

**MUST PROFITS MADE IN TRANSACTIONS
INVOLVING LATE-DELIVERED GOODS BE
DEDUCTED FROM THE INJURED PARTY'S
BREACH DAMAGES? IF NOT, WHAT
IMPACT SHOULD LATE-DELIVERED
GOODS HAVE?**

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This Article is not intended to, and indeed cannot, encompass every fact pattern or element of damages involving late-delivered goods. That said, while the author has attempted to shed light on a murky area of the law by discussing a variety of scenarios, it is entirely possible that the theses espoused herein will need to be further tempered and augmented as facts of a given set of circumstances require.

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INTRODUCTION

In non-commercial situations involving the late delivery of goods, it is often easy to say that post-breach performance by a breaching seller totally obviates the non-breaching party's damages. This is exemplified in the following hypothetical: A agrees to sell a spare bed to B, who plans to put it in his guest room. B pays A, but A fails to deliver the bed by the agreed upon date. If A actually does deliver the bed a month later, before B secures cover, then there is little chance that B would be viewed as having been damaged. This scenario is easily understood. It is also the basis for some courts' initial negative reaction to a non-breaching commercial plaintiff's effort to recover costs or lost profits owing to the seller's initial failure to deliver *and* also seeking to retain the profits that it made on its subsequent disposition of the late-delivered goods.

Such a reaction, while perhaps understandable, fails to recognize both the state of the law and the fact that in the commercial world, given buyers' frequently more critical needs, late delivery may not cure all.¹ Indeed, viewing the late delivery as totally obviating the non-breaching party's damages would not even be appropriate in the above example of the sale of a bed if A knew that B needed the bed by the specified date, because he was expecting house guests and, as a result of A's breach, B had to rent a bed to accommodate his visitors.

Moreover, in some commercial circumstances, the injured party may have lost volume because of the breach.² That the non-breaching party has actually lost volume is certainly apparent where the non-breaching party is unable to cover and, but for the breach, the seller would have resold the goods—or manufactured them into finished products and sold them—and would have still entered into the subsequent transaction, which involved the late-delivered goods.³ Indeed, to many resellers or manufacturers, the failure of a supplier to make timely delivery may result in a lost opportunity that can never be recovered.⁴ For example, if a manufacturer with no inventory needs delivery of twenty tons of aluminum each week to make cars in its factory, which is operating at full capacity, assuming that cover were not possible on short notice, a supplier's failure to make delivery one week would result in the loss of a week's worth of auto

¹ See generally 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.11, at 802 (3d ed. 1999) (discussing a buyer's damages).

² See U.C.C. § 2-708(2) (2003) (discussing the basis for recovery for lost volume). The section, however, "addresses a group of problems that the drafters did not well formulate or well understand." JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 7-8, at 275 (5th ed. 2000). Precisely what situations it covers is "a question of 'considerable complexity with no certain answer.'" *Id.* at 276.

³ As Professor Farnsworth indicates, "[i]f a recipient is a buyer of goods for resale whose volume is limited by supply because it is exceeded by demand, the recipient may claim to have lost volume if the supplier does not deliver what the contract requires." FARNSWORTH, *supra* note 1, at 805–06. This is true in a variety of other circumstances as well, for example, when the injured party is a manufacturer who could not replace goods which was the subject of the breached contract or when a construction company which could have performed two contracts simultaneously only gets to perform one because of the owner's repudiation. See discussion *infra* note 67 and accompanying text.

⁴ See John Hackley, Note, *UCC Section 2-714(1) and the Lost Volume Theory: A New Remedy for Middlemen?*, 77 KY. L.J. 189, 219 (1989) ("[I]n commercial transactions a late delivery can be as damaging as an insufficient delivery or no delivery.").

production that can never be made up without expanding the capacity of the factory.⁵

While a non-breaching party that promptly covers will not likely have lost volume, this does not mean that it should be precluded from obtaining cover damages and also retaining the profit that it made on a subsequent transaction involving late-delivered goods. Indeed, as discussed below, the law indicates that in appropriate circumstances even a covering purchaser must be allowed to retain profits made in any subsequent transaction involving the late-delivered goods in order for it to be in the same position that it would have been in had there not been any breach.⁶ The basic correctness of this conclusion is also demonstrated in the introduction and by the illustrations set forth in Part II, particularly by those which indicate that if the amount that the breaching party would otherwise have to pay the non-breaching party were reduced by the profits that the injured party made on the transaction involving the late-delivered goods, for no good reason other than the fact that the plaintiff made a good deal of profit on a transaction that it would have entered irrespective of the breach or the late-delivery, the injured party would not be placed in as good a position as it would have been in had the other party not breached.⁷

Whether or not a covering buyer, or even one that does not cover, must disgorge some or all of the proceeds of a subsequent transaction involving late-delivered goods depends on the same proof as in the lost volume cases. For example, this would include proof that, in the absence of the breach, the non-breaching party would have made both the originally contemplated transaction involving the goods, resale or sale of finished good, and the second transaction that, by happenstance, actually involved the late-delivered goods.⁸ While this analysis does lead to the

⁵ Similarly, if a supplier of specialized headlight assemblies were unable to deliver them for a period of time which coincided with a spike in the market for autos, even if the automobile manufacturer could, upon finally receiving the headlights, run its factory at full capacity there is a good chance that it will have forever lost the opportunity to have sold a certain number of cars because they could not be produced when consumers were ready, willing, and able to buy them.

⁶ See U.C.C. § 2-305 (stating that "the aggrieved party may be put in as good a position as if the other party had fully performed").

⁷ See *infra* note 123 and accompanying text.

⁸ See FARNSWORTH, *supra* note 1, § 12.10, at 800 (discussing examples of breaches that lead to lost volume).

correct result, as noted below, similar and sometimes identical results can also be achieved in a less complicated manner simply by examining the effect of the breach on the covering party's total cost of goods for the affected transactions.

I. *FERTICO: RETENTION BY A COVERING PLAINTIFF OF THE PROFITS MADE IN TRANSACTIONS INVOLVING THE LATE-DELIVERED GOODS*

One case that tried to tackle headlong the considerably more difficult of the two scenarios noted above, namely, the issue of just how, in a commercial context, post-breach performance by the breaching party should affect the damages recoverable by the non-breaching party that has effectuated cover, was *Fertico Belgium S.A. v. Phosphate Chemicals Export Ass'n*.⁹

In October 1978, Fertico, a Belgian commodity broker, contracted with Phoschem, an American exporter of phosphate fertilizer, for 35,000 tons of fertilizer to be delivered in two lots.¹⁰ As requested, Fertico provided Phoschem with a \$1.7 million letter of credit, an amount sufficient to cover full payment for the initial shipment.¹¹ The first shipment of 15,000 tons was to be delivered no later than November 20, 1978, and the remaining 20,000 tons were to be delivered by November 30, 1978.¹² Phoschem was aware that Fertico needed these shipments by those dates so that the bulk fertilizer could be bagged and shipped in sufficient time to satisfy a secondary contract that Fertico had with Iraq's Agricultural Ministry, Altaweed.¹³

Well before the initial delivery date, Phoschem advised Fertico that the fertilizer would not arrive until December 4, 1978, two weeks late.¹⁴ In response, Fertico informed Phoschem that the delay would cause "huge problems" with its contract with Al-

⁹ 70 N.Y.2d 76, 510 N.E.2d 334, 517 N.Y.S.2d 465 (1987). As noted both above and explained further in Part II, if an injured party does not/cannot cover, provided that it is a volume dealer in goods of the type in question, it presumptively will be deemed to have "lost volume," in which case it would be entitled to the profits from transactions foregone due to the failure of its supplier *and* to retain the profits made on the subsequent transaction(s) involving the late-delivered goods.

¹⁰ *Id.* at 80, 510 N.E.2d at 335-36, 517 N.Y.S.2d at 466-67.

¹¹ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

¹² *Id.*, 510 N.E.2d at 335, 517 N.Y.S.2d at 467.

¹³ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

¹⁴ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

taweed.¹⁵ Phoschem's impending breach compelled Fertico to act. On November 15, 1978, so as to avoid breaching its secondary contract with Altaweed, Fertico acquired 35,000 tons of substitute fertilizer on the open market at a price \$700,000 higher than the contract price with Phoschem.¹⁶

The shipment from Phoschem did not arrive in Belgium until December 17, 1978, and was not off-loaded until December 21, 1978.¹⁷ Despite Phoschem's breach, Fertico took possession of the fertilizer.¹⁸ Fertico believed that it "had no other choice"¹⁹ because prior to Fertico's learning of the breach, Phoschem had already drawn down the \$1.7 million letter of credit that Fertico had posted.²⁰ Fertico did, however, cancel the second shipment.²¹

Fertico stored the 15,000 tons that it had received from Phoschem while it sought a buyer for it, and on March 19, 1979, Fertico eventually sold it to another customer, Janssens.²² Based on the cost of the fertilizer purchased from Phoschem and the price at which Fertico sold it to Janssens, Fertico made a profit of \$454,000 on the transaction.²³

Thereafter, Fertico filed suit against Phoschem seeking \$1.25 million in damages due to Phoschem's breach of the agreement.²⁴ These damages included the increased cost of cover, \$700,000, and certain consequential damages relating to increased transportation costs.²⁵ The jury granted Fertico a verdict of \$1.07 million.²⁶ The Appellate Division vacated the award and ordered a new trial on damages.²⁷ Fertico appealed this intermediate appellate decision to the New York Court of Appeals, which determined that Fertico was entitled to the increased cost of cover plus consequential and incidental damages minus ex-

¹⁵ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

¹⁶ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

¹⁷ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

¹⁸ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

¹⁹ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

²⁰ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

²¹ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

²² *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

²³ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

²⁴ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 468.

²⁵ These costs involved Fertico's having to deliver the fertilizer to Altaweed at inland points of delivery as opposed to the port of Basrah (an obligation that was included in Fertico's renegotiated contract with Altaweed). *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467.

²⁶ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 468.

²⁷ *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 468.

penses saved.²⁸ As part of this decision, the Court of Appeals also concluded that Fertico's damages did not have to be reduced by the profits that Fertico made on the sale to Janssens.²⁹ That is, the Court of Appeals analyzed the subsequent sale to Janssens as a transaction that was separate and independent, i.e., one that would have been made regardless of any dealings with or breach by Phoschem.³⁰ Stated another way, the majority believed that in the absence of the breach, Fertico, as a dealer in such goods, would have acquired fertilizer on the open market and still made the sale to Janssens.³¹

The court reasoned that "[i]t would be anomalous to conclude that had it not been for Phoschem's breach Fertico would not have continued its trade and upon such reasoning to counterpoise the profits from the . . . sale against the damages arising from Phoschem's breach."³² In doing so, and in also granting Fertico the increased cost of cover, the court applied U.C.C. section 1-106, which directs that the remedies provided in the U.C.C. be liberally administered so as to put the aggrieved party in as good a position as if the other party had fully performed.³³ In this regard, the court stated that "[h]ad [the seller] fully performed, Fertico would have had the benefit of the [sale to Altaweed] and, as a trader of fertilizer, the profits from the Janssens' sale as well."³⁴ In response to a strong dissent, the majority stated that "[t]he dissent's characterization of the recovery by an injured party of damages for a breach of contract as a 'benefit' is wrong, since that functionally attributes a kind of

²⁸ *Id.* at 82, 510 N.E.2d at 337, 517 N.Y.S.2d at 468.

²⁹ *Id.* at 83, 510 N.E.2d at 337-38, 517 N.Y.S.2d at 469.

³⁰ *Id.*, 510 N.E.2d at 337-38, 517 N.Y.S.2d at 469.

³¹ *Id.* at 84, 510 N.E.2d at 338, 517 N.Y.S.2d at 469-70.

³² *Id.* at 83, 510 N.E.2d at 338, 517 N.Y.S.2d at 469.

³³ *Id.* at 84, 510 N.E.2d at 338, 517 N.Y.S.2d at 469.

³⁴ *Id.*, 510 N.E.2d at 338, 517 N.Y.S.2d at 469. In making this conclusion, the court did not, however, indicate what price Fertico would have had to pay for fertilizer to sell to Janssens had there been no breach by Phoschem. *Id.*, 510 N.E.2d at 338, 517 N.Y.S.2d at 469. The Appellate Division of the Supreme Court, from which Fertico's appeal was taken, did, however, allude to Fertico's having accepted the goods "in a rising market." See *Fertico Belgium S.A. v. Phosphate Chemicals Export Ass'n*, 120 A.D.2d 401, 404, 501 N.Y.S.2d 867, 870 (1st Dep't 1986). In the absence of evidence of market prices, however, there is no way to determine how much profit, if any, Fertico would have made on the sale to Janssens had there been no breach by Phoschem.

lien against the independently pursued benefits derived out of that separate transaction.”³⁵

The majority's approach was subsequently criticized in *Allied Semi-Conductors Int'l, Ltd. v. Pulsar Components Int'l, Inc.*,³⁶ both in dicta, where the court indicated that *Fertico* should be limited to its “exceptional” and “peculiar” facts,³⁷ and

³⁵ *Fertico*, 70 N.Y.2d at 85, 510 N.E.2d at 338, 517 N.Y.S.2d at 470.

³⁶ 907 F. Supp. 618 (E.D.N.Y. 1995).

³⁷ *Id.* at 631. *Allied* did not involve profits derived from the disposition of late-delivered goods. Moreover, the holding is, on one level, far more extreme than the holding in *Fertico* in that there is no question that the court's ruling placed *Allied* in a far better position than it would have been in had there been no breach. *Id.* at 631–32.

Allied involved the sale of 50,000 computer chips from Pulsar to *Allied* at \$10.45 each for subsequent sale to Apple Computer at \$11.00. *Id.* at 621. The chips in question were in fact delivered to *Allied* and, subsequently, to Apple. *Id.* Thereafter, 35,000 of the chips were found to be defective and were returned from Apple to *Allied* and then to Pulsar. *Id.* *Allied* obtained replacement chips at a cost of only \$2.835 per chip and thus made a tremendous profit on the 35,000 chips that it ultimately furnished to Apple. *Id.* at 621–22. In the suit that *Allied* brought against Pulsar for the return of the purchase price that it had paid for the defective chips, Pulsar sought to offset the extra profits that *Allied* made on the transaction against the money otherwise payable, i.e., it sought to limit *Allied*'s recovery to only the increased cost *Allied* incurred, here \$0, in securing replacement chips, on the basis that *Allied* was entitled only to the “anticipated benefit of its bargain,” i.e., the \$.55 per chip that it would have made on the resale of the Pulsar chips to Apple. *Id.* at 629.

