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AN ICONOCLASTIC VIEW OF MARKET PRICE

Historically, the full compensation principle has been relied upon to ensure that contract remedies facilitate, rather than interfere with, the role of bilateral exchange in the voluntary transactions that allocate resources in a market economy. The mechanism on which courts have settled to implement this imperative is, in the common run of cases, to award damages in an amount sufficient to place the aggrieved party in as good a monetary position as she would have been in had the contract been performed, or as is frequently said, to give the aggrieved party "the benefit of the bargain."[1] The damages principle of full compensation is both fair and efficient. It is fair because, at least in theory, it provides an adequate performance substitute for the aggrieved party. Furthermore, it is efficient because of its incentive effects and predictability. Parties continue to engage in transactions because they believe their financial interests will be protected.

Part 7 of Article 2 of the Uniform Commercial Code sets forth the ground rules by which aggrieved parties–both sellers and buyers of goods–may recover damages for breach.[2] These ground rules are stated in terms of both the classification and measurement of damages. On the classification side, the Code draws substantive distinctions among incidental, consequential, punitive, and general or direct damages. The classification matters to sellers because they are generally allowed, under section 1-305, to recover only general and incidental damages, but not consequential or punitive damages. The classification matters to buyers because consequential economic losses are subject to the "notice" or "foreseeability" requirement of *Hadley v. Baxendale*,[3] which limits liability for consequential damages to those losses that should have been contemplated by the contracting parties–or, as expressed in the Code, losses of which the parties had "reason to know."[4] General and incidental damages are not expressly subject to such a requirement.

As to both buyers and sellers, Article 2 sets forth numerous methods for calculating general damages, the choice of which typically turns on whether the aggrieved party retains the goods. My concern here is with section 2-713. Under this section, if the seller never delivers the goods or if the buyer rightfully rejects the seller's tender or revokes her

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1 Restatement (Second) of Contracts § 344(a) cmt. A (1981).

2 Although there are numerous statutory sources of law that now regulate modern commercial practice, the Uniform Commercial Code ("UCC" or "Code") is at the center of this universe of codification. Since first enacted by Pennsylvania in 1953, the Code, in one form or another is now the law in all fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The focus of this article will be on Article 2 (Sales) and the buyer's remedy of market price damages under section 2-713.

3 See Hadley v. Baxendale, (1854) 156 Eng. Rep. 145 (Exch. Div.) 149-52.

4 See U.C.C. § 2-715(2)(a) (stating that consequential damages include "any loss resulting from general or particular requirements and needs of which the *seller at the time of contracting had reason to know*") (emphasis added); *Baxendale*, 156 Eng. Rep. at 151.

acceptance, general damages will be the difference between the market price at the time when the buyer learned of the breach and the contract price.[5] Market price is, therefore, a critical element of the statutory formula that measures the buyer's general damages. But there are apparent difficulties with any formula that relies on market price.

For example, market price may vary at different times and places. Consequently, the drafters had to specify the relevant place and time at which to determine market price. They established the relevant place as "the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival"[6] and the relevant time as "when the buyer learned of the breach."[7] What they neglected to do, however, was to provide us with a statutory designation (e.g., wholesale or retail) of the appropriate market.

In this article, I intend to challenge the prevailing assumption by courts and commentators alike, that the relevant market in which to determine price is the market in which the buyer is likely to go to make a substitute purchase or cover. This view of the relevant market is implicit in the geographic and temporal choices made by the drafters and is made explicit in the Official Comments to section 2-713: "The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief."[8] The appropriateness of the cover market seems most compelling with respect to those buyers who intend to retain the goods for their own personal use. After all, their ultimate interest is in turning cash into goods ($ –> goods). However, for buyers who intend to resell the goods, the cover market is less relevant, for what they care most about is converting cash into more cash ($ –> goods –> $$). There is no statutory mandate that we treat dissimilar buyers in a similar manner. In fact, the jurisprudence and history of Article 2 as a realistic, fact-sensitive set of rules plainly contradict that idea.

It helps to appreciate the jurisprudential perspective of Professor Karl Llewellyn here. Llewellyn, the chief reporter for the Code and the principal draftsperson for Article 2, was one of the most influential figures in the realist assault on the conceptualism of the old order.[9] He strongly believed that to achieve "The Good, The True, The Beautiful in

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[5] U.C.C. § 2-713 reads:
Section 2-713. Buyer's Damages for Non-Delivery or Repudiation. (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 between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (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.
U.C.C. § 2-713. If the aggrieved buyer makes a substitute purchase (i.e., "covers"), then compliance with section 2-712 entitles it to recover the difference between the cover price and contract price.

