

## DOES FAILURE TO MITIGATE DAMAGES BAR RECOVERY OF THE COSTS OF MITIGATION?

Gregory Crespi\*

### ABSTRACT

*It is well established that a person who makes reasonable efforts to mitigate her damages after a breach of contract will be able to recover the costs of those mitigation efforts as incidental damages, and that a person who fails to make such efforts will be denied recovery of the damages that could have been avoided. But will a person who fails to take reasonable efforts to mitigate damages still be able to recover the probable cost of those mitigation efforts as an offset against the reduction in her damages for failure to mitigate, even though she did not incur those costs? The conventional wisdom among judges and scholars is that mitigation costs that were not incurred by an injured person are not recoverable as an offset or otherwise. In my opinion, however, this conclusion is not justified as a matter of social policy, and arguably is also not required as a matter of positive law, at least under common law if not also under Article 2 of the Uniform Commercial Code (“U.C.C.”).*

*In this Article, I first consider the proper resolution of this question as a matter of policy. I then review the applicable law, first with regard to sale of goods contracts governed by state statutes implementing Article 2 of the U.C.C., and then with regard to contracts governed primarily by general common law principles as articulated in the Restatement (Second) of Contracts. I will draw an analytical distinction between “primary” efforts made to mitigate the damages resulting from a contract breach, and “secondary” financing-type mitigation efforts intended to avoid the risk of further consequential losses that may result from the cash shortfall caused by non-avoidable losses from breach until*

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\* Homer R. Mitchell Endowed Professor of Commercial and Insurance Law, Dedman School of Law, Southern Methodist University. J.D., Yale Law School, Ph.D., University of Iowa. I would like to give thanks to the A.J. and Ann Wynen Thomas Memorial Endowed Research Award for their generous financial support during the preparation of this Article.

*they are reimbursed. I also consider the significance of the presence of applicable prejudgment interest statutes for this question.*

*I conclude on the basis of both fairness concerns and efficiency considerations that the probable costs of mitigation efforts that are not undertaken should as a matter of policy still be recoverable as an offset against any reduction in damages for failure to mitigate. I also conclude, however, that as a matter of positive law both the common law and U.C.C. Article 2 are unclear as to whether the recovery of probable mitigation costs that are not incurred is allowed, particularly the U.C.C., and particularly with regard to secondary mitigation efforts.*

## I. INTRODUCTION

It is well established that if a person injured by a breach of contract has the opportunity to mitigate her damages without thereby bearing undue risk, burden, or humiliation, but does not do so, then that person will be denied recovery of those damages that she could have so avoided.<sup>1</sup> It is also well established that a person may as a general matter recover the cost of reasonable mitigation efforts, along with her other recoverable losses.<sup>2</sup> The law is also clear that if a person makes reasonable efforts to mitigate damages, but those efforts prove to be unsuccessful, she still is entitled as a general matter to recover the cost of those mitigation efforts.<sup>3</sup>

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1. RESTATEMENT (SECOND) OF CONTRACTS § 350(1) & cmt. b (AM. LAW INST. 1981). This is of course in the absence of any agreement by the parties to remove the burden from the injured party of having to mitigate damages to avoid a reduction in recovery.

2. *Id.* § 347(b) & cmt. c. This is again in the absence of any agreement by the parties to the contrary. This broad statement as to the recoverability of the cost of reasonable mitigation efforts must also be qualified with regard to cases arising under Article 2 of the U.C.C., where the classification of specific mitigation expenditures by an injured seller as being “incidental” or instead “consequential” damages can be determinative of whether they are recoverable. U.C.C. § 2-710 (AM. LAW INST. & UNIF. LAW COMM’N 2017). Consequential damages are specifically granted to buyers of goods under U.C.C. § 2-715. *Id.* § 2-715(b). The comparable section 2-710 provision that is applicable to sellers, however, refers only to incidental damages and not to consequential damages. *Id.* § 2-710. Moreover, subsection 1-305(a) states that consequential damages are not available under the U.C.C. unless they are specifically provided for. *Id.* § 1-305(a). As a result, courts have generally concluded that sellers of goods are not entitled to recover consequential damages, and mitigation expenditures by injured sellers would therefore have to be categorized as “incidental” losses to be recoverable. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 7.3, at 215 & n.2 (3d ed. 1993). Professors White and Summers are highly critical of this result, however, and believe that courts can and should interpret the U.C.C. provisions to allow sellers as well as buyers of goods to obtain consequential damages as well as incidental damages. *See id.* § 7.4, at 215-16.

3. RESTATEMENT (SECOND) OF CONTRACTS § 347(b) cmt. c. Again, this is in the absence of contractual agreement to the contrary. *But see id.* (regarding seller damages under the U.C.C., where the classification of the costs of attempted mitigation efforts as “incidental” damages or instead as “consequential” damages may be significant).

There is another and more subtle question related to the mitigation of damages, however, for which the answer is unfortunately not quite so clear. If a person injured by the breach of a contract is in a position to reasonably mitigate damages, but does not do so, that person as noted above will not be able to recover the damages that could have been so avoided.<sup>4</sup> But under those circumstances, will that person nevertheless still be able to recover the probable costs of those reasonable mitigation efforts had they been undertaken,<sup>5</sup> even though the person did not actually incur those costs? In other words, should the penalty for a person that does not take reasonable steps to mitigate her damages be the loss of the right to recover all of the damages that could have been so avoided, without any offset of the probable costs that such mitigation efforts would entail<sup>6</sup> from this reduction in her award? Or should the party only lose the right to recover the net reduction of damages that could have been achieved by those mitigation efforts, after offsetting the probable costs of those efforts from the reduction in damages that would have resulted?

Let me try to clarify the scope of this question with a simple illustration. Consider the situation that arises if a person can mitigate her losses from a breach of contract by \$10,000 by taking reasonable mitigation measures that would probably cost only about \$500. If she takes those measures, so that her damages are thereby reduced by \$10,000, she will then be able to recover her remaining damages, including as an element of incidental damages the \$500 cost of those mitigation efforts. But what if that person does not take those mitigation efforts, and her losses are consequently \$10,000 greater than they might have been? Should one's recovery then be reduced by the full \$10,000 of avoidable losses as a result of one's failure to take those reasonable mitigation efforts, or instead only by the \$9500 net savings that would have resulted from the mitigation efforts once the \$500 probable costs of mitigation are also taken into account and offset? In this brief Article, I will consider this narrow and seemingly simple but actually rather difficult question.<sup>7</sup>

Let me preface my analysis by making clear my views as to the proper resolution of this question, as a matter of policy. I believe that

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4. *Id.* § 350(1).

5. I use the phrase "probable costs" throughout this Article to refer to mitigation costs that were not actually incurred, since the precise magnitude of what those costs would have been, had they been incurred, is necessarily at least somewhat uncertain since they have not been actually incurred.

