and found that the casket was wet. The sight "caused her considerable shock and made her extremely nervous as a result of which she became a nervous wreck." One of the Shingletons said he would not get the mud out of the vault and "to hell with the whole damned business, it's no concern of mine." This made Lamm "so nervous she could hardly stand up." She sued for breach of contract and, from judgment that she take nothing, she appealed. *Held:* Reversed.

Although "as a general rule," damages for mental anguish are not recoverable in a contract action, the law is "in a state of flux.... Where the contract is personal in nature and the contractual duty or obligation is so coupled with matters of mental concern or solicitude, or with the sensibilities of the party to whom the duty is owed, that a breach of that duty will necessarily or reasonably result in mental anguish or suffering, and it should be known to the parties from the nature of the contract that such suffering will result from its breach, compensatory damages therefor may be recovered.... The contract was predominantly personal in nature and no substantial pecuniary loss would follow its breach." Lamm v. Shingleton, 55 S.E.2d 810, 813 (N.C.1949).

For an unusual case granting recovery for "mental anguish" resulting from the defective construction of a new home, see B & M Homes v. Hogan, 376 So.2d 667 (Ala.1979). The court noted that the "largest single investment the average American family will make is the purchase of a home" and concluded that "any reasonable builder could easily foresee that an individual would undergo extreme mental anguish if their newly constructed house contained defects as severe as those shown to exist in this case." For a contrary and more traditional view, see Ostrowe v. Darensbourg, 377 So.2d 1201 (La.1979).

(2) *Employment Contracts.* Claims of damages for emotional distress are common in actions for breach of employment contracts. In Francis v. Lee Enterprises, 971 P.2d 707, 713 (Haw.1999), that though "damages for emotional distress ... are generally not recoverable in contract," they may be awarded where "the contract is of such a kind that serious emotional disturbance is a particularly foreseeable result if a breach occurs.... [I]n deciding whether such damages are recoverable, we shift the focus of the inquiry away from the *manner* of the breach and to the *nature* of the contract."

Courts have, however, generally found reasons to refuse such damages for breach of employment contracts. For example, in Saporoso v. Aetna Life & Cas. Co., 603 A.2d 1160, 1166–67 (Conn.1992), the Supreme Court of Connecticut concluded that there "is no reasonable basis in the evidence for a jury to have found that ... when the plaintiff resumed her employment with Aetna, it was reasonably foreseeable that if the plaintiff's employment should be terminated, with or without cause, she would suffer a continuing disability from a psychiatric disorder related to her employment or the circumstances of her discharge." See also Gaglidari v. Denny's Restaurants, 815 P.2d 1362, 1370, 1373 (Wash.1991), where the court said that its research had found only one state, Colorado, that rejects the "traditional common law doctrine ... that tort damages for emotional distress caused by breach of an employment contract are not recoverable" and added that "the overwhelming majority of courts deny recovery for mental distress damages even though they might be foreseeable within the rule stated in Hadley v. Baxendale."

(3) *The Case of the Designer Dress.* The purchaser of a custom-made wedding dress sued "the high fashion designer ... known to the cognoscenti simply as Halston" for "mental anguish" caused because the dress was allegedly improperly made and could not be worn by the purchaser's daughter at her wedding. *Held:* Cause of action dismissed. Levin v. Halston Ltd., 398 N.Y.S.2d 339 (N.Y.City Ct.1977).

(C) CERTAINTY

In an omitted part of the opinion you just read in *Kenford*, the court discussed its earlier decision in Kenford Co. v. County of Erie, 493 N.E.2d 234 (N.Y.1986). It recalled that in that decision it had reviewed DSI's award of $25.6 million in lost profits under its 20–year management contract and had "determined that those damages were not recoverable on the twofold basis that the County's liability for DSI's profits was not in the contemplation of the parties at the time of the execution of the contract and, secondly, the damages were too speculative and, thus, did not satisfy the legal requirement of proof with reasonable certainty."

You may remember that the term "speculative" also appeared in the opinion in *Naval Institute*, p. 9 above. There Berkley challenged as "speculative" the premise "that, but for the breach by Berkley, Naval would have sold in September the same number of hardcover copies it sold in August." In that case the court rejected the challenge, saying that "it is not error to lay the normal uncertainty in such hypotheses at the door of the wrongdoer who altered the proper course of events."

These two cases point up an important limitation on the disappointed promisee's right to contract damages. As put in a seminal New York case decided in 1858, damages for breach of contract must "be shown, by clear and satisfactory evidence, to have been actually sustained" and "be shown with certainty, and not left to speculation or conjecture." Griffin v. Colver, 16 N.Y. 489, 491 (1858).

Contemporary formulations, however, insist only on "reasonable certainty" rather than on "certainty" itself. Restatement § 352, for example, precludes recovery "for loss beyond an amount that the evidence permits to be established with reasonable certainty.'' Comment 1 to UCC § 1–106 explains that damages need not ''be calculable with mathematical accuracy,'' are ''at best approximate,'' and ''have to be proved with whatever definiteness and accuracy the facts permit, but no more.'' And UNIDROIT Principles art. 7.4.3 requires only ''a reasonable degree of certainty.'' Nevertheless, it is clear that in this regard the injured party has a more onerous burden than that imposed by the ordinary requirement to make its case by the ''preponderance of evidence.''

NOTES

(1) *Buyer for Resale (Reprise).* Recall that in Note 2, p. 663 above, the Court of Appeals upheld Hendricks' damage award against Daewoo in the face of a challenge based on Hadley v. Baxendale. As to certainty of proof of lost profits, however, Hendricks did not fare as well. *Held:* Affirmed conditioned on a remittitur of damages in excess of $45,000, otherwise Daewoo's motion for new trial to be granted.

''We can only conclude that no loss of prospective profits in an amount even approaching the $375,000 consequential damages award was proven in the manner required by Massachusetts law.... With no evidence of *past* profits, future profit margins, future business revenues or expenses, beyond [the year of the breach], and no formula or method for divining any other element in a rational projection or calculation of prospective profits, the jury was left entirely to guesswork ... The jury could have found, without impermissible resort to surmise and speculation, that Hendricks was entitled to recover no more than $45,000 for loss of prospective profits....'' Hendricks & Associates v. Daewoo Corp., 923 F.2d 209, 217, 220, 221 (1st Cir.1991).