[6] U.C.C. § 2-713(2).

[7] Id. § 2-713(1).

[8] Id. § 2-713 cmt. 1. Notwithstanding this statement in the Comment regarding the appropriate market, courts are free to adopt a "better" approach if one were offered.

[9] In fact, the term "legal realism" has its genesis in an article by Llewellyn. See Llewellyn, Karl N.: *A Realistic Jurisprudence – The Next Step*. 30 Colum. L. Rev. 431. 1930. Although realism was "neither a coherent intellectual movement nor a consistent or systematic jurisprudence," Horowitz, Morton J.: *The Transformation of American Law, 1780 – 1860. The Crisis Of Legal Orthodoxy*. Oxford, Oxford University Press, 1992. 169–170 p., one of its most basic characteristics was a rejection of the formalism of English law in favor of law that would work in context with an ever-changing American society.

Law,"[10] its rules have to be informed by reality–they have to be grounded in fact-situations–with emphasis placed upon the circumstances of the overall setting of the transaction.[11] These considerations can be seen throughout Article 2 supporting, for example, the principles of unconscionability,[12] good faith,[13] and a provision mandating that every agreement be read to include any applicable usage of the particular trade.[14]

Another example of where Llewellyn elevates commercial reality into the law is in section 2-509 ("Risk of Loss in the Absence of Breach"). In pre-Code days the concept of title served as the jack-of-all-trades in sales law.[15] One had only to decide who had title and the answers would neatly follow to such diverse questions as where the risk of loss lay, whether the seller could maintain an action for the price, whether the buyer could replevy the goods, and whether the seller's or buyer's creditors could levy on the goods.[16] But for Llewellyn, the neatness of such a singularity of issue was not worth its price:

> The quarrel thus is, first, with the use of Title for purposes of decision as if the *location* of Title *were* determinable with certainty; and second, with the insistence on reaching for a single lump to solve all or most of the problems between seller and buyer–and even in regard to third parties.[17]

Thus, when the drafting of the Code began, Llewellyn was convinced that the time had come to scrap title as a means to resolve sales controversies. The unpredictable applications[18] and irrationality of title led Llewellyn to fear that if its then-prominent role were enshrined in the Code, the effects would be intolerable. Making the most of his opportunity, Llewellyn boldly relegated title to backseat status in the Code. In its place are specific rules premised on considerations peculiar to the problem at hand. Take, for example, the default rules governing risk of loss. The several rules stated in section 2-509 are based on different methods of delivery and the character of the seller. By dealing with risk of loss in a number of settings, the risk is theoretically placed on the party in the best position to insure against the loss or take the necessary steps to avoid it. Thus, we have a far more practical solution to the issue than the location of title approach of pre-Code law.

Perhaps the most significant set of provisions that illustrate Llewellyn's realist tenet that legal rules must relate to the facts and circumstances of a given transaction are those that single out merchants for special treatment. Here, Llewellyn certainly intended to

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[10] See LLEWELLYN, Karl N: *On the Good, the True, the Beautiful, in Law*. 9 U. Chi. L. Rev. 224 1942.

[11] See generally TWINING, William: *Karl Llewellyn And The Realist Movement.* London – Dobbs Ferry, Weidenfeld and Nicolson – Oceana Publications, 1973. (providing an interpretation of Llewellyn's thought and its development).

[12] U.C.C. § 2-302.

[13] Id. § 1-304.

[14] Id. § 1-303.

[15] See generally Llewellyn, Karl N.: *Through Title to Contract and a Bit Beyond*. 15 N.Y.U. L.Q. Rev. 159 1938..

[16] Id.

[17] Id. At 166.

[18] Llewellyn explained: "Nobody ever saw a chattel's Title. Its location in Sales cases is not discovered, but created, often *ad hoc*." Id.at 165.

make rules more realistic or adhere more closely to the actual behavior of marketplace participants. In a comment to the 1940 draft of the Revised Uniform Sales Act (what later became U.C.C. Article 2), he wrote:

> There are a considerable number of situations in Sales in which the practices, understandings, and needs between merchants are strikingly different from those where one of the parties or both stands outside the business course of dealing-as-a-business. A private buyer of furniture, for instance, can find the goods wholly unusable for him because of an error in color or finish, whereas the same defect could be readily adjusted with a dealer-buyer. The processes of negotiating adjustment are different. The speed of remedy required is different.[19]

Thus, Article 2 contains 13 provisions specifically tailored for merchants.[20] In some cases, merchant obligations are placed upon the merchant regardless of whether the other party qualifies as a merchant.[21] However, in others, the obligations are imposed in transactions "between merchants."[22] Although one might quibble with the substance of Llewellyn's status-based classification scheme, no one has argued that the status of the parties should be irrelevant.