At trial before a magistrate judge, it was concluded that no such limitation of *Allied*'s damages was appropriate. The judge held that “[t]he initial sales transaction is to be treated independently of the cover transaction and any gains made on such cover will not defeat or diminish the buyer's damages as against the original seller.” 842 F. Supp. 653, 657 (E.D.N.Y. 1993) (citing *Fertico*, 70 N.Y.2d at 84, 510 N.E.2d at 334, 517 N.Y.S.2d at 465). Upon review, the District Court disagreed with the magistrate regarding the holding in *Fertico*, stating that “the *Fertico* decision does not hold that cover by a buyer to fulfill obligations on a third party contract is a separate and independent transaction.” *Allied*, 907 F. Supp. at 631. The court correctly noted that the transaction, which the *Fertico* majority had concluded to be a separate and independent one, was *Fertico*'s subsequent sale of the late-delivered goods to another customer. *Id.*

Nevertheless, the court concluded Pulsar was not entitled to avail itself of the fact that *Allied* had made far more than anticipated as a consequence of the breach. *Id.* at 632. The court simply found that the matter fell within the four corners of U.C.C. section 2-711, which provides that where a seller fails to make delivery or the buyer rightfully rejects or revokes acceptance of any goods, the buyer may cancel and may recover “so much of the [purchase] price as has been paid” plus the increased cost of cover. *Id.* at 630.

What cases like *Allied* illustrate is the “majority view” that where there is an unanticipated benefit that flows from the breach, equity favors the non-breaching party retaining the benefit. See David Simon & Gerald A. Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market*

Contracts, 92 HARV. L. REV. 1395, 1397 (1979). Indeed, had the court limited the return of Allied's purchase price for the defective goods, as Pulsar wanted, Pulsar would, for no reason other than having breached the contract, benefited in the amount of nearly a quarter-million dollars. While the non-breaching party should not be placed in a better position as a result of the breach, see FARNSWORTH, *supra* note 1, § 12.8, at 193, there is also the maxim at work, if not cited, in *Allied*, that the breaching party should not benefit from its breach. RICHARD A. LORD, WILLISTON ON CONTRACTS § 39.3, at 517 (4th ed. 2000); see also *Hughes Communications Galaxy, Inc. v. United States*, 38 Fed. Cl. 578 (Fed. Cl. 1997) (discussing how the federal government, which had breached its launch service contract with the plaintiff, was precluded from taking advantage of the fact that the plaintiff may have been able to make arrangements to shift the costs it incurred to other customers), *aff'd*, 271 F.3d 1060 (Fed. Cir. 2001). The court held that "[t]he breaching party is the wrongdoer and should not be able to take advantage of such arrangements." *Id.* at 581. One commentator has addressed the question of who should reap the benefit of profits made on a transaction involving late-delivered goods in situations like the one in *Fertico*: "Although market conditions might have affected the profit Fertico would have earned had there been no breach, it is more desirable to allow the aggrieved party to retain approximately the same profit it would have earned absent a breach, rather than to allow the breaching party to recover it." Hackley, *supra* note 4, at 200 n.82 (emphasis added). One can argue that this is what the *Fertico* majority tried to do. This appears, however, to be a far better description of what the court did in *Aluminum Distributors, Inc. v. Gulf Aluminum Rolling Mill Co.*, No. 87 C 6477, 1989 WL 157515 (N.D. Ill. Dec. 12, 1989), discussed in Section IV.

The holding in *Allied* stands in stark contrast to the conclusion reached by the court in *Allied Cannery & Packers, Inc. v. Victor Packing Co.*, 209 Cal. Rptr. 60 (Cal. Ct. App. 1984), in which a seller breached its contract to provide raisins that the buyer/middleman intended to resell and for which it had already contracted. *Id.* at 60–61. The resale would have resulted in a profit of \$4462.50. *Id.* at 61. The buyer/middleman did not cover, perhaps due to the fact that the market price of raisins had tripled. *Id.* Rather, pursuant to U.C.C. section 2-713, it sought the difference between its market price of raisins at the time of the breach and the price at which it had contracted for the raisins, i.e., \$150,281.25. *Id.* at 62. As provided for in U.C.C. section 1-106(1), the court denied such recovery on the basis that it would put the plaintiff in a substantially better position than it would have been in had the original contract not been breached. *Id.* at 66. In applying this limitation, the court stated three conditions that must be met before it would be applied: (1) the seller knows that the buyer had a resale contract, (2) the buyer/middleman is not able to show that it would be liable for breach of its re-sale contract, and (3) there has been no finding of bad faith on the part of the seller. *Id.* As stated in *KGM Harvesting Co. v. Fresh Network*, 42 Cal. Rptr. 2d 286 (Cal. Ct. App. 1995), "[t]he result in *Allied Cannery* seems to have derived in large part from the court's finding that Victor had not acted in bad faith in breaching the contract," a focus which the *KGM* court believed to be inappropriate in a commercial case. *Id.* at 292. *Allied Cannery* is discussed at some length both by Hackley *supra* note 4, at 206 and WHITE & SUMMERS, *supra* note 2, § 6-4, at 319, with the latter also discussing the impact of interesting permutation of the facts, e.g., the effect of the buyer's breach settlement with its resale purchaser. *Id.* at 320. The limitation noted above would not make sense where the buyer/middleman did not have a specific resale contract, because, as the seller knew, it was always reselling such goods (or using them to manufacture finished products for sale) at whatever the market price was at the time of such resale, etc. See generally *id.* at 302 n.30. In such instances, there is not any inherent

by commentators cited by the court.³⁸ In the latter regard, these commentators opined that Fertico had been overly compensated because:

The Code contemplates that the buyer will make a choice—either accept or reject the goods. The solution reached by the [*Fertico*] majority allows the buyer to have it both ways—profit as if the goods were accepted, and damages as if the goods had been rejected. The fault lies in treating the goods as accepted goods and then using the cover measure of damages as a test of the loss suffered. The [*Fertico*] majority's solution puts the buyer in a better position than the buyer would have been in had the contract been performed. This result is not warranted either under the generous remedies policy of the Code or by the scheme of remedies it provides.³⁹

The view that Fertico's acceptance of the goods automatically extinguished its right to the profits on their resale is not, however, held by a majority of authorities.⁴⁰ As Professors White and Summers and the Restatement indicate, whether the *Fertico* approach is appropriate does not turn on the reasonableness of the late acceptance; rather it turns on whether or not the non-breaching party regularly dealt with the type of goods in question.⁴¹ They point out that if, as the majority assumed in *Fertico*, Phoschem had performed and Fertico, as a regular dealer in phosphate, would have made both its sale to Altaweed and its sale to Janssens, then the *Fertico* majority would be correct.⁴² They also point out that if, as the *Fertico* dissent indicated, it was likely that had Phoschem not breached and Fertico, as a

thought of limiting damages to whatever profits the buyer/middleman anticipated, because no such amount was firm on the date of the breach. *See generally id.*

³⁸ *See Allied*, 907 F. Supp. at 631–32.

³⁹ 907 F. Supp. at 631 (citing Samuel J. M. Donnelly & Mary Ann Donnelly, *Commercial Law*, 39 SYRACUSE L. REV. 159, 183 (1988)) (alteration in original). This view was iterated somewhat by Hackley, *supra* note 4, at 219, although Hackley did recognize that where acceptance of the late-delivered goods was reasonable the *Fertico* approach should be applied. *Id.* at 222–25.

⁴⁰ The correctness of the majority view and the basic *Fertico* approach is further demonstrated at Part III in the Case 1 (Stable Markets) illustrations. Those illustrations demonstrate that offsetting the injured party's damages by the profit that it made on the subsequent transaction involving the late-delivered goods runs contrary to the goal of putting the non-breaching party in the same position it would have been absent breach. This unduly benefits the breaching party.

⁴¹ RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. f (1981); WHITE & SUMMERS, *supra* note 2, § 6-3, at 298–300.

⁴² § 347 cmt. f; WHITE & SUMMERS, *supra* note 2, § 6-3, at 298.

company that did not regularly deal in phosphate, would not have made the subsequent sale to Janssens, then “the dissent [would be] correct.”⁴³ This conclusion is entirely consistent with the citation to Corbin contained in *Fertico* that “[g]ains made by the injured party on other transactions after the breach are never to be deducted from the damages that are otherwise recoverable, unless such gains could not have been made, had there been no breach.”⁴⁴ It is also totally in accord with the view set out in the comments to Section 347 of the Restatement that “[i]f the injured party could and would have entered into the subsequent contract, even if the [first] contract had not been broken, and could have had the benefit of both, he can be said to have ‘lost volume’ and the subsequent transaction is not a substitute for the broken contract.”⁴⁵

As these citations indicate, the basic lost volume test—whether, in the absence of the breach the injured party would have made both the originally contemplated transaction and the subsequent one which actually involved the late-delivered goods—applies both in the situation like *Fertico* where cover was effectuated and there is no loss of volume and in the situation where, due to a lack of cover, volume was in fact lost. For this reason, a better way of summarizing this general rule would be to say that in the case of late delivery, absent more, a non-breaching party is entitled to its normal breach damages without reduction for the profit, if any, that was made on any subsequent transaction involving the late-delivered goods. This is only true *if*, in the absence of the breach, the injured party could and would have entered into that subsequent transaction.⁴⁶

⁴³ WHITE & SUMMERS, *supra* note 2, § 6-3, at 298.

⁴⁴ *Fertico Belgium S.A. v. Phosphate Chemical Export Ass’n, Inc.*, 70 N.Y.2d 76, 84, 510 N.E.2d 334, 338, 517 N.Y.S.2d 465, 469 (1987) (citing 5 CORBIN, CONTRACTS § 1041, at 256).

⁴⁵ § 347 cmt. f; *accord*, FARNSWORTH, *supra* note 1, § 12.11, at 226. Whether or not the subsequent transaction is a substitute for the one that would have been accomplished with the contracted goods is critical because reduction of loss through a favorable substitute transaction generally results in a smaller recovery by the injured party. See *Lasalle Talman Bank, F.S.B. v. United States*, 317 F.3d 1363, 1371 (Fed. Cir. 2003). For example, if unique goods which were the subject of the contract that was breached were going to be sold for \$50, but because of the breach and late delivery, they were sold for \$75, the non-breaching party’s increased profit on the substitute transaction could be used to reduce any damages incurred as result of the breach.

⁴⁶ So stated, the general rule would be applicable both to an injured party that was unable to engage in the originally contemplated transaction because of the

Even though correct as a basic premise, the general rule stated immediately above is, however, only one path to a correct analysis and result. Another is an outgrowth of the outcome in *Fertico* having been questioned on the facially plausible basis that all that occurred there was that contracted goods, originally targeted to go to Altaweed, simply went to Janssens and the goods that would otherwise have gone to Janssens simply went to Altaweed.⁴⁷ As this analysis goes, it is also reasoned that despite the breach, Fertico likely made just as much money as it would have had there been no breach⁴⁸ and that the “award of cover damages *in addition* to the retained profit represents a windfall.”⁴⁹ This latter conclusion is, however, premised on the assumption that the wholesale price that Fertico paid for the fertilizer actually shipped to Altaweed was the same as the wholesale price at which Fertico would, absent the breach, have purchased the fertilizer that it would have shipped to Janssens.⁵⁰

While the above analysis has an appealing symmetry and seems to make common sense, those characteristics mask a very basic point which calls the analysis into question. That is, it is extremely unlikely that the fertilizer that Fertico purchased

breach and the inability to cover and, to a party like *Fertico*, that promptly effectuated cover and thus did not lose any volume.

Although the above rule was applied in *Fertico* and its progeny, most notably *Aluminum Distributors, Inc. v. Gulf Aluminum Rolling Mill Co.*, No. 87 C 6477, 1989 WL 157515 (N.D. Ill. Dec. 12, 1989), it is not, however, applicable to every commercial situation where there is a late delivery. *Id.* For example, application is inappropriate where the non-breaching party was unreasonable in securing cover, i.e., where there was insufficient reason for it to believe that the goods would not have been delivered in sufficient time to use in the transaction intended. A plaintiff facing such a situation might be well advised to seek adequate assurance of performance under U.C.C. section 2-609 if that is possible. Armed with a failure by the seller to provide such adequate assurance, the reasonableness of the non-breaching party's obtaining cover will generally be increased. Absent this limitation a buyer would have a financial incentive to secure “cover” for the most minor of delays where no cover was required. Conversely, the *Fertico/Aluminum Distributors* thesis should certainly be applied even in circumstances involving only short delays, where there was an actual loss of volume, i.e., where due to the breach and an inability to cover the non-breaching party was not able to engage in the initial transaction that it had planned. In this regard, just as with securing cover at an extremely high price, it is wholly unlikely that a buyer would choose not to enter into a profitable transaction, even if only marginally profitable, “in reliance upon the outcome of an always uncertain law suit.” WHITE & SUMMERS, *supra* note 2, § 6-3, at 302.

⁴⁷ Hackley, *supra* note 4, at 220–21.

⁴⁸ *Id.* at 221.

⁴⁹ *Id.* at 222.

⁵⁰ *Id.* at 220–21.

upon hearing of Phoschem's impending breach would ever have been purchased for the transaction with Janssens. There would have been absolutely no need for Fertico to have gone into the spot market in November and ostensibly pay a premium for immediately deliverable fertilizer, when delivery to Janssens would not take place until March or April. Moreover, if, as is very likely the case, Fertico had to pay more for fertilizer on the spot market than it would have had to in the general wholesale market, even under the above analysis, it would be entitled to that extra cost as well as being entitled to retain the profits derived from the late-delivered goods.⁵¹

While the normal measure of cover, set out in U.C.C. section 2-712(2), is the cost of cover less the contract price plus any incidental⁵² and consequential damages minus expenses saved,⁵³ the real concern raised by the above analysis is whether Fertico's *total* cost of raw materials for the Altaweed and Janssens transactions increased because of the breach. Simply stated, did the breach put Fertico in a position economically worse than the one it would have enjoyed in the absence of the breach? As the analysis properly indicates, determining if this is the case need not be based on the anomalous application of the lost volume rules to a party that did not lose volume. Rather, damages can be determined simply by comparing the actual total cost that was incurred for fertilizer to accomplish the two affected transactions, the sales to Altaweed and Janssens, to the total cost that it should have incurred for the fertilizer in the absence of the breach. Since the fixed-price cost of goods under the original contract is contained both in the total actual costs for the fertilizer and the total that Fertico should have spent for the fertilizer, that item can be factored out of the comparison, leaving only a comparison between the price at which cover was obtained and the wholesale price of goods at the time that Fertico would have entered the market to purchase fertilizer for delivery to Janssens. Accordingly, the extent to which the cost of cover exceeded the wholesale market price at the time that Fertico would have entered the market to purchase fertilizer for delivery to

⁵¹ See *infra* Part III.A.