(2) *The Value of a Chance.* In Collatz v. Fox Wisconsin Amusement Corp., 239 Wis. 156, 300 N.W. 162 (1941), the plaintiff, one of two finalists in a quiz contest held at the defendant's theater, claimed a half interest in the automobile offered as a prize, on the ground that it had been arbitrarily awarded to the other finalist before completion of the contest. The court held for the defendant. The plaintiff ''suffered no damage because of the defendant's breach of the contract, for it cannot be assumed nor is it susceptible of proof that had the contest proceeded to a proper finish he would have become the winner.'' The classic case to the contrary is Chaplin v. Hicks, [1911] 2 K.B. 786, in which the winner of a preliminary round in a beauty contest prevailed. Accord: Wachtel v. National Alfalfa Journal Co., 176 N.W. 801 (Iowa 1920). See Restatement § 348(3); UNIDROIT Principles art. 7.4.3(2).

(3) *The Right to Work.* In *Parker*, could Shirley MacLaine have recovered more than $750,000? Would not starring in ''Bloomer Girl'' have enhanced her reputation as an actress? A few courts have favored recovery for lost reputation. See Herbert Clayton & Jack Waller, Ltd. v. Oliver [1930] A.C. 209, in which the court said: ''Here both parties knew that as flowing from the contract the plaintiff would be billed and advertised as appearing at the Hippodrome, and in the theatrical profession this is a valuable right.''

See also Malik v. Bank of Credit & Commerce Intl., [1997] 3 All E.R. 1, 11 (House of Lords) (Lord Steyn: ''there is no good reason why in the field of employment law recovery of financial loss in respect of damage to reputation caused by breach of contract is necessarily excluded''). Compare the discussion of sentimental value, p. 639 above.

American courts, however, have generally denied recovery for lost reputation on grounds of either uncertainty or unforeseeability. Cases are discussed in Redgrave v. Boston Symphony Orchestra, Note 2, p. 668 above. The court there noted that she did not claim that "her general reputation as a professional actress has been tarnished" but rather "that a number of specific movie and theater performances that would have been offered to her in the usual course of events were not offered to her." How did Redgrave's situation differ from MacLaine's?

Fera v. Village Plaza, Inc.

Supreme Court of Michigan, 1976.
396 Mich. 639, 242 N.W.2d 372.

■ T.G. KAVANAGH, CHIEF JUSTICE. Plaintiffs received a jury award of $200,000 for loss of anticipated profits in their proposed new business as a result of defendants' breach of a lease. The Court of Appeals reversed.... We reverse and reinstate the jury's award.

On August 20, 1965 plaintiffs and agents of Fairborn–Village Plaza executed a ten-year lease for a "book and bottle" shop in defendants' proposed shopping center. This lease provided for occupancy of a specific location at a rental of $1,000 minimum monthly rent plus 5% of annual receipts in excess of $240,000. A $1,000 deposit was paid by plaintiffs.

After this lease was executed, plaintiffs gave up approximately 600 square feet of their leased space so that it could be leased to another tenant. In exchange, it was agreed that liquor sales would be excluded from the percentage rent override provision of the lease.

Complications arose, including numerous work stoppages. Bank of the Commonwealth received a deed in lieu of foreclosure after default by Fairborn and Village Plaza. Schostak Brothers managed the property for the bank.

When the space was finally ready for occupancy, plaintiffs were refused the space for which they had contracted because the lease had been misplaced, and the space rented to other tenants. Alternative space was offered but refused by plaintiffs as unsuitable for their planned business venture.

Plaintiffs initiated suit in Wayne Circuit Court, alleging *inter alia* a claim for anticipated lost profits. The jury returned a verdict for plaintiffs against all defendants for $200,000.

The Court of Appeals reversed and remanded for new trial on the issue of damages only, holding that the trial court "erroneously permitted lost profits as the measure of damages for breach of the lease." 52 Mich.App. 532, 542, 218 N.W.2d 155, 160.

In Jarrait v. Peters, 145 Mich. 29, 31–32, 108 N.W. 432 (1906), plaintiff was prevented from taking possession of the leased premises. The jury gave plaintiff a judgment which included damages for lost profits. This Court reversed:

> "It is well settled upon authority that the measure of damages when a lessor fails to give possession of the leased premises is the difference between the actual rental value and the rent reserved. 1 Sedgwick on Damages (8th Ed.) par. 185. Mr. Sedgwick says:

" 'If the business were a new one, since there could be no basis on which to estimate profits, the plaintiff must be content to recover according to the general rule.'

"The rule is different where the business of the lessee has been interrupted. . . .

"The evidence admitted tending to show the prospective profits plaintiff might have made for the ensuing two years should therefore have been excluded under the objections made by defendant, and the jury should have been instructed that the plaintiff's damages, if any, would be the difference between the actual rental value of the premises and the rent reserved in the lease."

Six years later, in Isbell v. Anderson Carriage Co., 170 Mich. 304, 318, 136 N.W. 457, 462 (1912), the Court wrote:

"It has sometimes been stated as a rule of law that prospective profits are so speculative and uncertain that they cannot be recognized in the measure of damages. This is not because they are profits, but because they are so often not susceptible of proof to a reasonable degree of certainty. Where the proof is available, prospective profits may be recovered, when proven, as other damages. But the jury cannot be asked to guess. They are to try the case upon evidence, not upon conjecture."

These cases and others since should not be read as stating a rule of law which prevents every new business from recovering anticipated lost profits for breach of contract. The rule is merely an application of the doctrine that "[i]n order to be entitled to a verdict, or a judgment, for damages for breach of contract, the plaintiff must lay a basis for a reasonable estimate of the extent of his harm, measured in money". 5 Corbin on Contracts, § 1020, p. 124. The issue becomes one of sufficiency of proof. "The jury should not [be] allowed to speculate or guess upon this question of the amount of loss of profits." Kezeli v. River Rouge Lodge IOOF, 195 Mich. 181, 188, 161 N.W. 838, 840 (1917). . . .

The rule was succinctly stated in Shropshire v. Adams, 40 Tex.Civ.App. 339, 344, 89 S.W. 448, 450 (1905):

"Future profits as an element of damage are in no case excluded merely because they are profits but because they are uncertain. In any case when by reason of the nature of the situation they may be established with reasonable certainty they are allowed."

