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Damages - Uniform Commercial Code - Loss of Profits Not within Contemplation of Parties in Sale of Diesel Engine to Contract Carrier in Claim for Breach of Warranty Damages under Section 2-715

Robert Mickler

DAMAGES — UNIFORM COMMERCIAL CODE — LOSS OF PROFITS NOT WITHIN CONTEMPLATION OF PARTIES IN SALE OF DIESEL ENGINE TO CONTRACT CARRIER IN CLAIM FOR BREACH OF WARRANTY DAMAGES UNDER SECTION 2-715.

Keystone Diesel Engine Co. v. Irwin (Pa. 1963)

Defendant, Irwin, purchased a diesel tractor engine from Keystone to be installed in a tractor for use in his business as a contract carrier. The engine failed to operate properly and was repaired by Keystone without cost. When the engine required subsequent repairs, Irwin orally agreed to pay for the work. In an action in assumpsit brought by Keystone for the defendant's refusal to pay, the latter counterclaimed for loss of profit based on his inability to use the engine for twenty-seven days due to the seller's breach of implied warranty of merchantability. The lower court struck off the counterclaim and the Pennsylvania Supreme Court affirmed, *holding* that the loss of profits thus occasioned was not within the contemplation of the parties. *Keystone Diesel Engine Co. v. Irwin,* 411 Pa. 222, 191 A.2d 376 (1963).

There is no question that the line of authority preceding this case allows no recovery for consequential damages not contemplated by the parties. The rule of *Hadley v. Baxendale* is too well settled:

> [I]f 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.[1]

The Pennsylvania cases cited[2] in the opinion all follow the rule that: ". . . 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."[3] However, it is of importance to note that no case cited in the *Keystone* opinion was decided under the Uniform Commercial Code of Pennsylvania,[4] nor made any mention of it.

The Code provides that the measure of damages for breach of warranty "is the difference . . . between the value of the goods as accepted and the value they would have had if they had been as warranted. . . ."[5] It also provides for additional damages resulting from general or particular requirements or needs of the buyer which are shown to have been within

1. Hadley v. Baxendale, 9 Ex. 341, 355, 156 Eng. Rep. 145, 151 (1854).

2. Adams v. Speckman, 385 Pa. 308, 122 A.2d 685 (1956) (the action arose prior to the effective date of the Code); Taylor v. Kaufhold, 368 Pa. 538, 84 A.2d 347 (1951); Macchio v. Megow, 355 Pa. 565, 50 A.2d 314 (1947); Wolstenholme, Inc. v. Jos. Randall & Bro., 295 Pa. 131, 144 Atl. 909 (1929).

3. RESTATEMENT, CONTRACTS § 330 (1932).

4. PA. STAT. ANN. tit. 12A (1954).

5. PA. STAT. ANN. tit. 12A, § 2-714 (1963).

the contemplation of the parties.[6] Based solely on case law prior to the enactment of the Code and without reference to the explanatory legislative "comments," the court, interpreting these two sections, decided the loss of profit was not within that contemplation. It is singularly important to note that this is one of the few instances of the use of the Code by the court without the aid of the comments.[7]

In 1953 the Pennsylvania legislature enacted into law the Code as promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws and adopted the comments following each section. These comments and annotations, prepared by the several drafting committees, were to be among the "more significant"[8] aids to proper construction of the various sections. Many courts[9] are using them and while there is some controversy over the extent of their use and the weight to be given them, it seems to be universally accepted that at least they are to be used as aids in determining what result the drafters intended to achieve.[10] Even New York, which refused to adopt the Code section[11] recommending their use to aid in construction "for fear that the courts would place undue emphasis on the comments,"[12] conceded that ". . . existing principles of statutory construction would in any event permit recourse to the comments to resolve ambiguities. . . ."[13] Pennsyl-

6. PA. STAT. ANN. tit. 12A, § 2-715(2) (1963) reads as follows:

Consequential damages resulting from 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.

7. DEL DUCA & KING, COMMERCIAL CODE LITIGATION (1961) includes every reported Pennsylvania case as of December 1960, in which the Code (effective since 1954) was mentioned. In that span of six years, the Pennsylvania Supreme Court referred to the Code in only six opinions. In three of these, the cases arose prior to the Code. In every instance in which the Code was controlling, the court cited the comments in support of their ruling.

8. See Merrill, *Uniformly Correct Construction of Uniform Laws*, 49 A.B.A.J. 545, 547 (1963). The author states that the comments are "the more significant aids" to proper construction and also sees "heartening signs" (in the following cases and in others) that the habit of consulting the official comments is becoming an established practice. *In re* Eton Furniture Co., 286 F.2d 93 (3d Cir. 1961); Industrial Packaging Products Co. v. Fort Pitt Packaging Int'l, Inc., 399 Pa. 643, 161 A.2d 19 (1960); Sterling Acceptance Co. v. Grimes, 194 Pa. Super. 503, 168 A.2d 600 (1961).

9. See *e.g.*, cases cited, *supra* note 8.

10. Note, *The Uniform Commercial Code: Major Differences Between Massachusetts and Pennsylvania*, 71 HARV. L. REV. 674, 686 (1958). In discussing the use of the comments to the Code, the author said:

Since the new comments for the revised UCC had not been completed by the time Massachusetts enacted the Code, there was no choice but to omit reference to the comments, since the old ones were clearly obsolete. The comments will undoubtedly remain a legitimate source of legislative history for the Massachusetts Code, although they may not be given as persuasive an effect as in Pennsylvania. (Footnote omitted.)

11. Section 1-102(3)(f) reads as follows:

In construing and applying this act to effect its purposes the following rules shall apply: . . . (f) The Comments of the National Conference of Commissioners on Uniform State Laws and the American Law Institute may be consulted in the construction and application of this Act but if text and comments conflict, text controls.

