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THE DECLINE OF THE CONTRACT MARKET DAMAGE MODEL*

By James J. White**

In law school every American lawyer learns that the conventional measure of damages for breach of a sales contract is the difference between the contract price and the market price. Even before these rules were embodied in the Uniform Sales Act and the Uniform Commercial Code (UCC), they were a staple of Anglo-American common law. They remain the rules with which a court would determine damage liability not only for the sale of goods, but also for the sale of real estate and securities.

These rules are now stated in sections 2-713 and 2-708 of the Uniform Commercial Code. Section 2-713 reads in part as follows:

[T]he measure of damages for non-delivery or repudiation by the seller is the difference between the market price . . . and the contract price together with any incidental or consequential damages . . . .

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2. See 11 S. Williston, supra note 2, § 1399 nn.11 & 12.

In 2-708(1) the subtrahend and minuend are reversed.\(^4\)

The UCC is even less equivocal in choosing this measure of damages than was the earlier Uniform Sales Act, for the Sales Act provided the contract market formula merely as an example and had the following general expression: "The measure of damages is the loss directly and naturally resulting in the ordinary course of events, from the seller's breach of contract."\(^5\) In the UCC the generic statement of damage measure is gone. The contract market formula is embraced as the answer.

Starting with Professor Peters, several commentators have expressed puzzlement about the widespread acceptance of the contract market measure and about the justification for its use.\(^6\) It is now commonplace for commentators and courts to acknowledge that the formula does not put the plaintiff in the same position as performance would have, for "only by the sheerest of accidents"\(^7\) does the remainder produced by the formula equal the true value of the contract's performance to the plaintiff. In a series of unrelated cases that has arisen since 1980, several courts have gone beyond professors' puzzlement and have refused to apply the contract market formula as measure of a plaintiff's damages even in circumstances where the language of the Code seems to authorize the use of the contract market difference.\(^8\)

My thesis is that the contract market formula is no more than a model, a model of the kind used by social scientists to simplify and to

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4. Section 2-708(1) reads, in part, "[T]he measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price . . . and the unpaid contract price together with any incidental damages . . . ."

5. **Uniform Sales Act** § 67(2) (1950). Uniform Sales Act § 67(3) adopts the contract market formula, stating, "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 . . . ." *See also Uniform Sales Act* § 64(a) and (b).


remove variables that cannot be controlled. When we claim that a plaintiff’s true loss is equal to the market formula difference, we are confusing metaphor for reality. I argue here that the market formula should be rejected as a model where it produces too great or too little recovery.9 For the purpose of this article, I assume that the only goal of contract damages is to put the plaintiff in the same position as though the contract had been performed, not better and not worse.10

**CODE LIMITS ON THE USE OF THE FORMULA**

Although the Code adopts the contract market model in sections 2-708 and 2-713, it explicitly authorizes a plaintiff to use a different and more favorable model in certain circumstances. In other circumstances, namely where the plaintiff has either covered or resold, it appears that the Code prohibits the plaintiff from using the contract market model. In another circumstance where the plaintiff keeps the goods, it is clear that the Code prohibits the plaintiff’s use of it.

The most prominent departures from the contract market model are section 2-712, Cover,11 and section 2-706, Resale.12 In the former section, the buyer is permitted to “cover” by purchasing on the market when his seller breaches and to recover the difference between the cover price and the contract price. In the latter section, the seller, complying with somewhat more complex rules, may sell on the market and recover the difference between his actual sale price and the contract price that the defendant had agreed to pay. Although there is some dispute about whether and in what circumstances a plaintiff who has properly covered or resold is free to elect the contract market model as an alternative, it is clear that the defendant cannot force the plaintiff to use 2-713 or 2-708 in circumstances in which the plaintiff properly elects the use of cover or resale.

Sections 2-706 and 2-712 may do more than give the plaintiff an option. In some circumstances they may foreclose the plaintiff’s use of the formula where the plaintiff is shown to have covered or resold.

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9. I recognize that sometimes there will be honest disputes about what is too much or too little or about the standards to measure such values.
10. See U.C.C. § 1-106(1) (“remedies . . . administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . .”). See also RESTATEMENT OF CONTRACTS § 329 comment a (1932).
11. Where the buyer has properly covered, § 2-712(2) states, in part, “[t]he 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 . . . .”
12. Section 2-706(1) provides, in part, “[w]here the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages . . . .”
The question whether a plaintiff buyer who has covered or a plaintiff seller who has resold must use 2-712 (cover) or 2-706 (resale) is a matter of debate. Where the seller is a lost volume seller, resale should not be a limitation on the seller's right to recover under 2-708. In that case the seller could have resold, and yet made an additional sale, thus the resale of defendant's goods do not make up for the loss. However, on the buyer's side under 2-712 and on the seller's side when the seller is not a lost volume seller, Professor Summers and I have argued that a plaintiff may not use 2-713 and 2-708(1), but is limited to the cover or resale remedy. On the buyer's side that position is suggested by comment 5 to 2-713 which 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.