It is from these principles that the "new business"/"interrupted business" distinction has arisen.

"If a business is one that has already been established a reasonable prediction can often be made as to its future on the basis of its past history. * * * If the business * * * has not had such a history as to make it possible to prove with reasonable accuracy what its profits have been in fact, the profits prevented are often but not necessarily too uncertain for recovery." 5 Corbin on Contracts, § 1023, pp. 147, 150–151. Cf. Jarrait v. Peters, supra.

The Court of Appeals based its opinion reversing the jury's award on two grounds: First, that a new business cannot recover damages for lost profits for breach of a lease. We have expressed our disapproval of that rule. Secondly, the Court of Appeals held plaintiffs barred from recovery because the proof of lost profits was entirely speculative. We disagree.

The trial judge in a thorough opinion made the following observations upon completion of the trial.

> "On the issue of lost profits, there were days and days of testimony. The defendants called experts from the Michigan Liquor Control Commission and from Cunningham Drug Stores, who have a store in the area, and a man who ran many other stores. The plaintiffs called experts and they, themselves, had experience in the liquor sales business, in the book sales business and had been representatives of liquor distribution firms in the area.
>
> "The issue of the speculative, conjectural nature of future profits was probably the most completely tried issue in the whole case. Both sides covered this point for days on direct and cross-examination. The proofs ranged from no lost profits to two hundred and seventy thousand dollars over a ten-year period as the highest in the testimony. A witness for the defendants, an expert from Cunningham Drug Company, testified the plaintiffs probably would lose money. Mr. Fera, an expert in his own right, testified the profits would probably be two hundred and seventy thousand dollars. The jury found two hundred thousand dollars. This is well within the limits of the high and the low testimony presented by both sides, and a judgment was granted by the jury.
>
> "The Court cannot invade the finding of fact by the jury, unless there is no testimony to support the jury's finding. There is testimony to support the jury's finding. We must realize that witness Stein is an interested party in this case, personally. He is an officer or owner in Schostak Brothers. He may personally lose money as a result of this case. The jury had to weigh this in determining his credibility. How much credibility they gave his testimony was up to them. How much weight they gave to counter-evidence was up to them....
>
> "The Court must decide whether or not the jury had enough testimony to take this fact from the speculative-conjecture category and find enough facts to be able to make a legal finding of fact. This issue [damages for lost profits] was the most completely tried issue in the whole case. Both sides put in testimony that took up days and encompassed experts on both sides. This fact was adequately taken from the category of speculation and conjecture by the testimony and placed in the position of those cases that hold that even though loss of profits is hard to prove, if proven they should be awarded by the jury. In this case, the jury had ample testimony to make this decision from both sides...."

As Judge Wickens observed, the jury was instructed on the law concerning speculative damages. The case was thoroughly tried by all the parties. Apparently, the jury believed the plaintiffs. That is its prerogative.

The testimony presented during the trial was conflicting. The weaknesses of plaintiffs' specially prepared budget were thoroughly explored on cross-examination. Defendants' witnesses testified concerning the likelihood that plaintiffs would not have made profits if the contract had been performed. There was conflicting testimony concerning the availability of a liquor license. All this was spread before the jury. The jury weighed the conflicting testimony and determined that plaintiffs were entitled to damages of $200,000.

As we stated in Anderson v. Conterio, 303 Mich. 75, 79, 5 N.W.2d 572, 574 (1942):

> "The testimony ... is in direct conflict, and that of plaintiff ... was impeached to some extent. However, it cannot be said as a matter of law that the testimony thus impeached was deprived of all probative value or that the jury could not believe it. The credibility of witnesses is for the jury, and it is not for us to determine who is to be believed."

The trial judge, who also listened to all of the conflicting testimony, denied defendants' motion for a new trial, finding that the verdict was justified by the evidence. We find no abuse of discretion in that decision....

While we might have found plaintiffs' proofs lacking had we been members of the jury, that is not the standard of review we employ. "As a reviewing court we will not invade the fact finding of the jury or remand for entry of judgment unless the factual record is so clear that reasonable minds may not disagree." Hall v. Detroit, 383 Mich. 571, 574, 177 N.W.2d 161, 163 (1970). This is not the situation here.

The Court of Appeals is reversed and the trial court's judgment on the verdict is reinstated....

■ COLEMAN, JUSTICE (concurring in part, dissenting in part). Although anticipated profits from a new business may be determined with a reasonable degree of certainty such was not the situation regarding loss of profits from liquor sales as proposed by plaintiffs.

First, plaintiffs had no license and a Liquor Control Commission regional supervisor and a former commissioner testified that the described book and bottle store could not obtain a license. Further, the proofs of possible profits from possible liquor sales—if a license could have been obtained—were too speculative. The speculation of possible licensing plus the speculation of profits in this case combine to cause my opinion that profits from liquor sales should not have been submitted to the jury.

I ... would have allowed proof of loss from the bookstore operation to go to the jury, but not proof of loss from liquor sales. ... I would affirm the trial court judgment conditioned upon plaintiffs' consenting within 30 days following the release of this opinion, to "remitting that portion of the judgment in excess of $60,000. Otherwise, the judgment should be reversed and a new trial had.'' Plaintiffs are also entitled to the $1,000 deposit.

NOTES

(1) *New Businesses.* For a stricter view, see Evergreen Amusement Corp. v. Milstead, 112 A.2d 901 (Md.1955), an action against a contractor for damages for delay in the opening of a drive-in theater from June 1 to mid-August. The operator of the theater proffered a witness who had built a majority of the drive-in theaters in the area and who would have testified as to reasonably anticipated profits for the months in question by comparison with the theater's profits for the same months of the following year. The court held that it was not error to refuse to hear the witness. ''[T]he general rule clearly is that loss of profit is a definite element of damages in an action for breach of contract or in an action for harming an established business which has been operating for a sufficient length of time to afford a basis of estimation with some degree of certainty as to the probable loss of profits, but that, on the other hand, loss of profits from a business which has not gone into operation may not be recovered because they are merely speculative and incapable of being ascertained with the requisite degree of certainty. . . . While this Court has not laid down a flat rule (and does not hereby do so), nevertheless, no case has permitted recovery of lost profits under comparable circumstances.''