But why should any classification-based structure of rules not take into account other distinctions that may exist with regard to the categories of buyers and sellers? Indeed, as early as the 1930s, Professor Nathan Isaacs wrote a series of articles critical of the "cash-and-carry" conceptualism of the Uniform Sales Act of 1906 (the statutory precursor to U.C.C. Article 2).[23] He was mindful that squeezing a single set of rules out of a stereotypical transaction had its advantages–but at what cost? If the law of sales failed to track the differences that actually existed among market participants, he argued that we would see a "lack of plasticity or adjustability to time and circumstance, artificiality, inaccuracy, and occasional hardship."[24] Isaacs' interest in and insistence upon having the law conform to actual markets led him to suggest a refinement of sales law that would, at a minimum, take into account the different circumstances that surround transactions by a seller-manufacturer, consumer-purchaser, dealer-purchaser, and manufacturer-purchaser.[25]

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[19] Report and Second Draft: the Revised Uniform Sales Act 178 (1941)

[20] A "merchant" is defined "as a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction." U.C.C. § 2-104.

[21] See, e.g., id. § 2-205.

[22] See, e.g., id. § 2-201(2).

[23] See Isaacs, Nathan: *The Industrial Purchase and the Sales Act*. 34 Colum. L. Rev. 262, 262 1934. (describing the type of sale envisioned by the Sales Act "as one by a dealer who is likely to be the maker, to a lay consumer. The picture is satisfied by the horseman who stops at the saddler's door to buy a new saddle"); see also Isaacs, Nathan: *Dealer – Purchaser*, 1 U. Cin. L. Rev. 373 1927.

[24] Isaacs: *The Industrial Purchaser,* supra note 23, at 262.

[25] See generally id.

Two things seem fairly obvious. First, that Llewellyn was quite familiar with the practical ideas on classification expressed by Isaacs in his articles.[26] Second, and perhaps more importantly, Llewellyn shared those ideas. Like Isaacs, his skepticism about the merits of traditional legal distinctions or classification was pervasive. He was convinced that, if not drawn accurately enough, these distinctions would inevitably lead to partial, inconsistent, and incorrect analyses of contract problems.[27] He tended to regard the then-existing classification scheme of sales law as too "overbroad for intelligent use."[28]

Now, consider the undetailed and imprecise concepts like "seller" and "buyer." Within each there is neither guidance for the judge nor any substantive rules to create meaningful results in the cases. Yet, there is a remarkable contrast among sellers who are manufacturers, wholesalers, and large and small retailers. Similar distinctions can be drawn among buyers who are consumers, dealers, and industrial buyers for use. These subcategories are consistent with Llewellyn's commercial law conceptualism and are best seen in his fixation on expanding the scope of the legally relevant in the underlying transaction.

Why is it, therefore, in light of Llewellyn's concern for commercial reality, that Article 2 fails to differentiate among these various subcategories of buyers and sellers? Whether this statutory neglect of distinctions is the result of Llewellyn's assessment of the politics of legal change, a fear that he might be slicing doctrine a bit too thin, or perhaps some other cause, we have no way of knowing. Whatever may be the cause, nothing would suggest that, in some instances, sales law would not be improved by recognizing the need for different treatment for different subcategories of buyers and sellers.

Against this background, a reasonable assumption is that Llewellyn probably would have agreed that the adoption of a single, uniform market price standard in all section 2-713 actions should be rejected as too inflexible and simplistic to adequately address the compensation objectives of buyers for use and buyers for resale. The importance of the intended use of property in the determination of market price or value has for some time been the subject of heated debate in legal areas other than sales. Perhaps the most significant of these areas is bankruptcy, in which courts and commentators have struggled for years in an attempt to establish a use-theory of value.[29]

Given the importance of assessing value in bankruptcy, a court is faced with the predicament of having to choose between competing valuation standards.[30] Up until 2005,

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[26] See Llewellyn: *Through Title*, supra note 15, at 159 (describing the scholarship produced by Isaacs as "the most challenging material on our [s]ales law which I have seen in print").

