UNIFORM COMMERCIAL CODE—§§ 2-714 & 2-715—CONSEQUENTIAL DAMAGES AWARD—*R. I. Lampus Co. v. Neville Cement Products Corp.*, 232 Pa. Super. 242, 336 A.2d 397 (1975).

I. INTRODUCTION

The extent to which consequential damages can be recovered by an aggrieved party in a breach of contract action is often a troublesome question. The problem has been accentuated in Pennsylvania and made unnecessarily confusing by that state's supreme court. In *R. I. Lampus Co. v. Neville Cement Products Corp.*,[1] the Pennsylvania Superior Court criticized an earlier state supreme court case that is inconsistent with common law and current statutory provisions dealing with the recoverability of consequential damages. A resolution of the problem was unnecessary in the particular factual setting of *Lampus*, but the problem still exists and merits closer scrutiny. This case note will analyze the *Lampus* opinion, trace the development of the law of consequential damages, examine the misstatement of the law in Pennsylvania, and suggest the result compelled by law today.

II. THE *Lampus* OPINION

The defendant in *Lampus*, Neville Cement Products Corporation, was a manufacturer and installer of structural floor and ceiling planks.[2] The planks were made by assembling concrete blocks end to end and were designed to be incorporated into floor and ceiling systems in various industrial, commercial, and residential buildings. Plaintiff R. I. Lampus Company had been supplying one type of block to Neville for four years without difficulty; however, when Neville ordered a different type of block, the result was a problem that led to this litigation. In an effort to resolve the problem, Neville's agents communicated to Lampus notice of defects in the cement blocks. A satisfactory solution was not found, and Neville notified Lampus of its intent to hold Lampus responsible for certain damages.[3] Lampus sued to recover the unpaid purchase price of the

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[1] 232 Pa. Super. 242, 336 A.2d 397 (1975).

[2] The facts of the case are set out at 232 Pa. Super. at 245-50, 336 A.2d at 398-401.

[3] The court found that Neville had complied with Uniform Commercial Code § 2-607(3)(a), "which provides that where a tender has been accepted, 'the buyer must within a

delivered blocks and Neville counterclaimed for the damages suffered as a result of the defects in the blocks. The trial court allowed full recovery on Lampus' claim but allowed only four elements of Neville's counterclaim: "1) blocks rejected on the production line; 2) defective block in Neville's inventory; 3) structural floor systems destroyed ('blown up') during production, and, 4) loss of plant time resulting from the systems 'blown up.' "[4] The trial court denied six elements of Neville's counterclaim that were the subject of the appeal to the superior court. The items denied were:

> 1) blocks rejected after production, *i.e.* finished floor systems that could not be delivered to Neville's customers; 2) cost of disposing of defective blocks and floor systems; 3) cost of hiring additional personnel to inspect and handle the broken and rejected block; 4) costs incurred because Neville's customers rejected the floor systems, not including delivery costs or lost profits; 5) costs incurred to place special covers on defective ceilings; and 6) costs incurred to point and caulk the defective ceilings.[5]

On appeal, the superior court applied Uniform Commercial Code §§ 2-714 and 2-715[6] (hereinafter referred to as Code) and the interpretation given those sections by the Pennsylvania Supreme Court in *Keystone Diesel Engine Co. v. Irwin*.[7]

The superior court found for Neville on the first four of the appealed items of damages holding that all three of the elements of the test laid down in *Keystone* had been met.[8] The second element, requiring contemplation of the damages by the defendant at contract formation, was met because the ongoing relationship between the buyer and seller and their extensive negotiating sessions made it clear that "Lampus knew exactly what end use would be made of the blocks it manufactured."[9] Thus, as required by *Keystone*, "the record support[ed] Neville's claim that these six items of damages were within the contemplation of the parties at the time of contract."[10] The

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reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy . . . .'" *Id* at 257, 336 A.2d at 404.

[4] *Id.* at 249, 336 A.2d at 400.

[5] *Id.* at 249-50, 336 A.2d at 400-01.

[6] PA. STAT. ANN. tit. 12A, §§ 2-714 and 2-715 (Purdon 1975).

[7] 411 Pa. 222, 191 A.2d 376 (1963).

[8] See Part IVA *infra*, for explication of the *Keystone* test.

[9] 232 Pa. Super. at 256, 336 A.2d at 404.