There are only a few cases that deal with the question whether the cover or resale remedies foreclose the plaintiff from resorting to the contract market formula, but most agree with us. The third situation in which the Code has abandoned the contract market measure as the appropriate measure of damages for breach of contract arises when defective goods are accepted and never returned to the seller. In such circumstances 2-714(2) makes the measure of damages the "difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted . . . ." In the usual case that differential in value will not take account of changing market

14. See, e.g., Cosden Oil & Chem. Co. v. Karl O. Helm Aktiengesellschaft, 736 F.2d 1064, 1076 (5th Cir. 1984) ("[A] buyer who has truly covered may not be allowed to seek higher damages under section 2-713 than he is granted by section 2-712 . . . ."); Coast Trading Co. v. Cudahy Co., 592 F.2d 1074, 1081-83 (9th Cir. 1979) (seller who fails to satisfy resale conditions of 2-706 may not recover greater damages under 2-708 than he could have recovered if his resale had satisfied 2-706); Flood v. M. P. Clark, Inc., 319 F. Supp. 1043, 1047 (E.D. Pa. 1970) (where plaintiff covered, court would not award higher contract market damages). Cf. Ralston Purina Co. v. McFarland, 550 F.2d 967 (4th Cir. 1977) ("hedging" contract not considered cover; therefore plaintiff was entitled to contract market damages); Interior Elevator Co. v. Limmeroth, 278 Or. 589, 565 P.2d 1074 (1977) (Buyer sought and was granted contract market damages in spite of his having covered; however, the contract market damages were less than those recoverable under 2-712. The court apparently would have allowed damages based upon cover if the plaintiff had sought them.). See also G. Wallach, The Law of Sales Under the Uniform Commercial Code para. 8.02 and 10.02 (1981); 11 S. Williston, supra note 2, § 1381.
15. Section 2-714 provides in full,

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss
conditions. Assume, for example, that a buyer purchases corn which turns out to have a fungus that reduces its value by 10 percent. Assume further that the market price of corn drops from the contract price of $2.50 per bushel to $2.00. If the buyer does not revoke or reject, he is not free to sue for the contract market differential, but is limited to the 10 percent diminution in value suffered because the corn was moldy. It may seem self-evident that in that case the contract market differential would not measure the buyer's injury, for by hypothesis the plaintiff buyer is going to keep the corn that was delivered. Yet, it is no more self-evident in this case that the contract market difference does not measure the damages of the plaintiff than it will be in some of the cases we discuss below.

The fourth significant deviation from the contract market model is 2-708(2):

If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit . . . which the seller would have made from full performance by the buyer . . . .

This subsection is the most explicit and self-conscious departure from the market formula in the Code. In effect, it recognizes the right of a lost volume seller to recover his profit in circumstances in which the market model has a peculiarly uncomfortable fit with reality. As-

resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

16. See, e.g., Roy Stone Transfer Corp. v. Budd Co., 796 F.2d 720 (4th Cir. 1986); Consolidated Data Terminals v. Applied Digital Data Sys., Inc., 708 F.2d 385 (9th Cir. 1983).

17. For example, in Kaufman v. Diversified Indus., 460 F.2d 1331 (2d Cir. 1972), the plaintiff received and accepted delayed tender of securities in a failing market. The plaintiff then argued that the difference between the contract value and the actual value upon tender was the appropriate measure of damages. The court disagreed and held that, absent evidence that the plaintiff would have sold the securities during the period of delayed performance, delayed tender caused him no damage.

18. As it turns out, the courts have applied 2-708(2) and the commentators have argued for its application in a much broader array of cases than in the most obvious fixed-price goods example. See, e.g., Vitex Mfg. Corp. v. Caribtex Corp., 377 F.2d 795 (3d Cir. 1967); Union Carbide Corp. v. Consumers Power Co., 636 F. Supp. 1498 (E.D. Mich. 1986); Alter & Sons, Inc. v. United Eng'rs & Constructors, Inc., 366 F. Supp. 959 (S.D. Ill. 1973) (2-708(2) provided seller's damages for buyer's breach of contract to purchase specialized equipment that could not be readily resold); Snyder v. Herbert Greenbaum & Assoc., Inc., 38 Md. App. 144, 380 A.2d 618 (1977) (whether or not plaintiff qualified as a lost volume seller, he was entitled
sume a case in which the seller manufactures aircraft and can easily manufacture more airplanes than he has customers in any year. Assume further that his variable costs and price change little from the first to the last aircraft manufactured. If the person with a right to buy the fifth aircraft on the line that year breaks his contract, and the aircraft is manufactured and sold to the sixth person at the same price that the first had agreed to pay, the market formula in 2-708(1) will show no damages because the contract price will be equal to the market price and the formula would suggest that the seller had suffered no injury.