[27] Llewellyn intimated this when he wrote:

The building of rules of law is by its very nature based on classification. Sound and wise building of rules of law calls for sound and wise classification of the problem-situations. Such classification makes for justice-in-result[.]

K. N. Llewellyn, Memorandum Replying to the Report and Memorandum of Task Group 1 of the Special Committee of the Commerce and Industry Association of New York, Inc. on the Uniform Commercial Code (Aug. 16, 1954).

[28] See Llewellyn: *Through Title*, supra note 15, at 160.

[29] Valuations of property (both real and personal) occur in bankruptcy for reasons that are both too numerous and complex to detail here. For a list of some of these reasons, see Carlson, David Gray: *Secured Creditors and the Eely Character of Bankruptcy Valuations.* 41 Am. U. L. Rev. 63, 65-70 1991.

[30] Id at 64 ("Because valuations are not verifiable propositions, it is impossible to say as an objective matter

the Bankruptcy Code was relatively silent on the issue. Its only guidance came from section 506(a), which stated that value "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."[31] This statement and its legislative history suggest that courts will have to determine the relevant valuation standard on a case-by-case basis and that a valuation at one time for one purpose would not be binding at a later time for another purpose. Then, in 2005, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act, Congress added a new paragraph to section 506(a), which establishes that the applicable standard of valuation as to an individual debtor in a Chapter 7 or 13 shall be "replacement value."[32]

Even if one grants the wisdom of Congress in setting the proper valuation standard for Chapters 7 and 13 individuals, it is simply implausible to believe that the serious ambiguity that surrounds the concept of value has been finally removed from bankruptcy practice. For one thing, section 506(a)(2) says nothing about the choice between replacement at retail cost, replacement at wholesale cost, or replacement at a cost indicated in a widely distributed publication of price quotations, such as Bluebook. For another thing, in situations not covered by section 506(a)(2) courts are faced with the choice of either liquidation or going concern value. In making this choice, courts have tended to associate the former value with liquidation cases and the latter value in reorganization cases. Such an approach, is consistent with the mandate of section 506(a), which requires consideration of how the property is being used.

In the end, the valuation theorist, in any context, must rest his claims on the idea that value is necessarily a function of the purpose of the exercise and the anticipated use of the property. Thus, it is of no small import that such a theorist recognize that if there is no fixed meaning of the term "value" generally, what reason is there to believe that there should be a unitary concept of "value" in the field of damages that fails to give effect to its purpose and the situation at hand? This translates to nothing more than making a determination of value relevant to practical concerns.

Returning to section 2-713, one question that has been uniformly ignored entails the market price component of its damages formula. The question is, what market? As previously noted, Comment 1 to section 2-713 answers this question by referring to the market in which the buyer would have sought cover.[33] But this conventional market definition can lead to ambiguity and confusion when a contrast is drawn between two basic categories of buyers: there are those buyers who buy for use or consumption and those buyers who buy for resale. It is important to differentiate between these two categories. With regard to those buyers who purchase for use, not for resale, there is little reason to be skeptical of an approach that looks to the price in the relevant cover market. To the extent that section 2-713 is designed to reflect a hypothetical universe in which the buyer purchases substitute goods, there can be no other market that makes even remote sense.

whether valuation standards must adhere to 'liquidation' versus 'going concern' value, or between 'use' or 'exchange' value, or whether valuation should be *ex ante* or *ex post* transaction costs.").

[31] 11 U.S.C. § 506(a).

[32] Id. § 506(a)(2).

[33] See, supra note 8.

Quite a different possibility emerges when the buyer is some sort of middleman who intends to resell the goods. The consequence of middleman status is that two markets compete for attention: there is the market in which the buyer buys and the market in which it resells. Assume for example, that the seller breaches a contract to supply goods at $8,000 to a wholesaler or middleman buyer. The market price at the time the buyer learns of the breach, in the wholesale market in which he normally buys, is $10,000. On that same date, the higher retail market price in the buyer's selling market is $15,000. All academic commentary and case law assume that the relevant market price for purposes of section 2-713 is $10,000 and raise the issue of whether the buyer should be permitted to recover a total of $9,000 (damages for the lost resale contract ($15,000-$8,000 = $7,000) added to the buyer's market damages ($10,000-$8,000 = $2,000)).[34] The standard answer is that damages should be limited to the seller's actual loss, which in this hypothetical case, would be the $7,000 profit lost from its inability to resell.[35]