[10] *Id.* at 257, 336 A.2d at 404. Although all six items were so contemplated, the last two were not recoverable because they could have been "prevented by cover or otherwise," in terms of Code § 2-715(2)(a).

second element was the only real issue on appeal, since the other elements of the *Keystone* test were easily met: "[t]he types of losses claimed by Neville [were] clearly those which would naturally and ordinarily flow from Lampus' breach, and Neville proved those damages [with] reasonable certainty."[11]

The superior court simply could have made the above holding and been well within the bounds of both the Code and *Keystone*. Instead, the court questioned the *Keystone* opinion and its test for consequential damages. Although the court in the instant case did not need to resolve the specific problem presented by *Keystone*, the court realized that in another situation that case and the Code might be squarely in conflict. Accordingly, the superior court called upon the Pennsylvania Supreme Court to "clarify" the issue at the next opportune moment. It is this sua sponte questioning of *Keystone* that makes *Lampus* significant. After examining the historical development of the law of consequential damages, in general and in Pennsylvania, this case note will offer the proper resolution of the case in which the conflict between the Code and *Keystone* is unavoidable.

III. DEVELOPMENT OF THE LAW OF CONSEQUENTIAL DAMAGES: *Hadley v. Baxendale* AND BEYOND

A. *The Common Law and Consequential Damages*

Prior to 1854, the extent of enforcement of contract promises was a question for resolution by the jury.[12] The jury, not the judge, awarded whatever damages it deemed "reasonable."[13] But in the 1854 landmark case of *Hadley v. Baxendale*,[14] the court, in an effort to gain greater control over jury damage awards,[15] established a basic test for the calculation of damages in all contractual actions. The rule asserted in *Hadley* is as follows:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, *i.e.*, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contempla-

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[11] *Id.* 255, 336 A.2d at 403.

[12] R. NORDSTROM, LAW OF SALES § 153 (1970).

[13] *Id.*, citing Black v. Baxendale, 1 Ex. 410, 154 Eng. Rep. 174 (1847).

[14] 9 Ex. 341, 156 Eng. Rep. 145 (1854).

[15] R. NORDSTROM, *supra* note 12, § 153.

> tion of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under those special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract.[16]

Hadley stands for two general propositions with respect to the extent of enforcement of contract promises. First, the law will not require the defaulter to pay for all damages that stem, in some way, from his breach; and, second, the proper test for calculating the amount of damages is an inquiry as to what should have been foreseen by the defaulter at the time of contract formation.[17] The first proposition is of great theoretical importance in contract law but is not very helpful in deciding cases. Instead, courts use the test established by the second proposition in most contract actions in which money damages are sought. This test consists of three elements which should be examined in every case involving consequential damages. First, *Hadley* states that in all cases the aggrieved party can recover damages that "arise naturally" from the breach. Such damages are often termed "proximate," "natural," or "general" damages.[18] These damages are recoverable notwithstanding foreseeability—or they might be considered presumptively foreseeable. Second, *Hadley* holds that the aggrieved party can further recover those damages which a reasonable man would have contemplated would result from the breach "in the great multitude of cases." These damages must have been reasonably foreseeable at contract formation as a result of breach, the defaulter being held to have the foresight of the "average man." Third, *Hadley* states that the aggrieved party may recover

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[16] 9 Ex. at 354-55, 156 Eng. Rep. at 151.

[17] Fuller & Purdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 84-85 (1936).

[18] *See* 11 S. WILLISTON, CONTRACTS § 1344A (3d ed. 1968); 5 A. CORBIN, CONTRACTS § 1011 (1964).

damages due to the "special circumstances" of the contract, but only if these "special circumstances" were communicated to the defaulter before contract formation, and if the damages were reasonably foreseeable given these "special circumstances." The second and third components of the *Hadley* test are often called "special" or "consequential" damages.[19] In each element, the defaulter need not have actually contemplated the damages arising upon default; instead, the test asks, "if he had considered the question, would a reasonable man so conclude the loss was liable to result."[20]

Arguably, the second component could properly be included in the first, since both hold the defaulter to a "reasonable man" standard irrespective of actual knowledge. Thus only two elements of the *Hadley* test would be identified.[21] It is also arguable that the second and third component should be regarded as one, both turning on "reasonable foreseeability," given imputed and actual knowledge, respectively. These positions would not be illogical, nor would they be an indefensible reading of *Hadley*, but the three-component reading yields a better analysis of the case and is the one accepted in the Code.[22] The crucial point adduced, however, is that *Hadley* introduced the enduring notion that foreseeability is the key to the amount of contract damages to be awarded, and, more generally, the key to the extent of enforcement of contract promises.

While *Hadley* narrowed the scope of the defaulting party's liability in a contract action, court decisions around the early twentieth century went further. A judicially created doctrine known as the "tacit assumption" or "tacit agreement" test required that the circumstances of the contract formation had to show the defaulter expressly or impliedly ("tacitly") agreed to be liable for the consequential damages in question in order for consequential damages to be recoverable.[23] This doctrine was adopted by the United States Supreme Court in *Globe Refining Co. v. Landa Cotton Oil Co.*[24] But

[19] *See* 11 S. WILLISTON, *supra* note 18, § 1344A; 5 A. CORBIN, *supra* note 18, § 1011; R. NORDSTROM, *supra* note 12, § 153.

