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Construing UCC Section 2-708(2) to Apply to the Lost-Volume Seller

William L. Schlosser*

The consensus of opinion among commentators on the Uniform Commercial Code is that section 2-708(2), as written, fails to provide a sufficient remedy for the injury sustained by a lost-volume seller when his buyer breaches the sales contract by refusing to accept the goods. The author seeks to demonstrate that this opinion is based on an overly restrictive reading of section 2-708(2). While the traditional interpretation of the section 2-708(2) phrase "profit . . . which the seller would have made from full performance by the buyer" has limited the phrase's meaning to a single unit profit, the author contends that this phrase ought to be read to comprise two unit profits (the unit profit from the sale to the breaching buyer and the unit profit from the sale to the resale buyer). By utilizing this interpretation, the author believes that courts can provide for the legitimate needs of the lost-volume seller and at the same time remain faithful to the language of the section.

The commentators appear to agree that the language of section 2-708(2) of the Uniform Commercial Code precludes a recovery of all the damages incurred in the very case it was especially intended to cover — the case of the lost-volume seller.¹ The purpose of this Comment is to suggest a construction of section 2-708 which achieves the drafters' goal of providing the lost-volume seller with a full-damages recovery yet which is consistent with the express language of the section.

I. THE LOST-VOLUME SELLER

The circumstances that give rise to the lost-volume phenomenon are explained by Professor Corbin as follows:

If the seller is a manufacturer or producer of the subject of the sale, with capacity to produce enough such articles to supply all probable customers, the buyer's rejection does not make possible a second sale that the seller could not otherwise have made. Every new customer would have been supplied even if the buyer had kept the goods and performed his contract. The same is true if

¹ Professor Robert J. Harris, who has argued forcefully for the application of subsection 2-708(2) to the lost-volume seller situation, has admitted that "either some strange things must be done with the language of section 2-708 or the whole section must be treated very casually by the judges if absurd results are to be avoided." Harris, A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared, 18 STAN. L. REV. 66, 101 (1965).
the seller, though not himself a producer of the goods, is an intermediate dealer whose relations with a producer enable him to supply all obtainable customers. In these cases, the buyer's breach does not make possible a new sale in which the profit lost by the buyer's breach would be replaced.\footnote{2}

Hence, the lost-volume seller is an "expansible" seller; one who can manufacture (or obtain) as many units as he has buyers.\footnote{3} Since this seller will in effect lose a sale because of the buyer's breach, Professor Corbin concludes that the seller should be entitled to recover the profit he would have earned on the second sale:

The only "saving" that the buyer's breach makes possible in [the case of a lost-volume seller] is the "cost" of producing or procuring the subject of the sale; the seller is enabled to make one new sale without incurring the cost of a second article of the kind. In order to put the seller in as good a position as that in which performance would have put him, he must now be awarded the contract price diminished only by his cost of procurement. Normally, this "cost of procurement" by an intermediate dealer is the "wholesale price" to dealers, not the market value at retail, the difference being the dealer's profit.\footnote{4}

II. UCC Section 2-708(2)

Section 2-708\footnote{5} provides two formulas for computing the seller's

\footnote{2} 5 A. CORBIN, CONTRACTS § 1100, at 541-42 (1964). An example of the lost-volume phenomenon is provided in Neri v. Retail Marine Corp., 30 N.Y.2d 393, 399-400, 285 N.E.2d 311, 314, 334 N.Y.S.2d 165, 169-70 (1972), where the court, in considering the effects of a buyer's breach followed by resale for the same price, contrasted the situation where a private party sells his personal automobile with that where the seller is an automobile dealer with an unlimited supply of standard-priced cars. In the latter case, the court pointed out, the breach costs the dealer a sale. Had the buyer performed, the dealer would have made two sales instead of one.

\footnote{3} Professor Harris has stated that the concept of lost volume may also be applicable to situations where the expansible seller deals in services. Harris, A General Theory for Measuring Seller's Damages for Total Breach of Contract, 60 MICH. L. REV. 577, 581 (1962).