6. *See id.* § 350 cmt. b.

7. *See infra* Parts II–IV.

courts should not reduce the damages that they assess against a party who breaches a contract, when the injured party fails to reasonably mitigate, by any more than is necessary to uphold the basic avoidability of damages principle. I also believe, however, that courts should also attempt to provide sufficient incentive for future injured parties to behave efficiently after breach. These two goals could both be accomplished by courts reducing the recovery of an injured person who fails to mitigate by only the net reduction in damages that would have resulted had reasonable mitigation efforts been undertaken. They should offset from the reduction in damages that they impose to deny recovery for losses, that could have been avoided through reasonable mitigation efforts, the probable costs that would have been incurred in carrying out those mitigation efforts.

Such a result would be fair to the contract breacher in that it would prevent him from obtaining an undeserved windfall reduction in his damages when the injured party fails to make reasonable mitigation efforts, as compared to the compensatory damages that he would be obligated to pay had reasonable mitigation efforts been undertaken and the losses caused by the breach thereby reduced, and the cost of mitigation then included in the recovery as an incidental cost of the breach. In addition, an injured person who fails to make reasonable efforts to mitigate damages would be denied only the recovery of the net amount of damages that could have been avoided through those mitigation efforts, once the probable cost of those efforts is taken into account and offset, an appropriate result since that is how much those mitigation efforts would have saved.

Reducing the recovery of an injured person who fails to mitigate by only the net rather than the gross reduction in damages that would have resulted from mitigation efforts, had they been undertaken, is also relatively efficient in that it would preserve (although concededly would slightly weaken) the economic incentive for persons to mitigate damages whenever it is cost-effective for them to do so. Even with this smaller reduction in her recovery, a person would still be better off if she made reasonable efforts to mitigate damages than if she did not. Cost-effective mitigation efforts would still be encouraged.

I find convincing on both fairness and efficiency grounds these arguments for reducing the damages awarded to a person who fails to take reasonable efforts to mitigate by only the net rather than the gross reduction in damages that would probably result from the mitigation efforts. However, this position is not unassailable and reasonable persons might disagree with my conclusions. It is possible to envision a court first denying recovery of those damages that could have been

avoided through reasonable mitigation efforts that were not undertaken, applying standard avoidability principles to reach this result, and then also denying recovery of the probable cost of those mitigation efforts as an offset to that reduction in damages.

A court might reach this seemingly harsh result—one that appears to both undercompensate the injured person that fails to mitigate and also confer an undeserved windfall reduction in damages to the contract breacher—on one or more of several possible bases. First of all, since those probable mitigation costs were not actually incurred by the injured person, a court might rather simplistically conclude on that basis alone that those costs are not losses that merit recovery, even if only as an offset against a larger damages reduction that would be imposed due to the failure to reasonably mitigate. While there is some support to be found in contract law generally for awarding damages under circumstances when no out-of-pocket losses have been incurred,<sup>8</sup> courts in most contracts cases are only called upon to award damages where actual losses can be proven,<sup>9</sup> and may therefore be uncomfortable with the somewhat counterintuitive concept of ordering reimbursement of expenses that were not actually incurred.

Second, those probable mitigation costs, since they were not actually incurred, are only estimated costs. Such estimates may, under some circumstances, not be reasonably certain in their magnitude, and an injured person perhaps may be denied recovery by a court for that reason alone. Now the costs of mitigating damages, particularly the costs of typical covering purchases or subsequent resales, or of short-term financing-type arrangements entered into to offset temporary cash shortfalls after breach, can often be established with a fair degree of precision, and will not pose the same significant uncertainty problems as do, for example, claims based upon lost future profits or foregone opportunities. However, probable mitigation expenses that were not incurred are inherently less certain in amount than are actually incurred expenses, and in some instances their magnitude may pose substantial questions that a court would deem sufficient to justify denying their recovery.

Third, allowing such an offset from the reduction of damages for failure to mitigate will concededly undercut, to some extent, the incentive for future contracting parties to take reasonable efforts to

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8. Consider, for example, the right to recover the value of adequately proven foregone opportunities as part of a reliance interest-based contract damages award, or to recover adequately proven probable lost future profits as part of an expectation interest-based award.

9. James P. Nehf, *Contract Damages as a Substitute for Full Performance*, 32 *IND. L. REV.* 765, 770 (1999).

mitigate damages in the event of breach, since if such an offset is allowed then the penalty for failure to mitigate is reduced to that extent. This reduction in the incentive to mitigate may give some courts concern. However, mitigation efforts are generally regarded as being “reasonable” efforts for avoidability of damages purposes only in instances where the magnitude of the avoidable losses substantially exceeds the costs of mitigation. Under those circumstances, even if the probable costs of mitigation are offset against the much larger damages reduction that will be imposed for the failure to mitigate the injured person would still have been far better off had she undertaken those mitigation efforts and avoided those larger damages. The allowance of this relatively minor recovery of the probable costs of mitigation efforts that were not undertaken would still leave in place a sufficiently strong incentive to take all clearly cost-effective mitigation efforts.

Despite the problems that I have pointed out with each of these bases for denying recovery of probable mitigation costs that were not incurred, a court may for one or more of those reasons decide that it is better policy to reduce the recovery of an injured person who has failed to take reasonable mitigation efforts by the full amount of damages avoidable through those mitigation efforts, rather than by the smaller net amount of damages reduction that would have occurred had those mitigation efforts taken place and the probable costs of those mitigation efforts then been offset from those avoidable losses.

I have discussed some of the relevant policy considerations and offered my opinion as to the better result, but what is the actual state of the law? There is surprisingly little authority to be found that addresses this question. Several major single-volume contract law treatises that I have reviewed all closely agree on the general framework of mitigation of damages law, as one would expect, but none of them address this particular question regarding the right to recover probable mitigation costs that were not incurred, nor cite any precedents or statutes that would apply to these circumstances.<sup>10</sup> Moreover, those treatises in their rather brief discussions of mitigation issues do not always distinguish between the application of avoidability principles to sale of goods contracts and to other contracts not governed by U.C.C. Article 2—a distinction which could arguably be significant in this context given the different treatment of seller consequential damages under U.C.C. Article 2 as compared to common law.

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10. See E. ALLAN FARNSWORTH, *CONTRACTS* § 12.12, at 778 (4th ed. 2004); JOHN EDWARD MURRAY, JR., *MURRAY ON CONTRACTS* § 123(A)–(C), at 777-80 (5th ed. 2011); JOSEPH M. PERILLO, *CALAMARI AND PERILLO ON CONTRACTS* §§ 14.15–.17, at 506-11 (6th ed. 2009).