12. Note, *supra* note 10, at 686.

13. LAW REVISION COMMISSION, REPORT RELATING TO THE UNIFORM COMMERCIAL CODE, N.Y. LEG. DOC. No. 65(A) (1956).

vania, in the interest of uniformity,[14] omitted that section from its 1959 version in view of the fact that "existing principles of statutory construction" already adopted by the legislature[15] made that section superfluous. In this light, the refusal of the court in the instant case to use the comments in applying section 2-715 is surprising.

In deciding whether or not the defendant's counterclaim was properly stricken as a matter of law, its allegations were assumed to be true. Thus the issue was ". . . whether the damages sought for loss of profit were within the contemplation of the parties to the contract here in dispute."[16]

Comment 3 to section 2-715 reads in part as follows:

> . . . the seller is liable for consequential damages in all cases where he had reason to know of the buyer's *general or particular* requirements at the time of contracting. *It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part.* . . .
>
> Particular needs of the buyer must generally be made known to the seller while *general needs must rarely be made known, to charge the seller with knowledge.* (Emphasis added.)

The question to be immediately answered is whether the loss of profits here alleged flows from the "general needs" of the purchaser. The defendant was a contract carrier and known as such to the seller. It is obvious that the buyer would put the engine to use in his business. In this situation it is illogical and unreasonable to say that the seller did not at least contemplate the possibility that if the engine did not work, the purchaser would suffer production loss as well as loss of the value of the engine. The court admits: "there is no doubt that . . . a breach causing malfunction of the engine would produce a halt in productive capacity and damage could flow therefrom."[17] In light of this admission and the reasoning stated above, it is difficult to see how the court can say *as a matter of law* that this damage was not in the contemplation of the parties.

Another deficiency of Irwin's case according to the court was his failure to allege facts which would put Keystone on guard that he would hold it responsible for any loss of profit from his inability to use the engine in question. However, if this loss is the natural result of the breach, no such statement is required. If the possibility of loss were within the contemplation of the parties, specific statements of intention to affix liability for the loss would be mere surplusage.

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14. Merrill, *supra* note 8, at 547:

> For a variety of reasons, this provision was eliminated. One of the best reasons was that, because of the line of authorities already cited, this sort of provision is unnecessary surplusage. It is to be hoped that the judges will form the habit of consulting the official comments whenever they are confronted with a problem of construction under the Code.

15. PA. STAT. ANN. tit. 46, §§ 551-66 (1952).

16. Keystone Diesel Engine Co. v. Irwin, 411 Pa. 222, 224, 191 A.2d 376, 378 (1963).

17. *Ibid.*

To show that loss of profit on subsequent contracts should not be charged to the seller, the court relies on *Globe Refining Co. v. Landa Cotton Oil Co.*[18] which extends[19] the rule of *Hadley v. Baxendale.* The case disallows recovery for loss of profit on "completely unrelated business contracts." The loss involved in that case was due to carrier's breach of contract through failure to deliver,[20] a situation clearly distinguishable from the sale of machinery by a manufacturer who knows the needs of his purchaser, because of the different warranties involved. The case required that "knowledge *must be brought home* to the party sought to be charged,"[21] while the Code, speaking through the comments insists that ". . . general needs *must rarely be made known* to charge the seller with knowledge."[22] (Emphasis added.)

This language would place any loss of profit due to Keystone's breach within the general needs of the defendant, and hence, within Keystone's contemplation. The court readily admits the productive loss and the damage which follows. Profit is a natural consequence of productivity. What great step is it from loss of productive capacity to loss of profit? The latter should flow naturally and probably from the former.

Williston suggests that losses will be within the contemplation of the parties if seller knows the nature of the buyer's business without more.[23] Loss of profit from subsequent or collateral contracts is to be allowed whether or not the subsequent contract actually existed so long as the probability of resale (or use of machinery) was known.[24] Therefore it should not have been necessary for the defendant to allege any facts which would apprise plaintiff of the fact that defendant would hold him responsible for the inability to use the engine.

The court states that applying defendant's theory, whenever such a motor vehicle is sold for use in a profit motivated enterprise, the seller may be liable for loss of profit due to breach of warranty resulting from "completely unrelated contracts." Logic does not compel such a conclusion, nor does the Code contemplate such a result. Whenever an engine or a motor vehicle is sold, its sole purpose is its "productive capacity." It is not purchased for stock or as an asset to be owned for its "value as warranted" per se. Its value is its usefulness to the buyer. The "general needs" (of which the Code holds the seller must be aware) are not "unrelated contracts." Any manufacturer-seller today is aware of the effects of potential sub-par merchandise or performance and is prepared to sustain

18. 190 U.S. 540, 23 S.Ct. 754 (1903).
19. WILLISTON, SALES § 599b (1948).
20. In fact, the language of the *Globe* case quoted by the Pennsylvania court is itself a quote by Mr. Justice Holmes of Mr. Justice Willes in British Columbia & V. I. Spar, Lumber, & Saw Mill Co. v. Nettleship, [1868] 3 C.P. 499, 500, another carrier case.
21. 190 U.S. 540, 545, 23 S.Ct. 754, 756.
22. PA. STAT. ANN. tit. 12A, § 2-715, Comment 3 (1963).
23. WILLISTON, SALES § 599d (1948).
24. Gulf States Creosoting Co. v. Loving, 120 F.2d 195 (4th Cir. 1941); Fairbanks, Morse & Co. v. Austin, 288 Fed. 1 (9th Cir. 1923); Dally v. Isaacson, 40 Wash.2d 574, 245 P.2d 200 (1952); MCCORMICK, DAMAGES § 175 (1935).