\footnote{4} 5 A. CORBIN, supra note 2, § 1100, at 542 (footnote omitted).

\footnote{5} Section 2-708 provides:

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

UNIFORM COMMERCIAL CODE § 2-708 [hereinafter cited as UCC]. Throughout this
damages when the buyer repudiates or refuses to accept the goods. Subsection 2-708(1) contains the traditional sales-contract damages remedy — the difference between contract price and market price at the time and place of tender. Subsection 2-708(2) contains a residuary formula to be applied whenever subsection (1) is "inadequate to put the seller in as good a position as performance would have done." When this condition is satisfied, the aggrieved seller is entitled to receive "the profit (including reasonable overhead) which the seller would have made from full performance" plus any incidental damages.

The official comment to section 2-708 states that subsection (2) was drafted to provide the seller with a lost-profits remedy in cases of "fixed price" and "standard priced" goods, as well as other "appropriate" cases. Although the comment does not explicitly mention the lost-volume seller, the comment's reference to the "unfair ... results ... when fixed price articles [are] involved" indicates that in creating subsection 2-708(2) the draftsmen were probably concerned with the lost-volume seller's problem. It is in situations where the seller is constrained to sell all his goods at a fixed or

Comment, unless otherwise designated, all references to statutory sections are to sections of the Uniform Commercial Code.

6 See, e.g., UNIFORM SALES ACT § 64(3).

7 While this Comment principally considers the application of subsection 2-708(2) to the lost-volume seller only, there are, as Professors White and Summers have noted, two other classes of potential plaintiffs who qualify for subsection 2-708(2) because the other damages remedies provided by article 2 are inadequate — the component seller and the jobber seller. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 7-10 (1972); see also W. HAWKLAND, SALES AND BULK SALES, 153-54 (1958); Comment, The Uniform Commercial Code: Changes In the New York Law of Damages, 31 FORDHAM L. REV. 749, 755-56 (1963). The component seller is one who resells uncompleted goods for scrap because his buyer has breached before he could complete the assembly of the components. Since the other damage remedies, either explicitly or implicitly, require a completed product in order to be applicable, the component seller must rely on subsection 2-708(2). The jobber seller is one who serves essentially as an intermediary by taking title to the goods from the manufacturer and reselling them to the buyer. Because of the buyer's breach, the jobber never goes ahead and acquires the goods. And since the jobber does not have title to the goods, he has no damage formula other than subsection 2-708(2).

8 UCC § 2-708, Comment 2, provides:

The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially if a new venture is involved.
standard price that he is most likely to end up losing a sale and
a profit as a result of the breach. The reason is he cannot vary his
price to facilitate disposing of his entire stock.9

While there is little difficulty in understanding how the phe-
nomenon of a lost-volume seller operates, the formulation of a dam-
age remedy that responds to this phenomenon and is at the same
time consistent with language of subsection 2-708(2) has generally
posed great difficulty for the commentators. There is no question
that the first phrase — "the profit, (including reasonable overhead),
which the seller would have made from full performance by the
buyer" — is appropriate for measuring the damages incurred by
the lost-volume seller. Since the difference between contract price
and market price (which difference would be zero for fixed-priced
goods) is not an adequate measure of damages, the plaintiff's loss
must be measured by the cost to him of the lost volume. That
cost is the profit he lost when the buyer repudiated and decreased
by one his number of sales. While there is much debate concerning
the exact measurement of "profit" and "overhead,"10 the commen-
tors do not question the propriety of placing these terms in the
damages formula. Neither the second phrase ("incidental dam-
gages") nor the third phrase ("due allowance for costs reasonably
injured") is generally criticized, though Professor Harris believes
that the latter must be virtually read out of the formula in order
to reach a correct result in a lost-volume case.11

There is, however, one phrase which the commentators have
been unable to reconcile with the legitimate needs of the lost-vol-
ume seller — "due credit for payments or proceeds of resale." Prof-
essors White and Summers pose a hypothetical sale of a 747 jet
aircraft by Boeing to TWA to illustrate why this phrase causes diffi-
culties in the lost-volume situation.12 In the hypothetical, Boeing

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9 As Professor Harris points out, the flexible-price seller, on the other hand, "usually
does not 'consume' a precious customer upon resale, since his price flexibility enables
him to find an endless supply of customers at different points on the demand curve
as he lowers his price." Harris, supra note 1, at 96.