[20] Victoria Laundry (Windsor) Ltd. v. Newman Indus. Ltd., [1949] 2 K.B. 528.

[21] Commentators are divided over whether *Hadley* states one, two, or three "rules." R. NORDSTROM, *supra* note 12, § 153.

[22] See Part IIIB, *infra*.

[23] C. MCCORMICK, DAMAGES § 141 (1935); citing, *inter alia*, Southwestern Bell Tel. Co. v. Carter, 181 Ark. 209, 25 S.W.2d 448 (1930); Snell v. Cottingham, 72 Ill. 161 (1872); McKinnon v. McEwan, 48 Mich. 106, 11 N.W. 828 (1882); Booth v. Spuyten Duyvil Rolling Mill Co., 60 N.Y. 487 (1875); Lindley v. Richmond & Danville R. Co., 88 N.C. 547 (1883).

[24] 190 U.S. 540 (1903) (Holmes, J.).

the test was an unclear one at best, and it merely became another weapon in a court's arsenal that could be used when a court felt the damages would otherwise be excessive.[25]

Throughout the early part of this century, the basic test of *Hadley* continued to find acceptance in the United States, and was eventually incorporated into both the Uniform Sales Act and the Restatement of Contracts. The Uniform Sales Act, using the first component of the *Hadley* test, said the "measure of damages" for both failure to deliver and breach of warranty was "the loss directly and naturally resulting in the ordinary course of events from the . . . breach."[26] The Sales Act was not too instructive on consequential or special damages, saying only that "[n]othing in this act shall affect the right of the buyer or seller to recover . . . special damages in any case where by law . . . special damages may be recoverable . . . ."[27]

The Restatement of Contracts relied more heavily on foreseeability as the lesson of *Hadley*:

> . . . compensation is given for only those injuries that the defendant had reason to foresee as a probable result of his breach when the contract was made. If the injury is one that follows the breach in the usual course of events, there is sufficient reason for the defendant to foresee it; otherwise, it must be shown specifically that the defendant had reason to know the facts and to foresee the injury.[28]

The Restatement assumes that all direct or general damages, those authorized by the first component of the *Hadley* test, are presumptively foreseeable, and thus recoverable. As for consequential damages, the aggrieved party can always recover those damages that the reasonable man would foresee as following "in the usual course of events." Additionally, the aggrieved party can recover any further consequential damages arising from the "special circumstances" of the contract if those circumstances were known to the defaulter. In other words, the aggrieved party can recover whatever consequential damages the defaulter should have foreseen. The defaulter's foresight is first measured by a wholly objective "reasonable man" standard, and further measured by a combined objective-subjective standard of

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[25] *See* Fuller & Purdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 373, 375 (1937).

[26] UNIFORM SALES ACT § 67(2) (failure to deliver), and § 69(2) (breach of warranty).

[27] *Id.*, § 70.

[28] RESTATEMENT OF CONTRACTS, § 330 (1932).

what the "reasonable man" would expect given the actual knowledge of the defaulter.[29] This is the same test established in *Hadley*.

B. *The Code and Consequential Damages*

The law of sales as found in the Code also embraces the principles established in *Hadley*.[30] Specifically, the Code adopts the three-prong test of *Hadley*, and even incorporates some of the language of that nineteenth century case. The recovery of direct or general damages,[31] as envisioned by the first component of the *Hadley* test, is authorized by Code § 2-714(1): "[the buyer] may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable."[32] As an example of direct damages, Code § 2-714(2) states the test for breach of warranty damages: "The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount."[33] Although Code § 2-714(2) establishes a rule of thumb to be used in most warranty breaches, it is clear that additional damages can be recovered in some cases—whenever "special circumstances" show proximate damages of a different amount. The choice of the words "special circumstances" was a poor one on the part of the drafters of the Code, for "special circumstances" was the phrase used in *Hadley* to trigger consequential damages of an amount greater than those in the "usual course of events" if the circumstances were communicated to the defaulting party. Code § 2-714(2), however, only involves "proximate" or general or direct damages and

[29] Fuller & Purdue, *supra* note 17, at 85.

[30] The Code is said to codify the rule of *Hadley v. Baxendale*. *See, e.g.*, Gerwin v. Southwestern California Association of Seventh Day Adventists, 14 Cal. App. 3d 209, 92 Cal. Rptr. 111 (1971); Kelley v. Hanscom Brothers, Inc., 231 Pa. Super. 357, 331 A.2d 737 (1974); Ligon v. Chas. P. Davis Hardware, Inc., 492 S.W.2d 374 (Tex. Civ. App. 1973); R. NORDSTROM, *supra* note 12, § 153.

