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Eric C. Schneider

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UCC § 2-713: A Defense of Buyers' Expectancy Damages

ERIC C. SCHNEIDER*

INTRODUCTION

It has been suggested that section 2-713 of the Uniform Commercial Code [hereinafter referred to as UCC; further section references are to UCC sections unless otherwise specified]¹ should not have been enacted and should be repealed.² Although this centerpiece in the setting of buyers' remedies has been enacted in unchanged form in all UCC jurisdictions,³ it has been attacked by legal scholars as being an historical anomaly and contributing to hopeless confusion.⁴

This Article will examine section 2-713 and its official comments, along with companion sections of the UCC. It will then present the difficulties that have arisen in the application of section 2-713, and examine whether its provisions can be defended in light of modern economic theory. Hypothetical examples will first be used to demonstrate the economic effects of UCC application to possible fact patterns. Recent cases will then be surveyed to see how courts have been swayed by legal literature concerning section 2-713, and whether the courts' decisions are in conformity with either recent economic analysis or the underlying policy of the UCC.

I. SECTION 2-713 AND ITS TRADITIONAL CRITICISMS

Section 2-713 of the UCC provides:

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is *the difference be-*

* Associate Professor, University of Baltimore Law School. B.A., Connecticut, 1959; LL.B., University of California, Hastings School of Law, 1962; LL.M., New York University, 1968.

1. U.C.C. § 2-713 (1977) [further section references are to the Uniform Commercial Code, hereinafter cited as UCC, unless otherwise specified].

2. Childres, *Buyer's Remedies: The Danger of Section 2-713*, 72 Nw. U.L. REV. 837 (1978).

3. 1 U.L.A. 1-2 (Supp. 1986). "Some version of the Code has been enacted in every state except Louisiana, which has adopted only a part of the Code, not including that on sales." A. FARNSWORTH, *CONTRACTS* 24 (1982). The UCC is also the law in the District of Columbia and the Virgin Islands. Dates of enactment of the UCC are listed in 1 U.L.A. 1 (Master ed. 1976).

4. J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE*, 223-25 (2d ed. 1980).

tween the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.⁵

The formula for finding buyers' damages by application of section 2-713 is:

Market price at the time buyer learned of the breach
— contract price
— expenses saved as a result of seller's breach
+ incidental and consequential damages.⁶

The traditional criticisms⁷ directed at section 2-713 are: 1) The market price minus contract price formula lacks any relevant relation to "actual" damages suffered by a buyer because of breach of contract;⁸ and 2) The language of section 2-713 is not clear regarding the time for measuring market price in the case of anticipatory repudiation.⁹ The question that arises is whether "learned of the breach" in section 2-713(1) means the time the buyer learned of the repudiation, the time for performance (when actual breach occurs), or a reasonable time after buyer was told of seller's intention to breach.

This Article will concentrate on the first of these criticisms. Brief reference to recent decisions dealing with the second issue will be made in order to indicate a trend by courts to limit the concept of expectation damages. These cases are relevant because both criticisms revolve around the question of whether the code drafters were true to the underlying policy of the UCC as expressed in section 1-106, which is "to put the buyer in the same position as performance would have."¹⁰

Professors White and Summers agree that the drafters of section 2-713 could not have intended to put the buyer in the same position as performance, since performance would have given the buyer cer-

5. U.C.C. § 2-713 (1977) (emphasis added).

6. J. WHITE & R. SUMMERS, *supra* note 4, at 223.

7. *Id.* White and Summers list five questions not clearly answered by UCC § 2-713. See also Childres, *supra* note 2, at 837.

8. Childres, *supra* note 2, at 837.

9. J. WHITE & R. SUMMERS, *supra* note 4, at 223.

10. § 1-106. Remedies to be Liberally Administered

(1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specially provided in this Act or by other rule of law.

U.C.C. § 1-106 (1977).

tain goods for consumption or resale which would have resulted either in a net economic gain or loss for the buyer. The contract-market differential, they insist, bears no necessary relation to the change in the buyer's economic status that is caused by the breach. For example, in the case of a seller's breach it is probable that the formula of section 2-713 would yield the buyer a handsome damage award even though, in a falling market, performance by the seller would have caused the buyer a loss.¹¹ They suggest that the best explanation of section 2-713 is that it is "a statutory liquidated damage clause, a breach inhibitor the payout of which need bear no close relation to the plaintiff's actual loss."¹²

Professor Childres goes even further and finds that section 2-713 is a statutory punitive damages provision.¹³ The idea that section 2-713 amounts to a statutory liquidated damage clause not related to actual damages is a thread that has consistently run through the commentaries and, as we shall see later, has influenced recent court decisions. Perhaps the first statement of this theory was put forward by former Yale Law School Professor Ellen Ash Peters in 1963. She wrote:

While substitute-contract calculations may bear some relationship to actual injury, it is obvious that the market-contract formulae . . . can do so only by the sheerest of accidents. For the same reason, the market-contract standard has nothing to do with any supposed duty to mitigate damages, since the formulae do not reproduce the conditions under which mitigation could have occurred. An alternative way of looking at the market-contract is to view this differential as a statutory liquidated damages clause, rather than as an effort to calculate actual losses. If it is useful in every case to hold the party in breach to some baseline liability, in order to encourage faithful adherence to contractual obligations, perhaps market fluctuations furnish as good a standard as any.¹⁴

To illustrate the "unrealistic"¹⁵ nature of section 2-713, some version of the following hypothetical is used:

On October 1, seller contracts with buyer to sell 1000 cowhides for \$10,000, to be delivered November 1. Seller is aware that buyer is a middleman and intends to resell these hides to another party. Market price for hides goes up to \$14,000 for the 1000 hides by October 20, when buyer learns that seller will not perform the con-

11. J. WHITE & R. SUMMERS, *supra* note 4, at 224.

12. J. WHITE & R. SUMMERS, *supra* note 4, at 225.

13. Childres, *supra* note 2, at 853.

14. 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).

15. Childres, *supra* note 2, at 842.

tract. By November first, the market price for 1000 hides is \$15,000.

Given this fact pattern, various possible remedies are available to the buyer:

1) He may cover by buying hides on the market at the market rate under section 2-712. His damages under section 2-712¹⁶ would then be cover price (\$14,000) less contract price (\$10,000) plus incidental expenses.

2) If hides are not reasonably available on the market he may have a cause of action for replevin or specific performance, plus incidental expenses under section 2-716.¹⁷

3) But, it is clear that the UCC does not mandate that buyer seek either section 2-712 or 2-716 remedies. Buyer may choose not to cover, and instead rely solely on section 2-713.¹⁸ If he does so, section 2-713 may lead to varying results.

First, if hides are available on the market, but buyer decides not to cover, buyer loses his right to consequential damages for lost re-

16. § 2-712. "Cover"; Buyer's Procurement of Substitute Goods

1) After a breach within the preceding section the buyer may "cover" 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.

2) The buyer 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 as hereinafter defined (section 2-715), but less expenses saved in consequence of the seller's breach.

3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

U.C.C. § 2-712 (1977).

17. § 2-716. Buyer's Right to Specific Performance or Replevin

1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

U.C.C. § 2-716 (1977)

18. U.C.C. § 2-712(3) (1977) provides: "Failure of the buyer to effect cover within this section does not bar him from any other remedy." However U.C.C. § 2-715 (2)(a) (1977) precludes consequential damages from seller's breach if they could have been avoided by cover. Also, under U.C.C. § 2-716 comment 3 (1977), specific performance may not be available if buyer could cover; and under U.C.C. § 2-716(3) (1977) buyer's right to replevin for goods identified to the contract may be precluded if buyer could have covered. If buyer has covered he must use § 2-712. Comment 5 to § 2-713 states: "The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered." U.C.C. § 2-713 comment 5 (1977). See also J. WHITE & R. SUMMERS, *supra* note 4, at 233-34.

sale profits because this is an avoidable loss.¹⁹ In this situation section 2-713 will yield market price less contract price (or \$4000 damages) for buyer, if "learned of the breach" means the time that buyer first knew that seller would not perform. If we use time for performance to set market price, buyer's damages are \$5000. The question critics pose is whether either recovery is equal to buyer's *actual* loss resulting from seller's breach. In arguing they are not, the hypothetical fact pattern is extended to two separate possible events.²⁰ In both of these extentions, it is assumed that buyer has not covered because he believes the market in hides is getting cold. The critics then ask what would have happened if buyer proved to be correct and the market price quickly fell after November first to \$9000 for the 1000 hides.²¹ Clearly, if seller had performed, buyer would have lost \$1000. The section 2-713 remedy of \$4000 or \$5000 damages to buyer would then be inappropriate.

But what if buyer's guess proved wrong, and after November 1 the price for hides increased to \$16,000? Now, it is argued, had seller performed on November 1, buyer would have made a \$6000 gain.²² Again the section 2-713 remedy does not put the buyer in the same place as pformance would have.

The same argument has been made by critics in the situation where buyer, at the time of contracting with seller, and with seller's knowledge, intends to resell the items to *X*, some third party, for \$11,000, and does indeed make such a contract of resale with *X*.²³ Now, when seller breaches, buyer, *if he cannot cover*, can include in his section 2-713 damages the loss of the \$1000 resale profit as a foreseeable consequence of breach.²⁴ The formula²⁵ would thus give buyer's remedy as follows:

19. § 2-715. Buyer's Incidental and Consequential Damages

1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

- 2) Consequential damages resulting from the seller's breach include
- (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know *and which could not reasonably be prevented by cover or otherwise*; and
 - (b) injury to person or property proximately resulting from any breach of warranty.

U.C.C. § 2-715 (1977) (emphasis added).

20. J. WHITE & R. SUMMERS, *supra* note 4, at 224.

21. *Id.*

22. *Id.*

23. *Id.*

24. *See supra* note 19 for contents of U.C.C. § 2-715 (1977).

25. *See supra* note 6 and accompanying text.

Market price (\$14,000 (or 15,000))
 — Contract price (\$10,000)
 + incidental and consequential damages (\$1000)
 = \$5000 (or 6000).