If the seller would have made the sixth and subsequent sales even if the original buyer had not breached his contract, the seller has suffered an injury equal to the profit on one sale. Put another way, if the defendant had purchased his aircraft, the plaintiff seller would have had one additional sale and is injured by the breach to the extent of the loss of his profit on that sale. Recognizing this loss and understanding that the market formula would not grant any recovery, the drafters gave the plaintiff the option of recovering his lost profit under 2-708(2). As with 2-706 and 2-712, it is clear that the seller in a proper circumstance may elect to use 2-708(2) instead of 2-708(1). However, with those two sections, it is unclear whether the defendant can force the plaintiff to use 2-708(2); that is, it is not clear whether the defendant can assert 2-708(2) as a ceiling on the plaintiff’s damages under the contract market formula.19

The final explicit limit on the use of the market formula is found in 1-106. That provision says that remedies should be applied “to the


end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . .” The implication from 1-106(1) is that the goal of the drafters was to put the plaintiff in the same position as performance, not better and not worse. Courts that deviate from the market formula invariably rely upon 1-106. How the drafters could have intended 1-106 to fit together with the two formulae in Article Two is not clear. It is hard to see how one who held the pen in drafting 1-106 could also have put the market formulae into 2-708 and 2-713. Conceivably Llewellyn—the principal drafter of Article Two—regarded 2-713 and 2-708 merely as throwaways and believed that plaintiffs—at least those plaintiffs who are not lost volume sellers—would always end up in 2-706 and 2-712. Surely he visualized the latter two sections as important and powerful innovations that would resolve many of the damage issues in Article Two.

20. Apparently little consideration was given the actual interaction between 1-106 and the remedy provisions of Article Two. The New York Law Revision Commission considered 1-106 to counsel against an unduly restrictive interpretation of the Code’s remedial provision. 1 NEW YORK LAW REVISION COMM’N, STUDY OF THE UNIFORM COMMERCIAL CODE 201 (1955) [hereinafter N.Y. LAW REVISION COMM’N]. Section 1-106(1) is without roots in any prior uniform law; however its language can be found in earlier cases. E.g., Chicago, M. & St. P. Ry. v. McCaul-Dinsmore Co., 253 U.S. 97, 100 (1920) (“the actual loss caused by breach of a contract is the loss of what the contractee would have had if the contract had been performed, less the proper deductions . . . .”).

Prior to drafting the Code, Llewellyn himself recognized the problems with the contract market formula, stating: “The normal remedy for breach . . . remains for us damages. Our trouble is chiefly that our rules have so over-rigidified (especially on the amazingly naive assumption of a frictionless market) that the remedy is often inadequate, even when realized.” Llewellyn, What Price Contract—An Essay in Perspective, 40 YALE L.J. 704, 737 (1931). Even with the liberalizing addition of 1-106, the contract market formula still produces inadequate remedies. In his analysis of 2-708 for the New York Law Revision Commission, Professor Edwin Patterson noted the inconsistency, writing,

My thought here is that, literally speaking, the market value test is never wholly adequate “to put the seller in as good a position as performance would have done,” since even if the seller promptly resells at the available market price, he has the trouble, burden and risk of making another sale.

1 NEW YORK LAW REVISION COMM’N 695 n.371 (1955).

21. In fact, in an early version of the Code, section 1-106’s predecessor was included under the “Remedies” heading along with the contract market formulae. See UNIFORM REVISED SALES ACT 102(1) (1948 Draft), in 5 UNIFORM COMMERCIAL CODE DRAFTS 283 (E. Kelly ed., 1984).

22. In his commentary to the second draft of the Revised Sales Act, Llewellyn foresaw the cover and resale provisions as being the standard practice among merchants after a breach. He used the term “cover” to encompass both buyer’s cover and seller’s resale. REVISED SALES ACT § 58 and comment (2d Draft 1941), in UNIFORM COMMERCIAL CODE DRAFTS 522-24 (E. Kelly ed., 1984). Llewellyn commented, “[M]ost merchants in most cases will in fact resort to cover . . . .” REVISED SALES ACT § 58-A comment, id. at 526. See also Llewellyn, supra note 21, at 737-38 (favoring the English and German “cover” remedies as a means of avoiding the inadequacy of the contract market formula); 1 N.Y. LAW REVISION COMM’N 698-99 (1955) (analysis of 2-713 by Professor Honnold: “The purpose of Section 2-713(1) . . .
This review of Article Two’s damage provisions shows that the drafters did not embrace the market formula as the only or even the most frequently used model for measuring the plaintiff’s expectations. Their deviance in cover and resale transactions, in lost volume sales, and as to goods that are accepted, shows that the drafters regarded it as only a model and at least suggests that Llewellyn and his friends might welcome some of the deviant decisions that we discuss below.