[31] The Code deals with damages in sections other than those discussed below; *see, e.g.*, §§ 2-706, 2-708, 2-72, 2-713. This note is limited to the situation presented by Code § 2-714 and *Keystone* and *Lampus*, *i.e.* when goods have been accepted and it is too late for rejection and there has been a breach committed by the seller.

[32] PA. STAT. ANN. tit. 12A, § 2-714(1) (Purdon 1975). The first part of Code § 2-714(1) conditions recovery upon notification to the seller, as required in Code § 2-607(3), and applies only when the buyer has accepted the goods and the time to revoke acceptance has expired, as stated in Code § 2-608(2).

[33] *Id.*, § 2-714(2). Similar language was found in UNIFORM SALES ACT § 69(7).

merely states that the "difference in value" test will usually, but not always, be the proper method of calculating direct damages. But the Code requires that there be "special circumstances" in order to use a test other than the "difference in value" test and this has led some courts to use the *Hadley* consequential damages "special circumstances" test when dealing with direct or proximate damages.[34] The fact that the "special circumstances" of Code § 2-714(2) are not the "special circumstances" mentioned in *Hadley* with regard to unusual consequential damages is underscored by Code § 2-714(3), which states in effect that consequential damages are discussed elsewhere (*i.e.* not in § 2-714): "[i]n a proper case . . . consequential damages under [§ 2-715] may also be recovered."[35]

As authorized by Code § 2-714(3), consequential damages are defined in Code § 2-715(2):

> [c]onsequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.[36]

As indicated by the words "any loss," the apparent scope of this section is very broad. The only limitation is that the defaulter had to have "reason to know" of the circumstances that gave rise to the damages; that is, the damage had to be foreseeable as a result of the breach. Subsection (b) does not have the foreseeability requirement when injuries to persons or property are involved and seems to impose strict liability for such cases. The foreseeability aspect of Code § 2-715 is the *Hadley* test, and the Official Comments to the Code make explicit that the bifurcated test of *Hadley* on consequential damages, its second and third component, is followed. The defaulter is always held to the foresight of a reasonable man, as "general needs [of the buyer] must rarely be made known to charge the seller with knowledge [of these needs]."[37] "Special circumstances" that would allow further consequential damage recovery, as in *Hadley*, must be communicated to the seller at contract formation in order to succeed:

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[34] See Part IVA, *infra*.

[35] PA. STAT. ANN. tit. 12A, §2-714(3) (Purdon 1975).

[36] *Id.*, § 2-715(2). Code § 2-715(1) deals with incidental damages.

[37] *Id.*, § 2-715, Comment 3.

"[p]articular needs of the buyer must generally be made known to the seller . . . to charge the seller with [that] knowledge."[38]

By excepting from any award of damages the amount that could "reasonably be prevented by cover or otherwise," the Code adopts the modern viewpoint that damages the aggrieved party could have prevented are not recoverable. But this viewpoint is not so much a limitation on consequential damages as it is an assertion that the aggrieved party cannot recover damages that, in effect, he caused himself. The Official Comments to the Code make it clear that this factor is the only drawback to full recovery of all foreseeable damages: "[a]lthough the older rule at common law which made the seller liable for all consequential damages of which he had 'reason to know' in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise."[39] Furthermore, the language of Code §§ 2-714 and 2-715 clearly does not leave room for the "tacit agreement" or "tacit assumption" test, and the Official Comments make this explicit: "[t]he 'tacit agreement' test for the recovery of consequential damages is rejected."[40] The Comments further state that, "[i]t is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith."[41]

The Code obviously has followed the foreseeability test of *Hadley* and even gone beyond it in § 2-715(2)(b).[42] Introductory remarks in the Code state that the Code "shall be liberally construed and applied to promote its underlying purposes and policies,"[43] seemingly ruling out niggardly interpretations of those sections dealing with damages. The Code's liberal rephrasing of an old rule has been misconstrued in Pennsylvania and elsewhere, however, due to the *Keystone* decision. This misinterpretation is what the superior court criticized in *Lampus*.

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[38] *Id.*

[39] *Id.*, Comment 2.

[40] *Id.*

[41] *Id.*, Comment 3.

[42] See note 30 *supra*, and accompanying text.

[43] PA. STAT. ANN. tit. 12A, § 1-102(1) (Purdon 1975). Code § 1-102(2) lists one "purpose" of the Code as being "to simplify, clarify, and modernize the law governing commercial transactions." The word "modernize" is hardly self-defining, but it at least suggests that interpretations of the Code should not be tied to old precedents on commercial dealings, unless, of course, the Code is only a codification of the old law on the subject.