10 See, e.g., Speidel & Clay, Seller's Recovery of Overhead Under UCC Section 2-

11 Harris, supra note 1, at 105-06. Professor Harris argues that if the seller
receives an allowance for any of the costs he incurred in making the first sale, in-
including the costs that are "wasted" and cannot be attributed to the resale, he will be
overcompensated. His damages will include not only the profit he would have earned
but also an award of costs which, had the buyer actually performed, he would not
have recovered.

has contracted with a number of airlines for the sale of 100 747's during the coming year. TWA, which contracted to purchase the third 747 off the line for $20 million, breaches its contract, and as a result Boeing is forced to sell that particular plane to Pan Am. Pan Am had previously contracted for the delivery of the fourth 747 off the line, but accepts plane number three in its place.

Because of the breach by TWA, Boeing manages to sell only 99 747's, one short of its projected sales total for the year. In determining the measure of the damages that have resulted from the breach by TWA, Boeing's calculation of the damages to which it believes itself entitled are likely to appear as follows:

\[
\begin{align*}
&\text{\$2 million} \quad \text{(profit)} \\
+ &\text{\$1 million} \quad \text{(overhead)} \\
+ &\text{0} \quad \text{(incidental)} \\
+ &\text{0} \quad \text{(costs reasonably incurred [all allocated to Pan Am and so saved])} \\
- &\text{0} \quad \text{(credit for resale)} \\
= &\text{\$3 million damages}
\end{align*}
\]

While this calculation produces the logical and just result, it seemingly fails to account for the fact that Boeing was able to resell the plane which TWA refused. This resale will figure prominently in TWA's calculation:

\[
\begin{align*}
&\text{\$2 million} \quad \text{(profit)} \\
+ &\text{\$1 million} \quad \text{(overhead)} \\
+ &\text{0} \quad \text{(incidental)} \\
+ &\text{\$17 million} \quad \text{(costs reasonably incurred)} \\
- &\text{\$20 million} \quad \text{(credit for resale)} \\
= &\text{0 damage}
\end{align*}
\]

It should be readily apparent that Boeing has been damaged to the extent of one unit of lost profit ($3 million). Yet, unfortunately, as Professors White and Summer note, \(^{13}\) the generally accepted reading of subsection 2-708(2), with its command of due allowance for resale, will not yield this recovery.

One solution to the problem posed by this statutory language has been advanced by Professor Harris, \(^{14}\) and concurred in by Professors White and Summers: \(^{15}\) the court must simply ignore the "due credit for resale" language in true lost-volume cases. \(^{16}\) Professors White and Summer note, \(^{13}\) the generally accepted reading of subsection 2-708(2), with its command of due allowance for resale, will not yield this recovery.

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\(^{13}\) Id.

\(^{14}\) Harris, supra note 1, at 99.

\(^{15}\) J. White & R. Summers, note 7, § 7-13, at 235.

\(^{16}\) Professor Harris has outlined a three-pronged test for the determination of when
sor Nordstrom adopts a different approach to reach the same result. He would restrict the term "resale" so that it does not refer to the resale of the completed unit (or "entity"), but only to the sale of the component parts which have not yet been turned into a unit. In effect this would make the last phrase of the formula inapplicable in the case of a lost-volume seller.