**The New Cases**

In four cases decided since 1980, two United States courts of appeals, one federal district judge and one state appellate court have taken a step beyond the explicit UCC provisions to reject the market model. In each of the four cases the plaintiff argued for the contract market difference under 2-708 or 2-713 as its damage. In each of the cases the courts accepted the defendant’s argument that the contract market differential would overcompensate the plaintiff and was unavailable to it. Because they do more than simply authorize the plaintiff to elect to use a non-market model, and, in fact, force an unwilling plaintiff to use a non-market model, the cases are a large step beyond the Code’s explicit limitations upon the use of the market model.

Two of the cases are based in part upon an interpretation of 2-708(2). The other two cases, on buyer’s damages, have no similar statutory support and may be regarded as a more radical departure.

In the first of the four cases, *Nobs Chemical, U.S.A., Inc. v. Koppers Co.*, the plaintiff, Nobs, had a contract for $540,000 to sell one thousand metric tons of cumene (a hydrocarbon that is used as an additive for high-octane motor fuel) to Koppers. Nobs and its selling partner had a contract to purchase the cumene from a Brazilian seller for a net price of $445,000. Nobs’ profit on the completed contract would have been $95,000. When the price of cumene descended from $540 per ton to approximately $220 per ton, Koppers breached. Nobs

is presumably to prevent the buyer’s getting any more damages by waiting for the market to go down. . . . The buyer is thus encouraged to ‘cover’ promptly.”


The conflict between the contract market formula and actual loss formula is not unique to cases since the U.C.C. Prior cases also disagreed as to the proper measure of damages where the contract market formula may overcompensate the plaintiff. Compare Brightwater Paper Co. v. Monadnock Paper Mills, 161 F.2d 869 (1st Cir. 1947); Coombs & Co. v. Reed, 5 Utah 2d 419, 303 P.2d 1097 (1956); with Foss v. Heineman, 144 Wis. 146, 128 N.W. 881 (1910).

24. 616 F.2d 212 (5th Cir. 1980).
sued Koppers under the Texas equivalent of 2-708(1) and asserted a right to the difference between the contract ($540 per ton) and the market price ($220 per ton), approximately $320,000. The defendant argued successfully that the plaintiff should be foreclosed from the use of 2-708(1) and that its damages should be measured under 2-708(2). Relying both on Texas law\(^2\) to the effect that the measure of damages should put the plaintiff in the same position as though performance had occurred and upon the similar statement in 1-106, the court agreed with the defendant. It read 2-708(2) as applicable not only when the measure of damages in subsection (1) is “inadequate to put the seller in as good position as performance” but also to cover the case in which subsection (1) is “more than adequate” and thus overcompensates.\(^2\)

Apparently Nobs could not have purchased cumene on the market (at $220) and sold to its buyer (at the contract price of $540) because of its pre-existing contract with the Brazilian seller. Nor was it obligated after Koppers’ breach to buy from the Brazilian seller. The contract with the Brazilian seller was analogous to a requirements contract under which Nobs was obliged to purchase all of its requirements from the Brazilian firm, but it was not obliged to make any purchases if it had no requirements. For that reason, the case cannot be applied directly to the situation in which the seller is obliged to purchase the product at a high price, and thus suffer a loss because it must resell it at a much lower market price when its buyer breaches. Nor does the case speak directly to a situation where the seller has no contract to buy. In such a case the intermediate seller (Nobs) could change its plans and purchase on the low cost market. It would thus capture the benefit that arose from the falling price and from having a higher, fixed-price contract.

The second seller’s case is *Union Carbide Corp. v. Consumers Power Co.*\(^2\) Consumers Power agreed to purchase 10,000 barrels of residual fuel oil per day from Union Carbide from September, 1980 to the end of 1987. The contract was signed at or near the top of the oil market; shortly the price of residual oil plummeted. At the same time, it appears that Consumers Power’s need for residual oil to generate electricity declined. Union Carbide had entered into a contract with Petrosar for purchase of the residual fuel to be produced at Pe-


\(^2\) 616 F.2d at 214-15.

trosar's refinery in Sarnia, Ontario. Consumers' contract price was based upon the price in Union Carbide's Petrosar contract. Thus, Union Carbide was guaranteed a certain but fixed profit.

When Consumers Power refused to accept any more oil after the end of 1981, Union Carbide first made payments to Petrosar in lieu of taking the oil. Ultimately Carbide negotiated its release from its contract to purchase by paying $20 million (Canadian) to Petrosar and by assigning another contract to it. Carbide then sued Consumers Power and asserted a right to the contract market difference, which it estimated at approximately $120 million. At the time of the motion for summary judgment the plaintiff estimated its lost profits under 2-708(2) at approximately $30 million. Although there never was a trial on the issue of what the lost profits would have been, that too would have involved complicated legal and accounting analysis since Petrosar and its Sarnia refinery were reorganized after the Petrosar contract was cancelled.\(^2\) The refinery's output was redirected so that it produced less residual fuel and more highly valued products. To what extent Carbide's "net profit" from the Consumers Power contract under 2-708(2) could have been reduced or increased under the formula in 2-708(2) because of savings, expenses, and newfound profits in the Sarnia refinery's output was never litigated.

