

**R.E. Davis Chemical Corporation, an Illinois corporation, Plaintiff-
Appellee,
v.
Diasonics, Inc., a California corporation, Defendant Third Party
Plaintiff-Appellant,
v.
Glen D. Dobbin and Galdino Valvassori, Third Party Defendants**

United States Court of Appeals for the Seventh Circuit
826 F.2d 678 (1987)

[The buyer breaches and the seller transfers the good to an alternative buyer at the same price. Other than incidental damages can we assume that seller has not suffered any other damages on the sale? Suppose the seller would have ordinarily made the other sale, then there has been a loss in sales volume and lost contribution to profits. The lost contribution in profits is equal to the incremental revenues less incremental costs on the lost sales.]

JUDGES: Bauer, Chief Circuit Judge, Cudahy and Flaum, Circuit Judges.

OPINION: CUDAHY, Circuit Judge

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I.

Diasonics is a California corporation engaged in the business of manufacturing and selling medical diagnostic equipment. Davis is an Illinois corporation that contracted to purchase a piece of medical diagnostic equipment from Diasonics. ... Davis and Diasonics entered into a written contract under which Davis agreed to purchase the equipment. Pursuant to this agreement, Davis paid Diasonics a \$300,000 deposit Prior to entering into its agreement with Diasonics, Davis had contracted with Dobbin and Valvassori to establish a medical facility where the equipment was to be used. Dobbin and Valvassori subsequently breached their contract with Davis. Davis then breached its contract with Diasonics; it refused to take delivery of the equipment or to pay the balance due under the agreement. Diasonics later resold the equipment to a third party for the same price at which it was to be sold to Davis.

Davis sued Diasonics, asking for restitution of its \$300,000 down payment under section 2-718(2) of the Uniform Commercial Code (the "UCC" or the "Code"). ... ⁿ¹ Diasonics counterclaimed. Diasonics did not deny that Davis was entitled to recover its \$300,000 deposit less \$500 as provided in section 2-718(2)(b). However, Diasonics claimed that it was entitled to an offset under section 2-718(3). Diasonics alleged that it was a "lost volume seller," and, as such, it lost the profit from one sale when Davis breached its contract. Diasonics' position was that, in order to be put in as good a position as it would

have been in had Davis performed, it was entitled to recover its lost profit on its contract with Davis under section 2-708(2) of the UCC. ... Section 2-708 provides:

§ 2-708. Seller's Damages for Non-acceptance or Repudiation

(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.

ⁿ¹ The pertinent portion of section 2-718 provides:

§ 2-718. Liquidation or Limitation of Damages; Deposits

....

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, 20% of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover damages under the provisions of this Article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

Ill. Rev. Stat. ch. 26, para. 2-718(2) & (3) (1985).

...

The district court ... entered summary judgment for Davis. The court held that lost

volume sellers were not entitled to recover damages under 2-708(2) but rather were limited to recovering the difference between the resale price and the contract price along with incidental damages under section 2-706(1). Section 2-706(1) provides:

§ 2-706. Seller's Resale Including Contract for Resale

(1) Under the conditions stated in Section 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

Davis was awarded \$322,656, which represented Davis' down payment plus prejudgment interest less Dasonics' incidental damages. Dasonics appeals the district court's decision respecting its measure of damages as well as the dismissal of its third-party complaint.

II.

We consider first Dasonics' claim that the district court erred in holding that Dasonics was limited to the measure of damages provided in 2-706 and could not recover lost profits as a lost volume seller under 2-708(2). Surprisingly, given its importance, this issue has never been addressed by an Illinois court, nor, apparently, by any other court construing Illinois law. Thus, we must attempt to predict how the Illinois Supreme Court would resolve this issue if it were presented to it. Courts applying the laws of other states have unanimously adopted the position that a lost volume seller can recover its lost profits under 2-708(2). Contrary to the result reached by the district court, we conclude that the Illinois Supreme Court would follow these other cases and would allow a lost volume seller to recover its lost profit under 2-708(2).

...

Concluding that Dasonics is entitled to seek damages under 2-708, however, does not automatically result in Dasonics being awarded its lost profit. Two different measures of damages are provided in 2-708. Subsection 2-708(1) provides for a measure of damages calculated by subtracting the market price at the time and place for tender from the contract price. The profit measure of damages, for which Dasonics is asking, is contained in 2-708(2). However, one applies 2-708(2) only 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. . . ." ... Dasonics claims that 2-708(1) does not provide an adequate measure of damages when the seller is a lost volume seller. To understand Dasonics' argument, we need to define the concept of the lost volume seller. Those cases that have addressed this issue have defined a lost volume seller as one that has a predictable and finite number of customers and that has the capacity either to sell to all new buyers or to make the one additional sale represented by the resale after the breach.

According to a number of courts and commentators, if the seller would have made the sale represented by the resale whether or not the breach occurred, damages measured by the difference between the contract price and market price cannot put the lost volume seller in as good a position as it would have been in had the buyer performed.ⁿ¹³ The breach effectively cost the seller a "profit," and the seller can only be made whole by awarding it damages in the amount of its "lost profit" under 2-708(2).

ⁿ¹³ According to one commentator,

Resale results in loss of volume only if three conditions are met: (1) the person who bought the resold entity would have been solicited by plaintiff had there been no breach and resale; (2) the solicitation would have been successful; and (3) the plaintiff could have performed that additional contract.

We agree with Disonics' position that, under some circumstances, the measure of damages provided under 2-708(1) will not put a reselling seller in as good a position as it would have been in had the buyer performed because the breach resulted in the seller losing sales volume. However, we disagree with the definition of "lost volume seller" adopted by other courts. Courts awarding lost profits to a lost volume seller have focused on whether the seller had the capacity to supply the breached units in addition to what it actually sold. In reality, however, the relevant questions include, not only whether the seller could have produced the breached units in addition to its actual volume, but also whether it would have been profitable for the seller to produce both units. Goetz & Scott, *Measuring Sellers' Damages: The Lost-Profits Puzzle*, 31 Stan. L. Rev. 323, 332-33, 346-47 (1979). As one commentator has noted, under the economic law of diminishing returns or increasing marginal costs[,] . . . as a seller's volume increases, then a point will inevitably be reached where the cost of selling each additional item diminishes the incremental return to the seller and eventually makes it entirely unprofitable to conclude the next sale.

Thus, under some conditions, awarding a lost volume seller its presumed lost profit will result in overcompensating the seller, and 2-708(2) would not take effect because the damage formula provided in 2-708(1) does place the seller in as good a position as if the buyer had performed. Therefore, on remand, Disonics must establish, not only that it had the capacity to produce the breached unit in addition to the unit resold, but also that it would have been profitable for it to have produced and sold both. Disonics carries the burden of establishing these facts because the burden of proof is generally on the party claiming injury to establish the amount of its damages; especially in a case such as this, the plaintiff has easiest access to the relevant data. ...

...

[Discussion of third party interference with contract omitted]

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AFFIRMED IN PART, REVERSED IN PART AND REMANDED

* * *

Questions

1. What is the court's definition of a lost volume retailer? How damages are calculated when a purchaser breaches and the seller is a lost volume retailer?
2. Why does the court bring up the concept of increasing marginal cost? Why is this relevant in the case of a lost volume retailer?