(2) *Royalties from Artistic Creations.* The requirement of reasonable certainty has plagued plaintiffs whose claims are based on lost royalties from artistic creations. In Contemporary Mission, Inc. v. Famous Music Corp., 557 F.2d 918, 926, 927 (2d Cir.1977), a generous result was reached under New York law. The plaintiffs, a group of Roman Catholic priests who wrote musical compositions and recordings, sued Famous Music for breach of its contract to make and sell records on a royalty basis from the master tape recording of the priests' rock opera ''Virgin.''

The Court of Appeals held that the trial court erred in excluding a statistical analysis, together with expert testimony, in order to prove how successful the most successful of the opera's single recordings, ''Fear No Evil,'' would have been. The court acknowledged that the requirement of certainty ''operates with particular severity in cases involving artistic creations such as books, . . . movies, . . . and, by analogy, records.'' Nevertheless, at the time of the breach, ''the record was real, the price was fixed, the market was buying and the record's success, while modest, was increasing. Even after the promotional efforts ended, the record was withdrawn from the marketplace, it was carried, as a result of its own momentum, to an additional 10,000 sales and to a rise from approximately number 80 on the 'Hot Soul Singles' chart of Billboard magazine to number 61.'' The court, however, rejected the plaintiff's ''domino theory'' of projected damages under which, if ''Fear No Evil'' had become a ''hit,'' it would have generated opportunities for concert and theatrical tours and similar benefits, on the ground that ''these additional benefits are too dependent upon taste or fancy to be considered anything other than speculative and uncertain.''

(3) *Good Will.* The requirement of certainty is likely to be particularly troublesome to a claimant that seeks to recover for loss of business reputation, or what is commonly termed ''good will.'' For many years, Pennsylvania refused to allow recovery for loss of good will on the ground that ''damages of this nature would be entirely too speculative''. Harry Rubin & Sons v. Consolidated Pipe Co., 153 A.2d 472, 476 (Pa.1959) (wholesaler's loss of good will due to manufacturer's failure to deliver hula hoops). In 1990, however, Pennsylvania joined the overwhelming majority of states by overruling such cases ''to the extent they prohibit a plaintiff from alleging a claim for damage to good will as a matter of law.'' AM/PM Franchise

Ass'n v. Atlantic Richfield Co., 584 A.2d 915, 926 (Pa.1990) (gasoline franchisee's loss of good will due to franchisor's breach of warranty).

SECTION 4. "LIQUIDATED DAMAGES" AND "PENALTIES"

At the beginning of this book, it was pointed out that the law's concern is directed at relief of promisees to redress breach rather than at punishment of promisors to compel performance, and that for this reason punitive damages are not ordinarily awarded for breach of contract. The *promisee,* however, may be concerned with compulsion of the promisor. Consider the following explanation, given by a bridge engineer for the California Division of Highways, of the completion assessment—the per-day assessment for each day the contractor overruns the specified contract time. "The sole purpose of a completion assessment is to assure that the contract work will be done within the time specified, . . . to threaten the Contractor with sufficient monetary loss so that he will find it advantageous to apply sufficient men and equipment to the work to get it done on time. Whereas moderate liquidated damages such as $100 per day may well be used to insure the completion of a normal project having no special urgency, higher amounts are used to force faster work on jobs which must be finished in less than a normal construction time. High assessments may be used to emphasize the need for haste and should be of sufficient size to make it economically desirable that the contractor expedite his work by the use of multiple shifts or additional equipment." A. Elliott, A Study of Liquidated Damages on Highway Contracts 5 (Cal.Div.Hwys.1956). Should courts lend their aid to the enforcement of such penalties where the parties have bargained for and agreed to them?

NOTES

(1) *Penalties and Reliance Investments*. Sometimes a promisee can encourage the promisor's timely performance by stipulating liquidated damages. Of course, the promisor must agree to the stipulated damages and will likely demand compensation for being accountable for an award greater than the legal default. If the promisor agrees to the stipulated award, the promisee may feel more confident when relying on the contract because the promisor's commitments are more credible, given the heightened remedy. Consider the effect of such confidence on the incentives of parties to invest. If two sophisticated parties contract to provide efficient incentives to invest using a liquidated clause, should the court refuse to enforce the clause even if it appears punitive?

(2) *Paying for Nothing?* As suggested in the note above, promisors should be expected to demand compensation for facing a risk of paying high liquidated damages in the even of breach. If, following a breach by the promisor, the court refuses to enforce the liquidated clause, has the promisor been unjustly enriched?

Consider again the study of liquidated damages in California highway contracts mentioned above: "High liquidated damages have a tendency to make the contractors jittery. A fear of the high cost of delay will cause an involuntary rise in bid prices. All of the bidders' thinking on prices must inevitably be colored by the specter of the high damages lurking in the background. This only emphasizes the need to use this specialized treatment and high liquidated damages only on those projects where the urgency really exists. Otherwise the State will be paying extra for expediting jobs which do not need the hurry and will not justify the higher cost. High liquidated damages make a contractor susceptible to considerable labor pressure. When a contractor is working under high liquidated damages, it gives the unions a powerful lever to force compliance with demands which may or may not be justified. The contractor is forced to give in because he cannot afford a delaying argument or strike. This pressure also may have a widespread effect. When labor unions make an advance by this sort of a squeeze play against the contractor working under high liquidated damages, other contractors in the area find that they too must give the same benefits or face considerable trouble.'' A. Elliott, A Study of Liquidated Damages on Highway Contracts 21–22 (Cal.Div.Hwys.1956).

(3) *Penalties in Other Legal Systems.* What concerns might justify a limitation on freedom of contract with respect to penalties? Are terms providing for penalties more onerous than other terms? Some insights may be gained from a look at other legal systems.

According to article 1152 of the French Civil Code: ''When the agreement provides that the party who fails to carry it out shall pay a certain sum as damages, no larger or smaller amount can be awarded to the other party.'' In 1975, however, following a recommendation that there be judicial control over penal clauses in leases, this article was amended by adding: ''However, the judge may reduce or increase the penalty that has been agreed upon if it is plainly excessive or ridiculously low. No effect will be given to an agreement to the contrary.'' What might have prompted these changes?

No attempt was made in the CISG to draft a rule on stipulated damages. But see UNIDROIT Principles art. 7.4.13.

(4) *Penalties in California.* In 1977 California enacted a statute under which ''a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.'' Cal.Civil Code § 1671. The statute does not apply against a consumer and in certain other situations.