As in Nobs Chemical, Carbide was not free to go on the market and satisfy the Consumers Power contract. The contract between Consumers Power and Union Carbide clearly contemplated the sale of residual fuel from the Sarnia refinery that was to be sold to Carbide under the Petrosar contract. Had Carbide chosen to purchase on the market, the pricing mechanism in the Consumers Power contract would not have worked. The price in the Consumers Power contract was dependent upon the base price in the Petrosar contract and rested on the obvious assumption that the residual oil would be purchased from Petrosar.

Following Nobs Chemical, the court held that the plaintiff could not use market damages but was limited to 2-708(2). The court interpreted the word "inadequate" in 2-708(2) as follows:

[I]nadequate should be interpreted to mean incapable or inadequate to accomplish the stated purpose of the UCC remedies of compensating the aggrieved person but not overcompensating that person or specially punishing the other person.\(^2\)\(^9\)

28. Since Union Carbide was itself one of the shareholders in Petrosar, computation of incidental damages would also have been quite complicated.

Like the Court of Appeals for the Fifth Circuit, Judge Joiner relied upon the exhortation in 1-106, that a plaintiff should recover only damages necessary to put him in the same position as though performance had occurred.

In *H-W-H Cattle Co. v. Schroeder*, the plaintiff, H-W-H, was a middleman buyer of cattle. When seller failed to deliver 603 head of cattle, buyer sued for the higher contract market difference rather than for lost profits. Defendant argued that the buyer should be limited to its resale commission of $.35 per hundred weight. In this case H-W-H was an "order-buying cattle company which purchased cattle on commission for feedlots." H-W-H did not own any feedlots itself. It had made a contract to resell the cattle to Western Trio Cattle Co. for $67.35 per hundred weight. The difference between the $67.00 purchase price and the $67.35 equalled $1,371.83 for the cattle that were not delivered. Because H-W-H was a *buyer*, suing under 2-713 not under 2-708, the Court of Appeals for the Eighth Circuit could not rely on 2-708(2) or on the statutory history that lies behind 2-708(2). Protected exclusively by 1-106, the court had to make a frontal assault on 2-713. It found that the former Code section authorized the court to reject the apparently unqualified indorsement of the market measure in 2-713(1). For that reason this case and the one that follows are more radical departures from the market formula than the two prior cases.

The fourth and most elaborate case is *Allied Canners & Packers, Inc. v. Victor Packing Co.* The plaintiff, Allied, was a corporation that exported dried, canned, and frozen food from San Francisco. Defendant Victor was a Fresno packer and processor of fruits. Victor

30. 767 F.2d 437 (8th Cir. 1985).
31. 767 F.2d at 438.
32. There is one troublesome aspect to this case. How could the court be so sure that $1,300 would put the plaintiff in as good a position as if performance had occurred? What if its customer, Western Trio, had sued it for failure to deliver cattle? Would it not then need that additional amount, for which it did not have damage liability? The court stated only that Western Trio "had made no demand on HWH to fulfill the remainder of the contract." 767 F.2d at 440. It reported that Western Trio was "managed" by the same family that owned H-W-H. Moreover, it pointed out that the price of cattle declined during the summer of 1979 and, implicitly, suggested that Western Trio may not have been injured because the market may have been at or below the contract price at the time it would have or could have covered. Clearly if Trio would have had a right to damages and would have made that claim, the case should come out the other way. In that circumstance, the buyer's damages would clearly exceed its commission for it would have had to buy cattle on a higher market to satisfy Trio or it would have been liable itself for contract market damages to Trio. Of course, if as suggested above, the market promptly fell and if it therefore could have covered for less than the contract price, it might not have suffered any damages.
had agreed to sell a large quantity of select natural Thompson seedless raisins to be delivered F.O.B. port of Oakland during October 1976. The contract required Victor to sell raisins to Allied at 29.75 cents per pound with a discount of four percent. Seller characterized the four percent discount as "a commission" and the buyer called it "the standard trade discount." Allied in turn had made contracts with two Japanese purchasers for the raisins at 29.75 cents per pound; it would earn $4,462.50, the four percent differential. During the night of September 9, 1976, heavy rains severely damaged the raisin crop in California, which was then drying on the ground. As a result, the raisin administrative committee that controlled the allocation of raisins between American and overseas markets, withdrew its proposal to release overseas raisins to those who had not already bought them prior to September 10, 1976. For that reason Victor was unable to purchase raisins throughout the remainder of September. When raisins again became available in October—apparently because of the action of the administrative committee—the price was as high as 87 cents per pound. On September 15, Victor notified Allied that it would not deliver under the contract.