More subtly, we might realize that if the market price that matters for purposes of section 2-713 is the price at which the goods could be sold by the buyer, the preceding issue would no longer concern us. Even more subtly, this approach to market price would have the effect of transforming what are now perceived to be consequential damages recoverable under 2-715 (i.e, the seller's lost profit) to general or direct damages recoverable under section 2-713. By this process of re-characterization, damage claims that were previously denied would potentially become recoverable today. The reasons for this are several, but one stands out as most significant.[36]

Consequential damages within the scope of section 2-715 are limited to those "which could not reasonably be prevented by cover or otherwise."[37] There is, however, no mitigation requirement that would bar a buyer from recovery under section 2-713 merely because she decided not to take advantage of an available cover option. Therefore, a court inclined to take the approach suggested here to the determination of market price might well give an aggrieved buyer its consequential damages without regard to whether the lost profit could have been minimized by reasonable steps taken to replace the promised goods.

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[34] Of course, the claim for consequential damages assumes an inability to cover (i.e., mitigate) and that the loss was foreseeable by the seller at the time of contracting. See U.C.C. § 2-715.

[35] See, e.g., M. K. Metals, Inc. v. Container Recovery Corp., 645 F.2d 583, 590-91 (8TH Cir. 1981) (the buyer should recover only lost profits because "to allow damages on both of appellant's theories would amount to double recovery").

[36] For losses that fall outside the sections that govern general damages, section 2-715(2) limits liability by requiring that the seller have reason to know at the time of contracting the general or particular requirements or needs of the buyer. Recovery of lost profits under section 2-713 would not require such a showing. However, such a change in statutory focus is unlikely to alter the outcome of many cases. Presumably, most sellers who sell to wholesalers or middlemen have reason to foresee that if delivery is not made as agreed, the buyer will lose a profit on the anticipated resale. A "foreseeability" test would, therefore, in this situation, have little effect. Recovery under section 2-713 might also make inapplicable a generally worded clause limiting or excluding consequential damages under section 2-719(3). However, one suspects that this effect of shifting the buyer's recovery from section 2-715 to section 2-713 would be short-lived. Sellers would soon learn to redraft clauses to address this change.

[37] U.C.C. § 2-715(2)(a).

This idea, that lost resale profits should be measured through the medium of market price, not only tends to bring the buyer closer to full compensation,[38] it avoids what may be a number of potentially difficult issues. Gone would be the need to determine and allocate overhead expenses that would otherwise have to be deducted from the anticipated resale price if the buyer seeks his expected profit directly under section 2-715(2). Gone, too, would be the issues of whether there was a replacement market for the goods and whether it would have made good sense for the buyer to enter into that market.

These practical benefits aside, it is simply implausible to maintain that an award of damages based on the difference between a hypothetical cover price and the contract price is not in reality a partial surrogate for the recovery of lost profits. If the relevant market price for purposes of section 2-713 is the cost of cover, then the wholesale buyer is forced to recover one component of its lost profit under that section and the remainder of its lost profit under section 2-715(2)(a).[39] Ultimately, a switch to resale market price under section 2-713 eliminates this bifurcated recovery and assigns to one section the task of dealing with two parts of a total loss that share a common essence.

This article has attempted to present a more nuanced and better perception of the assessment of market-based damages under section 2-713. To the extent that current judicial solutions to several section 2-713 issues stem from the misperception discussed herein, and to the extent that the misperception can be corrected, it is hoped that reality would now trump fiction and, in so doing, better protect aggrieved buyers with this suggested common sense approach to monetary compensation.

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38 It is the opinion of this author that the contract liability system operates in such a manner that in the average run of cases, only a fraction of losses caused by actionable breach will ever be paid by the breaching party. In fact, there are so many legal and systemic barriers to full compensation that only as an act of hyperbole can it be said that damages recovered in contract litigation put the injured party in as good a position as if the contract had been performed. These barriers include the high costs of litigation, the refusal of courts to award damages for non-pecuniary harms, the judicial treatment of interest and the time-value of money, the accepted burden of proof for actual damages, and the remedial rules of foreseeability and proportionality.

39 In the earlier example, see text accompanying note 33, this would mean that the wholesale buyer would recover the market-contract price differential of $2,000 under section 2-713, then an additional $5,000 under section 2-715(2)(a), which, when combined, would constitute the entire loss resulting from the wholesale buyer's inability to resell.