Professor Childres maintains at this point that \$1000 is the most buyer should get. His argument is based on the idea that it is non-sense to “assume an entry into the market”²⁶ and thus give market price-contract price differential when buyer has not entered the market. Professors White and Summers argue that to give buyer both the market price-contract price differential and lost resale profit amounts to overcompensation.²⁷

II. LEGISLATIVE HISTORY

Prior to the formulation of section 2-713, both by the majority view at common law and under the Uniform Sales Act, a buyer was entitled to damages for breach based on the market price less contract price at the time set for performance.²⁸ This measure of dam-

26. Childres, *supra* note 2, at 843.

One should pause and ask what damages such a buyer has suffered. To begin on the negative side, he has not suffered market price-contract price differential damages, not having used the market. The only damages he *could* have suffered are the consequential—what he would have made had he received the goods. Consequentials he should recover, within tolerable standards, but not “together with” anything.

Id. at 843-44.

27. J. WHITE & R. SUMMERS, *supra* note 4, at 394 n.91.

28. It was not until the 19th century that a market rule of damages was used by courts without regard to whether a buyer intended to hold, invest or resell the goods. Professor Horwitz has traced the history of the concept of contract damages to show that prior to the eighteenth century, when there was no market for securities or commodities, property was believed to have an “objective” value. Horwitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 946-47 (1974). In the eighteenth century, “With the advent of commodity markets . . . the assumption that goods have a fixed intrinsic value ceased to be self-evident.” Simon & Novak, *Limiting The Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395, 1398 (1979). “The function of contract shifted: instead of simply being one method of transferring title to specific property . . . executory contracts became important instruments for futures agreements, designed to transfer risk from those wishing to insure against market fluctuations in supply and price to those wishing to speculate.” *Id.* at 1399. By 1818, in *Shepherd v. Hampton*, the Supreme Court of the United States held that the measure of damages for failure to deliver cotton on a contract was the difference between the contract price and the market price at the promised time of delivery. 16 U.S. (3 Wheat.) 200 (1818). “In the early development of the market damage rule in the last century, it was considered irrelevant whether the plaintiff buyer would or could have realized an on the market advantage (citation omitted). About 60 years ago cases appeared limiting damages to the plaintiff's lost profits.” Simon & Novak, *supra*, at 1397 n.2. See also UNIF. SALES ACT § 67(3), 1A U.L.A. 242 (1950).

(3) Where there is an available market for the goods in question, the measure of damages, in the absence of special circumstances showing proximate damages of a greater amount, is the difference between the contract price and the market or current price of the goods at the time or times when they ought

ages was to be used for both non-performance and anticipatory repudiation by a seller.²⁹ At both common law and under the Uniform Sales Act, a buyer who could show that he did not and could not learn of the breach until after performance was due, could increase his damage award by using market price on the date he actually learned of the breach.³⁰ This "special circumstance"³¹ exception, as the Uniform Sales Act called it, allowed a buyer greater damages on the theory that he could not have covered prior to learning of the breach and thus could not have protected himself from further market price increases. Market price damages so defined were considered "general damages" or "direct damages."³² A plaintiff buyer who was in a situation where there was no easily provable market price or where he had lost profits he hoped to make by resale of the goods, could sue for those lost profits. This loss was called "special, indirect or consequential."³³ This additional or consequential damage was, of course, subject to the foreseeability rules developed out of *Hadley v. Baxendale*.³⁴ That is, lost profits in excess of market price were not recoverable unless reasonably foreseeable by the defendant seller at the time of contracting, and not reasonably avoidable by the plaintiff buyer whether by cover or otherwise.³⁵

Under pre-UCC law, then, an aggrieved buyer was generally entitled to market price at the time and place for performance, even in anticipatory repudiation cases. There were, however, exceptions. If the buyer's cause of action came to trial before the date for contract performance, the market price at the time of trial would be used as

to have been delivered, or, if no time was fixed then at the time of the refusal to deliver.

UNIF. SALES ACT § 67(3), 1A U.L.A. 242 (1950).

29. Simon & Novack, *supra* note 28, at 1402 n.36.

30. *Id.*

31. UNIF. SALES ACT § 67, 1A U.L.A. 242 (1950).

§ 67. Action for failing to deliver goods—(1) Where the property in the goods has not passed to the buyer, and the seller wrongfully neglects or refuses to deliver the goods, the buyer may maintain an action against the seller for damages for non-delivery.

2) The measure of damages is the loss directly and naturally resulting in the ordinary course of events, from the seller's breach of contract.

3) Where there is an available market for the goods in question, the measure of damages, in the absence of special circumstances showing proximate damages of a greater amount, is the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered, or, if no time was fixed, then at the time of the refusal to deliver.

Id.

32. Simon & Novack, *supra* note 28, at 1402.

33. *Id.* at 1403.

34. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

35. D. DOBBS, *Handbook of the Law of Remedies* § 3.7, at 186-91 (1973).

the best evidence of the future market price.³⁶

Prior to the enactment of the UCC, commentators argued for the automatic use of performance date market damages because of

the desirability of maintaining a uniform rule and facilitating settlements; the public interest in encouraging contract performance and the proper functioning of the market; the prevention of defendant's unjust enrichment; the restoration of the very "value" promised to plaintiff; and the inherent difficulty and complexity of proving actual economic losses not encompassed within the contract terms.³⁷

This policy direction found expression by judges and commentators in phrases such as the following:

It is reasonably well established that, as against the wrongdoers, the law is willing to disregard the possibility that an award of market value at the time of the wrong may be too much. Such an award . . . will be allowed despite the fact that the property would have later been damaged or destroyed from other causes, or the fact that it would have depreciated in market value in the owner's hands—rough justice but a convenient and reasonable standard, which the courts are not inclined to refine and complicate at the wrongdoer's insistence.³⁸

Although this was the majority position, the question of whether an aggrieved buyer could get both direct and consequential damages for breach of contract or whether his damages should be limited to only consequential damages began to arise nearly seventy years ago.³⁹ Courts which entertained these questions and limited buyer's damages to lost profits arrived at differing conclusions depending on the nature of the buyer's position.⁴⁰

Whether, and, if so, to what extent, section 2-713 was intended to

36. Taylor, *The Impact of Article 2 of the UCC on The Doctrine of Anticipatory Repudiation*, 9 B.C. IND. & COM. L. REV. 917, 928 (1968).

37. Simon & Novack, *supra* note 28, at 1403.

38. C. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 48, at 184-85 (1935).

39. *Kaye v. Eddystone Ammunition Corp.*, 250 F. 654 (E.D. Pa. 1918); *Isaacson v. Crean*, 165 N.Y.S. 218 (N.Y. App. Term. 1917).

40. See Simon & Novack, *supra* note 28, at 1406-09, for the following propositions:

(1) "[I]f the first buyer has fully protected himself in his resale contract against liability over to the second buyer, then first buyer can only recover his lost profits." *Id.* (citing *Foss v. Heineman*, 144 Wis. 146, 149-56, 128 N.W. 881, 883-85 (1910); *cf. Andrew Weir & Co. v. Dobell & Co.*, 1 K.B. 722 (1916)).

(2) When the first buyer has reached an "advantageous settlement with the second buyer." *Id.* (citing for this proposition, *Compania Naviera Asiatic v. The Burmah Oil Co.*, No. 74-2025 (S.D.N.Y. Apr. 27, 1977); and, opposed to this proposition, *Pastor v. B. Lindner & Bros.*, 233 A.D. 396, 253 N.Y.S. 184 (1931); *Iron Trade Prods. Co. v. Wilkoff Co.*, 272 Pa. 172, 116 A. 150 (1922)).

(3) "[F]irst buyer is entitled to no more than his lost profits unless he can show with relative certainty that he will also be liable in damages to the second buyer." *Id.* (citing *Isaacson v. Crean*, 165 N.Y.S. 218, 219 (N.Y. App. Term. 1917); *Texas Co. v. Pensacola Maritime Corp.*, 279 F. 19, 30 (5th Cir. 1922); *Kay v. Eddystone Ammunition*

change the common law majority or Uniform Sales Act position of an aggrieved buyer in both the situation of failure of performance by a seller and anticipatory repudiation by a seller is unclear.⁴¹ Critics believing that it represents a change from the common law or Uniform Sales Act rule argue that, in the failure to perform situation, buyer's damages should be limited to "actual loss" or "provable lost profits."⁴² In a similar vein, in the case of anticipatory repudiation, buyer's damages are to be set according to the market at either the time buyer hears of the repudiation or a reasonable time thereafter.⁴³ Although there is no language in the UCC and no legislative history directly stating that section 2-713 was meant to change the pre-UCC rule,⁴⁴ commentators often cite section 1-106 for the general policy that remedies are to be "liberally administered" so that the aggrieved party may be put "in as good a position as if the other party had fully performed."⁴⁵ The official comment adds that compensatory damages are limited to compensation, are not to be a penalty, and are to be minimized.⁴⁶

Another approach of recent commentators is to use the tool of statutory construction.⁴⁷ Where the code in section 2-713 deals with anticipatory repudiation, it states that damages are to be set "at the time when the buyer learned of the breach—an addition to the traditional common law rule covering such damages."⁴⁸ The

Corp., 250 F. 654, 655 (E.D. Pa. 1918); *Bernhardt Lumber Co. v. Metzloff*, 113 Misc. 288, 299, 184 N.Y.S. 289, 295 (1920)).

(4) If the resale contract was known to seller at the time of the contract, lost profits may be a limit on damages. *Id.* (citing *Compania Naviera Asiatic v. The Burmah Oil Co.*, No. 74-2025 (S.D.N.Y. Apr. 27, 1977); *Foss v. Heineman*, 144 Wis. 146, 149-56, 128 N.W. 881, 883-85 (1910); *Tennessee Fertilizer Co. v. International Agr. Corp.*, 146 Tenn. 451, 465-71, 243 S.W. 81, 85-87 (1922)).

41. See J. WHITE & R. SUMMERS, *supra* note 4, at 243-46, for a discussion of opposing views.

42. Childres, *supra* note 2, at 841-42.

43. Note, *UCC 2-713: Anticipatory Repudiation and the Measurement of An Aggrieved Buyer's Damages*, 19 WM. & MARY L. REV. 215, 255 (1977).

44. *Id.* at 254.

45. U.C.C. § 1-106 (1977). For a complete text of this section, see *supra* note 10.

46. U.C.C. § 1-106 comment 1 (1977) states:

Subsection (1) is intended to effect three things:

1. First, to negate the unduly narrow or technical interpretation of some remedial provisions of prior legislation by providing that the remedies in this Act are to be liberally administered to the end stated in the section. Second, to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Act elsewhere makes it clear that damages must be minimized. Cf. Sections 1-203, 2-706(1), and 2-712(2). The third purpose of subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2-204(3).