Wasserman's Inc. v. Township of Middletown

Supreme Court of New Jersey, 1994.
137 N.J. 238, 645 A.2d 100.

■ POLLOCK, J. Pursuant to a public advertisement for bids, plaintiff Wasserman's Inc. (Wasserman's) and defendant, Township of Middletown (the Township or Middletown), entered into a commercial lease for a tract of municipally-owned property. The agreement contained a clause providing that if the Township cancelled the lease, it would pay the lessee, Wasserman's, a pro-rata reimbursement for any improvement costs and damages of twenty-five percent of the lessee's average gross receipts for one year. In 1989, the Township cancelled the lease and sold the property, but refused to pay the agreed damages.

[Wasserman's and a man doing business as ''Jo–Ro'' sued for damages according to the terms of the lease. (Jo–Ro was a plaintiff because Wasserman's had ceased doing business, apparently, and had sublet the store to Jo–Ro. The sublease provided that the parties to it would share any payments made by the Township under the cancellation provision.) The

Township answered, and sought a declaration that part of the cancellation provision was invalid—the part about paying Wassermans' 25% of its average yearly gross receipts.]

On cross-motions for summary judgment, the Law Division held that the lease and the cancellation clause were enforceable. It subsequently required the Township to pay damages in the amount of $346,058.44 plus interest. [On a first appeal, that was affirmed. This court granted certification.] We conclude that the lease is enforceable. We affirm the award of renovation costs and remand to the Law Division the issue of the enforceability of the stipulated damages clause.

I

[Wasserman's had won the lease by bidding for it. It provided for a monthly rental of $458.33 throughout a thirty-year term. Wasserman's object was to run a general store. The Township set the value of the property at $47,500. Initially the store comprised 3,200 square feet. During its occupancy, Wasserman's enlarged it. It sublet the premises to Jo–Ro not much more than two years after beginning its occupancy, charging Jo–Ro a monthly rent of $1,850.]

[The Township's cancellation of the lease was effective on the last day of 1988. Some six months later the Township sold the property at public auction for $610,000.]

At the center of the dispute is the cancellation clause in the lease. [The clause provided that, if the Township should cancel the lease, it would pay some of the cost of any improvements made by Wasserman's. (For any improvement, the amount was to be calculated by reference to the period of the tenancy remaining when the improvement was made, in relation to the entire term of the lease.] More controversial is the second half of the clause.... That provision requires the Township to pay "twenty-five percent of the lessee[']s average gross receipts for one year (to be computed by + (adding) the lessee[']s total gross receipts for the lessee[']s three full fiscal years immediately preceding the time of cancellation of the lease and ÷ (dividing by) 12 (twelve) ...." ...

II

The Law Division initially granted plaintiffs a partial summary judgment according "full force and effect" to the lease and the cancellation clause. On a subsequent motion, the court awarded plaintiffs damages of $346,058.44 plus ten-percent prejudgment interest. The trial court calculated damages as follows:

> $142,336.01 (construction costs) multiplied by 11.75 (remaining years) divided by 30 years (term of lease) for a total of $55,748.27.
>
> $3,483,722.25 (Jo–Ro's gross receipts for the years 1985, 1986, 1987) divided by 12 equalling $290,310.18.

Construction compensation	$ 55,748.27
Gross receipts compensation	+ 290,310.18
Total amount due	$346,058.45

III

[In a part of the opinion omitted here, the court rejected the Township's argument that the lease did not meet the requirements for a valid public contract.]

IV

The provision in the termination clause providing for damages based on the lessee's gross receipts presents a more difficult issue. The issue is whether that provision is an enforceable liquidated damages provision or is an unenforceable penalty clause.

Disapproval of penalty clauses originated at early common law when debtors bound themselves through sealed penalty bonds for twice the amount of their actual debts. Charles J. Goetz & Robert E. Scott, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, 77 Colum.L.Rev. 554, 554 (1977) (hereinafter Goetz & Scott). Because clauses in penalty bonds "carried an unusual danger of oppression and extortion," equity courts refused to enforce them. Id. at 555. "This equitable rule, designed to prevent overreaching and to give relief from unconscionable bargains, was later adopted by courts of law." John D. Calamari & Joseph M. Perillo, The Law of Contracts, § 14–31 at 639 (3d ed. 1987) (hereinafter Calamari & Perillo). In a sense, judicial reluctance to enforce penalty clauses is a product of history.

For more than five centuries, courts have scrutinized contractual provisions that specify damages payable in the event of breach. Wassenaar v. Panos, 331 N.W.2d 357 (Wis.1983) . . . [Hereafter, references to this case give page numbers only.] The validity of these "stipulated damage clauses" has depended on a judicial assessment of the clauses as an unenforceable penalty or as an enforceable provision for "liquidated damage." Thus, " '[l]iquidated damages' and 'penalties' are terms used to reflect legal conclusions as to the enforceability or nonenforceability, respectively, of stipulated damage clauses." Kenneth W. Clarkson et al., Liquidated Damages v. Penalties: Sense or Nonsense?, 1978 Wis.L.Rev. 351, 351 n. 1 (hereinafter Clarkson).

Thirty years ago, the Appellate Division distinguished liquidated damages and penalty clauses:

> *Liquidated damages* is the sum a party to a contract agrees to pay if he breaks some promise, and which, having been arrived at by a good faith effort to estimate in advance the actual damages that will probably ensue from the breach, is legally recoverable as agreed damages if the breach occurs. A *penalty* is the sum a party agrees to pay in the event of a breach, but which is fixed, not as a pre-estimate of probable actual damages, but as a punishment, the threat of which is

> designed to prevent the breach. Parties to a contract may not fix a penalty for its breach. The settled rule in this State is that such a contract is unlawful.

[Westmount Country Club v. Kameny, 82 N.J.Super. 200, 205, 197 A.2d 379 (1964) (citations omitted).]

Stating the distinction, however, has been easier than describing its underlying rationale. " '[T]he ablest judges have declared that they felt themselves embarrassed in ascertaining the principle on which the decisions [distinguishing penalties from liquidated damages] were founded.' " E. Allan Farnsworth, Contracts § 12.18 at 937 (2d ed. 1990) (alterations in original) (quoting Cotheal v. Talmage, 9 N.Y. 551, 553 (1854)). . . .