III. AN ALTERNATIVE CONSTRUCTION OF SUBSECTION 2-708(2)

While there is a certain appeal to the results achieved through such statutory amendment by interpretation, the outcome does not erase the fact that violence has been done to the express language of the statute. In truth, however, such violence is not indispensable to the attainment of the drafters' goal of ensuring a full recovery to the lost-volume seller. As noted in the introductory paragraph, the purpose of this Comment is to suggest a construction of the language of subsection 2-708(2) which will reconcile that language with the meaning which the drafters intended the subsection to have. This construction is based on the interpretation of the phrase "profit . . . which the seller would have made from full performance by the buyer." Evidently, it has generally been assumed that this phrase means the same as "profit which the seller would have made on the sale to the buyer." In the White and Summers hypothetical concerning the sale of the Boeing 747, for example, "profit" means the unit profit, or the profit which the seller would have made on the sale to the buyer, had the buyer not repudiated. This interpretation of the phrase appears to be gen-

18 Obviously, the commentators cited were not oblivious to this assault on the language of the statute. Indeed, Professor Harris recognized the problems inherent in his proposal that courts "ignore" certain language in subsection 2-708(2), but expressed the hope that: "Perhaps a court can ignore the terms of the subsection in this situation without running afoul of certain conventional norms of statutory construction, which preclude a judicial determination that legislative language is mere surplusage, on the ground that these terms would be surplusage in only one situation and would have meaning in the other three situations that can arise under the statute." Harris, supra note 1, at 106.
erally accepted by the commentators, although seldom with any discussion.\textsuperscript{19}

The interpretation of the statutory phrase as meaning "unit profit" is not the only one possible, nor even the one most reasonable. One difficulty with this definition is that it involves an alteration of the statutory language. The drafters did not use the phrase "profit which the seller would have made on the sale to the buyer" notwithstanding their use of this type of language in other sections of article 2, such as the use in section 2-706(6) of the phrase "profit made on any resale."\textsuperscript{20} The fact that they chose different language — "made from full performance" instead of "made on the sale" — indicates that they intended a different meaning.

In determining the meaning of the phrase "profit . . . which the seller would have made from full performance by the buyer," it must be kept in mind that, in the case of a lost-volume seller, the transaction in question involves two separate buyers. The appropriate profit is not merely the profit the seller would have made on the sale to the defaulting buyer (the unit profit); full performance by the first buyer would have resulted in a second profit as well — the one made on the sale of a second unit to the resale buyer. The second profit would have been earned had the first buyer not defaulted and made it necessary to sell the first unit to the second buyer. Because the seller cannot find an unlimited number of buyers, he will now sell one less unit than he would have been able to sell but for the first buyer's default. Thus, he ends up losing the profit on the second sale, the "lost sale," as well as the profit on the sale to the defaulting buyer. In its place, he receives a new unit profit earned on the resale.

Consequently, in a transaction involving a lost-volume seller, the "profit . . . which the seller would have made from full perfor-

\textsuperscript{19} The author has discovered little commentary on the meaning of the term "profit." Professor Nordstrom points out that the Code does not define the term but that the official comments indicate that "it normally means the 'list price less cost to the dealer or list price less manufacturing cost to the manufacturer.'" R. NORDSTROM, supra note 17, § 177, at 537. Professors White and Summers offer some discussion of the term, but this discussion is limited to the possibility that "profit" can include consequential damages such as those resulting from long delay in finding a resale buyer. J. WHITE & R. SUMMERS, supra note 7, § 7-12, at 233 n.62.

\textsuperscript{20} UCC § 2-706(6) provides:

The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (Section 2-707) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of Section 2-711).

(Emphasis added.)
mance by the buyer” should include both the profit he would have made on the sale to the buyer and the profit he would have made on the sale of an additional unit to the resale buyer. Of course, this formula does not make the breaching buyer liable for a double unit profit, because it grants him “due credit for payments or proceeds of resale.” Since the transaction as defined includes both buyers, the proceeds realized on the sale to the second buyer must be taken into consideration. Thus, “due credit” (diminished by “due allowance for costs reasonably incurred”) effectively cancels out one unit profit, leaving as a final result a single unit profit, the correct measure of damages.