⁵² Fertico's cost of storing the fertilizer it received from Phoschem until it was shipped to Janssens would be such an incidental damage. See U.C.C. § 2-715(1) (2003).

⁵³ *Id.* § 2-715(2).

Janssens is the amount due Fertico from Phoschem.⁵⁴ The court in *Fertico* did not indicate anything specific about the price of fertilizer after Phoschem's breach.⁵⁵ Accordingly, it is impossible to know if Fertico was overly compensated or under compensated pursuant to what, for want of a better term, shall be referred to herein as the simplified cover formula.

As discussed in the ensuing sections, the courts and commentators have attempted and, in round about ways, have succeeded, at least in part, in refining the *Fertico* thesis to avoid overcompensation. The route to achieving that goal, however, is often a complicated one.

II. REGULAR DEALERS AND THEIR NEED TO PROVE THAT THE SUBSEQUENT TRANSACTION WOULD HAVE BEEN ACCOMPLISHED IRRESPECTIVE OF THE BREACH

The question in *Fertico* of whether, in the absence of a breach by Phoschem, Fertico would have made both the sale to Altaweed and the sale to Janssens, is at the center of the controversy that surrounds the case. While a similar question is certainly central in all cases involving cover and the injured party's retention of the profits flowing from the late-delivered goods, other courts have achieved comparable results in a less controversial manner than did the court in *Fertico*. Notable in this regard is *Aluminum Distributors, Inc. v. Gulf Aluminum Rolling Mill Co.*,⁵⁶ a suit brought by another middleman against a supplier, Gulf Aluminum Rolling Mill Company (GARMCO), for breach of contract.⁵⁷ GARMCO had agreed to sell Aluminum Distributors, Inc. (ADI) a specified quantity of aluminum; however, it delivered the goods late.⁵⁸ As a result, ADI was forced to

⁵⁴ If any substantial time had elapsed between these two times, the wholesale market price at the time that Fertico would have entered the market to purchase fertilizer for delivery to Janssens would have had to be discounted to take into account the fact that Fertico did not have the use of the money used to purchase the fertilizer which ostensibly would otherwise have been delivered to Janssens. This would have been an additional cost that Fertico incurred for fertilizer necessary to accomplish the two affected transactions.

In this regard, under the simplified cover formula, Fertico would, of course, also have been entitled to any incidental or consequential damages caused by the breach.

⁵⁵ See *Fertico Belgium S.A. v. Phosphate Chemical Export Ass'n, Inc.*, 70 N.Y.2d 76, 80-82, 510 N.E.2d 334, 335-37, 517 N.Y.S.2d 465, 466-68 (1987).

⁵⁶ No. 87-C6477, 1989 WL 157515 (N.D. Ill. Dec. 12, 1989).

⁵⁷ *Id.* at *1.

⁵⁸ *Id.* at *3-4.

cover in order to fulfill its obligations under several resale contracts and to forego the ones for which it could not obtain cover.⁵⁹ Under the circumstances, GARMCO argued that ADI was not entitled to cover damages because it had accepted the aluminum or, alternatively, that it should be permitted to offset the profits ADI had made upon its resale of the late-delivered aluminum against ADI's cover damages.⁶⁰ The court largely rejected GARMCO's argument.⁶¹ The reason for this is fairly clear from a reading of the case—the court saw that ADI, as a volume dealer in aluminum, would still have made both the original sales and the subsequent ones that involved the late-delivered aluminum from GARMCO irrespective of the breach.⁶² To better understand the court's conclusion, one needs to examine the lost volume cases and the rationale that underlies them.

By far the most often discussed of the various lost volume situations is that of the lost volume seller whose customer breached its contract to purchase. This situation can be exemplified as follows: Buyer X agrees to purchase a new automobile from an auto-dealership for \$20,000. The dealership's cost for the car is \$18,000. Therefore, the dealer stands to make \$2000. The model in question is one that is in demand, but the dealership can obtain additional cars through alternative means. Buyer X repudiates the contract. A few days thereafter, however, the dealership is able to sell the car that was subject to X's contract to Buyer Y for \$20,000, and Y takes delivery on the very same day on which Buyer X was scheduled to do so. The dealership thus earned the \$2000 in profit that it would have made if it had sold the car to Buyer Y.

Notwithstanding X's assertion that the dealership suffered no loss, in these facts the law is that X is liable to the dealership for \$2000 in accordance with U.C.C. section 2-708(2) because, absent X's breach, the dealership would have made the sale to Buyer X *and* would have sold a car to Buyer Y and thus earned a total of \$4000 in profit. X's breach caused it to lose \$2000 of

⁵⁹ *Id.*

⁶⁰ *Id.* at *4.

⁶¹ *Id.* at *5.

⁶² Once again the court used the lost volume rationale but never used the term "lost volume." However, that would have been somewhat appropriate in *Aluminum Distributors* since ADI was not able to fully cover and therefore did in fact lose some volume as a result of GARMCO's breach. *Id.*

profit.⁶³ Thus X must pay the dealership \$2000 in order to put the dealer in as good a position as performance by X would have done.⁶⁴

A. *Application of the Lost-Volume Concept to Resellers and Others*

The logic underlying the result in the auto dealership hypothetical has caused it to be applied both explicitly and implicitly in a variety of situations where the non-breaching party is other than a mere re-seller, i.e., to “a multitude of plaintiffs who are neither lost volume sellers, nor jobbers, nor component sellers.”⁶⁵ For example, in the following hypothetical Professor Farnsworth discusses the concept of lost volume in a context that is much more akin to the circumstances of both *Fertico* and *Aluminum Distributors* than is the automobile dealership example noted above.⁶⁶ A builder contracts to build a building on an owner's land for \$100,000. The builder would have made a profit of \$10,000 by performing. However, the owner repudiates the contract before any work or preparation is performed. The builder promptly enters into another contract to build an identical building for \$100,000 at a profit of \$8000. The builder claims that he has lost volume as a result of the breach, i.e., “had the first contract not been broken, the builder could and would have made both contracts.”⁶⁷ Professor Farnsworth indicates that not only can the builder prevail on this assertion but also that the assertion can also be successfully made by injured parties in other commercial circumstances.

The same claim may be made by a manufacturer in similar circumstances, when manufacture of the goods is not begun,

⁶³ For other cases and an excellent explanation of the “lost volume seller” situation, see, WHITE & SUMMERS, *supra* note 2, § 7-9, at 384–89.

⁶⁴ A totally different result would, of course, have been reached if the transaction were only a sale between two private parties. That is, the owner's complete expectation interest is fulfilled if after X's repudiation, he were able to resell the car to Y at the same price in which case X would owe the owner nothing despite his clear breach. *Id.* at 386.

⁶⁵ *Id.* at 389; see also FARNSWORTH, *supra* note 1, at § 12.10, at 209–20.

⁶⁶ FARNSWORTH, *supra* note 1, § 12.10, at 215.

⁶⁷ *Id.* (citations omitted); see also RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. f, Illustration 16 (1981) (“Unless it is proved that [the builder] would not have undertaken both [jobs], [the builder's] damages are based on the net profit he would have made on the contract with [the owner], without regard to the subsequent transaction.”).

or . . . by a seller of goods that has bought the goods for resale . . . [and if the injured party] can show or the court will assume that [he] could and would have expanded [his] business to take both contracts and make [the] combined profit of \$18,000, but that as a result of the breach . . . has only one contract (the second one) on which the profit will be \$8,000, [he] will be allowed to recover \$10,000 damages on the first contract, with no subtraction for the profit made on the second contract.⁶⁸

B. The Suggestion in Aluminum Distributors of a Better Way To Determine if the Plaintiff Would Have Entered into the Subsequent Transaction

As noted, the Restatement applies the above rule to any commercial plaintiff provided that it could and would have entered into the subsequent transaction even if there had been no breach.⁶⁹ *Aluminum Distributors* certainly did not disturb this proposition.⁷⁰ It required the non-breaching party to demonstrate that it could otherwise have purchased a sufficient quantity of goods in time to enter into the transaction for which it used the late-delivered goods.⁷¹ However, *Aluminum Distributors* also suggests a better way to determine this, and thus whether the plaintiff must disgorge the profits it made on the late-delivered goods.⁷² The answer to the ultimate question of whether the non-breaching party would have entered into the subsequent transaction, had there been no breach, is rarely provable with absolute certainty.⁷³ In addition, any affirmative testimony by the plaintiff is often looked upon by the court as being at least somewhat self serving.⁷⁴ Therefore, *Aluminum Distributors* implicitly suggests that a better first step is to ask the much more manageable question of whether the non-breaching party was a regular volume dealer in the goods.⁷⁵ Where ques-

⁶⁸ FARNSWORTH, *supra* note 1, § 12.10, at 215–16.

⁶⁹ See RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. f (1981).

⁷⁰ No. 87–C6477, 1989 WL 157515, at *5 (N.D. Ill. Dec. 12, 1989). As discussed, whether this analysis is really required in the case of a covering plaintiff is quite another question. See *supra* note 47 and accompanying text.

⁷¹ *Id.* at *5.

⁷² *Id.*

⁷³ Indeed, it has been said that proving actual lost volume status is an almost impossible burden. See WILLIAM H. HENNING ET AL., THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE, 8–18 (1981).

⁷⁴ See *id.* at 8-17–8-18.

⁷⁵ See *Aluminum Distributors*, 1989 WL 157515, at *5.

tion is answered in the affirmative, provided that there is also a showing that the plaintiff had the capacity and intention to perform both the initial transaction and the subsequent one,⁷⁶ the burden would then appropriately shift to the breaching party to demonstrate "that it is more probable than not that the plaintiff would *not* have had both sales . . . and thus that the second resale profit . . . should be used to reduce the plaintiff's recovery."⁷⁷ The breaching party would likely try to do so by, among other things, attempting to prove that the injured party, for some reason, would not have acquired goods of the type under contract in the time between the initial breach and the late delivery and thus was able to enter into the subsequent transaction only because it accepted the late-delivered goods. It might also attempt to demonstrate either that, after the breach, the non-breaching party was operating at what was felt to be an optimum volume and that the late-delivered goods merely caused that optimum level to be exceeded or that the level of operations actually achieved upon delivery of the late-delivered goods could not have been reached but for the breach.⁷⁸ These arguments, however speculative and difficult to prove, are substantially facilitated where courts, albeit erroneously, have placed the total burden on the injured party to prove that it could and would have had both transactions if there had been no breach.⁷⁹

C. Application of the Regular-Dealer Concept to Plaintiffs Other Than Middlemen

As noted, the court in *Aluminum Distributors* readily assumed that, even without the breach, ADI, would have performed both the initial transaction and the subsequent transaction.⁸⁰ The *Fertico* majority did much the same thing.⁸¹ This

⁷⁶ Hackley, *supra* note 4, at 216; *cf. In re El Passo Refinery, L.P. v. UOP*, 196 BR. 58, 66 (Bankr. W.D.Tex. 1996) (using a "decisional matrix" to decide if the injured party had lost volume and suggesting that courts determine if the breach created the opportunity for the second transaction). See generally Roy R. Anderson, *Damages for Sellers Under the Code's Profit Formula*, 40 SW. L.J. 1021, 1059 (1986).

⁷⁷ WHITE & SUMMERS, *supra* note 2, § 6-3, at 298; see RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. f (1981); Anderson, *supra* note 76, at 1060; Hackley, *supra* note 4, at 191.

⁷⁸ See FARNSWORTH, *supra* note 1, § 12.10, at 218.

⁷⁹ See *id.*

⁸⁰ *Aluminum Distributors*, 1989 WL 157515, at *5.

⁸¹ See *Fertico Belgium S.A. v. Phosphate Chemicals Export Ass'n, Inc.*, 70 N.Y.2d 76, 80-81, 510 N.E.2d 334, 336, 517 N.Y.S.2d 465, 467-68 (1987).

assumption was not based on the plaintiff's role as a mere middleman.⁸² Indeed, a similar result would have been obtained by a broad spectrum of plaintiffs.⁸³ The only threshold requirement is a demonstration that the party regularly dealt with significant quantities of the goods, did a substantial amount of work of the type in question, used a substantial volume of raw materials or components of the type in issue to manufacture goods,⁸⁴ or had some other continuing involvement with the goods or work of the type in issue.⁸⁵

Take, for example, the situation of a manufacturer who needs large quantities of certain relatively long-lead-time raw materials to make a finished product, which it in turn sells to the general public⁸⁶ and the consequences of a breach by its raw materials supplier. Needless to say, it would be foolhardy for any such manufacturer not to have entered into substantial raw ma-

⁸² *Id.*, 510 N.E.2d at 336, 517 N.Y.S.2d at 467-68.

⁸³ See generally RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (applying the rule to all commercial plaintiffs).

⁸⁴ See FARNSWORTH, *supra* note 1, § 12.11, at 220-24.

⁸⁵ *Id.*

⁸⁶ This circumstance is substantially similar to that of an assembler of the various components discussed in WHITE & SUMMERS, *supra* note 2, § 7-10, where the supplier of one component breaches. In that instance the failure of the supplier has caused the curtailment of planned or at least desired manufacturing. An important difference is, however, that some assembly may have occurred even in the absence of the component in question and partially completed units of some value may exist. Where the primary raw material needed to run a production facility is not available production stops or slows and no partially completed goods exist.

Assuming that there was nothing particularly unique about the raw material that the seller was to provide, i.e., either it or raw material from other sources (if available) could have been used to manufacture the buyer's finished product, would the manufacturer's damages change if, instead of selling to the general public at whatever the going market price was, the manufacturer had a contract to sell a quantity of finished products to a third party at a fixed price but he was unable to do so because of the supplier's breach? To the extent that other raw material was not immediately available to produce the finished products for which the manufacturer had a contract, its initial lost opportunity and the minimum direct portion of the resulting damages are quite clear. It is the profit lost on the sale of finished goods, which could not be accomplished because of the lack of raw material. In this regard, the situation is similar to the lost sales ADI experienced in *Aluminum Distributors*.

As to the implication of any subsequent delivery of the raw materials by the breaching seller, the question would appear to be no different here than in *Aluminum Distributors* and for all of the reasons set forth above and discussed *infra*, the *Aluminum Distributors'* approach as adjusted by the corollaries set forth *infra* in Part III, would seem to be fully applicable. Indeed, in this example, the late-delivered raw materials would simply be used to meet other requirements that the manufacturer had.

terial supply contracts well before the date of planned manufacture. Though such foresight would indeed be prudent, the mere existence of such contracts does not guarantee that the supplier will not breach them or that cover at anything less than a high price can quickly remedy the ensuing failure of supply.