47. J. WHITE & R. SUMMERS, *supra* note 4, at 242.

48. See text, *supra* note 5.

added language raises the possibility that market price might be set at a time prior to the agreed performance date—a departure from the common law rule. The discussion centers on the meaning to be given “learned of the breach.” Some commentators argue that the plain meaning is that “breach” is the same as repudiation.⁴⁹ However, others argue that the “Commission’s silence on this [interpretive] question indicates both its failure to recognize the ambiguity and its intention to retain the pre-existing rules.”⁵⁰

49. J. WHITE & R. SUMMERS, *supra* note 4, at 242, states the authors’ belief that the most obvious (or naive) reading of § 2-713 is that a buyer learns of a breach when the seller repudiates the contract. That a statute should be given its plain and natural meaning if its language is clear “is a rule of construction, but to say that repudiation means breach is hardly plain, clear language.” *Id.*

Indeed, White and Summers state that “a buyer’s suit for damages under § 2-713 upon an anticipatory repudiation presents perhaps the most grizzly interpretative problem in Article 2.” *Id.* at 242. Further, White and Summers put forward some “elegant” arguments against the plain words interpretation of § 2-713. *Id.* at 245. See also Jackson, “*Anticipatory Repudiation*” and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance, 31 STAN. L. REV. 69, 102 n.114 (1978).

The Code’s inattention to the problem of damages in cases of anticipatory repudiation was pointed out in the early 1950’s. See 1 NEW YORK LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE 590-92 (1955) (commentary by Professor Honnold); Comment, *A Suggested Revision of the Contract Doctrine of Anticipatory Repudiation*, [64 YALE L.J. 85, at 103-05 1954]. It has been suggested that the poor drafting of the Code’s hypothetical market-damages formula reflected a feeling shared by Karl Llewellyn and the other draftsmen that only cover activity “deserved” protection, [citing UNIFORM REVISED SALES ACT § 58-A comment (2d draft 1941)], and that the market damages formulas were thus designed more as a statutory liquidated damages clause than as an attempt to implement the principle of compensation. [citation omitted] If that was the draftsmen’s intent, however, it appears wrongheaded. An arbitrary market-damages formula may interfere with, not further, desirable cover activity, whenever reliance on that formula would be profitable to the aggrieved party.

Id. And see, e.g., A. CORBIN, CONTRACTS § 981 (1951 & Supp. 1971); RESTATEMENT OF CONTRACTS § 318 (1932).

50. Note, *supra* note 43, at 266. Indeed, the primary reason for the additional language in § 2-713 was to accommodate § 2-723, which governs the calculation of damages for anticipatory repudiation when plaintiff buyer’s suit comes to trial before the date set for performance in the contract. J. WHITE & R. SUMMERS, *supra* note 4, at 245. At common law, in such a situation, market price at the time of trial would have been used. Taylor, *supra* note 36, at 928. This common law rule is changed by § 2-723, which sets damages according to market price when the aggrieved buyer has “learned of the repudiation.” Under the terms of § 2-723:

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

U.C.C. § 2-723 (1977).

Thus, to say that § 2-713 sets the repudiation date as the time to measure damages would render § 2-723 superfluous. Arguably § 2-713 was meant, in both non-delivery as well as repudiation cases, except those covered by § 2-723, to use market price at the time of performance, that being the time of the *breach*. Note, *supra* note 43, at 267. Other commentators find this result inconsistent with other provisions of the code. For

III. ECONOMIC ARGUMENTS AND GAMES THEORY

Arguments, based on legislative history and rules of construction

example, § 2-610 provides, in the case of anticipatory repudiation, that the aggrieved party may wait a commercially reasonable time for performance or resort immediately to any code remedy for breach.

Under § 2-610:

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

- (a) for a commercially reasonable time await performance by the repudiating party; or
- (b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and
- (c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704).

U.C.C. § 2-610 (1977).

It is proper that since buyer can only wait a commercially reasonable time under the code, the date for setting damages might be a date prior to the agreed performance date. "Otherwise," the argument is that, "an injured buyer would not be penalized for waiting until the delivery date and for accumulating his losses in a rising market." Note, *supra* note 43, at 268. Of course, if buyer's damages are to be measured at the time of learning of the repudiation, as some argue, then he cannot do what § 2-610 gives him the right to do—that is, to wait for a commercially reasonable time. J. WHITE & R. SUMMERS, *supra* note 4, at 243-45. This line of argument clearly assumes that an aggrieved buyer has a greater liability for a failure to mitigate than the code seems to require. "The Code drafters apparently did not intend to require the mitigation of compensatory damages by aggrieved buyers." Note, *supra* note 43, at 269 n.84. Comment 3 to § 2-712 provides in part:

Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for non-delivery under the next section.

However, this subsection must be read in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover.

U.C.C. § 2-712 comment 3 (1977) (emphasis added).

If damages for non-delivery are measured on the performance date, as intended by the drafters, comment 3 permits their accumulation in a rising market, placing no duty on the buyer to cover before the date of delivery and thereby to mitigate his losses. The drafters only limited the recovery of consequential damages, rather than resulting damages, the term used in U.C.C. § 2-610 comment 1 (1977), by a purchaser who fails to buy substitute goods. The statement that consequential damages are limited to those that could not have been obviated by cover is in accord with the common law rule. At common law, however, the term consequential damages referred to damages for losses occurring after the date of performance resulting from a buyer's inability to meet his resale obligations. Provided that a buyer purchases substitute goods in time to satisfy his resale customers, regardless of whether the cover takes place within a reasonable period following the repudiation, he suffers no losses for which consequential damages can be awarded. Thus, except in an unlikely situation in which substitute goods are unavailable after a reasonable period of time following the repudiation, the purported limitation on the recovery of consequential damages provides no incentive whatever for a buyer to obtain an early cover and thereby to mitigate his losses in a rising market. A similar attitude towards mitigation has led commentators to find § 2-712 and § 2-711 in conflict with the performance date market price formulation of § 2-713. Note, *supra* note 43, at 268. Under § 2-712, buyer is entitled to cover within a reasonable time after

regarding possible shifts from the common law position as supposedly evidenced by section 1-106, result in proposals that would limit section 2-713 to provable consequential damages or to market-based damages more at the seller's control than the buyer's. The soundness of these positions has also been subject to examination from the standpoint of economic policy. The examination has been driven by the question of what is a better interpretation of section 2-713 in terms of economic outcome both to society and the parties to a contract. What are at the core of these discussions are the interesting questions: What are efficiency and what are expectancy? Can they at times conflict, and if they do, which should prevail?

The methodology employed in economic analysis is, admittedly, reductionist.⁵¹ Phenomena, economists maintain, are reducible to discreet component factors. Each of these component factors is in turn subject to being tested by making special assumptions which isolate them for analysis. "The art of economics," it is said, "is picking assumptions that simplify a problem enough to better un-

a "breach" has occurred as defined by § 2-711. Section 2-711, however, allows a buyer this remedy without mentioning "breach," but lists the happening of events that trigger this right. The events listed in § 2-711 which give rise to a buyer's rights under § 2-711 are non-delivery, *repudiation*, or a rightful rejection or revocation of acceptance of the seller's goods. U.C.C. § 2-711 (1971).

Thus, a seller's repudiation within § 2-711 constitutes a "breach" within § 2-712, allowing the buyer to cover within a reasonable time after the repudiation. It is argued that this is inconsistent with a rule that "breach" be confined to the date of performance in § 2-713. Note, *supra* note 43, at 268-69.

This view ignores the fact that § 2-712 is an optional remedy with the innocent buyer having the choice of whether to cover, await performance or sue for market price. If cover is seen as more advantageous to a buyer, he must act within a reasonable time of repudiation. This is not to say that a "breach" has occurred until the buyer treats it as such.

51. Kelman, *Misunderstanding Social Life: A Critique of the Core Premises of "Law and Economics"*, 33 J. LEGAL EDUC. 274 (1983). "Here is my view of the 'core': (1) Human behavior is adequately described as utility-maximizing behavior of selfish, privatized individuals. All behavior *can* be (tautologically) reduced to such behavior, since the definition of utility-maximizing behavior is simply the observed behavior of a methodologically isolated subject." *Id.* at 275.

The purpose of scientific analysis is to identify the systemic component of phenomena and separate that component from the random phenomena. A generalization is useful and worthwhile even if it can explain only a portion of the behavior examined. This insight is derived from social science generally and regression methodology specifically. It was a liberating insight for legal scholarship because it freed scholars from the burden of explaining every case and problem and directed their attention to the identification of general tendencies.

Kitch, *The Intellectual Foundations of "Law and Economics"*, 33 J. LEGAL EDUC. 184, 187-88 (1983). *But see* Michelman, *Reflections on Professional Education, Legal Scholarship, and the Law-and-Economics Movement*, 33 J. LEGAL EDUC. 197 (1983). "Explanations—schemata that serve to organize some significant fraction of experience—are useful, to put it mildly, and that includes law and economics. The critical point is to avoid mistaking an organizing construct for a structural reality that, by defining the possible, limits vision and deadens will." *Id.* at 201.

derstand certain features of it, without inevitably causing those features to be unimportant ones."⁵²

In applying economic theory to an analysis of contract remedies, writers have suggested various approaches toward "controlling the behavior of contracting parties with respect to breach and reliance decisions" and have suggested how risks are to be allocated by courts when breaches do occur.⁵³ Justice Holmes is the usual starting point for the position that parties to a contract should be encouraged by the law to breach when to do so would be efficient.⁵⁴ For purposes of analysis, efficiency is said to refer to the relationship between the aggregate benefits of a situation and the aggregate costs of the situation. The usually accepted goal of economic activity was stated by the famed economist, Vilfredo Pareto, to be a situation from which no change can make someone better off without making someone else worse off.⁵⁵ That is, to reach Pareto-effi-

52. A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 5 (1983).

53. *Id.*

54. R. POSNER, ECONOMIC ANALYSIS OF LAW 88 (2d ed. 1977).

A starting point for analysis is Holmes' view that it is not the policy of the law to compel adherence to contracts but only to require each party to choose between performing in accordance with the contract and compensating the other party for any injury resulting from a failure to perform. This view contains an important economic insight. In many cases it is uneconomical to induce the completion of a contract after it has been breached.

Id. at 88 (citing OLIVER WENDELL HOLMES, *The Path of Law*, COLLECTED LEGAL PAPERS, 167, 175 (1920)).