Allied never covered. It negotiated a release of the contract with one of its Japanese purchasers. Although the second refused to release it from the contract, that buyer never sued Allied on the contract. The second buyer may have failed to sue because it regarded the force majeure clause in its contract with Allied as effective. In any event, the statute of limitations on that contract had run at the time of the trial between Allied and Victor. At the time of that trial, it was clear that Allied would have no legal obligation to its Japanese purchasers.

Predictably Allied sued under 2-713(1) for the contract market difference of $150,281.25. Defendant argued that plaintiff should be treated as a broker and should be awarded only its "brokerage fee" of $4,462.50.

The court ultimately agreed with the defendant and awarded only the four percent differential. Like the courts described above, the California court placed strong reliance upon 1-106. It also gave substantial analysis to the purpose of 2-713. Acknowledging the point first made by Professor Peters and repeated by others that 2-713 might be looked upon as a "statutory liquidated damage clause," the court found that this was not an appropriate case for such damages.

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34 If we were to accept the argument that 2-713 and 2-708 were in effect statutory liquidated damages, then section 2-718(1), which permits retroactive invalidation of such clauses,
The court hinted that the statutory liquidated damages idea might be appropriate when the defendant has acted in bad faith. However, it concluded that there was no evidence of bad faith or inappropriate conduct in this case by the seller, Victor. It reached that conclusion despite the fact that Victor was not itself the farmer, but merely a middleman purchaser and despite some testimony that Victor passed up the opportunity to buy substitute raisins at 36.25 cents per pound and fulfill its contract. The court also declined to accept Allied’s argument that it had lost not just this contract but the entire account with Shoei, the second Japanese purchaser.  

If one believes that putting the plaintiff in the same economic position as performance is the only purpose of granting contract damages in Article Two of the Uniform Commercial Code, the four cases seem correct and defensible. In each of them the court could be confident that the measure of damages it proposed more closely approximated the economic benefit that would have been earned from performance of the contracts than the market formula would have.

THE OTHER CASES

One might fairly assert that the four cases discussed above are sports, that they are deviant, for none of the plaintiffs was able to take advantage of the rising or falling market. Nobs could not buy on a low market because it had a requirements contract with its Brazilian seller. Carbide could not do so because it was obliged to deliver from Petrosar’s Sarnia refinery. Allied and H-W-H were each tied to their resale contracts. A defender of the market formula could concede the merit of those cases and yet maintain that the market formula is the

might suggest that 2-708 and 2-713 should also be altered in the light of actual events. I thank my co-author, Professor Speidel, for this idea.

35. My colleague, Avery Katz, has suggested the possibility that Allied bargained explicitly or implicitly for the right to get out of the contract in force majeure circumstances. If that is so, and if in fact Allied paid for that right, arguably Allied should enjoy the benefit of escaping its contract with the Japanese buyer and thus should recover the full contract market difference. Of course one can only guess about the real bargain over the force majeure clause and whether the post breach behavior of the Japanese buyer arose out of any explicit bargain. The clause might have been boilerplate put in the the contract by the Japanese buyer’s lawyer to allow them to escape from the contract in other circumstances.

The rights of the subpurchaser or of the upstream seller that is not a party to the lawsuit suggest interesting and difficult questions in several of these cases. If there was no explicit bargain and if the one actually injured is a party outside the contract (whether the Japanese buyer or the Brazilian seller) presumably that person should ultimately get the benefit of the damage recovery. Courts in each of these cases have apparently decided that the plaintiff will not transmit the recovery but will keep it and, in that sense, that the large recovery would be a windfall to the plaintiff.
proper measure in the great majority of cases where the plaintiff would have been free to "go on the market." The argument is appealing, but here too I have reservations about the unlimited use of the market model.

To understand the argument, consider two recent cases. In *Trans World Metals, Inc. v. Southwire Co.* the market for aluminum declined after the contract was signed. When buyer, Southwire, broke its contract for the purchase of aluminum, the court allowed the seller, Trans World, to recover the contract market difference of $6,702,529. It allowed that recovery in the face of defendant's argument that such payment overcompensated the plaintiff, and it rejected *Nobs Chemical* as an analogy. Absent Southwire's repudiation, Trans World may have been able to purchase on the market and so satisfy its contract with Southwire at a greatly reduced cost. If it had done so, it would have reaped a benefit equal to the difference between the contract price and the market price. Because Trans World was betting on the direction of aluminum prices, unlike the seller in *Nobs Chemical*, Trans World did not have a supply contract that guaranteed a profit on resale to Southwire. It should—so the argument goes—be awarded the contract market difference.

The second opinion, also by Judge Newman of the Second Circuit, is *Apex Oil Co. v. Vanguard Oil & Service Co.* There the buyer, a trader who intended to buy oil and resell it to another, sued for the contract market difference even though it had failed to cover and had not replaced the oil that should have been delivered under the contract. In rejecting the defendant's argument that the buyer should be barred from the contract market difference because of its failure to cover, the court concluded that the UCC formula "reflects a policy judgment that it makes more sense to award the amount of that saving to the buyer than to permit the non-performing and non-covering seller to retain it." At the time of the breach the buyer could have purchased replacement oil on the market at the higher market price. If it then resold that oil at the same, or a higher price, it would have been damaged by an amount at least equal to the difference between the higher market price and its contract price with the seller.