In such circumstances, where the manufacturer effectuates cover and can show that, had there been no breach, it had both the desire and the manufacturing capacity to produce the finished products that it made with the cover goods and the finished products it made in the appropriate subsequent period from the late-delivered goods, the manufacturer is entitled to its increased cost of cover and, absent more, the profits that it made on the finished goods manufactured from the late-delivered goods.⁸⁷ Indeed, such a remedy should be applied pursuant to the very broad provisions of U.C.C. section 2-714(1), Buyer's Damages for Breach in Regard to Accepted Goods. This provision permits the injured party to "recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined *in any manner which is reasonable*" and in turn encompasses the lost volume concept⁸⁸ contained in U.C.C. section 2-708(2)⁸⁹ or as such remedy may be applied pursuant to common law.⁹⁰ In either event,

⁸⁷ See discussion *supra* at footnotes 76–77 and accompanying text regarding the showings necessary to shift the burden to the breaching party of showing that, in the absence of the breach, the injured party would not have accomplished both the initially planned transaction involving the goods and the transaction that was subsequently occurred using the late-delivered goods.

⁸⁸ U.C.C. § 2-714(1) (2003) (emphasis added). In this regard, Professors White and Summers make reference to the extreme case of a manufacturer who ceases production as a result of a supplier's breach as exemplifying a party that has lost volume. WHITE & SUMMERS, *supra* note 2, § 7-11, at 392. The same would, however, be true where the manufacturer only produces less as a result of the supplier's breach.

⁸⁹ U.C.C. § 2-708(2) states in pertinent part:

If the [difference between the market price at the time and place of tender and the unpaid contract price together with any incidental damages] is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages

Id.

⁹⁰ 24 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 64:28, at 200 (Richard A. Lord ed., 4th ed. 2002). Because the cover remedy was not designed for accepting buyers, one commentator has construed the code's permission in U.C.C. section 2-714(1) to determine damages in these circumstances in any manner

profits made on transactions based on the late-delivered goods need not be deducted from the injured party's damages. Indeed, so long as the transaction involving the late delivered goods was neither a substitute for one that would have been accomplished had there been no breach⁹¹ or a bonus, that is, one which would not have been accomplished had there been no breach,⁹² the profits made on the subsequent transaction need not be applied in whole or in part to offset damages otherwise due the non-breaching party.⁹³

D. Why the Transaction Involving the Late-Delivered Goods Is Not Simply a Substitute, a Bonus, or Other Child of the Breach

The fact that the late-delivery need not be viewed as a substitute can be seen by reference to the hypothetical set out in the Introduction in which the supplier failed to make timely delivery of twenty tons of raw materials—the amount the non-breaching party used in its factory each week. If by the time that delivery is finally possible and accomplished some weeks or maybe months later, the manufacturer did or could have purchased the twenty tons for that week's needs, and perhaps the ensuing few

reasonable as a requirement that the injured party prove that rejection of the goods and revocation of the contract was not possible. Hackley, *supra* note 4, at 223. This position ignores the fact that under U.C.C. section 2-708(2) both cover costs and additional damages could be awarded if cover alone were inadequate to put the injured party in as good a position as performance would have done. See WHITE & SUMMERS, *supra* note 2, § 6-3, at 298. Hackley does, however, indicate that a reasonable justification for accepting the late-delivered goods could be to ensure that the injured party had an adequate volume of goods to continue performance at or near capacity. Hackley, *supra* note 4, at 223–24.

The amount of plaintiff's damages would be measured by the market price of the finished goods at the time that manufacture would have taken place but for the breach.

⁹¹ See discussion *supra* note 45 for an explanation of substitute transactions.

⁹² A bonus transaction would be exemplified as follows: Q, not a regular dealer, contracts to sell goods to a third party. However, its supplier breaches its contract and fails to deliver. Q secures cover and thus completes the transaction with the third party. Thereafter, the supplier makes delivery. Q, who never had any intention to sell any additional goods of this type, sells the late-delivered goods to a fourth party. The transaction between Q and the fourth party is a bonus that would not have occurred but for the breach. Accordingly, the breaching supplier can use the profits that Q made on that transaction to offset any damages otherwise payable.

⁹³ See discussion of substitution *supra* note 45, pointing out that a finding that the subsequent transaction was a substitution “generally results in a smaller recovery by the injured party.”

weeks', from other available sources, no substitution would be involved and the manufacturer need not reduce the damages otherwise due it by the profits that it made in transactions involving the late-delivered twenty tons.⁹⁴ That is, for purposes of determining damages due the injured party that obtained cover, the question is whether it is more likely than not that even without the late-delivered goods the factory would still have been able to operate at the same level of production that it did in the period immediately after acceptance of the late-delivered goods.⁹⁵ As noted previously, for a regular purchaser of such raw materials the presumption is that, even without the late-delivered goods, it would have secured sufficient material to maintain operations at the same level, the late-delivery was not a bonus and, as Professors White and Summers aptly describe it, the transaction involving the late-delivered goods was not "a child of the breach"⁹⁶ requiring that the profits therefrom be offset against damages otherwise due the non-breaching party.

E. The Applicability of U.C.C. Sections 2-714(1) and 2-708 in the Absence of Cover: Back to the Lost-Volume Situation

The applicability of U.C.C. sections 2-714(1) and 2-708 and the common law certainly would not change if, in the current hypothetical, the manufacturer was not able to obtain cover at commercially reasonable prices, and the manufacturer was therefore suing for lost profits on finished products that could not be produced because of the supplier's breach.⁹⁷ Indeed, on these facts there would appear to be little doubt that an opportunity was missed by virtue of the seller's breach and that the manufacturer is entitled to the profits that it would have made by producing the finished product from the raw materials which the supplier failed to supply and, absent more, the profits that it made in the subsequent production and sale of finished goods.⁹⁸

As noted, there is little distinction between the situations in *Fertico, Aluminum Distributors*, and that of the manufacturer

⁹⁴ Cf. discussion *supra* note 45 (explaining when a substitution transaction is involved).

⁹⁵ As set forth *supra* in note 6 and the accompanying text, where cover was not obtainable at commercially reasonable prices, the additional inquiry is a determination of what production was lost as a result of the breach.

⁹⁶ WHITE & SUMMERS, *supra* note 2, § 6-3, at 298.

⁹⁷ See discussion *supra* note 90.

⁹⁸ See *supra* note 6 and accompanying text.

that is unable to cover in the above hypothetical. The fact that the compensation sought in the named cases was the increased cost of cover while the manufacturer in the hypothetical is seeking lost profits is of no moment. In fact, part of what ADI sought and recovered in *Aluminum Distributors* was lost profits.⁹⁹ Moreover, while cover damages are more commonly awarded, the fact that lost profits are awarded in commercial cases where cover is not obtainable is not surprising since the increased cost of cover in reality merely represents the decrease in the profits that the non-breaching party made in its subsequent transaction because it had to use higher cost goods than it had anticipated.¹⁰⁰

The question over which the majority and the dissent argued so vehemently in *Fertico* was at its root simply the issue of whether or not Fertico was a volume buyer and seller of fertilizer.¹⁰¹ This issue would have been no different if Phoschem's breach had, in turn, prevented Fertico from fulfilling its contract with Altaweed and thus Fertico had sued for lost profits.¹⁰² The dissent would have said, just as in the hypothetical set out in note 64 *supra*, regarding a private owner's reselling his car for \$X after the original party repudiated a contract for the same price, that the profit on the subsequent transaction should be used to offset the loss on the first. On the other hand, the *Fertico* majority would insist that but for Phoschem's breach, Fertico, as a regular dealer in fertilizer, would have made the subsequent sale to Janssens irrespective of Phoschem's performance after the breach. That is, in the ensuing months, with or without Phoschem's performance, Fertico would have secured sufficient fertilizer to enter into the subsequent transaction with Janssens. The court in *Aluminum Distributors*, of course, would have agreed with the *Fertico* majority because it too was of the view that, where dealers in goods are involved, post-breach perform-

⁹⁹ *Aluminum Distributors, Inc. v. Gulf Aluminum Rolling Mill Co.*, No. 87 C 6477, 1989 WL 157515, at *5 (N.D. Ill. Dec. 12, 1989).

¹⁰⁰ See David Frisch & John. D. Wladis, *Uniform Commercial Code; General Provisions, Sales, Bulk Transfers, and Documents of Title*, 43 BUS. LAW. 1259, 1293 (1988).

¹⁰¹ See *Fertico Belgium S.A. v. Phosphate Chemicals Exp. Ass'n*, 70 N.Y.2d 76, 82-84, 87-88, 510 N.E.2d 334, 337-38, 340-41, 517 N.Y.S.2d 465, 468-69, 471-72 (1987) (stating majority and dissenting positions as to whether Fertico was a volume buyer and seller).

¹⁰² See WILLISTON, *supra* note 90, § 64:19, at 162-63; see also 11 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1022, at 116, 119 (1979).

ance by the breaching party resulting in profits to the dealer equal to or even greater than those that would have been achieved had there been no breach do not, in and of themselves, eliminate the damages of a lost volume dealer.¹⁰³

The damages recoverable by the hypothetical manufacturer would thus seem to turn on whether it is viewed as a volume buyer/processor of the raw material. If viewed in this light, as both *Fertico* and *Aluminum Distributors* suggest and as discussed *supra*, there is at least a rebuttable presumption, taking into account necessary lead times for the manufacturer's post-breach acquisition of raw materials, that its production of finished products in the subsequent period would have been the same irrespective of its supplier's belated performance.¹⁰⁴ Such a rebuttable presumption is entirely consistent with the observation of Professors White and Summers that the outcome in *Fertico* is a proper one unless the breaching party can show by a preponderance of the evidence that, had the supplier not breached, the non-breaching party would not have produced any more finished products than it did produce at or about the time of the breach *and* that without the belatedly supplied raw material it would not have produced as much finished product as it did in the subsequent period when late delivery was made.¹⁰⁵

Unless raw materials at commercially reasonable prices are nearly impossible to obtain from any source or sources at any time during the period between the supplier's breach and its belated performance, the task of the breaching supplier is to demonstrate that it is more reasonable than not that the manufacturer *could not* have produced as much without the supplier's late delivery. This is an extremely difficult task. This task is, of course, made even more difficult when the lag time between the breach and the belated performance is significant, and the manufacturer has had a long time to overcome the hole in its pipeline created by the breach and by the need to discount any

¹⁰³ See *Aluminum Distributors*, 1989 WL 157515, at *4-5.

¹⁰⁴ See *Allied Semi-Conductors Int'l, Ltd. v. Pulsar Components Int'l, Inc.*, 907 F. Supp. 618, 631 (E.D.N.Y. 1995) (reversing the lower court holding in *Fertico* because *Fertico* would have pursued the sale even if the original contract had been fully performed); WILLISTON, *supra* note 90, § 64:28, at 202 (stating that although it is sometimes assumed that the injured party would have undertaken a new transaction, that is a question of fact that must be examined in each case).

¹⁰⁵ WHITE & SUMMERS, *supra* note 2, § 6-3, at 298.

impairment of the non-breaching party's financial situation caused by the breach.¹⁰⁶

III. THE *ALUMINUM DISTRIBUTORS* APPROACH TO DEALING WITH ANY REAL OR PERCEIVED WINDFALL TO THE NON-BREACHING PARTY

Subsequent to *Fertico*, *Aluminum Distributors* indicated that an aggrieved buyer who accepts late-delivered goods should be entitled to its breach damages as in *Fertico*.¹⁰⁷ The court also suggested that *Fertico* should be limited so as to permit the non-breaching party to retain the profits from the transaction involving the late-delivered goods, in addition to its breach damages, only to the extent that the buyer can demonstrate that, at the time of late delivery, an identical quantity of similar goods was available from another seller at the same price as the late-delivered goods.¹⁰⁸ As both *Aluminum Distributors* and the commentators indicated, to the extent that the non-breaching party obtained the advantage of goods that were priced below the current market at the time that they were delivered, however belatedly, the breaching party should be allowed to offset the amount received in excess of any which would otherwise have been realized at the time of anticipated performance, against the damages owed as a result of its breach.¹⁰⁹ In *Aluminum Distributors*, this special benefit was measured by the difference between the market price at which ADI could have purchased alu-

¹⁰⁶ That is, it is important to remember that what is being examined here is what would have occurred in the absence of the breach, namely, what other raw materials could have been obtained in the absence of the breach by a subsequent date, that is, in the period between the date of the breach and the date of late delivery. In such an analysis, any negative financial consequences to the non-breaching party caused by the breach must, by definition, be treated as if they never occurred. On the contrary, the financial condition of the non-breaching party needs to be viewed as if there was no breach and that it made whatever profits it would have and been in the financial position that it would have been in had there been no breach.

¹⁰⁷ *Aluminum Distributors*, 1989 WL 157515, at *5.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*; see also David W. Barnes, *The Net Expectation Interest in Contract Damages*, 48 EMORY L.J. 1137, 1205 (1999) (recognizing both the basic correctness of the *Fertico* approach and a need for the courts to adjust any benefit obtained by the injured party from a subsequent transaction involving the late-delivered goods so as to take into account the improvement in the non-breaching party's well-being resulting from the transaction); Frisch & Wladis, *supra* note 100; Hackley, *supra* note 4, at 200, 219.

minum at the time of the late delivery and the price in the GARMCO contract.¹¹⁰

More specifically, in *Aluminum Distributors*, the court agreed with GARMCO and the dissent in *Fertico* that, because ADI had accepted the aluminum, it could not recover its cover damages under U.C.C. sections 2-711 and 2-712.¹¹¹ As comment 1 to section 2-711 specifically states, the cover remedy available in sections 2-711 and 2-712 applies only to a buyer who has not accepted the goods or “who has justifiably revoked his acceptance.”¹¹² However, the court did concur with the *Fertico* majority in holding that ADI was entitled to its cover costs under U.C.C. section 2-714(1) which, although rarely utilized,¹¹³ specifically deals with the situation where the buyer has accepted

¹¹⁰ *Aluminum Distributors*, 1989 WL 157515, at *5.

¹¹¹ *Id.* at *4; see also U.C.C. § 2-711 (2003). That section, entitled “Buyer’s Remedies in General; Buyer’s Security Interest in Rejected Goods” provides, in relevant part:

- (1) Where the seller fails to make delivery . . . then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract . . . the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid
 - (a) “cover” and have damages under the next section as to all the goods affected whether or not they have been identified to the contract . . .

Id. U.C.C. section 2-712, “ ‘Cover;’ Buyer’s Procurement of Substitute Goods,” provides:

- (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.