In addition, these several treatise discussions all overlook what may be an important distinction between what I describe as the “primary” mitigation efforts that a person may undertake to directly reduce the amount of damages that she will suffer from a breach, and that person’s possible “secondary” mitigation efforts to obtain external financing of any cash shortfall resulting from the breach that may persist even after those primary damages mitigation efforts have been undertaken, until settlement compensation or a judgment award is paid.<sup>11</sup> Such secondary mitigation efforts may be undertaken so as to avoid the risk of further consequential losses that might result from that shortfall. Such consequential losses may result, for example, from defaults by the injured person upon other obligations that take place because of the financial constraints imposed by the shortfall, or from consequent financial restrictions on the ability to pursue other profitable opportunities, until a settlement payment or damages award is received from the contract breacher. As I will discuss below, a court may choose to deal differently between primary and secondary mitigation efforts with regard to allowing recovery of probable mitigation costs when those mitigation efforts are not undertaken.<sup>12</sup>

Nor do any of these treatises consider the possible significance of applicable prejudgment interest statutes for the right to recover the probable costs of such secondary mitigation financial arrangements that are not undertaken. As I will discuss below, prejudgment interest statutes may well be regarded by some courts as having some bearing on the scope of recovery rights, both for the recovery of costs incurred for secondary mitigation measures, and for the probable costs of secondary mitigation measures that are not undertaken.<sup>13</sup>

In Part II of this Article, I more fully elaborate on this distinction between primary and secondary efforts to mitigate damages,<sup>14</sup> and on the potential significance of prejudgment interest statutes on the right to recover the probable costs of secondary mitigation efforts that are not undertaken.<sup>15</sup> Having developed this analytical framework, in Part III, I address the question of the right of a person who fails to take reasonable efforts to mitigate her damages, after the breach of a sale of goods contract that is governed by state statutes implementing U.C.C. Article 2, to recover the probable costs of those mitigation efforts.<sup>16</sup>

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11. *See infra* Part II.A.

12. *See infra* Part III.

13. *See infra* Part II.B.

14. *See infra* Part II.A.

15. *See infra* Part II.B.

16. *See infra* Part III.

I will separately consider the circumstances of seller breach and buyer breach of such sale contracts, and with regard to primary and secondary mitigation efforts,<sup>17</sup> and will also take into account the effect of prejudgment interest statutes.<sup>18</sup> In Part IV, I address these same questions with regard to those contracts not governed by U.C.C. Article 2, using the applicable provisions of the *Restatement (Second) of Contracts* as a general articulation of the governing common law principles.<sup>19</sup> Part V presents a brief overall conclusion.<sup>20</sup>

## II. PRIMARY AND SECONDARY MITIGATION EFFORTS, AND THE SIGNIFICANCE OF PREJUDGMENT INTEREST STATUTES FOR RECOVERY OF THE PROBABLE COST OF SECONDARY MITIGATION EFFORTS THAT ARE NOT UNDERTAKEN

### A. “Primary” and “Secondary” Mitigation Efforts Defined

Consider the circumstances of a person who has contracted to buy goods or services when the seller then breaches by failing to deliver the goods or services involved. Often the injured buyer can then reduce the damages that would result from not having the contracted-for goods or services simply by “covering” by purchasing those same or very similar goods or services from an alternative supplier, usually at a cost somewhat higher than the original contract price.<sup>21</sup> Such a covering purchase would avoid altogether the damages resulting from not having the goods or services.<sup>22</sup> If the extra cost of cover is substantially less than those damages thereby avoided, then covering would be regarded as a reasonable mitigation effort, and a failure to cover could be a basis for denying recovery of those damages that could have been so avoided.<sup>23</sup>

Such a reasonable covering purchase would be an example of what I will call a “primary” mitigation effort. The extra cost of cover and the transaction costs incurred to arrange a covering purchase would each generally be recoverable as an element of incidental damages, absent contractual agreement to the contrary. These extra costs could, however, under some circumstances be substantial enough in amount to cause a cash shortfall for the injured person during the perhaps extended time

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17. See *infra* Part III.A–B.

18. See *infra* notes 58-60, 92-94 and accompanying text.

19. See *infra* Part IV.

20. See *infra* Part V.

21. See U.C.C. § 2-712(1) (AM. LAW INST. & UNIF. LAW COMM’N 2017).

22. *Id.* § 2-715(2)(a).

23. See RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. b (AM. LAW INST. 1981).

period that may elapse prior to that person receiving reimbursement of those mitigation costs. This could then possibly lead to further consequential losses due to, for example, defaults on other obligations, or the inability to pursue other profitable opportunities. If a person obtains external financing of those extra costs of a covering purchase until reimbursement in order to avoid the risk of incurring these larger consequential losses, this would be an example of what I call a “secondary” mitigation of damages effort. This secondary mitigation effort would of course impose a cost on the injured person in transaction costs and later interest payments.

A person who has contracted to sell goods or services is in a precisely analogous position if the buyer breaches by non-payment. As a reasonable “primary” effort to mitigate her damages, the person could then resell the goods or services for whatever they would bring in the market. The difference between the original contract price and the usually lower resale price, and the extra transaction costs of arranging such a resale, would again generally be recoverable as elements of incidental damages, absent contractual agreement otherwise. The shortfall between the original contract price and the often lower net resale price (after subtracting any additional transaction costs that are incurred in connection with the resale) may again, under some circumstances, be substantial enough to cause significant financial difficulties for the injured person during the time period prior to receiving reimbursement of that shortfall. This shortfall could again lead to further consequential losses for the seller by forcing it to default on other obligations, or by making it necessary to forego other profitable opportunities. If the injured seller obtains external financing of that shortfall for that time period in order to avoid the risk of these larger consequential losses, that financing arrangement would again be an example of a “secondary” mitigation of damages effort, undertaken at a cost to the seller of arranging that financing and then making the required principal and interest payments.

As I will discuss below, neither U.C.C. Article 2 nor the *Restatement (Second) of Contracts* is entirely clear regarding whether a person who could reasonably mitigate the risk of consequential damages through secondary, external financing-type mitigation efforts, but does not do so, will be able to recover the probable costs of such financing arrangements.<sup>24</sup>

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24. See *infra* Parts III–IV.