IV. THE MISSTATEMENT OF THE LAW IN PENNSYLVANIA

A. *The* Keystone *Decision*

The leading case in Pennsylvania on Code §§ 2-714 and 2-715 is *Keystone Diesel Engine Co. v. Irwin.*[44] As *Lampus* correctly hints, *Keystone* was wrongly decided because of its inconsistency with the common law, prior Pennsylvania case law, and the Code. In *Keystone*, the buyer of a semi-tractor engine counter-claimed for damages stemming from the seller's breach of warranty. The Pennsylvania Supreme Court held that the aggrieved party could collect whatever damages were suffered as long as (a) "they were such as would naturally and ordinarily follow from the breach;" (b) "they were reasonably foreseeable and within the contemplation of the parties at the time they made the contract;" and, (c) "they can be proved with reasonable certainty."[45] All three elements must be shown in order to recover; in *Keystone* the buyer easily proved the first and third, but failed on the second. The buyer failed, according to the court, because he did not communicate to the seller at the time of contract formation sufficient facts to put the claimed loss within the contemplation of the seller.[46] The court held that only such an explicit communication to the seller would have allowed greater than "difference in value" damages of Code § 2-714(2); otherwise, the "special circumstances" requirement of that section were not met.[47]

This holding is not consistent with the rule originally advanced in *Hadley*, since that case did not require actual communication of information to the seller in order to hold him accountable for any and all damages that "arise naturally" or "in the great multitude of cases." The test is one of reasonable foreseeability by an average man, not actual knowledge of the seller. Only if the buyer is claiming damages arising from the peculiar "special circumstances" of a sale is the actual knowledge of the seller relevant—then, and only then, must the buyer have made a communication to the seller of the unusual facts of the case.

The requirement of actual communication to the seller to recover extra consequential damages when "special circumstances" exist, as outlined in *Keystone*, is substantially the same as that out-

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[44] 411 Pa. 222, 191 A.2d 376 (1963).
[45] *Id.* at 224, 191 A.2d at 378.
[46] *Id.* at 225-26, 191 A.2d at 379.
[47] *Id.* at 225-26, 191 A.2d at 378-79.

lined in *Hadley*. But, as mentioned earlier,[48] the phrase "special circumstances" in Code § 2-714(2) does not mean there what it meant in *Hadley*, so it was inappropriate to apply the meaning given those words in *Hadley* in a Code § 2-714(2) context. While *Hadley* dealt with consequential damages, Code § 2-714(2) is concerned only with "proximate" or direct or general damages, and establishes the "difference in value" test as a rule of thumb for such damages calculations. Furthermore, that subsection only applies to breach of warranty cases by its own terms. Nothing in the language of the Code suggests that the "difference in value" test should ever be the exclusive remedy even in direct damages calculation, and Code §§ 2-714(3) and 2-715(2) make clear that the test does not cover the consequential damages calculation. The Official Comments establish this fact by stating that "[§ 2-714(2)] describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure."[49] *Keystone*, however, has made it the sole direct damage remedy available. Thus, the court in *Keystone* eliminated all consequential damages, except in the rare circumstance where the buyer actually communicated his needs to the seller. Actual communication was needed under *Hadley* to obtain greater than usual consequential damages, but it is always needed under the court's interpretation of Code § 2-714(2) in *Keystone* in order to obtain anything more than "difference in value" damages. A reading of the Code and its Official Comments makes clear, however, that the "special circumstances" mentioned in Code § 2-714(2) mean that whenever the "difference in value" test is inadequate to calculate damages, that test need not be used.

The source of the error in *Keystone* appears to be a misreading of prior Pennsylvania court opinions. As late as 1957 in *Taylor v. Kaufhold*,[50] the state supreme court had said that the buyer could recover damages if, (a) they naturally flow from the breach, *or* (b) they were reasonably foreseeable and within the contemplation of the parties at contract formation, *and* (c) they can be proved with reasonable certainty.[51] *Keystone* adopted this language,[52] citing the *Taylor* case, but omitted the "or" between the first and second parts, and in

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[48] See Part IIIB, *supra*.

[49] PA. STAT. ANN. tit. 12A, § 2-714, Comment 3 (Purdon 1975).

[50] 368 Pa. 538, 546, 84 A.2d 347, 351 (1957).

[51] *Id.*; the same language is found in Adams v. Speckman, 385 Pa. 308, 122 A.2d 685 (1956) and Macchia v. Megow, 355 Pa. 565, 50 A.2d 314 (1947).