¹¹² See *Aluminum Distributors*, 1989 WL 157515, at *4; *Fertico Belgium S.A. v. Phosphate Chemicals Exp. Ass’n*, 70 N.Y.2d 76, 85–86, 510 N.E.2d 334, 339–40, 517 N.Y.S.2d 465, 470–71 (1987). Comment 1 to U.C.C. section 2-711 states that the remedies listed in section 2-711 “are those available to a buyer *who has not accepted the goods* or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods.” U.C.C. § 2-711, cmt. 1 (emphasis added). The *Fertico* majority apparently ignored this comment and improperly relied in part on U.C.C. sections 2-711 and 2-712 in holding that *Fertico* was entitled to its cover costs. *Fertico*, 70 N.Y.2d at 81–83, 510 N.E.2d at 336–37, 517 N.Y.S.2d at 468.

¹¹³ Roy Ryden Anderson, *Buyer’s Damages For Breach in Regard to Accepted Goods*, 57 MISS. L.J. 317, 329 (1987).

the goods.¹¹⁴ The *Aluminum Distributors* court did so because it found that “GARMCO clearly knew that ADI had purchased the aluminum for resale and that the late deliveries would render ADI in breach of its contracts with third parties and require it to cover or lose the sales.”¹¹⁵ Because section 2-714(1) specifically deals with the situation where acceptance has occurred, unlike the plaintiff in *Fertico*, in order to be awarded damages, ADI was not required to demonstrate the existence of circumstances that virtually compelled it to accept the late-delivered goods.¹¹⁶ The court also held that section 2-714(1) entitled ADI to the profits it lost on planned resales that were canceled as a result of GARMCO’s delays.¹¹⁷

Quite significantly, the court further concluded that GARMCO could offset profits that ADI made on the resale of the late-delivered aluminum against damages but only to the extent that ADI failed to prove that it received no market-related benefit by obtaining and reselling the late-delivered goods,

We further find that GARMCO may not offset against these [cover and lost profit] damages ADI’s profits on the resale of the late-delivered aluminum as costs saved due to the breach, unless ADI fails to prove that it could otherwise have purchased similar aluminum for resale and hence would nevertheless have made these additional sales. . . . [I]f GARMCO can show that the price of the aluminum ADI would otherwise have purchased to make these additional sales would have been higher than the price ADI paid GARMCO for the aluminum, this difference in price may be deducted from the damages GARMCO owes ADI, as profits ADI would not have earned but for GARMCO’s breach.

¹¹⁴ See U.C.C. § 2-714(1).

¹¹⁵ *Aluminum Distributors*, 1989 WL 157515, at *5. As previously noted, U.C.C. section 2-714(1) provides that “[w]here the buyer has accepted goods and given notification . . . he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller’s breach as *determined in any manner which is reasonable*.” U.C.C. § 2-714(1) (emphasis added). Although, as stated above, the *Fertico* majority improperly relied on U.C.C. sections 2-711 and 2-712, they also held that “[t]he loss resulting to *Fertico* by having to acquire cover, even in the face of its acceptance of a late-delivered portion of the fertilizer, is properly recoverable under section 2-714(1).” *Fertico*, 70 N.Y.2d at 84, 510 N.E.2d at 338, 517 N.Y.S.2d at 469.

¹¹⁶ See *Aluminum Distributors*, 1989 WL 157515, at *4–5.

¹¹⁷ *Id.* at *5.

... ADI is entitled to keep any profits it made on the late-delivered aluminum so long as it proves it could otherwise have obtained comparable aluminum to fill those sales at comparable prices. GARMCO is entitled to offset from the above damages any decrease in profits ADI would have received if it had canceled delivery of the late-delivered aluminum and has instead made the fourth party sales from aluminum purchased from other sources. Such damages will place ADI in the same position as if GARMCO had not breached.¹¹⁸

The commentators that recognized the appropriateness of the *Fertico* approach with the addition of such a market-related limitation did so in order to ensure general adherence to the principle that the aggrieved party should not be placed in a better position than it would have been in had there been no breach.¹¹⁹ In this regard, it should be noted that in attempting

¹¹⁸ *Id.* In this passage the court described any special benefit two ways: first as the "difference in price" between the price that ADI would otherwise have had to pay for aluminum in order to make the additional sales and its contract price with GARMCO and thereafter as "any decrease in profits ADI would have received if it had cancelled delivery of the late-delivered [GARMCO] aluminum and . . . instead made the fourth party sale from aluminum purchased from other sources." *Id.* While the later reference to "decrease in profits" might seem to open the door to calculating those decreased profits by taking into account items such as an increased cost of labor, increased overhead, *etc.* in a later period (an approach not without some merit) the court, despite using seemingly different ways to describe the special benefit, really appears focused solely on any benefit created by a difference in the price of aluminum at the time of GARMCO's late delivery and the price set forth in the ADI's contract with GARMCO. *Id.*

¹¹⁹ For example, Frisch and Wladis concluded in their August 1988 survey of U.C.C. decisions that:

Both the majority and dissenting opinions [in *Fertico*] seem a bit wide of the mark. First, there is nothing inherently improper in permitting the recovery of cover damages when the goods have been accepted. If *Fertico* had not covered when it did, Phosphate would have had to compensate it for the entire profit lost on its contract with *Altaweed*. In effect, cover damages in this case represent no more than a portion of that profit lost because of an increase in the acquisition cost of the fertilizer sold to *Altaweed*. First, the majority erred in blindly accepting the fact that *Fertico* would have made the sale even without Phosphate's fertilizer. Second, assuming that sale could have been made, the profit received would depend on the then market price of fertilizer. In a rising market, to give *Fertico* the full profit on the sale of the fertilizer purchased from Phosphate is, indeed, to give it more than it would have earned from full performance of the Phosphate contract.

Frisch & Wladis, *supra* note 100, at 1293. Hackley notes:

From an economic standpoint, there may be situations where a middleman should be allowed to keep resale profits from late-delivered goods *and* recover a portion of the increased cost of replacement goods. If, for example,

to do so in *Aluminum Distributors*, the court indicated that the breaching party may have been entitled to an offset if it could demonstrate that the price of the late-delivered goods was more favorable than goods which the non-breaching party would otherwise have purchased. In that case, “this difference in price may be deducted from the damages [the breaching party] owes [the non-breaching party], as profits [that the non-breaching party] would not have earned but for [the] breach.”¹²⁰

The basic soundness of *Aluminum Distributors*’ acceptance of the *Fertico* approach with the addition of a market related limitation can be demonstrated by the following illustrations, the first of which assumes that the aluminum market remained stable between T1, when the parties entered into their contract, and T2, when late delivery was actually made or, in the absence of any breach, ADI otherwise would have obtained goods for the subsequent transaction.¹²¹ These illustrations show that, with some adjustments, the *Aluminum Distributors*’ approach properly takes into account the difference in the plaintiff’s economic status at the end of all relevant transactions and the economic status that it would have enjoyed in the absence of the breach, what White & Summers describe as “[t]he real question.”¹²²

A. Case 1: Stable Market Conditions: The Validation of *Fertico*

As the following illustration indicates, in a generally stable market, reduction of the damages owed the injured party (ADI)

a middleman normally buys goods in a stable long-term market, he might prove that a replacement purchase on the spot market made necessary by a late delivery was more costly than a purchase normally would have been on the long-term market. In other words, although a middleman might have two profitable resales notwithstanding a late delivery, he might show that his total profit from the two transactions was reduced because he had to pay more for a quick purchase to replace the late-delivered goods, and that had there been no breach, the purchase necessary to fulfill a second resale would have been less costly on a long-term market.

Hackley, *supra* note 4, at 224–25.

¹²⁰ *Aluminum Distributors*, 1989 WL 157515, at *5.

¹²¹ As discussed *infra*, while basically sound, the *Aluminum Distributors* approach to calculating the special market benefit by which a breaching party may offset the damages otherwise due the injured party is, however, in need of refinement particularly where the factual situation is more complex than in Case 1, e.g., in situations involving highly fluctuating markets. See *infra* Part III, Cases 2a and 2b.

¹²² White & Summers, *supra* note 2, § 6-3, at 298 (discussing what the outcome should have been in *Fertico*).

(here the increased cost of cover caused by having to purchase on the spot market, that is, the difference between the cost of cover (\$525) and the contract price (\$500)), by the profits (\$100) that ADI made when it sold the late-delivered goods at \$600 would result in ADI being considerably worse-off than had there been no breach.

(A) NO BREACH			
T1: GARMCO's Timely Delivery and ADI's Resale Thereof		T2: ADI's Subsequent Purchase and Resale	
Wholesale market price:	\$500	Wholesale market price:	\$500
GARMCO/ADI contract price:	\$500	Subsequent purchase price:	\$500
Resale market price:	\$600	Resale market price:	\$600
ADI resale price:	\$600	ADI resale price:	\$600
ADI profit:	\$100	ADI profit:	\$100
ADI's total profit: \$200 (\$100+\$100)			
(B) BREACH			
T1: GARMCO Breach/ADI Cover Purchase ADI's Resale of the Cover Goods		T2: GARMCO's Late Delivery/ADI's Resale of the Late-delivered Goods	
Wholesale market price:	\$500	Wholesale market price:	\$500
GARMCO/ADI contract price:	\$500	GARMCO/ADI contract price:	\$500
"Spot" purchase/cover price:	\$525 ¹²³ * * * *		
Resale market price:	\$600	Resale market price:	\$600
ADI resale price:	\$600	ADI resale price:	\$600
ADI profit:	\$75	ADI profit:	\$100
ADI's total profit: \$175 (\$75+\$100)			

¹²³ It is also assumed that, in order to cover for GARMCO's late delivery, ADI had to make a quick purchase in the "spot" market and thus paid a premium of \$25 above market value in order to obtain readily-deliverable goods.

White and Summers suggest that a buyer that continually makes purchases should not be able to select the most expensive purchase as the one purchased as cover under section 2-712(1), but should rather be limited to the average cost of the goods purchased in the relevant period. *Id.* at 302. This may, however, be unfair to plaintiffs, such as manufacturers that lack unlimited capacity, and as such, absent the breach, may very well not have purchased the most expensive of the goods. Thus the highest priced goods may quite likely have been the ones that were purchased to fill the hole in the plaintiff's pipeline caused by the seller's breach. Moreover, even Professors White and Summers acknowledge that, "it seems unlikely that a buyer in reliance upon the outcome of an always uncertain law suit will spend more than necessary to cover." *Id.*

Obviously, in this illustration, ADI's recovery of the increased cost of cover (\$25), the profit that it made on the resale of the cover goods (\$75), *and* its retention of the profits on the resale of the late-delivered goods (\$100), are all necessary to place ADI in as good a position as it would have been in had GARMCO fully performed in which case, as can be seen in (a), its total profit would have been \$200. If ADI's increased cost of cover were offset by the \$100 profit that it made on the resale of the late-delivered goods, ADI would only make a total profit of \$100,¹²⁴ whereas in the absence of the breach it would have made \$200.

Under the "simplified 'cover' formula" discussed *supra* in Part I, the result is the same. All that need be done is for the breaching party to pay the non-breaching party \$25, that is, the amount by which the cost of 'cover' (\$525) exceeds the wholesale market price: at the time of the late-delivery (\$500), assuming that this is the date on which, in the absence of the breach, ADI would have gone into the wholesale market to purchase goods for the subsequent transaction. By augmenting the \$175 that ADI made from the transactions, ADI's total profit would be \$200, that is, the amount that it would have made absent the breach.

GARMCO would, however, try to argue that the resale was a bonus transaction, that is, one that came about in addition to all of the ones that the non-breaching party otherwise would have made at or about the time of the late-delivered goods and thus that ADI got a windfall from the sale of the late-delivered goods in the form of extra profits. When the profit on the bonus transaction (\$100) is netted against the increased cost of cover (\$25), GARMCO would assert that ADI made an additional \$75 in profit as a result of the breach.

(A) NO BREACH			
T1: GARMCO's Timely Delivery and ADI's Resale Thereof:		T2: ADI's Subsequent Purchase and Resale:	
GARMCO's cost of Material:	\$375		
Wholesale market price:	\$500	Wholesale market price:	\$500

¹²⁴ \$175 as indicated in (b) above
plus \$25 for the increased cost of cover
less \$100 for the profits on the resale of the late-delivered goods
 \$100

GARMCO/ADI contract price:	\$500	Subsequent purchase price:	\$500
Resale market price:	\$600	Resale market price:	\$600
ADI resale price:	\$600	ADI resale price:	\$600
ADI profit:	\$100	ADI profit:	\$100
GARMCO profit:	\$125*****		
ADI's total profit: \$200 (\$100 + \$100)			
(GARMCO's profit: \$125)			
(B) BREACH			
T1: GARMCO Breach/ADI Cover Purchase Goods:		T2: ADI's Subsequent Resale of the Cover:	
Wholesale market price:	\$500	Wholesale market price:	\$500
GARMCO/ADI contract price:	\$500	Subsequent purchase price:	\$500
"Spot" purchase/cover price:	\$525* * * *		
Resale market price:	\$600	Resale market price:	\$600
ADI resale price:	\$600	ADI resale price:	\$600
ADI profit:	\$75	ADI profit:	\$100
		T3: GARMCO's Late Delivery and ADI's Resale Thereof:	
		GARMCO's cost of Material:	\$375
		Wholesale market price:	\$500
		GARMCO/ADI contract price:	\$500 ¹²⁵
		Resale market price:	\$600
		ADI resale price:	\$600
		ADI profit:	\$100
		GARMCO profit:	\$125
ADI's total profit: \$275 (\$75+\$100+\$100)			
(GARMCO's profit: \$125)			

GARMCO would thus contend that: (1) by virtue of the subsequent transaction involving the late-delivered goods, ADI had already benefited by the breach. That is, having made a total profit of \$275 as compared to the profit of only \$200 that it would have made had there been no breach and (2) if it had to pay ADI another \$25 for the increased cost of cover, in order for ADI to be in the same position as it would have been had there been no breach, ADI must disgorge the profit (\$100) which it made on the resale of the late-delivered goods, or at least \$25 of it, equaling the damages that GARMCO is being called upon to pay.

However, GARMCO's argument is flawed. Complying with GARMCO's wishes would result in a violation of the rule that so

¹²⁵ It is assumed that, under the contract between GARMCO and ADI, the price of the aluminum was fixed and thus stayed constant during the rising market.

long as the transaction involving the late-delivered goods was neither a substitute for one that would have been accomplished had there been no breach or a bonus, that is, one which would not have been accomplished had there been no breach, the profits made on the subsequent transaction need not be applied in whole or in part to offset damages otherwise due the non-breaching party.¹²⁶ Moreover, by offsetting ADI's damages in the amount of the profits it made on the subsequent non-substitute/non-bonus transaction involving the late-delivered goods, GARMCO, despite its breach, would be relieved of any obligation to pay damages, while ADI, as a volume dealer, would have to absorb the increased cost of cover. Under this scenario, solely because of the profit that ADI made on a transaction that it would have entered irrespective of any dealings with GARMCO, GARMCO would wind up making the same profit for having breached the contract (\$125)¹²⁷ that it would have made had it performed in accordance with the contract (\$125).