55. A. POLINSKY, *supra* note 52, at 7. H. LIEBHAFSKY, THE NATURE OF PRICE THEORY 10-11 (1963).

It is often argued that a state of economic efficiency has been attained whenever it is impossible to increase the welfare of any one individual within a given society without reducing the welfare of any other individual. However, it is recognized that the notion of economic efficiency so defined is not alone a basis for public policy recommendations, since considerations of equity, which admittedly rest on subjective grounds, are also important. For this reason such considerations (for example, whether or not total welfare will be increased by increasing the welfare of some at the expense of others) are often eliminated from the problem by assuming that the distribution of income is "given." Moreover, it is not enough to assume merely that the wants of consumers are given, but it must also be assumed that "consumers should get what they want" (to use Professor Kenneth Boulding's phrase) and that these wants are independent of the other variables in the system.

By making these assumptions, the concepts and definitions of price theory can be and have been employed to build models in which that allocation of resources which would occur in a perfectly competitive economy is rationalized as being in accordance with "optimum conditions of welfare." In fact, in a perfectly competitive system there would be no advertising, and no selling costs would be incurred by firms . . . ; and, thus, the most obvious connection between production and wants is eliminated from this model. Too, in such a system no firm's sales would be large enough, in relation to the total market for the given output, to lead it to believe that by its own actions it could influence the price of the product which it sells. And so the firm would sell at prices fixed by market forces.

However, it is not clear that the conditions which are envisaged by this

ciency or Pareto-optimality, a rule of law should seek the greatest aggregate benefit over losses. If a move from situation *A* to situation *B* does this, it is Pareto-optimal as long as the move to situation *B* does not put one of the parties to the transaction in a worse position than under situation *A*.⁵⁶

There has been a wide ranging discussion in legal literature about the place and effect of economics and legal sanctions on human behavior.⁵⁷ A part of this discussion has centered on a point germane to the issue of the validity of section 2-713 as legislation. Some adherents of the law and economics approach have tried to show that, in general, legislation is inferior to judge-made law in achieving efficiency-producing rules.⁵⁸ While recognizing the costs of uncertainty,⁵⁹ they point out that for courts to follow any rule rigidly would result in inefficient holdings. They have suggested that the efficiency of the common law results from the fact that parties to a dispute are more likely to litigate when inefficient, rather than efficient rules govern their dispute.⁶⁰

model could ever be attained without a social revolution in this country, and even then, it is not clear that production by many small firms, none of which is large enough to affect the price of its product by its own actions, is desirable in a society in which automation and large capital investments are the order of the day. The model is thus open to the charge that it lacks realism and cannot serve as a basis for public policy.

Id.

56. See Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 491 (1980), where the concept of "Potential Pareto Superiority," also called the Kaldor-Hicks criterion, is discussed. This requires, "not that no one be made worse off by the move, but only that the increase in value be sufficiently large that the losers could be fully compensated." *Id.*

57. B. ACKERMAN, *ECONOMIC FOUNDATION OF PROPERTY LAW* vii (1975); Baker, *The Ideology of the Economic Analysis of Law*, 5 PHIL. & PUB. AFF. 3 (1975); G. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* (1976); Brenner, *The Economics—An Imperialist Science?*, 9 J. LEGAL STUD. 179 (1980); Buchanan, *Good Economics—Bad Law*, 60 VA. L. REV. 483 (1974); Glasner, *On the Difference between Wealth and Liberty*, 2 INT'L L. REV. 227 (1982); Kelman, *Misunderstanding Social Life: A Critique of the Core Premises of "Law and Economics,"* 33 J. LEGAL EDUC. 274 (1983); Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227 (1980); Michelman, *Norms and Normativity in Economic Theory of Law*, 62 MINN. L. REV. 1015 (1978); Ogus, *Economics, Liberty and the Common Law*, 18 J. SOC. PUB. TCHRS. L. 42 (1980); Schnelling, *On the Ecology of Micromotives*, 25 PUB. INTEREST 59 (1971); C. GOETZ, *LAW AND ECONOMICS CASES AND MATERIALS* 1-67 (1984).

58. See generally F. HAYEK, *LAW, LEGISLATION AND LIBERTY: RULES AND ORDER* (1973); B. LEONI, *FREEDOM AND LAW* (1981).

59. Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974).

60. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51, 61 (1977); Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); but see Goodman, *An Economic Theory of the Evolution of Common Law*, 7 J. LEGAL STUD. 393 (1978):

The principal difficulty with this explanation is that it ignores the way in which precedents were formed in the historical evolution of common law. At the time of Blackstone, no single court decision was considered binding on

A more radical approach questions whether any form of enforcement,⁶¹ being intervention, is efficient, since it is bound to add to aggregate costs and thus be inefficient. The truth of this argument⁶² may be borne out by further empirical research. Stewart Macaulay, in a limited study, concluded that many contractual negotiations between business persons reflect minimal planning regarding legal sanctions or the effects of defective performance.⁶³ There are in almost all such relationships, observable motivations to perform regardless of what legal rules apply.⁶⁴ Indeed, it is argued that

future courts. In general, a binding precedent for succeeding adjudications could only arise from a series of similar decisions in separate cases. If judges decided randomly between an efficient rule and an inefficient rule, we would expect no clear precedent to be forthcoming. In order for continued litigation to produce efficient legal precedents, efficient judicial decisions must have had a higher probability of occurring. . . .

This paper presents a third explanation for the development of common law. The explanation requires no particular assumption about litigation rates (litigation may occur randomly) and no particular assumption about the motivation of judges (judges may be initially neutral with regard to the issue of economic efficiency). We do assume, however, that the judges are amenable to persuasion by the efforts of the litigants appearing before the court. A model of an adversary proceeding is proposed in which the probability that a particular litigant will win a favorable decision depends upon the efforts of both litigants to influence the court and upon the weight of judicial bias. Since parties before the court have an obvious interest in the decision, they have incentives, not necessarily equal, to affect that decision through efforts that incur legal costs—expenses for legal research, factual investigation, forensic talent, and so forth. The fundamental assumption made throughout is that any increment in legal expenses . . . will induce an increment, however small, in the probability . . . of winning a favorable decision.

Id. at 394.

61. Kennedy & Michelman, *Are Property and Contract Efficient?*, 8 HOFSTRA L. REV. 711, 762-70 (1980). For a Confucian view, see Birmingham, *Legal Moral Duty in Game Theory: Common Law Contract and Chinese Analogies*, 18 BUFFALO L. REV. 99, 99-103 (1968-69).

62. *But see* Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L. J. 1261 (1980).

The role of damages or sanctions in generating socially optimal behavior can be focused more sharply by observing the distinction between *internal* and *external effects*. Because self-interested maximizing behavior entails consideration of only internal costs and benefits, unfettered individual behavior is incompatible with social optimization in circumstances in which significant external costs or benefits are present. Individuals will oversupply activities with external costs and undersupply those with external benefits. By imposing costs and creating incentives, the law can cause individuals to consider external effects in their decisionmaking and thus “internalize” them.

Id. at 1275-76 (emphasis added).

63. Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 60 (1963).

64. *Id.* at 63.

[N]on-legal norms mentioned by Macaulay may be interpreted as part of the occupational morality of businessmen. Let me repeat the norms he cites: “commitments are to be honored in almost all situations”; “one does not welsh on a deal”; “one ought to produce a good product and stand behind it”; “a man’s word or handshake . . . is the equivalent of the bindingness of a

contract law is not only unneeded in most such situations, but even thought to be “undesirable” in that it can get “in the way of creating good exchange relationships between business units.”⁶⁵ Nevertheless, when an arrangement is thought to have a higher risk of problems, the gains of noting contract law outweigh its costs.⁶⁶

As a result of studies like Macaulay’s, it has been suggested that enforcement mechanisms appropriate in one sort of contractual arrangement might not be appropriate or efficient in another.⁶⁷ Indeed, it is argued that traditional damage rules like section 2-713 be limited to only the “classical model” of contractual relationship, where the parties do not have an ongoing relationship, and where the parties are able to know and assign at the time of contracting all relevant risks optimally.⁶⁸ It is because of the relative rarity of such situations that businessmen find rules of contract either irrelevant or a hinderance to business activity.⁶⁹ Certainly in contractual relationships, which are long term and where the parties are incapable of reducing important terms of the arrangement to well defined obligations, informal arbitration, third party assistance, or ongoing negotiation of specific terms is superior to resort to legal action.⁷⁰ Nevertheless, even with such devices, the parties, when a dispute arises, will be playing out their roles in a self maximizing way against an undercurrent of legal rules.⁷¹ Indeed, as long as the par-

contract.” These and other norms comprising the occupational morality of business executives and some staff specialists may function as counter-norms, from the point of view of the legal system, as the recent price-fixing case in the electrical industry suggests. Eventually, some of these new and emerging non-legal norms may supersede the law of contract.

Evan, *Comment on Macaulay*, 28 AM. SOC. REV. 67, 69 (1963).

65. Macaulay, *supra* note 63, at 64.

66. *Id.* at 65.

67. *Id.* at 66. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U.L. REV. 854 (1978).

68. Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1090 (1981).

69. Macaulay, *supra* note 63, at 64.

70. Goetz & Scott, *supra* note 62, at 1266.

But existing explanations of the legal enforcement of promises are incomplete and perhaps misleading. A principal limitation has been the failure to consider the effects of various levels of legal enforcement on the making of promises. Inquiry has generally focused instead on the effects of legal sanctions on decisions to breach or perform, assuming that the promise has already been made. Yet, a decision to enforce promises, and the subsequent choice of remedy, does not merely mold the performance behavior of contracting parties; it also shapes both the nature and amount of promise-making activity.

Appropriately calibrated enforcement rules can be used to achieve the optimal number and type of promises based on the degree and form of adaption by promisor and promisee.

Id.

71. Goetz & Scott, *supra* note 68, at 1149-50.

ties can work out results by which they both benefit, there will never be resort to legal process or legal rules.

Game theory⁷² is a graphic way to show when resort to legal rules will be effective and what influence legal rules can have on behavior. Section 2-713 is well adapted to game theory. Given its history, the section does seem to have been intended to apply to the classic form of contract: that is, a market contract "to sell a specified quantity of a commodity at a specified date in the future, under conditions in which all damages can be determined by hypothetical or actual purchase or liquidation of the commodity in a market that is always available."⁷³ The contract is "classical" in that it is not a long term relationship between the parties and the parties generally know the risks and accept or assign them. This sort of contract is "essentially a bet against the future course of the market."⁷⁴ Parties willing to bear reciprocally the risks of the marketplace seek a price that is certain by contract.