*B. Secondary Mitigation Costs and Prejudgment Interest Statutes*

For some contract breaches there are applicable statutes in force that provide for prejudgment interest to be awarded, at a specified interest rate, for the time period between the breach and the later issuance of the judgment.<sup>25</sup> Such prejudgment interest awards are intended primarily to compensate the injured party for being denied recovery between the time of injury and the later award of judgment, for the loss of the time value of money and opportunities to invest that money over that period.<sup>26</sup> But a person who has obtained external financing of the amount of that recovery for the time period prior to the award of judgment, arranged in order to avoid the risk of consequential losses from that shortfall, has not been denied the use of those funds. If a person who has made such secondary mitigating financial arrangements to avoid the risk of consequential losses is then able to obtain recovery of the costs of this mitigation effort, where she is also able to recover statutory prejudgment interest on her damage award that is primarily designed to compensate for exactly these kinds of costs, it can be argued that this kind of recovery would be duplicative. As will be discussed below, this complication resulting from the existence of prejudgment interest statutes will also need to be considered when one is analyzing whether an injured party that does not arrange such secondary mitigation financing in order to avoid the risk of consequential losses should still be able to recover the probable costs of such financing.<sup>27</sup>

Having discussed the policy considerations that are applicable to this question of the recovery of probable mitigation costs that were not incurred, and having set out some general analytical categories and complications, let me turn now to a more specific analysis of the current state of the law. I will first consider the right of an injured person to recover the probable costs of reasonable efforts to mitigate damages, after the breach of a sale of goods contract that is governed by U.C.C. Article 2, when that person fails to make reasonable primary efforts to mitigate damages, or does so but then fails to take reasonable secondary mitigation efforts to avoid the risk of consequential losses resulting from the remaining damages that were not reasonably avoidable by primary mitigation measures.<sup>28</sup> I will then consider this question with regard to

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25. For an extensive discussion of prejudgment interest statutes, see generally Michael S. Knoll, *A Primer on Prejudgment Interest*, 75 TEX. L. REV. 293 (1996).

26. *Id.* at 302 ("Prejudgment interest is assessed in order to place the parties in the same position they would have been in had the defendant paid the plaintiff an amount equal to the original judgment when the injury occurred.")

27. See *infra* Part III.A.2, B.2.

28. See *infra* Part III.

contracts that would instead be governed by general common law principles as articulated in the *Restatement (Second) of Contracts*.<sup>29</sup>

### III. RECOVERY OF THE PROBABLE COSTS OF MITIGATION OF DAMAGES UNDER U.C.C. ARTICLE 2 WHEN ONE HAS FAILED TO MITIGATE

The U.C.C. is not entirely clear regarding whether a person that is injured by the breach of a sale of goods contract has a right to recover probable mitigation of damages costs that were not actually incurred, either directly or as an offset against the reduction in damages that will be imposed for the failure to take reasonable efforts to mitigate. Let me first address how U.C.C. Article 2 applies under these circumstances to the common situation where a seller has breached a sale of goods contract by failure to deliver,<sup>30</sup> and then I will address how it applies under these circumstances to the equally common situation where a buyer of goods has breached the contract by failing to make payment when due.<sup>31</sup>

#### A. Seller Breach by Non-Delivery

When a seller fails to deliver goods, the usual primary mitigation action that is available to the injured buyer to reduce her damages from the breach is to cover by purchasing substitute goods from another seller, usually at a higher price.<sup>32</sup> The U.C.C. implements the general principle of denying recovery of reasonably avoidable damages at subsection 2-715(2)(a) where it limits the consequential damages that a buyer may obtain to “any loss . . . which could not reasonably be prevented by cover or otherwise.”<sup>33</sup> A buyer who covers after the seller’s breach will, under subsection 2-712(2), be able to recover the difference between the cost of cover and the original contract price.<sup>34</sup> The buyer under that provision will also be able to recover the transaction costs of arranging cover as incidental damages,<sup>35</sup> which are defined at subsection 2-715(1) to include the costs “incurred” or other “expenses . . . in connection with effecting cover,”<sup>36</sup> and also any consequential loss under subsection

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29. See *infra* Part IV.

30. See *infra* Part III.A.

31. See *infra* Part III.B.

32. See *infra* notes 33-37 and accompanying text.

33. U.C.C. § 2-715(2)(a) (AM. LAW INST. & UNIF. LAW COMM’N 2017).

34. *Id.* § 2-712(2).

35. *Id.*

36. *Id.* § 2-715(1).

2-715(2)(a) that could not be reasonably prevented by cover or otherwise.<sup>37</sup>

Let me first consider the question presented by a buyer who after a seller breach by non-delivery fails to engage in the primary mitigation action of entering into a covering transaction.<sup>38</sup> Can that buyer recover as an offset from her damages reduction for failure to mitigate the probable extra costs of cover? These costs would include both the extra amount that would have to be paid for the substitute goods over and above the original contract price as well as any transaction costs that would be incurred in arranging a substitute transaction. I will then consider the question of the right of a buyer who does cover as a primary mitigation measure, but who then fails to engage in the secondary mitigation action of arranging financing of the resulting cash shortfall after covering so as to avoid possible further consequential losses, to recover the probable costs of such a financing arrangement.<sup>39</sup>

#### 1. Failure to Engage in the Primary Mitigation Effort of Covering After a Seller Breach by Non-Delivery

At subsection 2-712(3) and the associated Official Comment 3 to that subsection, the U.C.C. makes clear that a failure to cover by the buyer after a seller breaches the contract by non-delivery is not a bar to the buyer obtaining a remedy.<sup>40</sup> The buyer may choose to not make a substitute covering purchase,<sup>41</sup> and may under subsection 2-713(1) still recover the difference between the market price of the goods at the time the buyer learned of the breach (i.e., the cost of covering by a substitute purchase had cover been undertaken) and the (usually lower) contract price.<sup>42</sup> In other words, if the buyer fails to cover when doing so would have been a reasonable measure to mitigate the larger damages that would otherwise result from seller non-delivery, under the standard principle of denying recovery of reasonably avoidable damages that is embodied by subsection 2-715(2)(a), the buyer will be denied recovery of those consequential damages that could have been avoided by a covering transaction.<sup>43</sup> The buyer will instead be awarded only the extra cost of cover that would have to have been paid for the substitute goods over and above the original contract price.

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37. *Id.* §§ 2-712(2), 2-715(2)(a).

38. *See infra* Part III.A.1.

39. *See infra* Part III.A.2.

40. U.C.C. § 2-712(3) & cmt. 3.

41. *Id.* § 2-712 cmt. 3.

42. *Id.* § 2-713(1).

43. *Id.* § 2-715(2)(a) & cmt. 2.