[52] See note 45 *supra*, and accompanying text.

effect substituted "and." Thus under this interpretation, in order for damages to be recoverable, they must flow naturally from the breach *and* be within the contemplation of the parties. This reading eliminates all damages that naturally flow from the breach "in the great multitude of cases" and which reasonable men would foresee but which were not actually foreseen or contemplated by the defaulter because the aggrieved party failed to communicate explicitly to him sufficient facts at contract formation to make the claimed loss within his actual contemplation.[53]

Another possible explanation for the errant holding in *Keystone* is found in a line of cases preceding the enactment of the Code. In these cases, as in *Keystone*, the damages suffered far outweighed the consideration received by the defaulter and the courts refused consequential damages awards even though the defaulter arguably had notice of the aggrieved party's particular situation. Some commentators have suggested that this line of judicial reasoning may explain *Keystone*.[54] If so, the rationale is surely inconsistent with the admonition in the Code that its provisions be liberally administered.

Keystone judicially imposes upon the language of the Code a requirement not dissimilar from the "tacit agreement" or "tacit assumption" test espoused earlier in this century.[55] The court in *Keystone* cited with approval *Globe Refining Co. v. Landa Cotton Oil Co.*,[56] the leading case endorsing the tacit agreement test. But the language of the Code unequivocally rejects such a requirement.[57] *Keystone* not only resurrects this discredited doctrine, but also imposes it upon proximate damages, the subject of Code § 2-714(2), whereas prior to *Keystone* the doctrine had been thought to apply exclusively to consequential damages.[58]

The practical effect of *Keystone* is to restrict severely the amount of damages recoverable by an aggrieved purchaser of goods in Pennsylvania. This is consistent with other holdings of the Pennsylvania Supreme Court which narrow the amount of damages recovera-

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[53] See note 46 *supra*, and accompanying text.

[54] R. NORDSTROM, *supra* note 12, § 153, note 67, citing Winslow Elevator & Mach. Co. v. Hoffman, 107 Md. 621, 69 A. 394 (1908) and Rochester Lantern Co. v. Stiles & Parker Press Co., 135 N.Y. 209, 31 N.E. 1018 (1892); *see also*, Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1206, n.259 (1970).

[55] See Part IIIA, *supra*.

[56] 190 U.S. 540 (1903). See text at note 24, *supra*.

[57] See note 40, *supra*, and accompanying text.

[58] C. MCCORMICK, *supra* note 23, § 141.

ble,[59] thus narrowing the extent of enforcement of contract promises. Whether such a narrowing of damages is wise as a business expedient is arguable, but when the legislature has spoken so clearly on the topic, it certainly is improper for a court to inject conflicting law with respect to such policy matters.

B. Lampus—*Recognition of the Conflict*

Two specific problems with *Keystone* are noted by the court in *Lampus*. First, the court mentions that Code § 2-715(2)(a) is merely set forth in *Keystone* and not discussed at all. Thus it is "less than certain that the 'special circumstances' test was intended to apply to [Code § 2-715(2)(a)] as well as to § 2-714(2)."[60] As one commentator has suggested, the net result of *Keystone* is to leave "a residue of confusion in the application of the basic 'contemplation' test in contracts for the sale of goods."[61] Second, the court points out the conflict between the language of *Keystone* and that of the Code.[62] In essence the court outlines the difficulties discussed above[63] in stating that *Keystone* is effectively a restriction on the language of the Code. The *Lampus* court notes that Code § 2-715(2)(a) allows all damages of which the seller "had reason to know" at contract formation, explicitly rejecting the "tacit agreement" test, while *Keystone's* discussion of Code § 2-714(2) works to negate the language of Code § 2-715(2)(a).

In criticizing *Keystone*, the court in *Lampus* quoted from a law

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[59] The Court has consistently held that a loss of profits is too speculative to recover, even for an established business with good records. Harry Rubin & Sons, Inc. v. Consolidated Pipe Co., 396 Pa. 506, 153 A.2d 472 (1959); Michelin Tire Co. v. Schulz, 295 Pa. 140, 145 A. 67 (1929). This result, too, has been the subject of much criticism. Neville Chemical Co. v. Union Carbide Corp., 422 F.2d 1205, 1227-28 (3d Cir. 1970); Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 277 (1963); Comment, *Loss of Goodwill and Business Reputation as Recoverable Elements of Damages Under Uniform Commercial Code § 2-715—The Pennsylvania Experience*, 75 DICK. L. REV. 63, 65 (1970).

[60] 232 Pa. Super. at 253, 336 A.2d at 402.

[61] *Id.*, quoting Holahan & Murray, *Commercial Transactions, 1956-1965, Decennial Survey of Pennsylvania Law*, 27 U. PITT. L. REV. 185, 334 (1966).

[62] The court speaks in terms of a "possible conflict" between *Keystone* and the Code, 232 Pa. Super. at 253, 336 A.2d at 402, but it is clear the court feels the supreme court ruled incorrectly when it requests that court to "clarify to the extent possible what is a 'proper case' for consequential damages . . . ." *Id.* at 355, 336 A.2d at 403. The court seems to feel its position in the judicial hierarchy precludes any stronger criticism of the supreme court's decision in *Keystone*. In most instances, however, the superior court will be the court of last resort for litigants throughout Pennsylvania. *See* PA. STAT. ANN. tit. 17, § 211.302 *et seq.* (Purdon 1975), for the jurisdiction of the superior court.