Game theory views such a contract as a bet against the market in which certain assumptions control. We assume a two-person non-cooperative,⁷⁵ non-zero sum,⁷⁶ noniterative⁷⁷ game, "in which the

72. Game theory is a method for the study of decision making in situations of conflict. It deals with human processes in which the individual decision-unit is not in complete control of other decision units entering into the environment. It is addressed to problems involving conflict, cooperation, or both, at many levels. The decision-unit may be an individual, a group, a formal or an informal organization, or a society. . . . The essence of a "game" in this context is that it involves decision makers with different goals or objectives whose fates are intertwined. The individuals are in a situation in which there may be many possible outcomes with different values to them. Although they may have some control which will influence the outcome, they do not have complete control. . . . The individual must consider how to achieve as much as is possible, taking into account that there are others whose goals differ from his own and whose actions have an effect on all. . . . He must adjust his plans not only to his own desires and abilities but also to the desires and abilities of others. . . . The outcome of a game will depend on the strategies employed by every player . . . and possibly on events beyond the control of any player.

Birmingham, *supra* note 61, at 102 (quoting M. SHUBIK, *GAME THEORY AND RELATED APPROACHES TO SOCIAL BEHAVIOR* 3, 8, 9, 13 (1964)).

73. Barton, *The Economic Basis of Damages For Breach of Contract*, 1 J. LEGAL STUD. 277, 277-78 (1972).

74. *Id.* at 278.

75. The prospective buyer and seller in the game . . . exist in an individualistic, self-centered, Hobbesian, Freudian state of nature in which there is no love relationship between the two and neither has developed any guilt or superego. Neither has experienced any religious conversion or other direct contact with God, and both have absolutely no social, cultural, ethical, moral, or legal institutions or values.

Carroll, *Two Games That Illustrate Some Problems Concerning Economic Analysis of Legal Problems*, 53 S. CAL. L. REV. 1371, 1376 (1980).

76. "Non-zero sum means that a single play can benefit both players or that one player can benefit without damaging the other." *Id.* at 1378.

In using game theory in his article, Barton states:

I believe, however, that the model outlined in text which shows the market

sole objective of each player is to increase her [or his] own utility."⁷⁸ The situation, without benefit of legal sanctions, can be put into the following matrix:⁷⁹

		SELLER (S)	
		Honor	Breach
BUYER (B)	Honor	5,5	0,9
	Breach	9,0	4,4

Buyer controls the symbols horizontally while seller controls them vertically. The numbers represent payoffs in each cell of the matrix. The first number in each cell represents buyer's position after the transaction. The second number in each cell represents seller's position after the transaction. For the matrix to work, there must be a certain set of relationships among the relative magnitudes of the cells. We assume at the start of the game that buyer has money he values at 4. Seller values the same amount of money at 5. Seller has goods which he values at 5 and which buyer values at 4. By honoring the contract, both buyer and seller get a payoff of 5, as seen in the upper left box. But if seller is self-maximizing, seller can shift to the upper right box and gain 5 by taking buyer's money and breaching by keeping the goods. This results in buyer having 0 and seller having 9. Buyer may have an incentive to move to the lower right block to minimize his loss. When both buyer and seller breach, as they are forced to do by the cost of not seeking a 9 when the other seeks 9,⁸⁰ they end up with equilibrium in the lower right

contract as a zero-sum game is more appropriate. First, it corresponds to the actual win-loss character of the market bet. Second, it allows more explicit contrast with the clearly non-zero sum features of the "non-market" transactions.

Barton, *supra* note 73, at 279-80 n.5.

77. Non-iterative means the game is played only once.

78. Carroll, *supra* note 75, at 1377. The utility of any position is, of course, subjective. Another assumption of game theory is that "we are able to attribute cardinal values to the utility of each individual in both [goods] and money in the form of utility numbers. Thus, a given utility number has an identical value to each player and, therefore, interpersonal utility comparisons can be made." *Id.* It is also assumed that the "relative utilities of the . . . players . . . do not change during the course of the transactions." Carroll, *Four Games and the Expectance Theory*, 54 S. CAL. L. REV. 503, 505 (1981).

79. The matrix used in the text is adapted from Carroll, *supra* note 75, at 1380, and Carroll, *supra* note 78, at 506. For other versions of the Prisoner's Dilemma see generally *supra* note 61 and Barton, *supra* note 73.

80. This is because players are said to have a dominant strategy. A dominant strategy is a particular play that a player will make when acting rationally, no matter what

box with each having one unit less than if they performed. The conclusion to be drawn from this matrix is that without enforcement by damages that will do away with the incentive to breach, both buyers and sellers will tend to be in a situation which, arguably, is a net loss to themselves and society as a whole.⁸¹ That is, an inefficient solution results if no damages or a very small damage amount is assessed against the breaching party.⁸²

Whether to give damages or not is thus not the issue, but rather how much to give.⁸³ The idea that breach itself is inefficient is clearly rejected by the traditional law and economics writers.⁸⁴ These writers, accepting the figures underlying our game theory matrix, conceive of reality as allowing a net gain to a breaching party and society without doing harm to the non-breaching party—a Pareto-optimal result.⁸⁵ Economist Richard Posner puts the proposition most succinctly by positing a situation where a party is tempted to breach a contract simply because his profit from the breach would exceed his profit from honoring the contract. Posner argues that “if his profit from breach would also exceed the ex-

the other player elects to do. In our matrix, Seller's (*S*) dominant strategy is to play the Breach column because *S* will prefer 0,9 over 5,5 and 4,4 over 9,0. Buyer (*B*) does not have a dominant strategy because *B* prefers 5,5 over 0,9 but favors 9,0 to 4,4. Of course, *B* may assume *S* will play (*S*'s) dominant strategy and thus choose 4,4 as the least harmful choice.

81. Goetz & Scott, *supra* note 62, at 1279, 1285, 1332.

82. Carroll, *supra* note 78, at 507-09. Carroll maintains, however, that the expectancy measure of damages does not necessarily change the dominant strategy of the seller toward breach. The matrix below suggests this result:

		<i>S</i>	
		Honor	Breach
<i>B</i>	Seeks Remedy	5,5	5,5
	Does not seek Remedy	5,5	0,9

Seller is indifferent between honor and breach if *B* seeks a remedy (*S* ends up with 5 either way) but with breach, *S* stands a chance of getting 9.

83. *Id.* at 507. Carroll's analysis suggests that only a form of specific relief plus a fine will deter breach.

84. See E. FARNSWORTH & I. YOUNG, *CASES AND MATERIALS ON CONTRACTS* (3d ed. 1980); R. POSNER, *supra* note 54, at 89-90; RESTATEMENT (SECOND) OF CONTRACTS § 369 Reporters Note (1977); Barton, *supra* note 73, at 287-91; Clarkson, Miller & Muris, *Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351, 359-62; Goetz & 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, 558 n.19 (1977).

85. See *supra* note 66.

pected profit to the other party from completion of the contract, and if damages are limited to loss of expected profit, there will be an incentive to commit a breach.”⁸⁶ Such a breach will be value-maximizing and “should be encouraged.”⁸⁷ For example, we assume, as we did for our matrix, that buyer values money at 4 and goods at 5, while seller values money at 5 and goods at 4. A third party (*X*) is added, who values goods at 7, but money at only 4. We have two possible results in terms of utility, according to those who argue that breach is efficient.

If seller honors the contract, the result is:

buyer has goods worth = 5

seller has money worth = 5

X has money worth = 4

Total = 14

If seller breaches, sells to *X*, and pays expectancy damages to buyer:

buyer has his money (4) plus damages (1) = 5

seller has money from *X* (7) less damage (1) = 6

X has goods = 7

Total = 18

The victim of the breach gets damages, so he should be “indifferent” to the breach and not deterred from entering contracts in the future. The societal advantage of breach in this situation is that “it facilitates the movement of goods and services to their highest value user.”⁸⁸

The argument for the efficiency of breach has been seen to be both “vacuous”⁸⁹ and misleading. It is vacuous because on analysis it is found to be meaningless. If one assumes a user to exist who puts a higher value on the goods than does the buyer, and if free market assumptions including the pricing system apply, the goods will go to that higher value user whether seller breaches or not.⁹⁰ The only question is whether buyer should get the goods and sell them to the highest value user or whether seller should breach his contract with buyer to sell to the highest value user. This is a question of distribution of wealth rather than efficiency in the creation

86. R. POSNER, *supra* note 54, at 89-90.

87. *Id.* at 90.

88. Jackson, “Anticipatory Repudiation” and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance, 31 STAN. L. REV. 69 (1978).

89. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1450 (1980).

90. “If consumers’ wants are taken as data, and if prices truly reflect consumers’ preferences, then resources are being allocated in accordance with consumers’ preferences . . .” H. LIEBHAFSKY, *supra* note 55, at 23.

of wealth. With breach, seller gets the gain from a rising market. With no breach, buyer gets the gain.⁹¹ The efficiency of breach argument is therefore empty. But more importantly, it directs attention away from what does matter by assuming cost free market transactions.

The fact is, of course, that we do not have a world of cost free market transactions. "If one assumes costless market transactions, the decisions of courts concerning liability for damage would be without effect on the allocation of resources."⁹² All that is achieved by a legal rule that encourages or discourages breach is a distribution of income between buyer and seller.

The free market model used by classical economists has the price mechanism providing an efficient allocation of resources. For this mechanism to work, the price must reflect all the social costs and benefits of their production. Transaction costs are thus not to be assumed away but are now found to be "central to the study of economics."⁹³ Although there are still skeptics,⁹⁴ most recent economic analysis has been aimed at understanding the effects of transaction costs on both the efficiency of a breach of contract and the distribution of wealth.⁹⁵

IV. THE EFFECT OF DAMAGE AWARDS: A RESTRICTION ON BUYERS' EXPECTANCY

It seems to be true that contract damages have been under-assessed by courts.⁹⁶ That is, they have not reflected market transaction costs.⁹⁷ Placing the choice between damage standards on an assessment of their relative costs has put commentators in a posi-

91. In fact, there might be greater efficiency. If *S* honors the contract and *B* sells to *X*, we have:

B has money = 7
S has money = 5
X has goods = 7
TOTAL = 19

92. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 10 (1960).

93. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J. L. & ECON. 233 (1979).