However, whether a buyer who chooses not to cover will under subsection 2-713(1) and section 2-715 also be allowed to recover the probable transaction costs of arranging a covering purchase, costs that were not actually incurred, is more problematic. Under subsection 2-713(1) a buyer who fails to cover after a seller breach by non-delivery will also be able to recover any incidental damages or consequential damages that are allowable under section 2-715.<sup>44</sup> However, it is unlikely that the probable transaction costs of arranging a covering transaction, if the buyer chooses not to cover and therefore to not actually incur those costs, would qualify under subsection 2-715(1) as recoverable incidental damages, given that provision's textual limitation of incidental damages to "incurred" expenses.<sup>45</sup>

A more promising argument for recovery would be that those probable transaction costs of a covering purchase, although not incurred, would still qualify as a "loss" under subsection 2-715(2)(a), and should therefore still be recoverable as an offset from the reduction in consequential damages imposed due to the failure to mitigate.<sup>46</sup> The argument would be that those probable transaction costs, though not actually incurred, should nevertheless be regarded as a "loss" in economic terms because they could not be avoided except by incurring the even larger losses resulting from failure to cover. Another way to look at the situation is to note that a person who fails to mitigate damages has in effect elected to bear a larger avoidable damages loss, rather than the smaller cost of mitigation efforts, but necessarily must bear at least the smaller cost. So, one has no choice but to bear at least the "loss" of one's probable mitigation costs.

If those probable mitigation costs are regarded as qualifying as a "loss," they are clearly a loss that is recoverable under subsection 2-715(2)(a) because they "could not reasonably be prevented by cover or otherwise,"<sup>47</sup> since a covering purchase to avoid larger consequential damages would necessarily require incurring the transaction costs of cover.<sup>48</sup> Only the remaining consequential damages that would result from not having the goods, net of the probable transaction costs of covering, could be reasonably prevented by cover, so therefore only that portion of the consequential damages should be denied recovery for failure to mitigate. The probable transaction costs of cover that

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44. *Id.* § 2-713(1).

45. *See id.* § 2-715(1).

46. *Id.* § 2-715(2)(a) & cmt. 2.

47. *Id.* § 2-715(2)(a).

48. *See id.* § 2-715 cmt. 1.

were not incurred should be offset from the overall reduction of consequential damages.

In summary, I think the fairest result here that is consistent with the rather restrictive statutory language of section 2-715 would be to first concede that the probable transaction costs of cover that were not incurred by an injured buyer do not qualify as recoverable incidental damages under the literal text of subsection 2-715(1).<sup>49</sup> But one should then conclude that those costs are nevertheless a recoverable loss under subsection 2-715(2)(a) as an offset against the reduction in damages for failure to mitigate, since they are consequential losses that could not reasonably be prevented without incurring larger losses.<sup>50</sup> This latter conclusion is based on the point noted above that, first of all, a covering purchase would obviously lead to the injured buyer incurring those transaction costs, and, second, not covering would lead to the injured buyer thereby bearing even larger uncompensated consequential losses than those transaction costs. Bearing those larger consequential losses is thus not a reasonable means of avoiding those probable transaction costs under subsection 2-715(2)(a).

2. Failure to Engage in the Secondary Mitigation Effort of Financing the Cash Shortfall Resulting from the Combination of a Seller Breach by Non-Delivery and a Subsequent Covering Purchase

A buyer that covers with a substitute purchase after a seller breach by non-delivery may then also as a further secondary mitigation of damages effort choose to arrange external financing of the extra costs of cover, including both the extra amount paid over and above the contract price for the substitute goods and the transaction costs of arranging the covering purchase, in order to avoid the risk of consequential damages from the cash shortfall caused by these extra costs until they are later reimbursed. The transaction and interest payment costs of such financing would presumably be recoverable under subsection 2-712(2) and section 2-715.<sup>51</sup> Although there is a split of judicial authority regarding whether such secondary mitigation costs should be regarded as incidental damages or instead as consequential damages,<sup>52</sup> this is a matter of no

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49. *See id.* § 2-715(1).

50. *See id.* § 2-715(2)(a) & cmt. 2.

51. *Id.* § 2-712(2)(a).

52. *See* WHITE & SUMMERS, *supra* note 2, §§ 7-3 to -4, at 214-16 (noting the split of judicial authority on whether the interest costs of substitute funding to avoid cash flow difficulties that is necessitated by a buyer's breach should be regarded as recoverable incidental damages under U.C.C. section 2-710, or instead as non-recoverable consequential damages).

import in the context of a seller breach since for buyers both forms of damages are recoverable under section 2-715.<sup>53</sup>

But what if a buyer engages in the primary mitigation effort of covering by making a substitute purchase after a seller breach by non-delivery, but then fails to engage in further reasonable secondary mitigation of damages efforts to temporarily finance the resulting extra payment and transaction costs of covering, and as a result risks suffering later consequential losses of one sort or another that could have been reasonably avoided by making those financing arrangements? Such a buyer under subsection 2-715(2)(a) will probably be denied any resulting consequential losses that could have been reasonably avoided “by cover or otherwise,” with the financing arrangement that was not undertaken being regarded as an “otherwise” reasonable means of avoidance of those consequential losses.<sup>54</sup> But will the buyer then be able to recover the probable transaction and interest payment costs of that financing effort that was not undertaken?

Once again, the questions will arise as to whether probable mitigation costs that are not actually expended would qualify as “incurred” incidental damages under subsection 2-715(1),<sup>55</sup> and if not whether those costs would then qualify under subsection 2-715(2)(a) as consequential losses that could not be reasonably prevented.<sup>56</sup> I would again argue that the fairest result that is consistent with the restrictive Article 2 statutory language would be to regard those probable financing costs as recoverable consequential losses that were not reasonably avoidable, since their avoidance by eschewing such financing arrangements would lead to an unacceptable risk of even larger consequential losses.

Under the U.C.C., as well as at common law, damages are not recoverable if their amount cannot be proven with reasonable certainty.<sup>57</sup> That being said, a court considering whether to allow recovery of the probable costs of financing a cash shortfall that remains after primary mitigation measures have been taken, but where that secondary mitigation financing effort was not undertaken, is not likely to be unduly troubled by the uncertainty as to the magnitude of those probable costs. This is because the costs of such short-term financing arrangements for a particular person are likely to be fairly easy to determine with a fair

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53. U.C.C. § 2-715(1)–(2).

54. *Id.* § 2-715(2)(a).

55. *Id.* § 2-715(1).

56. *See id.* § 2-715(2)(a).

57. *Id.* § 1-305 cmt. 1; RESTATEMENT (SECOND) OF CONTRACTS § 352 (AM. LAW INST. 1981).

degree of precision. The greater uncertainty that is presented under these circumstances will typically be whether the probability and magnitude of the various consequential losses that may result from the cash shortfall remaining after the primary mitigation efforts have been undertaken are sufficiently great so as to reasonably justify such secondary mitigation financing efforts in order to avoid those risks. But this question goes to the reasonableness of those secondary mitigation efforts, not to the question addressed in this Article of whether the probable cost of reasonable secondary mitigation efforts that are not undertaken are recoverable either directly or as an offset to the denial of any resulting consequential damages.