It could be argued that this construction of the first phrase is incorrect because it actually measures the profit which the seller would have made from full performance by both the first buyer and the second buyer, while the statute seems to refer to the performance by only one buyer. This objection, however, ignores the fact that, in true lost-volume cases, full performance by the second (resale) buyer has either already occurred or is assumed to be inevitable.

This interpretation does not interfere with the application of the subsection 2-708(2) formula to jobber and component sellers, the two other cases to which the subsection applies. In those cases the reasoning discussed in relation to lost-volume sellers does not apply, and “profit . . . which the seller would have made from full performance by the buyer” refers only to the unit profit, that is, the “profit which the seller would have made on the sale to the buyer.” There is a distinction between these two cases and the lost-volume case which makes this outcome possible. If there is no completed unit available for sale, as is the case with the jobber and component sellers, the critical assumption that there is another buyer who would perform fully cannot be made. If there had been an additional buyer, the components seller would have completed manufacture of the unit or the jobber seller would have purchased the unit from the manufacturer, and a resale would have occurred. But since there is no buyer for an additional unit, even full performance by the defaulting buyer would not have resulted in two unit profits. By way of contrast, in the case of the lost-volume seller,

21 It must be remembered that the second branch of Professor Harris’s three-branch test for the determination of lost volume is that the solicitation of the purchaser of the resold item would have been successful. See note 16 supra.

22 See note 7 supra.
there was an additional buyer willing and able to purchase the extra unit, but, because of the first buyer's default, this additional buyer purchased the original unit instead.

Consequently, in the case of the components seller and the jobber seller, the "profit . . . which the seller would have made from full performance by the buyer" is merely the unit profit, which is the profit the seller would have made on the sale to the only buyer available. Therefore, if the profit term is construed as suggested in the preceding discussion, it will be the same interpretation generally accepted in cases of components sellers and jobber sellers, and one which most commentators agree works.23

Moreover, this proposed construction of subsection 2-708(2) does not conflict with the language of the second paragraph of the official comment to the section. That comment contains a method of measuring the "profit" ("list price less cost to the dealer or list price less manufacturing cost to the manufacturer"). The phrase used in subsection 2-708(2), however, is not merely "the profit," but "the profit . . . which the seller would have made from full performance by the buyer."24 If this statutory phrase is construed to comprise two unit profits in lost-volume cases, the language in the comment can be reconciled with this construction since the comment can be read as only defining the phrase "unit profit," a concept which is essential to the computation of damages for all three classes of sellers covered by the subsection — jobber, components, and lost-volume. In lost-volume cases, this definition would then be used to compute each of the two underlying unit profits which comprise the "profit . . . which the seller would have made from full performance by the buyer."

This interpretation of subsection 2-708(2) is easily applied in lost-volume cases and produces the correct results. For example, considering the White and Summers hypothetical in conjunction

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23 The jobber, since he does not actually have the goods to begin with (and therefore cannot have a "resale"), has no difficulty in utilizing the formula set out in subsection 2-708(2). As for the components seller, Professor Harris notes that the 1955-1956 amendments to section 2-708 made it clear that subsection (2) was to govern multiple-components cases, and that the five-term formula of that subsection works well in such cases. Harris, supra note 1, at 99.