94. *Id.*

95. "Work on the economics of torts led theorists to concentrate on transaction costs as the crucial factor. And this, in turn, paved the way for the realization that it is essential to focus on transaction costs when seeking to understand the significant features of contract law." Hansmann, *The Current State of Law and Economics Scholarship*, 33 J. LEGAL EDUC. 217, 221 (1983) (parentheses deleted).

96. Macaulay, *supra* note 63, at 65.

Macaulay, from interviews with executives, gives as a reason businesses do not file suit for breach of contract, that "the law of contract damages may not provide an adequate remedy even if the firm wins the suit; one may get vindication but not much money." *Id.*

97. Farber, *supra* note 89, at 1444-45.

tion of arguing from little or no empirical data, relying primarily on "experience and intuition."⁹⁸

For example, it is argued that breach by a seller who can get more than his contract price from a third party (*X*) is inefficient because it involves greater transaction costs than if *X* were to contract and buy the goods from buyer. That is, in either case *X* must negotiate a purchase.

The negotiating cost should be the same whether *X* is dealing with seller or buyer.⁹⁹ However if *X* deals with seller there is the additional cost of the breach added in.

The costs associated with breach are numerous. Some, such as pre-judgment interest and attorney fees, have traditionally received attention.¹⁰⁰ Recently, other more subtle costs have been given much considered thought. The most analyzed of these has been called "opportunity cost." Opportunity cost is, from the buyer's point of view, what he has given up to make and keep the present contract with seller. True damages should then be measured by the "difference between the value of the stream of consumption choices not taken—and those choices induced by the promise."¹⁰¹ Of course detrimental adaption in behavior is rarely a total loss and, since promisees often do not totally believe promises will be performed, they tend to hedge their bets.¹⁰² What it comes down to is measuring risk again: that is, a prospective gain from adaptive (reliance) behavior is balanced against the risk of loss. This has a double-edged effect. It limits buyer's reliance loss in case the promise by seller is not performed; but if the promise is performed it tends to lessen the benefits for buyer.¹⁰³ The argument to be made here is that certainty of legal rules and increased enforcement will make self protective behavior by buyers less necessary, thus increasing beneficial reliance,¹⁰⁴ and one supposes, resulting in a net gain to society as well as buyers.

98. Goetz & Scott, *supra* note 62, at 1321.

99. Farber, *supra* note 89, at 1445, 1450-55.

For the purpose that the cost of dealing with *S* is greater, see Diamond & Maskin, *An Equilibrium Analysis of Search and Breach of Contract, I: Steady States*, 10 BELL J. ECON. 282 (1982).

100. Farber, *supra* note 89, at 1450; Carroll, *supra* note 91, at 512-15.

101. Goetz & Scott, *supra* note 62, at 1269.

Where observable reliance is distinguished from true reliance damages, the latter use of reliance is argued to be the basis of expectancy damages.

An aspect of opportunity costs has been called "Duopoly Cost." When a seller breaches and sells on the market, he also diminishes a market that was available to buyer. This reduction in market opportunity is a cost of breach to buyer. See Coase, *The Problem of Duopoly Reconsidered*, 2 REV. ECON. STUD. 137 (1935); Nutter, *Duopoly, Oligopoly, and Emerging Competition*, 30 S. ECON. J. 342 (1963).

102. Goetz & Scott, *supra* note 62, at 1270.

103. *Id.* at 1281.

104. *Id.* at 1286-87.

A contract damage rule that does not reflect fully the buyer's costs will induce sellers to breach their contracts and is, from a social perspective, inefficient. While earlier writers encouraged breach by sellers and ignored transaction costs, recent writers stressing the central role of transaction costs on efficiency have argued that additional sanctions be placed on a breaching party. To deter economically undesirable breaches, it has been suggested that plaintiffs be able to recover, in a contract cause of action, nonpecuniary losses¹⁰⁵ as well as supercompensatory damages in the nature of punitive damages.¹⁰⁶ It is also suggested that because the bargaining process facilitates the optimal allocation of risk, rules providing for supercompensatory damages can also be bargained for.¹⁰⁷ In other words, liquidated damage provisions which amount to penalties for breach, if fairly bargained over, should be enforced. It has even been suggested that traditional limitations on the availability of specific performance remedies be relaxed to assure that disappointed purchasers are put in as good a position as they would have been had the promisor performed.¹⁰⁸ The adoption of these proposals may lead to a different result. If legal sanctions for breach are too severe, they will be seen as added costs,¹⁰⁹ or risks of promising, which could cause a reduction in the amount of contracting that is done, thereby resulting in a net loss to society.¹¹⁰

Since a damage formula has an effect on distribution and efficiency, the equity or fairness of the rule in each case is important. Parties should be aware that if there is a breach, the breaching party must pay full compensation. It is not then inequitable to give buyer

105. Rea, *Nonpecuniary Loss and Breach of Contract*, 11 J. LEG. STUD. 35 (1982).

106. Farber, *supra* note 89.

107. Goetz & Scott, *Liquidated Damages, Penalties and Just Compensation Principles: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977); Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 446 (1980).

108. Schwartz, *The Case for Specific Performance*, 89 YALE L. J. 271 (1979); Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49, 69-70.

109. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 44 (1960).

It would clearly be desirable if the only actions performed were those in which what was gained was worth more than what was lost. But in choosing between social arrangements within the context of which individual decisions are made, we have to bear in mind that a change in the existing system which will lead to an improvement in some decisions may well lead to a worsening of others. Furthermore we have to take into account the costs involved in operating the various social arrangements (whether it be the working of a market or of a government department), as well as the costs involved in moving to a new system. In devising and choosing between social arrangements we should have regard for the total effect. This, above all, is the change in approach which I am advocating.

Id.

110. Goetz & Scott, *supra* note 62, at 1281-83.

a remedy that will make him truly indifferent to a breach by defective performance or repudiation. This should include both the risk of any market price increase of the goods up to the date of performance allocated to the seller under the contract, as well as consequential and incidental expenses, including lost resale profits, subject to the limitations of avoidability, foreseeability and certainty.

Two views emerge from the legal literature on contract damages. One decries what it sees as a pattern of over-compensation by courts under section 2-713. The other argues that the courts have been undercompensating victims of breach and thus encouraging inefficient breach. A review of the cases decided under section 2-713 will show a pattern that reflects this unsettled debate.¹¹¹ In general, two problems are raised: 1) Should section 2-713 damages be limited to lost profits? (sometimes called actual or provable damages or consequential damages); and 2) In the case of anticipatory repudiation, does "date of breach" under section 2-713 mean that one measures market price at the time of repudiation, on the date set for contract performance, or at a reasonable time after repudiation? At the time of his article in 1977, Professor Childres found five cases which he cites as relevant examples of the over-compensatory nature of section 2-713.¹¹²

In *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*,¹¹³ buyer, a middleman, contracted to purchase potash from seller. Before the date set for performance, the market price of potash rose dramatically and seller refused to deliver. The buyer made unsuccessful attempts to cover. Buyer had made contracts to resell the potash and clearly had lost profits on those contracts but apparently failed to prove lost profits at trial.¹¹⁴ Professor Childres criticizes the court for "adopting a formulation which circumvented the aggrieved buyer's failure of proof," by awarding market price at the time of failure of delivery less contract price. He states, "[t]here is no contention by the court that the damages it was awarding were the actual damages suffered by the buyer."¹¹⁵

Professor Childres is right about the court's silence on the issue of actual damages, but only because the issue was not before the court. As the court said, "[c]onsequential damages are not at issue on this appeal."¹¹⁶ The court merely assumed that section 2-713 is

111. Consistent with Macaulay's findings, § 2-713 is not often mentioned in cases and there is no empirical evidence about its use in settlements or negotiations.

112. See generally Childres, *supra* note 2.

113. 508 F.2d 283 (7th Cir. 1974).

114. *Id.* at 294-95.

115. Childres, *supra* note 2, at 850.

116. 508 F.2d at 294.

the measure to be used. This is consistent with the view that the contract price-market price differential is the most certain measure of risk allocation. The court stated as much: "the buyer has a right to rely on the party to the contract to supply him with goods regardless of what happens to the market price. That is the purpose for which such contracts are made."¹¹⁷ The decision seems clearly in line with the risk allocation of the contract and is, if anything, undercompensatory because of buyer's inability to prove lost resale profit.

In *Gawlick v. American Builders Supply, Inc.*,¹¹⁸ buyer contracted to purchase a car with clear title from seller for \$600. The car with clear title would have had a market price of \$1360. When seller could not produce clear title, buyer brought suit and was compensated with damages based on the market price-contract price differential.¹¹⁹ Professor Childres argues that this is "hypothesized as if the buyer had covered" and that buyer in this case should have been limited to restitution damages because there was no evidence that she purchased the car for future monetary gain.¹²⁰

In *Gerwin v. Southeastern California Association of Seventh Day Adventists*,¹²¹ buyer contracted to purchase bar equipment from a bankrupt country club. The appellate court held that plaintiff's alleged lost profits from seller's breach should not have been allowed because of indefiniteness and unforeseeability. The court did allow buyer the difference between market price and contract price.¹²² Again, the parties to the dispute did not put in issue the use of the market price less contract price formula. The only dispute on appeal was as to the sufficiency of the evidence or certainty of the amount of the market price. Nevertheless, Professor Childres argues the court "awarded money for damages which were never incurred by the buyer."¹²³

In these three cases, Professor Childres would limit remedies to mere restitution or reliance damages and would not allow expectation damages. Professor Childres' final two cases do not cite section 2-713, but he claims they follow its formulation.

In *Gillingham v. Stadler*,¹²⁴ buyer contracted to purchase hay for \$20 per ton. After delivery of some of the hay, seller sold the rest to other buyers for \$25 per ton. The court awarded buyer \$5 per un-

117. *Id.*

118. 86 N.M. 77, 519 P.2d 313 (1974).

119. *Id.* at 79, 519 P.2d at 314.

120. Childres, *supra* note 2, at 851.

121. 14 Cal. App. 3d 209, 92 Cal. Rptr. 111 (1971).

122. *Id.* at 217-23, 92 Cal. Rptr. at 116-20.