The existence of any applicable prejudgment interest statutes may, however, create some additional complications. The import of prejudgment interest statutes for the other items of a recovery for breach of contract are not explicitly addressed by the U.C.C., except to the extent that the general endorsement of the expectation damages principle in section 1-305 suggests that supra-compensatory duplicative recoveries should not be allowed.<sup>58</sup> Where a prejudgment interest statute applies, a court may regard the recovery of reasonable secondary mitigation financing costs that have been incurred by the injured person as being duplicative of that statutory recovery, particularly if the applicable statutory interest rate is high enough to cover the full transaction and interest payment costs of such financing, and therefore deny that recovery.<sup>59</sup> And under those circumstances where such reasonable secondary mitigation efforts were not made—the focus of this Article—courts under subsection 2-715(2)(a) would first deny recovery of any consequential losses that could have been avoided by such efforts, and then would require that the prejudgment interest award be calculated only on the basis of the smaller allowable recovery.<sup>60</sup> But under those circumstances as well, some courts may disallow recovery of the probable transaction and interest payment costs of such financing arrangements that were not made, again on the basis that such a recovery would be duplicative of the award obtained under the prejudgment interest provisions.

### 3. Summary

In brief summary, the language of U.C.C. Article 2 leaves open the argument as to whether a buyer who fails to reasonably cover by making

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58. See U.C.C. § 1-305(a).

59. See *supra* Part II.B.

60. See U.C.C. § 2-715(2)(a) & cmt. 2.

a substitute purchase after a seller breach by non-delivery may still recover the probable transaction costs of arranging a covering transaction as an offset to her reduction in damages for the failure to cover. It is also unclear whether a buyer who engages in primary mitigation efforts by entering into a covering purchase after a seller breach by non-delivery, but who then fails to arrange for reasonable financing of any resulting temporary cash shortfall to avoid possible consequential losses that may result from that shortfall, may still recover the probable costs of arranging such financing, either directly or as an offset to disallowed consequential damages.

Finally, the existence of applicable prejudgment interest statutes may influence some courts that might otherwise be inclined to allow recovery of probable secondary mitigation costs that were not incurred to now disallow recovery of those probable costs as duplicative. This result is strongly suggested but does not appear to be compelled by the applicable U.C.C. provisions.

#### *B. Buyer Breach by Non-Payment*

While under U.C.C. Article 2 buyers of goods are entitled to consequential damages resulting from a breach by the seller, subject to foreseeability and avoidability limitations,<sup>61</sup> sellers are generally not allowed to recover consequential damages resulting from a buyer's breach.<sup>62</sup> The typical breach of a sale of goods contract by a buyer would be by non-payment when payment is due, and the typical reasonable primary mitigation measure available to an injured seller who faces potential consequential damages from being denied receipt of those funds would be to first resell the goods for what they would bring in the market.<sup>63</sup> Then, if necessary to meet any significant remaining cash shortfall resulting from the buyer's non-payment exceeding those net resale proceeds, after deducting the transaction costs of the resale, and which shortfall risks causing further consequential losses, a seller may also elect to pursue the secondary mitigation effort of seeking to borrow substitute funds to cover that shortfall until a settlement payment is made or a judgment is awarded.

Let me first consider the question of a seller's right to recover the probable transaction costs of reselling the goods after a buyer's breach

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61. *Id.* § 2-715(2)(a).

62. *See supra* note 2.

63. U.C.C. § 2-703(d); RESTATEMENT (SECOND) OF CONTRACTS § 350 cmts. b-c (AM. LAW INST. 1981).

by non-payment, if that seller elects not to resell the goods.<sup>64</sup> I then turn to the question raised by a seller who does resell the goods after a buyer's breach as a primary mitigation effort, but who then fails to engage in reasonable secondary mitigation efforts to finance the resulting cash shortfall after the resale so as to avoid the risk of consequential damages resulting from that shortfall.<sup>65</sup>

#### 1. Failure to Engage in the Primary Mitigation Effort of Reselling the Goods After a Buyer's Breach by Non-Payment

If a seller does resell the goods after a buyer's breach by non-payment then under subsection 2-706(1), the seller can recover the difference between the unpaid contract price and the (usually lower) resale price, along with the transaction costs of conducting the resale,<sup>66</sup> which are regarded as being recoverable "incidental damages" under section 2-710.<sup>67</sup> This is all subject to an exception not relevant here for lost-volume sellers.<sup>68</sup> But what if the seller does not resell the goods after the buyer's breach by non-payment? Under subsection 2-708(1) the seller then can recover only the difference between the unpaid contract price and the market price at the time and place of delivery, plus any incidental damages.<sup>69</sup> Reflecting the application of the general principle of denying the recovery of reasonably avoidable losses, subsection 2-706(1) thus denies the seller the recovery of that portion of the unpaid contract price that could have been avoided through reasonable resale.<sup>70</sup>

This is all clear enough, but do the probable transaction costs of such a resale that did not take place nevertheless qualify under section 2-710 as recoverable "incidental damages"<sup>71</sup> that would provide an offset against the reduction in damages for failure to mitigate by resale? Probably not, since section 2-710 is similar in structure and language to subsection 2-715(1) that defines incidental damages for buyers.<sup>72</sup> The

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64. *See infra* Part III.B.1.

65. *See infra* Part III.B.2.

66. U.C.C. § 2-706(1).

67. *Id.* § 2-710.

68. *See id.* § 2-708(2).

69. *Id.* § 2-708(1).

70. *Id.* § 2-706 cmt. 2.

71. *Id.* § 2-710.

72. *Compare id.* ("Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach."), *with id.* § 2-715(1) ("Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the

literal text of section 2-710 also limits those damages to costs “incurred.”<sup>73</sup> This provision therefore would also likely be interpreted by courts to not allow the probable transaction costs of arranging a resale that were not actually incurred to be treated as incidental damages and offset against the reduction in damages that is imposed by subsection 2-708(1) on avoidability grounds.<sup>74</sup>

As I have discussed above in the context of seller breach,<sup>75</sup> the probable transaction costs of the injured buyer arranging a covering transaction, if the buyer does not do so, may arguably qualify for an offset against the reduction in consequential damages for failure to mitigate imposed by subsection 2-715(2)(a),<sup>76</sup> because if transaction costs were not “incurred,” they do not qualify as recoverable incidental damages under subsection 2-715(1).<sup>77</sup> Transaction costs may qualify under subsection 2-715(2)(a) as losses on the part of the buyer that are not reasonably avoidable because they could be avoided at the cost of even larger consequential losses.<sup>78</sup> However, this same interpretive approach cannot be taken with regard to justifying seller recovery of the transaction costs of resale if those costs are not incurred. This is because the U.C.C. does not allow for seller recovery of consequential damages.<sup>79</sup> Since seller consequential damages are not allowed under U.C.C. Article 2 there would *a fortiori* then be no reduction in the seller’s consequential damages for the seller’s failure to mitigate through resale, and as a result no basis for an offset of the probable transaction costs of a resale that did not occur.