As the law has evolved, a stipulated damage clause "must constitute a reasonable forecast of the provable injury resulting from breach; otherwise, the clause will be unenforceable as a penalty and the non-breaching party will be limited to conventional damage measures." Goetz & Scott, supra, 77 Colum.L.Rev. at 554. So viewed, "reasonableness" emerges as the standard for deciding the validity of stipulated damages clauses. See *Wassenaar* at 361 (noting that "[t]he overall single test of validity is whether the clause is reasonable under the totality of circumstances").

The reasonableness test has developed as a compromise between two competing viewpoints concerning stipulated damages clauses. The Wisconsin Supreme Court has described the policy considerations underlying these viewpoints:

> Enforcement of stipulated damages clauses is urged because the clauses serve several purposes. The clauses allow the parties to control their exposure to risk by setting the payment for breach in advance. They avoid the uncertainty, delay, and expense of using the judicial process to determine actual damages. They allow the parties to fashion a remedy consistent with economic efficiency in a competitive market, and they enable the parties to correct what the parties perceive to be inadequate judicial remedies by agreeing upon a formula which may include damage elements too uncertain or remote to be recovered under rules of damages applied by the courts. In addition to these policies specifically relating to stipulated damages clauses, considerations of judicial economy and freedom of contract favor enforcement of stipulated damages clauses.
>
> A competing set of policies disfavors stipulated damages clauses, and thus courts have not been willing to enforce stipulated damages clauses blindly without carefully scrutinizing them. Public law, not private law, ordinarily defines the remedies of the parties. Stipulated damages are an exception to this rule. Stipulated damages allow private parties to perform the judicial function of providing the remedy in breach of contract cases, namely, compensation of the nonbreaching party, and courts must ensure that the private remedy does not stray too far from the legal principle of allowing compensatory damages. Stipulated damages substantially in excess of injury may justify an inference of unfairness in bargaining or an objectionable *in terrorem*

> agreement to deter a party from breaching the contract, to secure performance, and to punish the breaching party if the deterrent is ineffective.

[*Wassenaar* at 362.]

Consistent with the principle of reasonableness, New Jersey courts have viewed enforceability of stipulated damages clauses as depending on whether the set amount "is a reasonable forecast of just compensation for the harm that is caused by the breach" and whether that harm "is incapable or very difficult of accurate estimate." Westmount Country Club, supra, 82 N.J.Super. at 206, 197 A.2d 379....

Uncertainty or difficulty in assessing damages is best viewed not as an independent test, Calamari and Perillo, *supra*, § 14–31 at 641; Goetz & Scott, *supra*, 77 Colum.L.Rev. at 559 (stating, "liquidated damages provisions have seldom been voided solely because the damages were easy to estimate"), but rather as an element of assessing the reasonableness of a liquidated damages clause, *Wassenaar* at 363. Thus, "[t]he greater the difficulty of estimating or proving damages, the more likely the stipulated damages will appear reasonable." *Ibid.*

Some courts in other jurisdictions have also considered whether the parties intended the clause to be one for liquidated damages. Clarkson, *supra*, 1978 Wis.L.Rev. at 353. Even those courts recognize that "subjective intent has little bearing on whether the clause is objectively reasonable." *Wassenaar* at 363....

Although the Appellate Division has indicated that courts should determine the enforceability of a stipulated damages clause as of the time of the making of the contract. *Westmount Country Club*, *supra*, 82 N.J.Super. at 206, 197 A.2d 379, the modern trend is towards assessing reasonableness either at the time of contract formation or at the time of the breach. Calamari & Perillo, *supra*, § 14–31 at 642 (stating, "there are two moments at which the liquidated damages clause may be judged rather than just one").

Actual damages, moreover, reflect on the reasonableness of the parties' prediction of damages. "If the damages provided for in the contract are grossly disproportionate to the actual harm sustained, the courts usually conclude that the parties' original expectations were unreasonable." *Wassenaar* at 364; see 5A Corbin on Contracts § 1063 (1951) (Corbin) ("It is to be observed that hindsight is frequently better than foresight, and that, in passing judgment upon the honesty and genuineness of the pre-estimate made by the parties, the court cannot help but be influenced by its knowledge of subsequent events."). Determining enforceability at the time either when the contract is made or when it is breached encourages more frequent enforcement of stipulated damages clauses. Calamari & Perillo, supra, § 14–31 at 642.

Two of the most authoritative statements concerning liquidated damages are contained in the Uniform Commercial Code and the Restatement (Second) of Contracts, both of which emphasize reasonableness as the touchstone. Farnsworth, *supra*, § 12.18 at 938. [Here the court set out UCC § 2–718(1) and Restatement § 356(1).]

Consistent with the trend toward enforcing stipulated damages clauses, the Appellate Division has recognized that such clauses should be deemed presumptively reasonable and that the party challenging such a clause should bear the burden of proving its unreasonableness.... Similarly, most courts today place the burden on the party challenging a stipulated damages clause....

In commercial transactions between parties with comparable bargaining power, stipulated damage provisions can provide a useful and efficient remedy. See Priebe & Sons v. United States, 332 U.S. 407, 411–13 (1947).... Sophisticated parties acting under the advice of counsel often negotiate stipulated damages clauses to avoid the cost and uncertainty of litigation. Such parties can be better situated than courts to provide a fair and efficient remedy. Absent concerns about unconscionability, courts frequently need ask no more than whether the clause is reasonable. We do not reach the issue of the enforceability of liquidated damage clauses in consumer contracts. Notwithstanding the presumptive reasonableness of stipulated damage clauses, we are sensitive to the possibility that, as their history discloses, such clauses may be unconscionable and unjust....

V

The purpose of a stipulated damages clause is not to compel the promisor to perform, but to compensate the promisee for non-performance. Farnsworth, supra, § 12.18 at 936 ... Thus, the subject cancellation clause is unreasonable if it does more than compensate plaintiffs for their approximate actual damages caused by the breach.

Whether measured from the time of execution of the contract or from the termination of the lease, ... damages based on gross receipts run the risk of being found unreasonable. Generally speaking, gross receipts do not reflect actual losses incurred because of the cancellation. Gross receipts, unlike net profits, do not account for ordinary expenses; nor do they account for the expenses specifically attributable to the breach. Here, we cannot determine whether the stipulated amount was based on damages that would likely flow from a breach or whether it is an arbitrary figure unrelated to any such damages....