123. Childres, *supra* note 2, at 851.

124. 93 Idaho 874, 477 P.2d 497 (1970).

delivered ton.¹²⁵ Again, Professor Childres argues that to award “damages absent consequential damages . . . is to grant the buyer a windfall.”¹²⁶

Finally, Professor Childres cites *Charles County Broadcasting Co. v. Meares*.¹²⁷ In this case the seller was found to have, in bad faith, delayed the execution of documents necessary for an FCC-approved transfer of a radio station to buyer. The contract price was \$100,000, and the market price was \$200,000. The court held that buyer was to get the \$100,000 difference as “compensatory damages.”¹²⁸ Professor Childres claims that this was not a compensatory, but rather a “punitive” recovery.¹²⁹ He states that the court “restricted such recovery to cases where the seller acts in bad faith.”¹³⁰ This is a misreading of the *Charles County Broadcasting* case, and a misunderstanding of the case, Maryland law, and equitable remedies. The plaintiff in *Charles County Broadcasting* initiated its cause of action in equity, seeking the remedy of specific performance.¹³¹ Once equitable jurisdiction attached, the issue of whether equity could give compensatory damages arose. Although Maryland has recently effected a merger of law and equity, at the time of this case the court was still struggling with the issue of whether legal remedies could be given in courts of equity.¹³² The court in *Charles County Broadcasting* stated that if the remedy of specific performance is a possibility when plaintiff brings suit, “but while the action is pending, a vendor disables himself from performing his contract, damages may be awarded in lieu of specific performance.”¹³³ The court goes on to say that damages are to be “based on value at the time the transfer was to be made, and not on contract price.”¹³⁴ Indeed, the court orders damages which are based on the market-contract differential. Professor Childres’ characterization of this as punitive is mistaken. In Maryland, as in almost all jurisdictions, an equity court can render a money judgment

125. *Id.* at 878, 477 P.2d at 502.

126. Childres, *supra* note 2, at 852.

127. 270 Md. 321, 311 A.2d 27 (1973).

128. *Id.* at 332, 311 A.2d at 33-34.

129. Childres, *supra* note 2, at 852-53.

130. *Id.* at 852 (emphasis added).

131. The specific performance sought was actually an order that Charles County Broadcasting execute an additional agreement which had become a necessary condition to approval of the transaction by the Federal Communications Commission. *Charles County Broadcasting*, 270 Md. at 322, 311 A.2d at 29.

132. MD. R. PROC. 2-3011 (1986) currently provides, “There shall be one form of action known as a ‘civil action.’” See Bourne & Lynch, *Merger of Law and Equity Under the Revised Maryland Rules: Does It Threaten Trial by Jury?*, 14 U. BALT. L. REV. 1, 5-10 (1984).

133. *Charles County Broadcasting*, 270 Md. at 325, 311 A.2d at 30 (1973) (citations omitted).

134. *Id.* at 332, 311 A.2d at 34 (1973) (citation omitted).

for compensatory, but never for punitive, damages.¹³⁵ Professor Childres based his conclusion on the court's statement that loss of bargain damages are "available when a vendor acts in bad faith."¹³⁶ The Maryland court cites *Hartsock v. Mort*,¹³⁷ an 1892 Maryland case, which quotes from the Michigan case of *Hammond v. Hannin*,¹³⁸ as follows:

If the vendor acts in bad faith,—as, if having title he refuses to convey, or disables himself from conveying,—the proper measure of damages is the value of the land at the time of the breach, the rule, in such case, being the same in relation to real as to personal property. But, on the other hand, if the contract of sale was made in good faith, and the vendor for any reason is unable to perform it, and is guilty of no fraud, the clear weight of authority is that the vendee is limited in his recovery to the consideration money paid and interest, with perhaps in addition, the costs of investigating the title.¹³⁹

This view, essentially the English rule,¹⁴⁰ does not by its very terms restrict loss of bargain remedies to proof of bad faith in an action at law under section 2-713. In fact, pre-UCC sale of goods cases have consistently given loss of bargain damages in Maryland without any showing of bad faith.¹⁴¹ Clearly, the remedy in *Charles County Broadcasting* was not thought by the court to be, as Professor Childres puts it, a penalty. Professor Childres, basing his position on this misunderstanding, makes the unfounded claim that in all of the five cases he discusses there is the notion that the court "is using [section] 2-713 as a punitive damage provision."¹⁴²

Nevertheless, Professor Childres' article, as well as the position taken by Professors White and Summers, has had an effect on the outcome of two recent decisions which have not permitted a buyer's remedy to include "loss of bargain."

In *M. K. Metals, Inc. v. Container Recovery Corp.*,¹⁴³ buyer contracted with seller to purchase scrap material. Buyer had con-

135. "This long-standing and almost universal rule is based on the notion that an equity court is a 'court of conscience' and 'will permit only what is just and right with no element of vengeance.'" Brown, *The Law/Equity Dichotomy in Maryland*, 39 MD. L. REV. 427, 444 n.114 (1980) (citing *Superior Constr. Co. v. Elmo*, 204 Md. 1, 20, 104 A.2d 581, 585 (1954)).

136. *Charles County Broadcasting*, 270 Md. 334, 311 A.2d 35. Childres, *supra* note 2, at 852 n.9.

137. 76 Md. 281, 288-89, 25 A. 303, 304 (1892).

138. 21 Mich. 374, 387 (1870).

139. *Charles County Broadcasting*, 270 Md. 324, 311 A.2d 31.

140. See C. McCORMICK, DAMAGES §§ 177-179 (1953).

141. *Phillips Sheet & Tin Plate Co. v. W. W. Boyer & Co.*, 133 Md. 119, 105 A. 166 (1918); *Packard Iron & Metal Co. v. H. P. Pearl & Co.*, 139 Md. 498, 115 A. 761 (1921).

142. Childres, *supra* note 2, at 852-53.

143. 645 F.2d 583 (8th Cir. 1981).

tracted to resell the material after it had been processed. M. K. Metals' expert on the issue of lost resale profit calculated lost profits based on the difference between the cost of scrap metal at the contract price and the resale price M. K. Metals was receiving for a ton of processed metal (minus freight and processing costs). At trial, buyer asked for an instruction that it be entitled to market price less contract price plus lost profits on resale contracts which could not be kept because of the breach. The court of appeals allowed only lost profits stating, "because [buyer's] calculations [of lost profits] were based on contract price rather than market price (which was considerably higher), his estimate of lost profits, in fact, already included the difference between contract price and market price."¹⁴⁴ The court cited White and Summers for the proposition that to limit damages to only lost profits in this situation was proper because "to allow damages on both of appellant's theories would amount to double recovery."¹⁴⁵

In order to analyze this decision, we can view it as we have prior hypotheticals. We assume again that buyer values money at 4 and goods at 5 while seller values money at 5, and goods at 4. We also have X, who is under contract to purchase the goods from buyer. X values the goods at 7, but money only at 4. The additional factor now to be added is that on the date of performance of buyer's contract with seller, (Z), who reflects the market demand, values the goods at 6.

If seller breaches in this case and buyer cannot cover, section 2-713 should give buyer:

Market price at time of breach	6
Less contract price	-5
Plus buyers's lost resale price	+2
Damages	=3

The court in *M. K. Metals* agrees with Professors White and Summers that this amounts to a double recovery and that buyer should get only +2.

But one should ask whether giving only +2 in damages fulfills the policy of the UCC to put the buyer in the position he would have been had seller performed. Professors White, Summers and Childres base their position on the idea that market price (6) is merely hypothetical cover and is not a measure of real damage because buyer has not in fact entered the market.¹⁴⁶ The flaw in this

144. *Id.* at 590.

145. *Id.* at 590-91 n.4.

146. J. WHITE & R. SUMMERS, *supra* note 4, at 224-25; Childres, *supra* note 2, at 843.

argument is the assumption that buyer can ever actually separate himself from the market. In fact, buyer is tied to the market in various ways. In our hypothetical, buyer not only loses his resale profit, he may also be subject to a lawsuit by *X* which will have as its damage basis market price at the time buyer breaks his contract with *X*. Buyer and *X* have also assigned risks as to future market activity. If, at time of performance of the contract between buyer and *X*, the market value of the goods has risen to 9, then buyer will be liable to *X* for market price (9) less contract price (7), or +2. Buyer can certainly recover this loss from seller as a foreseeable consequence of seller's breach; and no one will argue that if buyer now gets damages of lost profit (-1) plus damages suffered in consequence of the breach (-2) that buyer is getting double recovery. What is clear is that seller, in making the contract with buyer, assumed the risk of a rise in market prices. Buyer assumed the risk that the price of the goods would remain stable or at least not fall. If seller turns out to have been wrong, and the market price goes up before date of performance, then seller should pay the contract/market differential, just as buyer would suffer a loss if the market price drops.

If, under the policy of section 1-106, buyer is to be treated as though he had the goods, then we must take into account that buyer would have had a choice of whether or not to fulfill his contract with *X*. Buyer, on seeing a rising market, may prefer to hold the goods and not sell them to *X* in the hope that market price will go well above 6 or 7. If buyer delivers to *X*, he makes +1. If the market price of the goods goes over 9, he can hold the goods in the hope that they will continue to rise to offset the damages he must pay *X*.

On the other hand, buyer may try to sell to another immediately upon getting the goods, anticipating that the market will cool before he must deliver to *X*. Buyer has contracted *into* this position and seller should not unilaterally be able to retract the gamble they both agreed to take and have his/her liability limited by buyer's having hedged his bet by a second contract with *X*. Market price less contract price at time set for performance best equates with the value of this gamble to buyer. Buyer had positioned himself in a limited risk situation by making a contract with *X*. Buyer's position is based on his reliance that seller will perform. Buyer could have made a contract with another seller who would have delivered the goods.

If seller now does not deliver, he deprives buyer of his options. This is an *opportunity cost* to buyer for having chosen to contract with seller rather than another seller who would have delivered. In effect, seller has deprived buyer of the goods on the date they set for

performance and should pay the going rate for the goods on that date.

If buyer has also been made unable to perform his contract with *X* because cover is not available, he should also get his lost resale profit (or damages he suffers as a result of a suit by *X*). Seller should not, through breach, be able to replace the risk he took in his contract with buyer by taking over buyer's risk on the contract with *X*. Measuring lost opportunity cost may, in general, be difficult, but arguably, the allocation of risk as represented by the market price at time of performance/contract price differential is its most certain measure.¹⁴⁷ The *M. K. Metals* decision completely disregards this main purpose of the contract; that is, the allocation of market risks. Under the court's teaching, section 2-713 would allow no more than consequential damages.¹⁴⁸

The *M. K. Metals* court actually adopted a view that started in an article by Professor Peters,¹⁴⁹ which was amplified by Professors Childres, White and Summers. Professors White and Summers, while agreeing that the best explanation of section 2-713 is that it is "a statutory liquidated damage clause, a breach inhibitor,"¹⁵⁰ argue that this is not consistent with the policy of section 1-106, which is to put buyer in as good a position as performance and no more. Indeed, White and Summers equate the use of section 2-713 with the granting of punitive damages as part of their argument for giving a buyer only lost profits when he has not been able to cover.¹⁵¹

Another decision, *Allied Cannery & Packers, Inc. v. Victor Packing Co.*,¹⁵² is a very recent example of a court's struggle not to

147. See Jackson, *supra* note 88, at 94-95, who proposes that the spot price as of the date of repudiation be used. He admits, however, that a traditional commentator would say that this is antithetical to the expectation principle.