I think that as a matter of policy, a seller who does not resell the goods after a buyer’s breach should still be allowed to recover the probable transaction costs of arranging for a resale, in a manner analogous to allowing a buyer who does not cover to recover the probable transaction costs of arranging a covering purchase as an offset to her reduction in consequential damages. But unfortunately, I do not see how that result can be reached under U.C.C. Article 2 given: (1) the narrow U.C.C. section 2-710 definition of seller incidental

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delay or other breach.”).

73. *Id.* § 2-710.

74. *Id.*; *see id.* § 2-708(1).

75. *See supra* Part III.A.

76. U.C.C. § 2-715(2)(a).

77. *Id.* § 2-715(1).

78. *Id.* § 2-715(2)(a).

79. WHITE & SUMMERS, *supra* note 2, § 7-6, at 218.

damages,<sup>80</sup> and (2) the disallowance altogether by the U.C.C. of seller consequential damages.<sup>81</sup>

2. Failure to Engage in the Secondary Mitigation Effort of Financing the Cash Shortfall Resulting from the Combination of a Buyer Breach and a Subsequent Resale Transaction

Now consider any financing that is actually arranged by a seller to avoid the risk of later consequential damages by covering the remaining financial shortfall that has resulted from a buyer's failure to meet her payment obligations when due, after the receipt of the net proceeds from resale of the goods. The transaction costs and interest payment obligations incurred in obtaining such financing may or may not be recoverable by the seller. This depends on whether the reviewing court regards such mitigation financing costs as qualifying as "incidental damages" under section 2-710,<sup>82</sup> and there is a split of judicial authority on the proper characterization of such financing costs.<sup>83</sup> If a court regards such secondary mitigation expenses as qualifying as incidental damages under section 2-710 then they may be recoverable.<sup>84</sup>

But what if a seller does not actually arrange for such secondary mitigation financing of cash shortfalls resulting from a buyer breach and a subsequent lower-priced resale, and thereby suffers the risk of further consequential losses stemming from the resulting shortfall? Even if probable secondary mitigation costs are regarded as consequential losses, they will not be recoverable simply because the U.C.C. does not make seller consequential losses recoverable.<sup>85</sup> And, as I have noted above, it is unlikely that the probable costs that this secondary mitigation financing would have involved, had it been arranged, would be recoverable as incidental damages under section 2-710 since they were not actually "incurred."<sup>86</sup> Even if those costs were recoverable under the U.C.C., moreover, there would still be the problem noted above regarding potential duplicative recovery given state statutes providing for prejudgment interest.

In summary, if probable financing costs were regarded by a reviewing court as incidental damages, a highly unlikely result given that the language of section 2-710, like subsection 2-715(1), requires

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80. See U.C.C. § 2-710.

81. WHITE & SUMMERS, *supra* note 2, § 7-6, at 218.

82. See U.C.C. § 2-710.

83. See WHITE & SUMMERS, *supra* note 2, §§ 7-3 to -4, at 214-16.

84. See U.C.C. § 2-710.

85. See *id.* § 2-715(2)(a).

86. See *supra* Part III.B.1.

costs to be “incurred,”<sup>87</sup> then the seller would be awarded the net costs of such financing arrangements had they been reasonably undertaken in order to avoid larger consequential losses. This result would parallel the result discussed above for a buyer who fails to engage in secondary mitigation of damages after a covering purchase by arranging temporary financing of the extra costs of that purchase and the associated transaction costs.<sup>88</sup> But if those probable financing costs are instead regarded as consequential damages in character—which seems much more likely for the reasons discussed above with regard to buyer’s damages—then there would probably be a different result reached for sellers than for buyers with regard to recovery of probable secondary mitigation financing costs that are not incurred. This is an unfortunate but seemingly unavoidable consequence of the different treatment of consequential damages for buyers and for sellers under the U.C.C.

The fact that under the U.C.C. sellers cannot recover consequential damages also undercuts one of the primary rationales that I have noted above for allowing an injured person to recover probable mitigation costs that were not incurred.<sup>89</sup> As I have discussed, to not allow the injured person to recover those probable costs as an offset against the reduction in her damages for failure to mitigate would provide an unfair windfall damages reduction to the breacher as compared to what he would have had to pay had the mitigation efforts been undertaken and the cost of those efforts recovered as additional incidental damages. But since the U.C.C. does not award consequential damages to sellers of goods, one could argue that the expenditures that were made by sellers to mitigate consequential damages should not be charged to the buyer as incidental damages. Since actual expenditures to avoid such damages will not reduce the buyer’s liability for the breach, neither should expenditures that would have been incurred if the seller had made reasonable efforts to mitigate.

In other words, if a court concludes that sellers should not be allowed to recover their actual mitigation costs that are related to avoidable consequential damages, damages that are not recoverable under the U.C.C. in any event, then also disallowing the recovery of probable mitigation costs that were not incurred would not put breaching buyers in any better position than if the mitigation efforts had taken place. In that event, the allowance of recovery of probable mitigation costs cannot be justified on the basis of preventing unjustified windfalls

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87. See *supra* notes 73-74 and accompanying text.

88. See *supra* note 54 and accompanying text.

89. See *supra* notes 46-48 and accompanying text.

to breaching buyers or unfairness to sellers, and would have to be justified on some other basis.

As noted above in the context of secondary mitigation financing arrangements made by buyers after a seller breach by non-delivery,<sup>90</sup> a court considering whether to allow recovery of the probable costs of financing a cash shortfall that remains after primary mitigation measures have been taken, but where that secondary mitigation effort was not undertaken, is not likely to be unduly troubled by uncertainty as to the magnitude of those probable costs. The transaction and interest payment costs of such short-term financing arrangements for a particular person are likely to be fairly easy to determine with a fair degree of precision. The greater uncertainty here, once again, will typically be whether the probability and magnitude of the various consequential losses that may result from the cash shortfall remaining after primary mitigation efforts are sufficiently great to reasonably justify such secondary mitigation financing efforts in order to avoid those risks. But this question once again goes to the reasonableness of those secondary mitigation efforts, not to the question here addressed in this Article of whether the probable cost of reasonable secondary mitigation efforts that are not undertaken are recoverable.

The existence of an applicable prejudgment interest statute may again create some additional complications. The import of such statutes for other items of a recovery for breach of contract are, as I have noted, not explicitly addressed by the U.C.C.,<sup>91</sup> although the general endorsement of the expectation damages principle in subsection 1-305(a) suggests that supra-compensatory duplicative recoveries should not be allowed.<sup>92</sup> Where a prejudgment interest statute applies, a court may regard the recovery of reasonable secondary mitigation financing costs that have been incurred as being largely duplicative of that statutory recovery, particularly if the applicable statutory interest rate is high enough to cover the full transaction and interest payment costs of such financing, and deny that recovery. Under those circumstances where such reasonable secondary mitigation efforts were not made, the focus of this Article, courts under subsection 2-715(2)(a)<sup>93</sup> would first deny recovery of any consequential damages that could have been avoided by such efforts, and then would allow the prejudgment interest award to be calculated only on the basis of the smaller allowable recovery. But they

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90. See *supra* note 57 and accompanying text.