When assessing the damages owed to ADI in this situation, one must take into consideration the fact that there is no basis to justify GARMCO's benefiting from its own breach and that such damage formulas are only used in an attempt to approximate the profit that the injured party would have made. Additionally, one must take into account that as between the injured party and the breaching party, where there is a windfall of some sort coming out of the calculation of damages, of which there is none in the illustration, the law tends to favor the injured party.¹²⁸ Each of these propositions support the appropriateness of the basic *Aluminum Distributors'* approach and no reduction of the damages owed ADI in this instance.

¹²⁶ See *supra* note 96 and accompanying text.

¹²⁷ \$125 (profits from the contract itself)

less \$25 (payment to ADI for the increased cost of cover)

plus \$100 (the amount of profit on the resale of the late-delivered goods that ADI disgorged)

\$200

¹²⁸ See discussion *supra* note 37. In this regard Professors White and Summers also recognize the approximate nature of such remedies under the U.C.C., wherein they note that "[section] 2-712 will overcompensate an occasional buyer because, for example, the seller will be unable to prove that the buyer specifically benefited from the added quality of the cover" and that reducing damages based on the plaintiff's post-breach behavior will "enrich an occasional seller." WHITE & SUMMERS, *supra* note 2, §§ 6-3, 6-4, at 304, 320.

B. Case 2: Rising Market Conditions: The Validation of Aluminum Distributors

What the court in *Aluminum Distributors* did, and the court in *Fertico* failed to do, was to take into account the fact that between the date of the breach and the date of the late delivery, the wholesale price of the goods had increased.¹²⁹ As the two illustrations below involving such a situation indicate, offsetting the increased market value of the late-delivered goods from damages otherwise due, as the court did in *Aluminum Distributors*, is generally appropriate. In this regard, it should be noted that no offset was made of any profits that ADI earned on the transaction, a transaction that the court recognized ADI would have entered irrespective of any late-delivered goods. Rather, the offset was accomplished pursuant to the directive of U.C.C. section 2-714(1), which calls for the calculation of damages in a reasonable manner, and through the court's recognition that GARMCO delivered goods to ADI that were more valuable at the time of delivery than the fixed price that ADI had paid for them.

The first illustration below demonstrates that, in a constantly increasing market the late delivery of fixed-priced goods caused ADI to receive goods for which, if bought at the time of late delivery, it would have had to pay more on the wholesale market. That is, if instead of accomplishing the subsequent transaction with the late-delivered goods, the price of which was \$500, ADI had used goods available on the wholesale market, its cost would have been greater. In the example, ADI would have paid \$525 rather than the contract price of \$500. It follows then that ADI's traditional damages should be offset by this increased special market benefit.

(A) NO BREACH			
T1: GARMCO's Timely Delivery:		T2: ADI's Subsequent Purchase:	
Wholesale market price:	\$500	Wholesale market price:	\$525
GARMCO/ADI contract price:	\$500	Subsequent purchase price:	\$525
Retail market price:	\$600	Retail market price:	\$625

¹²⁹ As discussed *supra* note 1199, *Fertico* was substantially criticized for alluding to, but failing to deal with, an increase in the wholesale price of fertilizer.

ADI retail price:	\$600	ADI retail price:	\$625
ADI profit:	\$100	ADI profit:	\$100
ADI's total profit:	\$200 (\$100+\$100)		
(B) BREACH			
T1: GARMCO Breach/ADI Cover Purchase:		T2: GARMCO's Late Delivery:	
Wholesale market price:	\$500	Wholesale market price:	\$525
GARMCO/ADI contract price:	\$500	GARMCO/ADI contract price:	\$500
"Spot" purchase/cover price:	\$525 ¹³⁰ * * * *		
Resale market price:	\$600	Resale market price:	\$625
ADI resale price:	\$600	ADI resale price:	\$625
ADI profit:	\$75	ADI profit:	\$125
ADI's total profit:	\$200 (\$75 +125)		

As part (b) of the illustration shows, if ADI were permitted to recover its cover damages (\$25), the difference between the contract price and the spot market price of cover, *and* retain all of the profits made on the resale of the late-delivered aluminum from GARMCO, it would make a total profit of \$225, \$200 from the transactions plus \$25 in damages, and would have been placed in a better position than if GARMCO had fully performed, in which case ADI's profit would only have been \$200.¹³¹ Accordingly, in this situation,¹³² the holding in *Aluminum Distributors* would permit GARMCO to offset the market-related benefit that ADI obtained as a result of the breach (\$25) against ADI's cover

¹³⁰ It is again assumed that, in order to cover for GARMCO's late delivery, ADI had to make a quick purchase in the "spot" market and, thus, paid a premium of \$25 above market value. *See Aluminum Distrib., Inc. v. Gulf Aluminum Rolling Mill Co.*, No. 87 C 6477, 1989 WL 157515, at *4 (N.D. Ill. Dec. 12, 1989) (alluding to the fact that the cover market price of aluminum had risen).

¹³¹ This also bears out the thesis that "[i]f . . . the [non-breaching party] resells the goods at a higher price than the market price on the date of tender [set forth in the contract], 2-708(1) overcompensates." WHITE & SUMMERS, *supra* note 2, § 7-11, at 390. Of course, a market adjustment per *Aluminum Distributors*, although not discussed by the professors, would obviate the benefit derived from a rising market.

¹³² Unlike the situation described *infra* in Part III, assuming that the delay between T1 and T2 in this instance was not great, it would not require discounting of any special market benefit that the non-breaching party gained as a result of the late delivery.

damages (\$25). In the above example, ADI would not recover anything from GARMCO.¹³³

The simplified cover formula, which calls for the payment of damages equal to the amount by which the cover price exceeds the wholesale price of the goods on the date that the injured party would have gone into the market and bought substitute goods for the late delivered goods, reaches the same result as the *Aluminum Distributors* approach used above. That is, applying the formula in the above illustration would call for GARMCO to pay ADI the difference between \$525, the cover price, and \$525, the wholesale price on goods on the date of the late delivery,¹³⁴ that is, nothing.

It must be reiterated that this result is permissible, whereas the offset that GARMCO sought in Case 1 is not, because here no offset is being made of any profits that ADI earned on the transaction that ADI would have entered irrespective of any late-delivered goods. Rather, the offset was accomplished solely because the late-delivered goods delivered to ADI were cheaper than goods which ADI could otherwise have purchased to enter into that transaction.

The dissent in *Fertico* argued that the mere possibility of the buyer reaping a "windfall,"¹³⁵ such as the above illustration indicates is possible without an *Aluminum Distributors* adjustment, is sufficient to demonstrate that the basic approach adopted by the majority in *Fertico* and continued in *Aluminum Distributors* is flawed:

[A] buyer who must go into the market to obtain goods will ordinarily not be able to rely on the availability of a "standard price"; rather, unlike the seller who has an unlimited supply of

¹³³ Of course, under the *Aluminum Distributors* approach, in the situation where cover was not effectuated, the non-breaching party's damages would be the profit that it lost on the transaction that was not accomplished, reduced by any difference between the wholesale price of goods on the date of the late delivery and the contract price. *Aluminum Distributors*, 1989 WL 157515, at *5.

¹³⁴ At least presumptively, the date of late-delivery is also the date on which the injured party would have gone into the market to secure goods for the subsequent transaction. However, where, as in *Fertico*, the late-delivered goods were held several months before resale, this presumption would appear inapplicable and a date more consistent with the normal lead-time between the securing of goods in the wholesale market and reselling them should apply. See generally Frisch & Wladis, *supra* note 100, at 1292-96 (discussing the limitations of buyers' remedies).

¹³⁵ *Fertico Belgium S.A. v. Phosphate Chemicals Exp. Ass'n*, 70 N.Y.2d 76, 86, 510 N.E.2d 334, 339, 517 N.Y.S.2d 465, 471 (1987) (Titone, J., dissenting).

standard-price goods in its inventory, the reselling buyer remains at the mercy of the wholesale market's price fluctuations. Because of these differences, it *cannot* "be safely assumed" that the aggrieved buyer-dealer would have made a second sale at a particular profit were it not for the seller's breach. To the contrary, the occurrence of and profit on a second transaction would depend on such other, unrelated variables as the availability and wholesale market price of the goods at the time the buyer-dealer went into the market to acquire them. Thus, the rationale for the seller-dealer's lost-profit remedy is simply inapplicable to buyer-dealers.

. . . [W]hile a second sale may have been theoretically possible even without the breach, the uncertainties occasioned by the buyer/seller's need to return to the marketplace for more goods of the same kind preclude the assumption, implicit in the majority's holding, that the second sale and its accompanying profit would have been made on the same terms even if no breach had occurred.¹³⁶

This position is echoed by some who assert:

The Code specifically provides for the seller to recover lost profits where no other remedy is effective. No similar remedy is provided for a buyer. A seller can recover lost profits in the situation where the seller has, if not an unlimited supply of the goods, at least the ability to fulfill two contracts. Here, Fertico did not have an unlimited supply of goods. As a buyer Fertico would normally have to go into the market to purchase goods for a second deal. Because it appears from the case that the price of fertilizer was increasing, that second purchase arguably would have been at a higher price. By allowing Fertico to keep the profit, Fertico received more on the second transaction than it would have otherwise, thereby reaping a windfall because of the breach.¹³⁷

This view is, however, unduly harsh. Indeed, there is no need for the courts to be so punitive as to totally deprive a non-breaching party of the profits of the subsequent transaction when, in most cases, either a simple adjustment for any special market-related benefit obtained by virtue of an upward movement of the market between T1, when the goods were originally contracted for, and T2, when they were actually delivered, or the

¹³⁶ *Id.* at 88–89, 510 N.E.2d at 340–41, 517 N.Y.S.2d at 472 (Titone, J., dissenting) (citations omitted).

¹³⁷ Donnelly & Donnelly, *supra* note 39, at 182–83 (citations omitted).

application of the simplified cover formula can easily obviate any such windfall.¹³⁸

While both the *Aluminum Distributors* approach and the simplified cover formula work very well in the above illustration, in the real world, escalation in the market price of goods frequently occurs, albeit not uniformly, between the date on which the contract is signed and the date on which delivery is required as well as between this original delivery date and the date of late-delivery. Moreover, rises in wholesale prices and retail prices do not always track exactly. As a result, some fine-tuning of these damage formulations is needed for such circumstances.

1. Case 2a: Rising-but-Fluctuating Market: The *Aluminum Distributors* Corollaries

As the illustration in Case 2a below demonstrates, rote application of the *Aluminum Distributors* approach can, in certain circumstances, leave the injured party in a worse position than had no breach occurred, that is, with total profits of only \$210¹³⁹ as compared to profits, absent the breach, of \$220. For this reason, as explained below, the amount of any offset must be limited so that it: (a) does not exceed the amount by which the market value of the goods on the date of late-delivery exceeds the market value of the goods on the date that delivery should have occurred and (b) cannot be so large as to put the non-breaching party in a worse position than it would have been absent the breach. In fact, irrespective of the size of the offset, the non-breaching party cannot be put in a worse position than had there been no breach.

NO BREACH	
T1: Date of GARMCO/ADI Contract:	
Wholesale market price on date of breach:	\$500
GARMCO/ADI contract price:	\$500
T3: GARMCO's Timely Delivery/ADI's Resale:	
Wholesale market price:	\$530
GARMCO/ADI contract price:	\$500
Resale market price:	\$620

¹³⁸ As discussed *infra* in Part III, even in non-volatile markets, in some instances there may, however, be a need to discount the amount of change in the market so as to factor out the length of time between T1 and T2.

¹³⁹ See *infra* note 141.

ADI resale price:	\$620
ADI profit:	\$120
T4: ADI's Subsequent Purchase of Aluminum and Resale Thereof :	
Wholesale market price:	\$555
Subsequent purchase price:	\$555
Resale market price:	\$655
ADI resale price:	\$655
ADI profit:	\$100
ADI's total profit:	\$220 (\$120+\$100)
(B) BREACH	
T1: Date of GARMCO/ADI Contract:	
Wholesale market price on date of breach:	\$500
GARMCO/ADI contract price:	\$500
T2: GARMCO Breach/ADI Cover Purchase:	
Wholesale market price on date of breach:	\$510
GARMCO/ADI contract price:	\$500
"Spot" purchase/cover price:	\$535
Resale market price:	\$610
ADI resale price:	\$610
ADI profit:	\$ 75
T3: DATE ON WHICH GARMCO SHOULD HAVE DELIVERED:	
Wholesale market price:	\$530
T4: GARMCO's Late Delivery /ADI's Resale of the Late-delivered Aluminum:	
Wholesale market price:	\$555
GARMCO/ADI contract price:	\$500* * * *
Resale market price:	\$655
ADI resale price:	\$655
ADI profit:	\$155
ADI's total profit:	\$230 (\$75 +155)

In this illustration, if ADI were allowed to recover its traditional cover damages of \$35 (\$535-\$500) and retain all of the profits it made on the resale of the late-delivered aluminum, it would make a total profit of \$265 (\$230+\$35). This would admittedly place ADI in a better position than if GARMCO had not breached because in the latter case, ADI's total profit would only have been \$220. Application of the *Aluminum Distributors* approach would, however, reduce the damages that GARMCO has to pay to ADI by \$55, that is, the difference between the contract price (\$500) and the aluminum wholesale price at the time of late delivery (\$555). However, such application ignores the fact

that (a) some of the increase in market value may have inured to ADI's benefit even if there had been no breach¹⁴⁰ and that (b) by rotely following the *Aluminum Distributors'* formula, ADI's total profit would only be \$210,¹⁴¹ which is \$10 less than it would have been had GARMCO not breached. Ignoring these facts is inappropriate. To avoid doing so, the *Aluminum Distributors'* formula needs to be supplemented with the following three corollaries. First, the maximum amount of any potential offset should be calculated by the amount by which the wholesale market price on the date of late delivery (\$555) exceeds the wholesale market price *on the date performance should have occurred* (\$530), rather than the difference between the wholesale market price on the date of late delivery and the contract price. This change yields a better measure of the benefit that ADI got from the late delivery.¹⁴² Second, the amount of any offset must be further limited, if necessary, so that the non-breaching party is never put in worse a position than had there been no breach. Third, irrespective of the limitation of any offset, the non-breaching party must never be left in a place that is worse than the position in which it would have been absent the breach.