[63] See Part IVA, *supra*.

journal article in a footnote: "[t]he Code is dedicated to the expansion of all damages, of all kinds . . . ."[64] If the court meant to embrace this statement, it was going a little too far in its criticism of the restrictions of *Keystone*. While the Code expands damages somewhat, for example, by doing away with the "tacit agreement" test, it does not "expand all damages, of all kinds." The Code adopts a moderate position on damage recovery which is reflected in the introductory portions of the Code: "[t]he remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law."[65]

V. THE PROPER RESOLUTION

A. *The Code Result*

A correct resolution of the question of the extent of enforcement of contract promises merely lies in a common sense reading of the language of the Code which, it has been shown,[66] is itself a codification of the principles established in *Hadley*. Code § 2-714(1) authorizes recovery of all general or direct or proximate damages—those which arise "in the ordinary course of events from the seller's breach."[67] Code § 2-714(2) provides one method of calculating damages for breach of warranty, the "difference in value" test, but authorizes the recovery of greater damages whenever they exist—whenever there are "special circumstances," but not in the sense that phrase was used in *Hadley*. Consequential damages, as defined in Code § 2-715(2), can be recovered on the authority of Code § 2-714(3) *whenever they exist*—the mere fact that the damages exist making it a "proper case." The Official Comments state that the buyer may always recover those damages that a reasonable man would have foreseen, and may be awarded additional damages flowing from the "special circumstances" of the case, using that phrase as it was used in *Hadley*, if these particular needs as opposed to general needs of the buyer were communicated to the seller at contract formation. And Code § 2-715(2)(b) requires no foreseeability at

[64] 232 Pa. Super. at 254-55, n. 5, 336 A.2d at 403, n.5, quoting Peters, *supra* note 59, at 277.

[65] PA. STAT. ANN. tit. 12A, § 1-106(1) (Purdon 1975).

[66] See note 30, *supra*, and accompanying text.

[67] PA. STAT. ANN. tit. 12A, § 2-714(1) (Purdon 1975).

all for consequential damages in the case of injury to persons or property.

If the court's concern in *Keystone* was to avoid awarding what it considered excessive damages, parties to contracts of sale of goods can easily provide for that contingency within the provisions of the Code. Code § 1-102(3) states that "[t]he effect of provisions of this Act may be varied by agreement . . . ."[68] Similarly, Code § 2-719(3) provides: "[c]onsequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages . . . where the loss is commercial is not [prima facie unconscionable]."[69] The Pennsylvania supreme court, among others, has upheld a commercial contract that prohibited the awarding of consequential damages.[70] Thus parties concerned about the possibility of damage claims that far outweigh their gain under the contract have this simple course open to them, which will become part of the basis of their bargain and possibly help avoid litigation. Therefore the protection of *Keystone,* if that is what it was, is unnecessary, as well as a gross misinterpretation of the law as found in the Code.

Another way to reach the result of *Keystone* while rejecting its rationale was indicated by the court in *Lampus*. The court suggested that the *Keystone* court could have held the buyer's lost profits in that case to be a proper element of consequential damages but not recoverable because they were preventable by cover (or otherwise) in terms of Code § 2-715(2)(a).[71] Again, the Code has provisions designed to protect against excessive damage award, and the courts need not be concerned with whether it might consider the recovery excessive if operating without the Code. The courts are not operating on a clean slate, but are bound by the terms of the Code, and will have to recognize this and apply the law as mandated by the legislature.

B. *Other Court Opinions*

The Pennsylvania Superior Court made only oblique criticisms of *Keystone* in *Lampus*, since it did not need to resolve the possible conflict between *Keystone* and the Code in that particular case. But

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[68] *Id.*, § 1-102(3).

[69] *Id.*, § 2-719(3).

[70] K & C, Inc. v. Westinghouse Electric Corp., 437 Pa. 303, 263 A.2d 390 (1970). *See also, e.g.*, Avenell v. Westinghouse Electric Corp., 41 Ohio App. 2d 150, 324 N.E.2d 583 (1974).

[71] 232 Pa. Super. at 255, n.6, 336 A.2d at 403, n.6.

other courts have spoken on the question in general and have commented directly on *Keystone*. The weight of authority rejects the *Keystone* analysis and reaches the result *Lampus* suggested as outlined above. In *Adams v. J. I. Case Co.*,[72] the Appellate Court of Illinois dealt with a factual pattern very similar to that in *Keystone* and noted that Code § 2-715(2)(a) does not require a "tacit agreement" or a prior understanding that the seller be bound for consequential damages.[73] The court said that if *Keystone* required these it was to be rejected.[74] Indeed, *Keystone* does require them.[75] In *Adams*, the court considered damages flowing from the particular needs of the buyer and held that traditional "special circumstances" must be shown to recover consequential damages flowing from them. Nowhere does the court suggest that "special circumstances" as defined in *Hadley* must be shown to recover consequential damages flowing from the general needs of the buyer or to recover proximate or direct damages of an amount greater than the "difference in value" test of Code § 2-714(2) would produce.