24 Professor Shanker, in his Comment, appears to ignore this distinction. He states that "Schlosser stretches the statutory word 'profit' to mean two profits . . . . " Shanker, The Case for a Literal Reading of UCC Section 2-708(2) (One Profit for the Reseller), 24 CASE W. RES. L. REV. 697, 698 (1973) (emphasis added). But the interpretation of section 2-708(2) here proposed is not of the single statutory word "profit" as Professor Shanker implies; rather it is of the entire statutory phrase.
with Professor Harris's lost-volume criteria, it is clear that Boeing qualifies as a lost-volume seller. First, there should be little doubt that Boeing, as a major aircraft producer and the sole producer of the 747, would have solicited Pan Am (presumably a major purchaser of the 747) even had there been no breach by TWA. Second, there is no reason to suppose that the ultimate success of the sale to Pan Am was dependent on TWA's breach. Finally, there is no doubt that Boeing could have met its contractual obligation. Thus, the term "profit (including reasonable overhead) which the seller would have made from full performance by the buyer" is the profit which Boeing would have made on the sale to TWA ($3 million, including reasonable overhead) plus the profit Boeing would have made on the manufacture and sale of an additional plane to Pan Am ($3 million, including overhead), a total of $6 million. Adding costs reasonably incurred ($17 million), and subtracting credit for resale ($20 million), we arrive at the correct result, $3 million.

In some cases, however, the "unit profit" will vary: the variable costs of producing X number of units might differ from those of producing X plus 1 number of units or, if standard-priced goods are not involved, the prices of the two units might differ. While such factors make the problem of computing damages more complicated than the hypothetical discussed above, the formula in subsection 2-708(2) is flexible enough to produce correct results even in these situations. For example, (returning to the 747 hypothetical) suppose the cost of producing an additional plane for sale to Pan Am would have been only $16 million, as opposed to the $17 million cost of building the plane meant to be sold to TWA. Suppose further that Pan Am paid only $19.5 million, instead of $20 million, for the plane. Applying the proposed formula, "profit ... which the seller would have made from full performance by the buyer" is equal to the profit expected from the sale to TWA ($3 million) plus the profit which would have been made from the sale of an additional plane to Pan Am ($3.5 million) for a total of $6 million.

See note 16 supra.

The increment in the total cost attributable to producing an additional unit will almost always be lower than that of any of the units previously manufactured or bought, because overhead (fixed costs) can be spread out over a greater number of units. The formula in subsection 2-708(2) takes account of this difference as "reasonable overhead." A change in the variable costs, however, will change the measure of "profit ... which the seller would have made from full performance by the buyer." For a discussion of possible methods of measuring "overhead," see generally Speidel & Clay, supra note 10.
$6.5 million. Adding to this the costs incurred ($17 million) and subtracting resale proceeds ($19.5 million) produces a total of $4 million in damages. It can readily be seen that this figure is the correct amount; Boeing actually made a profit of $2.5 million, while it would have made a profit of $6.5 million if TWA had not breached. Its net loss as a result of TWA's breach is thus $4 million.

IV. CONCLUSION

The construction of subsection 2-708(2) proposed in this Comment is intended to provide a workable interpretation of the statutory language as actually written, without adding or ignoring language or giving the existing terms anything but their ordinary meanings. In comparing this approach with those taken by other commentators who advocate ignoring or arbitrarily limiting the subsection's language, the reader should remember that section 2-708 of the Uniform Commercial Code represents a relatively new type of statute. Unlike the comparable sections of its predecessor, the Uniform Sales Act, this statute purports to be a damages formula which will fully compensate the seller for the totality of his actual loss in all cases covered, not one which will serve as a mere guideline for the courts.\(^\text{27}\) In light of the fact that section 2-708 is intended to cover all measurements of a seller's damages when the buyer refuses to accept the goods, the reader can understand the difficulty involved in drafting such a statute, as well as the difficulty in construing the finished product. Given the significant role it must play, the statute must not be interpreted in a manner that would preclude it from functioning fully. And it is always preferable to adhere to the express language of a statute if such a course does not produce absurd results.

The interpretation suggested in this Comment makes this preferable route possible. The drafters of subsection 2-708(2) did a better job than they are generally given credit for, and, correctly interpreted, the subsection's damages formula can have the wide applicability which the drafters intended.

\(^{27}\) Section 64 of the Uniform Sales Act is the ancestor of UCC § 2-708. Professor Harris refers to the section 64 language as "breezy indeed." Harris, supra note 1, at 99-100.