¹⁴⁰ That is, on the date when delivery was scheduled, the wholesale value of aluminum had increased, as had ADI's potential for profits in the rising retail market for aluminum. The latter is true unless the particular aluminum was already the subject of a resale contract prior to the date of anticipated delivery. Had there been no breach, ADI would have sold the aluminum at or near the peak of the market.

¹⁴¹ \$230
plus \$ 35 increased cost of cover (\$535-500)
less \$ 55 wholesale market price at time of delivery less contract price (\$555-500)
\$210

¹⁴² See Frisch & Wladis, *supra* note 100, at 1293-94. This would also be consistent with the authorities cited *supra* in note 37, indicating that where there is an unanticipated benefit that flows from the breach, all other things being equal, equity favors the non-breaching party retaining the benefit.

Doing so would be consistent with the remedy provided in U.C.C. section 2-714 for acceptance of non-conforming goods: "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 [i.e., delivered on time]." U.C.C. § 2-714(2) (2003).

Where, as in *Fertico*, the late-delivered goods were held for several months before resale, the presumption that the date of late-delivery would also be the date upon which the non-breaching party would have gone into the market to buy substitute goods to accomplish the subsequent transaction would appear inapplicable and a date more consistent with the normal lead-time between securing goods on the wholesale market and reselling them should apply. See *supra* note 1344.

Applying these corollaries to the above illustration, the maximum potential offset would be \$25 (\$555), wholesale value of the goods when late-delivery is made, less \$530, wholesale value of goods when delivery should have been made. Offsetting this amount from the damages that GARMCO would otherwise have had to pay (\$35) would make GARMCO responsible for paying damages in the amount of \$10 and ADI's total profit would be \$240. Since the latter amount is more than the \$220 that ADI would have earned absent the breach, nothing further is required.¹⁴³

Under the simplified cover formula, GARMCO would be required to pay ADI the amount by which the increased cost of cover (\$535) exceeds the market value of the goods on the date of actual delivery (\$555). Since, in this case, the increased cost of cover did not exceed the market value of the goods on the date of actual delivery, GARMCO would not owe ADI anything and ADI's total profit would only be \$230.

2. Case 2b: Alternative Illustration of Rising-but-Fluctuating Market: The *Aluminum Distributors* Corollaries

The viability of these corollaries is further demonstrated in the Case 2b illustration, which again attempts to portray the real world situation of ever-fluctuating wholesale and retail markets for goods. The illustration also demonstrates how the *Aluminum Distributors* approach, used in conjunction with the suggested corollaries, fares in those circumstances. As the illustration shows, the application of *Aluminum Distributors* and its corollaries results in the breaching party not having to pay any breach damages and the non-breaching party making a slightly higher total profit than it would have made absent the breach.

<i>NO BREACH</i>	
<i>T1: Date of GARMCO/ADI Contract:</i>	
<i>Wholesale market price on date of breach:</i>	<i>\$500</i>
<i>GARMCO/ADI contract price:</i>	<i>\$500</i>
<i>T3: GARMCO's Timely Delivery/ADI's Resale:</i>	
<i>Wholesale market price:</i>	<i>\$525</i>

¹⁴³ For a discussion of the approximate nature of such a damage formula and why the injured party and not the breaching party should be the one to be benefited, see discussion *supra* note 37.

<i>GARMCO/ADI contract price:</i>	\$500
<i>Resale market price:</i>	\$680
<i>ADI resale price:</i>	\$680
<i>ADI profit:</i>	\$185
<i>T4: ADI's Subsequent Purchase of Aluminum and Resale Thereof:</i>	
<i>Wholesale market price:</i>	\$540
<i>Subsequent purchase price:</i>	\$540
<i>Resale market price:</i>	\$655
<i>ADI resale price:</i>	\$655
<i>ADI profit:</i>	\$115
<i>ADI's total profit:</i>	\$300 (\$185+\$115)
<i>(B) BREACH</i>	
<i>Date of GARMCO/ADI Contract:</i>	
<i>Wholesale market price on date of breach:</i>	\$500
<i>GARMCO/ADI contract price:</i>	\$500
<i>T2: GARMCO Breach/ADI Cover Purchase:</i>	
<i>Wholesale market price on date of breach:</i>	\$510
<i>GARMCO/ADI contract price:</i>	\$500
<i>"Spot" purchase/cover price:</i>	\$535
<i>Resale market price:</i>	\$610
<i>ADI resale price:</i>	\$610
<i>ADI profit:</i>	\$ 75
<i>T3: DATE ON WHICH GARMCO SHOULD HAVE DELIVERED:</i>	
<i>Wholesale market price:</i>	\$535
<i>Resale market price:</i>	\$680
<i>T4: GARMCO's Late Delivery/ADI Resale of Late-delivered Aluminum:</i>	
<i>Wholesale market price:</i>	\$540
<i>GARMCO/ADI contract price:</i>	\$500* * * *
<i>Resale market price:</i>	\$655
<i>ADI resale price:</i>	\$655
<i>ADI profit:</i>	\$115
<i>ADI's total profit: \$190 (\$75+\$115)</i>	

Under the *Aluminum Distributors* approach (a), the cover damages due ADI would be \$25¹⁴⁴ reduced by the amount, if any, that the market value of the goods at the time of late delivery (\$540) exceeds the contract price (\$500). Accordingly, pursuant

¹⁴⁴ \$525 (spot market price)
less \$500 (contract price)
\$25

to this approach, GARMCO would not owe ADI anything, and ADI's total profit would remain \$190. Needless to say, this would result in ADI profiting considerably less than it would in absence of the breach.

In applying the above corollaries to the *Aluminum Distributors* approach in the Case 2b illustration—because the wholesale market price of the goods at the time of the late delivery (\$540) exceeded the market value at the time delivery should have occurred (\$535)—the maximum potential offset against cover costs would be \$5. This would result in cover damages being reduced from \$25 to \$20 and a total net profit to ADI of \$210 (\$190+\$20), which is \$90 less than the \$300 it would have made had there been no breach. As such, the corollaries would require that GARMCO pay an additional \$90 so as to put ADI in the same position as it would have been absent the breach, that is, ADI's total profit would be \$300 (\$190 plus the cost of cover (\$25) less the offset (\$5) plus the additional amount GARMCO would have pay to equalize ADI's position (\$90)). GARMCO would, thus, have to pay ADI a total of \$110.

The simplified cover formula, on the other hand, would require GARMCO to pay the amount, if any, by which the cost of cover (\$525) exceeded the wholesale market price at the time that ADI would have entered the market to purchase fertilizer (\$540), discounted if and as needed. Here that amount would be \$0. Accordingly, under the simplified cover formula, ADI's total profit would be \$190. Since this is considerably less than the profit ADI would have made absent the breach, the corollary restoring the non-breaching party to the position in which it would have been absent the breach clearly must be applied. Therefore, GARMCO would have to pay \$110, the same amount of payment it would have made under the approach in the preceding paragraph.

C. Case 3: *Falling Markets*

Where the going market price for the goods declines at or after the time of contracting, generally the buyer is well advised to reject the goods and to purchase substitutes elsewhere at lower prices. Not surprisingly, in such circumstances, it is advantageous for the breaching party to deliver the goods, albeit later than prescribed, at a contract price that is higher than the breaching party could then sell them in the market place. The

above notwithstanding, rejection of the goods by the buyer may still not be provident in some circumstances, for instance, where goods of a similar quality are not readily obtainable. Additional examples include situations involving federal contracts containing clauses that, at least ostensibly, require the buyer to continue contract performance despite what appears to be a breach of contract by the governmental seller¹⁴⁵ or other situations in which the buyer/middleman may do itself more harm by canceling the contract.¹⁴⁶ In the latter situations, whether or not cover has been effectuated, "if the buyer has an immediate need for the contracted goods, for example to supply a resale customer, good business practice, as well as the duty to mitigate [any incidental or consequential] damages, may require him to accept the deficient tender,"¹⁴⁷ and seek his damages by offset against the contract price or otherwise.¹⁴⁸ Indeed, acceptance of the goods is also entirely appropriate where the buyer is a constant purchaser of such goods for the purpose of supplying the operations of its manufacturing facility.¹⁴⁹

¹⁴⁵ Indeed, because the federal government believes the buyer cannot reject the late-delivered goods, it also believes that it remains obligated to provide the goods even after very substantial delays.

¹⁴⁶ See, e.g., *Chemetron Corp. v. McLouth Steel Corp.*, 381 F. Supp. 245, 250 (N.D. Ill. 1974) (holding that it was not necessary for Chemetron to cancel its contract for the delivery of liquid oxygen and/or nitrogen in order to sue for damages relating to McLouth's spotty contract performance, because if it had done so, "Chemetron would . . . have been in an even worse position and less able to serve its customers if it had received no product at all from McLouth"), *aff'd*, 522 F.2d 469 (7th Cir. 1975); cf. Hackley, *supra* note 4, at 219.

¹⁴⁷ Anderson, *supra* note 113, at 328–29. Indeed, "[s]ometimes the exigencies of the market necessitate further dealings between [the parties]" which could encompass the acceptance of the late-delivered goods. WHITE & SUMMERS, *supra* note 2, § 6-3, at 303.

In *Aluminum Distributors*, the court concluded that GARMCO clearly knew that ADI had purchased the aluminum for resale and consequently, ADI need not prove that acceptance of the late-delivered goods was reasonable. See *supra* note 1155 and accompanying text.

¹⁴⁸ See Anderson, *supra* note 113, at 329. That said, it has been argued that, in order to avoid the offset of profits made on the transaction subsequent to receipt of the late-delivered goods against cover damages (or profits lost on a forgone transaction), the buyer/middleman should have to demonstrate that: (1) the acceptance of the late-delivered goods was reasonable and (2) there was a loss of profit despite the acceptance and use/resale of the late-delivered goods. Hackley, *supra* note 4, at 223–24.

¹⁴⁹ This can also be explained, at least in part, by the fact that in a falling market acceptance of the goods at a later time does not put the late-delivering seller in any worse position than he would otherwise be if the buyer rejected the goods and he had to sell them on the open market.

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PROFITS FROM LATE-DELIVERED GOODS

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1. Case 3a: Falling Market/No Effect on Spot Market Price

<i>(A) NO BREACH</i>			
<i>T1: GARMCO's Timely Delivery and ADI's Resale:</i>		<i>T2: ADI's Subsequent Purchase and Resale Thereof:</i>	
<i>Wholesale market price:</i>	\$500	<i>Wholesale market price:</i>	\$475
<i>GARMCO/ADI contract price:</i>	\$500	<i>Subsequent purchase price:</i>	\$475
<i>Resale market price:</i>	\$600	<i>Resale market price:</i>	\$575
<i>ADI resale price:</i>	\$600	<i>ADI resale price:</i>	\$575
<i>ADI profit:</i>	\$100	<i>ADI profit:</i>	\$100
<i>ADI's total profit:</i>	\$200 (\$100+\$100)		
<i>(B) BREACH</i>			
<i>T1: GARMCO Breach/ADI Cover Purchase ADI's Resale of the Cover Goods:</i>		<i>T2: GARMCO's Late Delivery ADI's Resale of the Late-delivered Goods:</i>	
<i>Wholesale market price:</i>	\$500	<i>Wholesale market price:</i>	\$475
<i>GARMCO sale price:</i>	\$500	<i>GARMCO sale price:</i>	\$500
<i>"Spot" purchase/cover price:</i>	\$525 ¹⁵⁰ * * * *		
<i>Resale market price:</i>	\$600	<i>Resale market price:</i>	\$575
<i>ADI resale price:</i>	\$600	<i>ADI resale price:</i>	\$575
<i>ADI profit:</i>	\$75	<i>ADI profit:</i>	\$75
<i>ADI's total profit:</i>	\$150 (\$75+\$75)		

In this situation, ADI should be compensated for the increased cost of cover (\$25). However, this is not enough to place ADI in as good a position as it would have been had GARMCO fully performed. That is, even with that payment, ADI is still short \$25 as a result of the decrease in market price. Indeed, if GARMCO had not breached and ADI had purchased aluminum on the wholesale market for the T2 sale, ADI would have saved

¹⁵⁰ This example assumes that the falling market would not affect the "spot market" price. This assumption is premised on the spot purchase being made during T1, the period during which the contract was entered into and the delivery was supposed to have arrived.

\$25. Accordingly, GARMCO would have to pay ADI the sum of \$50.

Since it did not have reason to do so, the court did not address the issue of a falling market in *Aluminum Distributors*. If, however, in the above example, GARMCO is allowed to offset the amount of any market benefit against damages otherwise due, it makes sense that it should also have to compensate ADI for any market loss, particularly where doing so would put ADI in as good of a position as it would have been had there been no breach. Therefore, GARMCO should have to pay the \$25 for cover *plus* the \$25 profit loss ADI incurred as a consequence of having to resell the late-delivered goods in a falling market.

The same result is achieved under the simplified formula. Here, the amount by which cost of cover (\$525) exceeded the wholesale market price at the time that ADI would have entered the market to purchase aluminum for delivery to its second customer (\$475) is the amount due ADI from GARMCO. Indeed, GARMCO's payment of \$50 would increase ADI's total profit on the transactions from \$150 to \$200, the amount that it would have made in the absence of any breach.

2. Case 3b: Falling Market/Lower Spot Market Price

The Case 3a illustration is premised on the idea that the falling market did not affect the spot market purchase. The possibility of this fact depends largely on how soon the spot purchase is made to cover after the contract price is set. In a situation like *Fertico*, where only a few weeks separated the two events, it is possible that the market conditions would not have changed much. However, if the spot purchase was made six months later to cover GARMCO's breach (assuming that the delivery date was not until six months after the contract was entered), it is very likely that the spot market price would also have been affected by the falling market price. In such a scenario, it is even possible that the spot purchase would cost less than the original GARMCO sale price. ADI would, therefore, receive a benefit in the sense that the cost to cover would be less than the original sale price. However, the falling market would also affect the resale price of the late-delivered goods, and ADI may still need compensation for this loss in order to be placed in as good a position as it would have been had there been no breach. The following example clarifies this point:

(A) NO BREACH			
T1: GARMCO's Timely Delivery and ADI's Resale:		T2: ADI's Subsequent Purchase and Resale Thereof:	
Wholesale market price:	\$500	Wholesale market price:	\$475
GARMCO/ADI contract price:	\$500	Subsequent purchase price:	\$475
Resale market price:	\$600	Resale market price:	\$575
ADI resale price:	\$600	ADI resale price:	\$575
ADI profit:	\$100	ADI profit:	\$100
ADI's total profit:	\$200 (\$100+\$100)		
(B) BREACH			
T1: GARMCO Breach/ADI Cover Purchase ADI's Resale of the Cover Goods		T2: GARMCO's Late Delivery/ ADI's: Resale of the Late-delivered Goods	
Wholesale market price:	\$500	Wholesale market price:	\$475
GARMCO sale price:	\$500	GARMCO sale price:	\$500
"Spot" purchase/cover price:	\$500 ¹⁵¹ * * * *		
Resale market price:	\$600	Resale market price:	\$575
ADI resale price:	\$600	ADI resale price:	\$575
ADI profit:	\$100	ADI profit:	\$75
ADI's total profit:	\$175 (\$100+\$75)		

In this illustration, the cost of cover was the same as the original contract price; however, the falling market caused ADI to lose \$25 on the resale of the late-delivered goods. In order to place ADI in as good of a position as it would have been had GARMCO not breached, ADI should be able to recover this lost \$25 as well. Nevertheless, a court may be reluctant to make such a liberal interpretation of *Aluminum Distributors* because the cost of cover is a wash. However, failing to do so would be an error.