Courts also have disapproved the use of gross receipts as a measure of damages apart from stipulated damages clauses.... Evaluating damages based on gross income is problematic partly because such damages would be too speculative or uncertain. Furthermore, basing damages on gross profits could award the plaintiff a windfall....

We cannot determine from plaintiffs' gross receipts the losses they sustained because of the Township's cancellation of the lease. The subject clause requires the Township to pay damages of twenty-five percent of the lessee's average gross receipts for one year. Under the lease, average gross receipts are calculated by taking an average of the lessee's total gross receipts for three fiscal years immediately preceding the cancellation. So calculated, Jo–Ro's average yearly gross was $1,161,240.75. Twenty-five percent of this figure amounts to $290,310.18.

This amount, however, does not necessarily reflect plaintiffs' actual losses on considering operating expenses or relocation costs and other expenses attributable to defendant's breach. As reflected in Jo–Ro's income-tax returns, Jo–Ro earned a net profit of $3,649 in 1985, $414 in 1986, and sustained a loss of $323 in 1987. We recognize the difference between tax losses and actual losses. Yet, to the extent that tax returns reflect actual profit or loss, they demonstrate the unreasonableness of damages exceeding $290,000, which were calculated on the basis of gross receipts.

The decision whether a stipulated damages clause is enforceable is a question of law for the court.... Although the question is one of law, it may require resolution of underlying factual issues....

On balance, we believe we should remand this matter to the trial court to consider the reasonableness of the clause in light of this opinion. In resolving that issue, the court should consider, among other relevant considerations, the reasonableness of the use of gross receipts as the measure of damages no matter when the cancellation occurs; the significance of the award of damages based on twenty-five percent of one year's average gross receipts, rather than on some other basis such as total gross receipts computed for each year remaining under the lease; the reasoning of the parties that supported the calculation of the stipulated damages; the lessee's duty to mitigate damages; and the fair market rent and availability of replacement space. We leave to the sound discretion of the trial court the extent to which additional proof is necessary on the reasonableness of the clause. Because stipulated damages clauses are presumptively reasonable, ... the burden of production and of persuasion rests on the Township.

To summarize, we affirm the judgment of the Appellate Division that the Township is liable to plaintiffs for terminating the lease.... We also affirm the judgment of the Appellate Division awarding plaintiffs damages of $55,748.27 for renovation costs. We remand to the Law Division the issue whether the clause requiring payment of stipulated damages based on the lessee's gross receipts is a valid liquidated damages clause.

NOTES

(1) *Arguments on Remand.* If you were the lawyer for the defendant Township on remand, what arguments and evidence would you use to meet the "burden" of challenging the clause? If you were the lawyer for the plaintiffs, Wasserman's and Jo–Ro, how would you counteract Justice Pollock's critical remarks on gross receipts as a standard? Is it relevant that on termination the plaintiffs lost the use for twelve more years, at an annual rental of only $5,500, of property then worth some $600,000? Does their unproductive use of the property affect your answer?

(2) *A "Second Look"?* Note that Justice Pollock reports that "the modern trend is towards assessing reasonableness either at the time of contract formation or at the time of the breach." This echoes the language of UCC § 2–718, which speaks of the "anticipated or actual harm." But Article 2A of the Code, dealing with

leases of goods, departs from the language of Article 2 and speaks of only the "anticipated harm." UCC § 2A–504(1).

In Kelly v. Marx, 705 N.E.2d 1114, 1117 (Mass.1999), the court, in allowing the seller of a house to keep the purchaser's 5% deposit as liquidated damages, rejected the "second look" approach described by Justice Pollock in favor of a "single look" approach. "In addition to meeting the parties' expectations, the 'single look' approach helps resolve disputes efficiently by making it unnecessary to wait until actual damages from a breach are proved.... The 'second look,' by contrast, undermines the 'peace of mind and certainty of result' ... the parties sought when they contracted for liquidated damages. It increases the potential for litigation by inviting the aggrieved party to attempt to show ... evidence of damage flowing from the breach...." The court rejected the argument that the "'second look' approach would allow the court to guard against undue windfalls, such as the one the defendants would receive here, ... because the defendants suffered no loss from the breach."

(3) *Subterfuge?* Can a party by the use of subterfuge accomplish the same purpose that a penalty would accomplish? Instead of providing a penalty of $10,000 a day for each day's delay in construction beyond June 1, up to a maximum of $100,000, an owner might adjust the price and provide a *bonus* of $10,000 a day for each day's early completion before June 10, up to a maximum of $100,000.

The proscription of penalties might not extend to alternative performances. Instead of having an employee promise not to compete or pay a penalty of $100,000, an employer might have the employee promise either not to compete or, in the alternative, pay $100,000. Is this a "subterfuge" or a different sort of agreement? Is it arguable that the provision in *Wasserman's* was such an agreement?

(4) *Arbitration and Liquidated Damages.* Suppose that Wasserman's lease had included the arbitration clause recommended by the American Arbitration Association. See Note 2, p. 28 above. Would the court have enforced an arbitration award granting damages under the clause even if the court had considered it a penalty clause? In Matter of Associated General Contractors, 335 N.E.2d 859, 859 (N.Y. 1975), New York's highest court concluded that a party, having "chosen the arbitration forum for the resolution of disputes," was bound by the arbitrators' determination "that the damages clause was not a penalty and was therefore enforceable."

PROBLEMS

(1) *A Corvette Stalled.* Jim Steinke contracted with Circle B to restore its vintage Corvette car. Circle B paid $2,000 down, leaving a balance of $10,000. For delay, the contract provided for "a penalty of $100 per day assessed and deducted from the amount of $10,000." When Steinke finished the work 160 days late, Circle B refused to pay the $10,000 balance and claimed an additional $6,000. What result? How would you have drafted the clause on behalf of Circle B? Circle B Enterprises v. Steinke, 584 N.W.2d 97 (N.D.1998).

(2) *Paradise Lost.* A travel bureau offers a kosher Passover vacation at a resort hotel in Puerto Rico, including two complete Seders. Its contract includes a provision for "liquidated damages" based on a sliding scale and culminating in forfeiture of 100% of the price for cancellations made within 14 days of departure. Is

the provision enforceable against a client who cancels 13 days before departure? See Turner–Schraeter v. Brighton Travel Bureau, 685 N.Y.S.2d 692 (App.Div.1999).