In both *Southwire* and *Apex Oil*, Judge Newman rejected the defendant's argument that the market formula overcompensated the

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36. 769 F.2d 902 (2d Cir. 1985).
37. 769 F.2d at 908-09 & n.5.
38. 760 F.2d 417 (2d Cir. 1985).
39. 760 F.2d at 424.
plaintiffs. Note, however, that the judge was not necessarily awarding, and did not say that he was awarding, damages exactly equal to the plaintiff's loss. These cases are different from the first four because here the plaintiff might have damages that equal or exceed the market formula number, whereas the first four plaintiffs surely did not.

Yet it is pure metaphysics to say that these plaintiffs suffered damages exactly equal to contract market difference. If the contract had been performed in Southwire, the seller might have purchased at the lower market price and fulfilled the contract, but the opinion contains no such finding. The seller might have been a manufacturer who could not economically close his manufacturing facility and turn to the market. The seller might have been uninformed about the market and turned to a different market, or have been unable to turn to the market because of legal or pragmatic obligation to purchase from a third party who was not selling at that market price. In sum we can only guess about the economic benefit of the contract to the buyer.

One can make exactly the same point about Apex Oil. Because he conceded it, we know that the plaintiff buyer failed to cover. By awarding him the difference between the contract and market—the hypothetical cover difference—we are treating him as though he could have resold the oil for at least the amount of the market price that prevailed at the time of breach. Had the contract by the seller been performed, it is plausible that the buyer would have made much more or much less by resale at a higher or a lower price than the market price on the date of breach.

One is tempted to treat these and other mainstream cases as entirely different from the four cases discussed above. Some might say that the market model exactly fits the plaintiff's behavior and returns him the economic benefit of the contract, but that is not true. In fact, these cases differ in only one important respect from the four cases decided above. There one is certain that the market formula grants more than the economic value of the contract. Here one is less certain. If one could be certain that Trans World would not have resorted to the lower market to satisfy its contract, and if one could be positive that Apex would have held the oil until the market price went well below the market at the time of breach, the cases are no different from Nobs Chemical, Consumers Power, and the others.

I argue, therefore, that these cases are not part of a different genus; they belong to the same family and they are distinguished from
one another by our confidence about the fit between the market model and the economic value of the contract.

Does that mean that *Apex Oil*, *Southwire*, and similar cases are incorrectly decided? I do not believe so, but I do believe it is time to question the routine acceptance of the market formula even here. One should not criticize Judge Newman for giving the most obvious and conventional reading to 2-713 and 2-708(1). Applying those sections to these cases is the proper judicial role, to listen to the legislatures' instructions. I suggest only that it is time to listen more carefully to 1-106 in certain of these cases.

For at least two reasons the market formula should not be discarded. First, to abandon completely the market formula would be a clear violation of the drafters' intention. It is one thing for the California court to say that the drafters did not intend 2-713 to apply to that particular case; it is quite something else to say there are no cases to which 2-713 could apply. Neither Llewellyn nor the legislatures could have intended that.

Secondly, a complete rejection of the market formula would unnecessarily complicate all contract damage cases. If a plaintiff can prove the market formula and the defendant is incapable of proving it overcompensates, judicial efficiency should allow the plaintiff to recover the contract market difference. To require every plaintiff to prove the economic value of the contract without use of the market model would make even the smallest contract case into an accountant's nightmare.

I suggest only that the defendant be given an opportunity to prove the value of the contract to the plaintiff. If, for example, the defendant can prove that the plaintiff who is purchasing cattle invariably held those cattle for a two-month period to fatten them and then sold them, and show further that the market declined by the time he would have sold them, the market formula should be rejected in such a case. I would allow the defendant to offer such proof.

If defendants can prove actual losses would have been less than contract market damages, should plaintiffs be allowed to prove the inverse? For instance, the defendant may be able to show that the plaintiff, a buyer of cattle, typically purchases cattle, fattens them for market, and sells them at least a month later. In a falling market, the defendant could show that the plaintiff's actual loss is less than contract market damages since plaintiff would not have sold when the price was high. If such proof is accepted, it would be difficult to deny a plaintiff the chance to make the same proof in a rising market. In such a situation, the plaintiff would demonstrate that he would have waited, as he always has, before reselling. His failure to cover in such a situation should not prevent the plaintiff from recovering an amount greater than contract market damages. In a free and efficient market it is difficult to say that any decision
CONCLUSION

It would be a fair criticism of this paper to say that I have assumed away the hard questions. By assuming that the exclusive goal of contract damages is to put the plaintiff in the same position as performance would have, I have ignored many hard questions about why that is the only and the appropriate goal.41