Indeed, *Aluminum Distributors* can be interpreted as requiring an analysis of the specific market-based facts for the transac-

¹⁵¹ Premised on a \$475 price based on the falling market plus a \$25 premium since the purchase was from the spot market.

tion at issue.¹⁵² In *Aluminum Distributors*, the court performed this analysis to determine whether ADI received a market benefit.¹⁵³ The Case 3a and 3b illustrations merely expand this theory to determine whether ADI would incur a market loss if there were a falling market. This fact specific approach could be very helpful in recovering lost profits from a breaching seller. However, it is also possible that courts will avoid such a detailed inquiry for fear of getting bogged down or of treading in waters too remote from the breach.

IV. IS THE *ALUMINUM DISTRIBUTORS* APPROACH TOO FAVORABLE TO A BREACHING SELLER? SOME ADDITIONAL FACTORS THAT NEED TO BE CONSIDERED

It is true that unlimited application of *Fertico* can, as noted above, deliver a windfall to the buyer in a rising market. On the other hand, the dissent in *Fertico* advocated an approach that would simply bar all buyers from recovering cover damages in the event of late-delivery. In sum, the approach set forth in *Aluminum Distributors* greatly tempers any potential windfall. Under *Aluminum Distributors*, the non-breaching buyer should be awarded cover damages and/or lost profits *and* be permitted to retain its full profit from the resale of the late-delivered goods, except to the extent that it can be shown that it received a direct market-related benefit as a result of the breach.

As fair as the basic *Aluminum Distributors* approach generally is, it does not respond to the question of why the breaching party should get any benefit from fortuitous post-breach increases in the market for the goods that it failed to deliver. This is particularly true in light of the rule discussed in detail earlier in this Article that, so long as the transaction involving the late-delivered goods was neither a substitute for one that would have been accomplished had there been no breach or bonus, the profits made on the subsequent transaction need not be applied in

¹⁵² See *Aluminum Distrib., Inc. v. Gulf Aluminum Rolling Mill Co.*, No. 87 C 6477, 1989 WL 157515, at *4-5 (N.D. Ill. Dec. 12, 1989) (holding that reasonably calculated damages include the cost of covering and lost profits as long as the buyer can prove it could have covered).

¹⁵³ *Id.* at *5 (requiring GARMCO to show that the price of the aluminum that ADI would have purchased to cover would have been higher than the price paid to GARMCO in order to offset damages as a result of a market benefit).

whole or in part to offset damages otherwise due to the non-breaching party.

Professors White and Summers raise, but reject, the possibility that the drafters of U.C.C. section 2-708 believed that plaintiffs, in general, were too little rewarded and that breaches were undeterred. However, the professors assert that if this was the drafters' philosophy, then it is conceivable that they regarded some sections of the U.C.C., for example, section 2-708(1), as liquidated damage clauses available to the plaintiff irrespective of its actual damage.¹⁵⁴ They note that such a position is, however, inconsistent with the philosophy stated in section 1-106 and comment 1 thereto which indicates 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."¹⁵⁵

The remedy created in *Aluminum Distributors* does not, however, conflict with the above rule. Indeed, it does not seek to directly diminish any profit that ADI made as a result of a booming resale market for aluminum. Rather, consistent with the direction of section 2-714(1) to determine damages in a manner which is reasonable,¹⁵⁶ it simply comports with the reality that the value of the goods themselves had, through neither party's efforts or fault, simply changed by the time that the late-delivery occurred and indicates a belief that this change in value should be taken into consideration in calculating damages. This is particularly true where doing so would simply help keep the ag-

¹⁵⁴ WHITE & SUMMERS, *supra* note 2, at 395 (discussing why lost profits are often appropriate for buyers).

¹⁵⁵ *Id.* (citing U.C.C. § 1-106, cmt. 1 (2002)). As Professor Farnsworth puts it, No matter how reprehensible the breach, damages are generally limited to those required to compensate the injured party for lost expectation, for it is a fundamental tenet of the law of contract remedies that an injured party should not be put in a better position than had the contract been performed.

FARNSWORTH, *supra* note 1, § 12.8, at 193 (citations omitted). The seemingly inviolate "fundamental tenet" was, however, rejected by the Federal Circuit in *LaSalle Talman Bank, F.S.B. v. United States*, 317 F.3d 1363, 1371-72 (Fed. Cir. 2003), in favor of the considerably narrower view of the Restatement (Second) of Contracts section 347, comment e, which urges a reduction in the damages payable to the non-breaching party only when the non-breaching party "makes an especially favorable substitute transaction." RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. e (1981) (emphasis added).

¹⁵⁶ See *Aluminum Distributors*, 1989 WL 157515, at *4-5 (holding that the court must grant ADI damages which are otherwise reasonable).

grieved party from being placed in a substantially better position than it would have been in had a breach not occurred.

Moreover, another reason why the breaching party's damages should be affected by the market into which the late-delivered goods were interjected lies in the fact that once the breach occurred and the seller became liable for the increased cost of cover and/or profits lost as a result of the non-delivery, he still made the late-delivery to the buyer. This was probably done in the hope of avoiding liability for any damages, when in reality the breach had already relieved him of his duty to provide the goods. Had he recognized this, in a rising market, instead of delivering the goods to the buyer at the price set in the contract, he could and would have sold them on the open market at a higher price. Thus, he would have benefited from the market to the same extent that the buyer ultimately did and to which the breaching seller had every right to do as well.¹⁵⁷

¹⁵⁷ This can be seen in the following comparison showing the benefit that the breaching seller gave up by virtue of making the late-delivery in a rising market:

GARMCO Breach/No Late Delivery to ADI:		GARMCO Breach/With Late Delivery to ADI:	
GARMCO's sale price to ADI:	\$500	GARMCO's sale price to ADI:	\$500
GARMCO's price to other buyer at T2:	\$575	Market value at time of late delivery:	\$575
GARMCO's cost of material:	\$375	GARMCO's cost of material:	\$375
GARMCO's profit from sale:	\$200	GARMCO's profit from sale to ADI:	\$125
Damages owed to ADI:	(\$100)	Damages owed to ADI:	(\$100)
Net to GARMCO:	\$100	Net GARMCO:	\$25

Conversely, in a declining market, a breaching seller delivering the goods late avoided losses that it would have suffered if it had been forced to sell the goods at the current market price rather than at contract price. This is a reason why the seller should be liable for any additional losses which the buyer incurs in a subsequent transaction involving the late-delivered goods. See the example below.

To compensate the breaching party, or rather, to ensure that damage awards do not under-compensate the non-breaching party by permitting the breaching party too great an offset and the plaintiff too little a recovery, two things need to be done. First, courts applying the holding in *Aluminum Distributors* must be sure that the special benefit obtained by the non-breaching party would not have been obtained, neither in whole nor in part, absent the breach. Second, to the extent any special benefit is derived as a result of the breach after a significantly lengthy amount of time, the amount of the special benefit should be discounted so as to value it as of the time when delivery would have occurred but for the breach.

The first point noted immediately above is illustrated by the following example of a situation where the alleged special benefit could have been obtained even if there had been no breach: A company in the business of producing and selling crushed rock secures the right from a land owner to remove all of the rock from a specified pit at any time during a three-year period at a fixed price per ton. The company is, however, thereafter precluded by the landowner from commencing and completing operations when, in year two of the contract, it desired to remove the rock. Assuming, (1) that the company covered at the same price as in the contract but thereafter the wholesale price of rock increased dramatically and (2), that in year three the landowner permitted the company to remove the rock, should the special benefit of getting below-market price rock in year three be used to offset the damages for which the landowner is liable to the crushing company?¹⁵⁸ While a strict reading of *Aluminum Dis-*

GARMCO Breach/ No Late Delivery at T2:		GARMCO/With Late Delivery at T2:	
GARMCO's sale price to ADI	\$500	GARMCO's sale price to ADI:	\$500
GARMCO's price to another at T2	\$475	Market value at time of late delivery:	\$475
GARMCO's cost of material:	\$375	GARMCO's cost of material:	\$375
GARMCO's profit from resale:	\$100	GARMCO's profit from sale to ADI:	\$125
Cover damages/lost profit: owed ADI:	(\$100)	Cover damages/ lost profit: owed ADI:	(\$100)
Net cost or benefit to GARMCO:	\$0	Net cost or benefit to GARMCO:	\$25

¹⁵⁸ For the reasons noted *supra* in the text accompanying note 46, if the company had not been able to cover, the answer to the above question would clearly be

tributors would suggest that the answer is “yes,” it can be argued that doing so would overly benefit the breaching party and not properly compensate the non-breaching party. Unlike a simple supply contract involving only a few deliveries, the breaching party in this hypothetical, by entering into a long-term fixed price contract, had ceded all rights to any increase in market value of the rock to the buyer for a three-year period. Indeed, that was a right for which the crushing company had paid. Under the original contract, the crushing company had the right to perform and reap the benefit of the market at any time during the term of the contract. Thus, giving the landowner a credit for such market increase could very well be viewed as giving away something to which the buyer was entitled by contract.¹⁵⁹ On the other hand, for the reasons noted above, the owner’s material breach obliged him to stop performance and, after the breach, and the accruing of liability, the owner could have sold the rock to a third party at a higher price.¹⁶⁰

With regard to the need to discount the value of any special benefit, if for no other reason than that it came into existence at a time that differs from when the breach damages were incurred, using the undiscounted value of the benefit at the time of belated delivery in the future as an offset against damages will allow the breaching party to unduly benefit from its breach and result in a substantial under-compensation of the non-breaching buyer.¹⁶¹ That is, in order to properly deduct any special benefit from the non-breaching party’s damages, the effect of the difference in time when each item was incurred needs to be factored out. This can be done in one of two ways. The first is adding the time value of money for the period between the breach and the late delivery to the non-breaching party’s damages. Thus, the

“no” because the company would have lost volume.

¹⁵⁹ Under this thesis, an offset would also be inappropriate if the contract indicated that its term would be extended in the event of any delay by the landowner, causing performance to occur in year four (i.e., at a time still within the contemplation of the original contract). The basis for denying this offset would again be that the increase in market price occurred at a time during which the contract indicated that the crushing company was entitled to the benefits of any such increase.

¹⁶⁰ This factor arguably should not be applied in the case of those federal contracts where the government believes the buyer cannot reject the late-delivered goods and in turn believes that it remains obliged to provide the goods even after very substantial delays.

¹⁶¹ See ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS, § 9.2 at 530-31(4th ed 1992).

net amount due the non-breaching party would equal the present net value of the damages incurred as of the date of the late delivery less any special benefit:

$$\text{Net amount due} = \text{Damages incurred}^{162} X(1+r)^{t163} - \text{the special benefit}$$

This formula can also be restated more simply as: the net amount due the non-breaching party is the damages incurred less the value of any special benefit discounted for the period between the non-breaching party's incurring the damages and the date of the special benefit:

$$\text{Net amount due} = \text{Damages incurred} - \text{the special benefit} / (1+r)^t$$

CONCLUSION

Most of the criticism of *Fertico* is misplaced. Particularly misplaced is the criticism stemming from a reading of *Fertico* that calls for the reduction or elimination of any compensation to a commercial dealer who, despite a breach by a critical supplier, makes a profit on the subsequent transactions involving any late-delivered goods. Both the law and the economics of the situation bode otherwise. Where the breaching party was aware of the non-breaching party's intention to resell the goods or use them to produce finished goods, the injured party need not demonstrate the existence of circumstances that virtually compel it to accept the late-delivered goods. Moreover, an *Aluminum Distributors*-type adjustment can easily obviate any windfall that the injured party would otherwise obtain because of a rise in the market value of the goods and consequent receipt of late-delivered goods at a price that is below their then-current market price.

This is not to say that the *Fertico/Aluminum Distributors* approach is applicable to every circumstance. Indeed, it is not

¹⁶² The lost profits or increased cost of cover due to the breach.

¹⁶³ "r" is the applicable rate of interest, that is, the higher of the rate of interest on outstanding borrowings by the non-breaching party or the reasonable rate of return that the buyer could have made on the money. Both are usually a function of the prime rate. The highest rate is used because it is reasonably assumed that the non-breaching party would have availed itself of the highest rate either by paying down a high rate loan or investing in a secure investment, thus yielding a high rate of return.

"t" is the time between the non-breaching party's incurring the damages (normally the time of the breach) and the date of the special benefit (the date of late delivery).

likely to be applicable to short delays in delivery unless the delay results in damage to the non-breaching party. However, where applicable, these cases find that a regular dealer need not prove with nearly absolute certainty that it would have entered into the subsequent transaction involving the goods even in the absence of the breach. In other words, a dealer need not show that it lost volume. Rather, once a showing is made that the injured party is a regular dealer that had the capacity and intention to perform both the initial transaction and the subsequent one, irrespective of the late-delivered goods, the burden shifts to the breaching party to prove that the subsequent transaction would not have occurred but for the breach and without regard to any negative financial consequences caused by the breach.

Moreover, the pure *Aluminum Distributors*-type adjustment to exclude any special, market-related benefit that the non-breaching party acquired is not itself appropriate in every instance. Indeed, as described above, individual circumstances may require that the basic *Aluminum Distributors* approach be slightly adjusted by applying one or more of the following corollaries:

1. The contract must be examined closely to see if any special benefit caused by market changes between the anticipated and actual dates of delivery were already allocated to the non-breaching party.
2. The maximum amount of any potential offset against damages otherwise due to the non-breaching party should be calculated by the difference between the wholesale market price of the goods on the date of late delivery and the wholesale market price of the goods on the date performance should have occurred.
3. Where there is a significant amount of time between the date of delivery set out in the contract (or otherwise anticipated) and the date of actual delivery, any special benefit caused by market shifts should be appropriately discounted.
4. Under no circumstances should the breaching party ever put the non-breaching party in a worse position than had there been no breach.
5. If there is a "windfall," as between the non-breaching party and one who has breached its contract, the law favors the non-breaching party.