DAVE GUSTAFSON & CO. v. STATE, 156 N.W.2d 185 (S.D.1968) [Gustafson surfaced a new state highway that paralleled an older road that remained open during and after the construction. From the $530,724.14 due for the work, the state withheld $14,070 that it claimed as liquidated damages for a delay of 67 days. The contract provided a graduated scale of ''liquidated damages per day'' under which damages of $210 per day were fixed for a contract in an amount of over $500,000 but not more than $1,000,000. This daily damage multiplied by 67 gave $14,070. When Gustafson sued, the trial court upheld the state's claim and Gustafson appealed.]

■ HANSON, PRESIDING JUDGE.... [As this court said in an earlier case,] ''A provision for payment of a stipulated sum as a liquidation of damages will ordinarily be sustained if it appears that at the time the contract was made the damages in the event of a breach will be incapable or very difficult of accurate estimation, that there was a reasonable endeavor by the parties as stated to fix fair compensation, and that the amount stipulated bears a reasonable relation to probable damages and not disproportionate to any damages reasonably to be anticipated.''

This case reflects the modern tendency not to ''look with disfavor upon 'liquidated damages' provisions in contracts. When they are fair and reasonable attempts to fix just compensation for anticipated loss caused by breach of contract, they are enforced ... They serve a particularly useful function when damages are uncertain in nature or amount or are unmeasurable, as is the case in many government contracts.'' Priebe & Sons v. United States, 332 U.S. 407....

Judged in this light and by the standards established in Anderson v. Cactus Heights Country Club, 80 S.D. 417, 125 N.W.2d 491, the provision in question must be considered to be one for liquidated damages rather than a penalty for the following reasons: I. Damages for delay in constructing a new highway are impossible of measurement. II. The amount stated in the contract as liquidated damages indicates an endeavor to fix fair compensation for the loss, inconvenience, added costs, and deprivation of use caused by delay. Daily damage is graduated according to total amount of work to be performed. It may be assumed that a large project involves more loss than a small one and each day of delay adds to the loss, inconvenience, cost and deprivation of use.... For the same reasons we must conclude the amount stipulated in the contract bears a reasonable relation to probable damages and is not, as a matter of law, disproportionate to any and all damage reasonably to be anticipated from the unexcused delay in performance.

Affirmed.

NOTES

(1) *Take-or-Pay.* Contracts in the petroleum industry sometimes contain what are known as ''take-or-pay'' clauses, which have been attacked as penalty provi-

sions. Here is one court's analysis. "Under a take-and-pay clause, the pipeline is required annually to take and pay for a minimum contract quantity of gas. A take-and-pay clause benefits the producer by maximizing revenue through the steady depletion of gas reserves.... Under a take-or-pay clause, the pipeline is required annually to take and pay for a minimum contract quantity of gas *or* pay for a specified quantity. A take-or-pay clause differs from a take-and-pay clause in that it assures the producer a constant cash flow rather than the actual purchase of the contract quantity of gas over the term of the contract.... In addition, a take-or-pay clause adds some measure of flexibility in a long-term gas purchase contract by allowing the pipeline to pay for a specified quantity in lieu of taking the contract quantity without endangering its long-term source of supply.... Because one of the alternative performances in a take-or-pay contract is the payment of money, courts have distinguished the 'pay' provision from a liquidated damage provision." Prenalta Corp. v. Colorado Interstate Gas Co., 944 F.2d 677, 680, 689 (10th Cir.1991).

(2) *Questionable Categories.* As this chapter has suggested, an injured party may have difficulty in recovering for loss that falls in a variety of categories. These include sentimental value, value of a chance, emotional distress, lost volume, loss of reputation, and loss of good will. To what extent will loss in these categories, if not recoverable in the absence of agreement, serve to support the enforceability of a clause stipulating damages? See Wassenaar v. Panos, 331 N.W.2d 357 (Wis.1983), discussed in *Wasserman's*. Recall that in Schneberger v. Apache Co., Note 1, p. 656 above, the Supreme Court of Oklahoma, in adhering to *Peevyhouse*, noted that the parties to the contract "were free to specify in the contract what the measure of damages would be in the event of a breach."

(3) *Equitable Relief.* Should a valid liquidated damages clause bar equitable relief that would otherwise be available? See Karpinski v. Ingrasci, Note 1, p. 440 above; Bowen v. Carlsbad Ins. & Real Estate, Inc., 724 P.2d 223 (N.M.1986).

Can parties by explicit provision bar equitable relief that would otherwise be available? Can parties by explicit provision make equitable relief available where it would not be otherwise? For a case holding that specific performance was available against farmers who had contracted to sell the cotton that they produced where at trial "the parties stipulated that the cotton involved was unique," see R.L. Kimsey Cotton Co., Inc. v. Ferguson, 214 S.E.2d 360 (Ga.1975). See Note 3, p. 587 above.

PROBLEMS

(1) Suppose that in the Dave Gustafson case the state highway had connected with a bridge that was also under construction, but by a different contractor. Would the result have been the same if, because of a delay by that contract, the bridge had also been closed for 67 days, so that the highway could not have been used even if it had been completed on time?

Would it affect your answer if the contractor responsible for the bridge had had a similar clause stipulating damages and had argued that it was invalid because the delay in the highway would have prevented the use of the bridge even if it had been completed on time?

Compare Massman Constr. Co. v. City Council of Greenville, 147 F.2d 925 (5th Cir.1945), with California & Hawaiian Sugar Co. v. Sun Ship, Inc., 794 F.2d 1433 (9th Cir.1986), and Southwest Engineering Co. v. United States, 341 F.2d 998 (8th Cir.1965).

(2) Seller contracts to deliver to Buyer a machine that is readily available on the market for $1,000 more than the contract price. If Seller fails to deliver, what are the rights of the parties under each of the following provisions?

(a) In the event of Seller's failure to deliver, Seller shall pay Buyer a penalty of $10,000.

(b) In the event of Seller's failure to deliver, Seller shall be liable to Buyer for $10,000 in liquidated damages.

(c) Seller hereby agrees, at Seller's option, to either deliver the machine to Buyer or to pay Buyer $10,000.