In *Beal v. General Motors Corp.*,[76] a United States District Court had a clear choice of following either *Keystone* or *Adams*, and chose the latter.[77] The court noted that *Keystone* relied upon pre-Code principls in establishing a "tacit agreement" test, and since *Adams* and the Code rejected this, *Adams* was the better precedent to follow. The court stated: "under [the *Adams*] test, the question then is whether the loss for which recovery is sought is one that results from the general or particular requirements or needs of which the seller at the time of contracting had reason to know."[78] This language is merely a paraphrase of the Code and a reflection of the Official Comments that state that the general needs of the buyer "must rarely be made known [to the seller] to charge the seller with

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[72] 125 Ill. App. 2d 388, 261 N.E.2d 1 (1970).

[73] *Id.* at 405-06, 261 N.E.2d at 9.

[74] *Id.* at 406, 261 N.E.2d at 9.

[75] See Part IVA, *supra*.

[76] 354 F. Supp. 423 (D. Del. 1973).

[77] The federal district court was hearing a diversity suit with a question not yet decided by the state courts of that district. 354 F. Supp. at 428. The court also notes that "[f]ew courts have spoken to the question what is a 'proper case' for the award of consequential damages within the contemplation of [Code] § 2-714(3)." *Id.* at 427. For another case that followed *Adams*, see Jerry Alderman Ford Sales, Inc. v. Bailey, 291 N.E.2d 92 (Ind. App. 1972). One court has followed *Keystone* but it considered itself bound by Pennsylvania law and made no independent determination of the underlying issue of law. Jones & McKnight Corp. v. Birdsboro Corp., 320 F. Supp. 39 (N.D. Ill. 1970).

[78] 354 F. Supp. at 428.

knowledge" and only the "particular needs of the buyer must generally be made known to the seller" to charge him with knowledge.[79]

Other cases have not mentioned *Keystone* by name, but plainly reject its holding and rationale. Some cases suggest that only the requirements of Code § 2-715(2) need be met to recover consequential damages, thus making them recoverable whenever they exist. These cases never mention the unfortunate "special circumstances" language of Code § 2-714(2).[80] Another case mentioned the language of Code § 2-714(2) but found that those "special circumstances" mean that whenever the "difference in value" test is inadequate to measure proximate damages other damages can still be recovered using other means of calculation.[81] Another court relied solely on foreseeability and said, "since [the relevant] . . . losses were foreseeable they are recoverable . . .," citing Code § 2-715 and dovetailing with *Hadley*.[82]

VI. CONCLUSION

The Pennsylvania Superior Court is to be commended for questioning the holding and rationale of *Keystone* in *Lampus*. *Keystone* is inconsistent with both common law principles and prior Pennsylvania case law and is a blatant misreading of the Code. On the next appropriate occasion the Pennsylvania Supreme Court should overrule this aberration and reaffirm the century-old principles of *Hadley* that have been approved by the legislature by the adoption of Code §§ 2-714 and 2-715. While it is going too far to say "[t]he Code is dedicated to the expansion of all damages, of all kinds,"[83] the Code has authorized greater damages than *Keystone* would suggest. It explicitly has left certain conscionable limitations of damages to be agreed upon by the parties to the contract, and does not contemplate that such limitations be imposed upon the parties by a court.

J. Douglas Drushal

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[79] PA. STAT. ANN. tit. 12A, § 2-715, Comment 3 (Purdon 1975).

[80] *See, e.g.*, Safeway Stores, Inc. v. L.D. Schreiber Cheese Co., 326 F. Supp. 504 (W.D. Mo. 1971); Marion Power Shovel Co. v. Huntsman, 246 Ark. 149, 437 S.W.2d 784 (1969); Water Works and Industrial Supply Co. v. Wilburn, 437 S.W.2d 951 (Ky. 1968).

[81] Lewis v. Mobil Oil Corp., 438 F.2d 500, 507 (8th Cir. 1971). *See also* General Supply & Equipment Co., v. Phillips, 490 S.W.2d 913 (Tex. Civ. App. 1972).

[82] Gurney Industries, Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588, 599 (4th Cir. 1972).

[83] 232 Pa. Super. at 254-55, n.5, 336 A.2d at 403, n.5, quoting Peters, supra note 59, at 277. *See* notes 64 & 65 *supra*, and accompanying text.