The question why plaintiff’s damages should be more or less than the value of the contract is for another day. Partly I fail to confront that question because I am not confident of the answer. One can argue that limiting the plaintiff to recovery of the value of performance will facilitate efficient breaches of contract.42 However, when one begins to analyze particular breaches of contract, often it is impossible to tell whether a breach is efficient. It seems likely that Consumers Power’s breach of its contract that caused Union Carbide and Carbide’s seller to redirect the output of the refinery to other products at least played a part in producing an efficient outcome. Usually one cannot draw such conclusions. Moreover, some of the common arguments about the efficiency of various breaches are flawed.43

Indeed one might argue for larger damages—special or punitive damages—also on efficiency grounds. One can certainly construct a...
plausible argument that certainty of contract performance itself has efficiency consequences. In a regime of great uncertainty, parties will spend time and money to prevent or anticipate breaches, or they will avoid some contracts altogether.\textsuperscript{44} If a contracting party is uncertain about his opposite number's willingness to carry out the contract, he may engage in a variety of strategic, hostage-taking behavior. Clearly, such strategic behavior and the foreclosure of certain sensible contracts would be inefficient. This fact argues for larger, not smaller, penalties to be imposed upon breaching parties. But how does one measure these inefficiencies? And how does one measure the extent to which added penalties increase the likelihood of performance? If these costs are unmeasureable, the problems become imponderable. I despair, therefore, of making the case that either increasing or decreasing contract damages will improve efficiency.

Finally, one might argue for larger damages on the ground that breaking a contract is an immoral act and that the law should punish such acts. The dominant theme of American contract law for nearly a century has been Justice Holmes' statement that there is nothing immoral about breaking a contract.\textsuperscript{45} A party is always free to perform or to pay damages; no moral opprobrium attaches to the selection of the damage alternative. In theory the breaching defendant gives the plaintiff his due in the form of damages or performance. Although few academics have challenged this proposition, some courts seem to be in open rebellion.\textsuperscript{46} Some of these cases rest squarely on moral grounds. Some might read the good faith requirement in Article Two to make some breaches of contract immoral acts. Doubtless there are silent judicial devotees to that theory even in the commercial context, and presumably they would be happy to impose

\textsuperscript{44} See Schiro, \textit{supra} note 43, at 1744-45; Farber, \textit{supra} note 43.


penalties even on the efficient but immoral breacher. If this new morality captures our courts and legislatures, a century of contract damage ideas must be discarded.

I conclude, therefore, by conceding that the goal I have chosen for contract damages is not the only conceivable goal, and I concede my own confusion and doubt about the ultimate policies that are achieved by this damage remedy compared with another. I confess, too, considerable skepticism about the proposition that even substantial changes in contract damage remedies will have a measureable effect upon the behavior of contracting parties. Some breaches of contract are not rational decisions; they are dictated by events beyond the parties' control. Even a scheming contract breacher must make his decision in ignorance of a large variety of events that will affect the expected value of his damage liability even if the law were absolutely certain and known to him. Because of the radical uncertainty about a specific damage recovery, a business breacher may short-circuit its measurement and instead respond to the certain and imminent events: for example, "If I buy the cumene for the contract price of $540,000 when the market price is $220,000, I will suffer an instant loss of $320,000. Perhaps I should breach and hope to win the lawsuit or hope that the other party does not sue me."

In the end this paper contains a modest proposal. It does not argue for a radical rethinking of the goal of contract damages. Rather it takes as a given that we wish to put the plaintiff in the same position as though performance has occurred and argues that the contract market model frequently displaces other and better models. It is my view that we should become less respectful of the contract market formula and be more willing to use other models.

47. E.g., K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985). Cf. Allied Canners & Packers, Inc. v. Victor Packing Co., 162 Cal. App. 3d 905, 915-16, 209 Cal. Rptr. 60, 66 (1984) (leaving open the question of whether bad faith would warrant higher damages in order to prevent unjust enrichment). The sentiment disfavoring contract breaches is not new. See, e.g., Coombs & Co. v. Reed, 5 Utah 2d 419, 303 P.2d 1097 (1956) (court was unwilling to sanction an enrichment in favor of one who breached his contract); Foss v. Heineman, 144 Wis. 146, 154-55, 128 N.W. 881, 884-85 (1910) (although evidence did not indicate a "moral unfairness" in the breach, court hinted that breaching party should not benefit from such a breach).

48. Professor Speidel has suggested to me that some of these cases might be explained as a judicial effort to lighten the burden on one who has suffered changed circumstances in cases where the change is not sufficiently extreme to allow a complete abolition of the contract under 2-615. He puts forward the interesting hypothesis that the Allied case might be one where the court thinks the seller should not escape from the contract entirely, but where it is using the damage sections of the Code to lighten the seller's loss in view of the fact that its failure to perform arose from a quasi-catastrophe.