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

J. WHITE & R. SUMMERS, *supra* note 4, at 394-95 n.91.

149. Peters, *supra* note 14, at 259.

150. J. WHITE & R. SUMMERS, *supra* note 4, at 225.

151. *Id.* at 234.

152. 162 Cal. App. 3d 905, 209 Cal. Rptr. 60 (1984).

overcompensate the victim of a breach. In reaching its decision, the court employs not only the narrow view of compensatory damages put forth by White and Summers, it also carries forward Professor Childres' misconceived position that section 2-713 is a penal provision which only allows complete section 2-713 relief in cases of bad faith. It is worth looking at the case in some detail as an example of an array of misconceptions about expectation damages.

Buyer, an exporter of raisins, entered into two contracts to buy from seller a total of 375,000 pounds of raisins at 29.75 cents per pound. The total contract price was therefore \$111,562.50 less a four percent discount of \$4462.50. Buyer had contracts to resell the raisins to Japanese firms at the price of \$111,562.50 so that its profits on resale would have been the \$4462.50. These contracts, unlike others we have reviewed, took place in an environment of governmental regulation. The Raisin Administration Committee [hereinafter referred to as RAC], established pursuant to a federal marketing order, determines the amount of raisins grown in the United States which must be sold outside the Western Hemisphere or to government-sponsored programs. Members of RAC, including the seller here, could purchase such raisins from RAC at below-normal market price if they filed an application with RAC and deposited ninety-five percent of the price. At the time of buyer's contract with seller, seller was able to purchase raisins from RAC at 22 cents per pound. One month before the contract was to be performed and before seller had filed an application or deposit with RAC, heavy rains severely damaged the raisin crop which was drying on the ground. RAC thereupon withdrew its offer to supply raisins to those who had not yet applied. Seller then notified buyer that they could not deliver on the contract. Buyer could not cover on the market. One of buyer's customers agreed to rescind its contract with buyer, so buyer sued for section 2-713 damages in the amount of \$150,281.25, representing 262,500 pounds of undelivered raisins at a market price of 87 cents per pound less the contract price of 29.75 cents per pound.¹⁵³

The court awarded buyer only lost profits of \$4,462.50. In doing so, it gave various familiar reasons taken from law review articles critical of section 2-713 as a damage measure. Borrowing language from Professors Childres, Peters, White and Summers, section 2-713 is called "hypothetical cover"¹⁵⁴ and thus does not, "absent pure accident, result in a damage award reflecting the buyer's actual loss."¹⁵⁵ The court also repeats White and Summers to the effect

153. *Id.* at 907-09, 209 Cal. Rptr. at 60-62.

154. *Id.* at 911, 209 Cal. Rptr. at 63.

155. *Id.* at 912, 209 Cal. Rptr. at 64.

that section 2-713 is an historical anomaly¹⁵⁶ and concludes along with these writers that section 2-713 is an “statutory liquidated damages clause.”¹⁵⁷

The court also cites commentators who have argued the opposite position; that “buyer’s resale contract and damage claims made thereunder are irrelevant to an award of damages, and that damages cannot be limited to a plaintiff’s actual economic loss.”¹⁵⁸ This view of section 2-713, the court finds, is in conflict with the policy stated in section 1-106 that an aggrieved party be put “in as good position as if the other party performed.”¹⁵⁹ Finding no clear resolution of this conflict in the literature, the court ultimately uses a view that seems to be derived from Professor Childres’ misreading of the *Charles County Broadcasting* case: that a buyer is entitled to market damages under section 2-713 only on a showing that the buyer acted in bad faith.¹⁶⁰

By limiting buyer to lost resale profits, 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. If the court wanted to avoid giving greater damages, it would have been better for it to view what occurred to the availability and price of raisins as being beyond the risks contemplated by the parties and thus to have ruled under the doctrine of commercial impracticability as provided in section 2-615(a).¹⁶¹

156. *Id.*

157. *Id.* at 912-13, 209 Cal. Rptr. at 64-65.

158. *Id.* at 914, 209 Cal. Rptr. at 65.

159. *Id.*

160. *Id.* at 915, 209 Cal. Rptr. at 66.

161. § 2-615. Excuse by Failure of Presupposed Conditions.

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

U.C.C. § 2-615(a) (1977).

See J. WHITE & R. SUMMERS, *supra* note 4, at 1132 n.176, citing a California case, *Mineral Park Land Co. v. Howard*, 172 Cal. 289, 156 P. 458 (1916), as the strongest authority for the proposition that increased costs alone can render performance commercially impracticable.

Comment 4 to section 2-615 states:

Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made

V. ANTICIPATORY REPUDIATION: A FURTHER RESTRICTION ON BUYERS' EXPECTANCY

Recent decisions having to do with anticipatory repudiation confirm that there is currently a trend to restrict a buyer's expectation remedy. The question here is whether the courts' decisions reflect the parties' allocation of risk and transaction costs in giving expectation damages through their interpretation of section 2-713's "learned of the breach" language.

In 1980, when Professors White and Summers wrote on this subject, they had found five cases they thought held that the date buyer learned of repudiation was equivalent to the date "buyer learned of the breach."¹⁶² One case held the "breach" occurred within a reasonable time after buyer learned of the repudiation.¹⁶³ One case has followed the common law majority position that even with anticipatory repudiation, breach occurs on the date set for performance.¹⁶⁴

at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section.

U.C.C. § 2-615 comment 4 (1977).

The use of § 2-615 seems particularly appropriate in a situation where there is no free market, supplies are controlled by the government, and bad weather has caused a short supply and marked price increases.

162. J. WHITE & R. SUMMERS, *supra* note 4, at 243 n.135.

For cases adopting this obvious interpretation of the "learned of the breach" language, see *Oloffson v. Coomer*, 11 Ill. App. 3d 918, 196 N.E.2d 871, 12 U.C.C. 1082 (1973) (buyer of corn under a contract calling for fall delivery limited to contract-market damages as of June 3rd, date of seller's repudiation); *Fredonia Broadcasting Corp., Inc. v. RCA Corp.*, 481 F.2d 781, 12 U.C.C. 1088 (5th Cir. 1973) (Fifth Circuit said in calculating contract-market damages resulting from seller's repudiation, 2-713(2) specifies that the measuring market price is the price at the time the buyer learned of the breach); *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283, 16 U.C.C. 7 (7th Cir. 1974) (measure of damages for seller's repudiation is contract-market difference at time buyer learned of the breach); *Bliss Produce Co. v. A. E. Albert & Sons, Inc.*, 35 Agric. Dec. 742, 20 U.C.C. 917 (1976) (buyer may recover damages for seller's repudiation based on contract-market difference on date buyer learned of the breach); *Burgess v. Curly Olney's, Inc.*, 198 Neb. 153, 251 N.W.2d 888, 21 U.C.C. 794 (1977) (measure of damages for repudiation by the seller is contract-market difference on the day the buyer learned of the breach).

Id.

163. *Id.*

For a case interpreting the "learned of the breach" language to mean a "commercially reasonable time" after the buyer learns of the repudiation, see *First Nat'l Bank v. Jefferson Mortgage Co.*, 576 F.2d 479 (3d Cir. 1978) (damages resulting from seller's anticipatory repudiation should be measured from date buyer learned of the breach where buyer failed to show it was commercially reasonable to await seller's performance for any significant amount of time after the repudiation).

164. *Id.* For a case interpreting the "learned of the breach" language to mean "time of performance" in anticipatory repudiation cases, see *Cargill, Inc. v. Stafford*, 553 F.2d

Other cases available at that time (and since) give unanimous approval of the position that date of repudiation is the same as the "date buyer learned of breach."¹⁶⁵ There is still some discussion of the use of a reasonable time after the breach but no recent holdings for this position.¹⁶⁶ These decisions do not discuss allocation of risk, transaction costs, efficiency, or distribution of wealth. They assume their interpretation to be the only possible reading of section 2-713 and ignore the common law rule that time of performance is time of breach.

CONCLUSION

Until recently, it could be said that judges applied section 2-713 in varying ways without exhibiting the need to justify their positions. In fact, in the past, judges seldom even commented on the existence of opposing views or competing policies.¹⁶⁷ This situation understandably annoyed commentators and led to numerous articles suggesting that section 2-713 be abolished, changed, or interpreted to give more just and efficient results. The suggested changes have ranged from those that would limit buyers' relief to consequential damages to those that would award buyers' unconventional relief for nonpecuniary loss or even allow punitive damages. This Article has pointed out that the first view is based on too narrow a notion of efficiency and that the latter view involves unnecessary restructuring of contract law. If a judge gives full section 2-713 expectancy damages including both transaction costs and opportunity costs as evidenced by the contract/market price differential at time of breach, plus consequential damages, the policy of the UCC will be met.

Lately, in both *M. K. Metals* and *Allied Cannery & Packers*, judges have taken account of the conflicting views surrounding section 2-713. Unfortunately, both courts, one in the Eighth Circuit, the other in California, have adopted the most restrictive positions on buyer's damages. This Article is intended to reverse that trend.

1222 (10th Cir. 1977) (under § 2-713, where the aggrieved buyer neither covers nor seeks specific performance, and the buyer has a valid reason not to cover, damages resulting from a seller's anticipatory repudiation should normally be measured from the time performance would have been due under the contract).

165. *URSA Farmers Coop. Co. v. Trent*, 58 Ill. App. 3d 930, 374 N.E.2d 1123 (1978); *Weiss v. Karch*, 62 N.Y.2d 849, 46 N.E.2d 155, 477 N.Y.S.2d 615 (1984); *Pendleton Grain Growers v. Pedro*, 271 Or. 24, 530 P.2d 85 (1975).

166. *See Weiss v. Karch*, 62 N.Y.2d 849, 466 N.E.2d 155, 477 N.Y.S.2d 615 (1984).

167. *Simon & Novack*, *supra* note 28, at 1397.