91. See *supra* note 58 and accompanying text.

92. See U.C.C. § 1-305(a) (AM. LAW INST. & UNIF. LAW COMM'N 2017).

93. *Id.* § 2-715(2)(a).

may again choose to disallow recovery of the probable transaction and interest payment costs of such financing arrangements, again on the basis that such a recovery would be largely duplicative of the award obtained under the prejudgment interest provisions.

### 3. Summary

In brief summary, U.C.C. Article 2 is unclear regarding whether a seller who fails to reasonably resell the goods after a buyer breach by non-payment may still recover the probable transaction costs of arranging a resale transaction as an offset to her reduction in damages for her failure to resell. It is also unclear whether a seller who engages in primary mitigation efforts by entering into a resale transaction after a buyer breach by non-payment, but who then fails to arrange financing of any shortfall remaining after resale as a secondary mitigation measure in order to avoid the risk of further consequential losses that may result from that shortfall, may still recover the probable costs of arranging such financing. The existence of applicable prejudgment interest statutes may influence some courts that might be inclined to allow such a recovery of probable mitigation costs to now disallow that recovery as duplicative. This result is suggested, but does not appear to be compelled by the applicable U.C.C. provisions.

I will not take a position in this Article regarding whether the reasonable financing costs of secondary mitigation of the consequences of cash shortfalls resulting from breach, if those costs are not incurred, are properly regarded as “incidental” damages or instead as “consequential” damages, although I think that the text of the applicable provisions points strongly towards a consequential damages characterization. I merely wish to point out that if those costs are regarded as consequential rather than incidental damages they will then be far more difficult for sellers to recover than buyers, a result that seems difficult to justify as a matter of policy.

#### IV. RECOVERY OF THE PROBABLE COST OF MITIGATION OF DAMAGES AT COMMON LAW WHEN ONE HAS FAILED TO MITIGATE

Let me now briefly analyze the comparable questions presented by attempts to recover primary or secondary probable mitigation costs that were not incurred when those recovery attempts are governed by common law principles rather than by U.C.C. provisions. For expositional convenience, I will conduct this analysis applying only the provisions of the *Restatement (Second) of Contracts*, although I recognize that for any particular jurisdiction there may be statutes or

judicial precedents in force that would alter those results for disputes arising in that jurisdiction. Unlike my prior U.C.C. analysis, I will not attempt to distinguish here between the situations facing buyers or sellers of the services or other items involved in the contract.

The *Restatement (Second) of Contracts* at subsection 350(1) articulates the general avoidability of damages principle.<sup>94</sup> However, it does not specifically address whether an injured person who could reasonably mitigate losses through primary mitigation measures, but who fails to do so and therefore is denied recovery of the avoidable portion of her damages, can still recover as an offset from the denied recovery of the probable costs of mitigation that the person did not actually incur. Official Comment b to section 350 states that when there is a failure to mitigate damages then the “loss that [the injured party] could reasonably have avoided . . . is simply subtracted from the amount that would otherwise have been recoverable as damages.”<sup>95</sup> That Comment unfortunately once again does not make clear whether, by use of the phrase “loss that . . . could reasonably have avoided,” the drafters are referring to the gross amount of damages avoidable through mitigation, or instead the smaller net amount of damages that could have been avoided after offset of the probable cost of the mitigation effort from the amount of avoidable damages.<sup>96</sup>

There are several illustrations provided to section 350 that together shed some further light on this question, but that unfortunately fail to resolve the central issues presented.<sup>97</sup> Illustration 5, for example, presents a sale of goods contract hypothetical demonstrating that a buyer of goods who fails to take the reasonable step of covering after breach will be denied the avoidable consequential damages, but may recover the extra cost of the substitute purchase over and above the contract price that such a covering transaction would have required.<sup>98</sup> It thus takes the same position as does the U.C.C. at subsection 2-713(1) for seller breaches by non-delivery, where a buyer who fails to cover after a seller breach can still offset the extra costs of cover over and above the contract price from the reduction in recovery.<sup>99</sup> That illustration, while

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94. RESTATEMENT (SECOND) OF CONTRACTS § 350(1) (AM. LAW INST. 1981) (“Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.”).

95. *Id.* § 350 cmt. b.

96. *See id.*

97. *See, e.g., id.* cmts. b–c, illus. 1–8.

98. *Id.* cmt. c, illus. 5. The specific numbers used in the illustration are \$25,000 in buyer profits that were lost as a result of a failure to cover, with a covering purchase costing \$11,000, \$1000 more than the original \$10,000 contract price. *Id.*

99. U.C.C. § 2-713(1) (AM. LAW INST. & UNIF. LAW COMM’N 2017); RESTATEMENT

involving a sale of goods contract, does not attempt to specifically limit this principle of allowing recovery of the extra cost of cover when the buyer does not cover the sale of goods context, and therefore presumably extends to comparable non-goods transactions.<sup>100</sup> However, that illustration is narrowly specified in that it only addresses the recoverability of the extra cost that would have to be paid for substitute goods, and not the additional transaction costs that would also be incurred in arranging a substitute purchase.<sup>101</sup> The central question addressed in this Article—whether the transaction costs of a primary mitigation cover purchase that are not incurred nevertheless qualify for recovery and offset against any reduction in recovery for failure to mitigate as either incidental or consequential damages—is left unanswered.

At common law, of course, courts would not be constrained by the relatively narrow limitation of incidental damages to actually incurred expenses that is imposed by U.C.C. subsection 2-715(1),<sup>102</sup> but they still may be reluctant to regard primary mitigation costs that were not actually incurred as being recoverable incidental damages. Those courts would still have the option that I have discussed above in the U.C.C. Article 2 context of regarding the probable transaction costs of cover as being consequential losses that are not reasonably avoidable, and thus allow recovery of those costs as an offset against the reduction in damages for failure to mitigate.<sup>103</sup>

Illustration 7 presents another sale of goods hypothetical, this time involving a buyer breach rather than a seller breach.<sup>104</sup> This illustration denies a seller who elects to not resell the goods after the breach the right to recover the avoidable damages of the available market resale price from the buyer, and only allows recovery of the smaller difference between the contract price and the resale price, in a manner which closely parallels the U.C.C. treatment of this situation under subsection 2-708(1).<sup>105</sup> But that illustration also unfortunately does not address whether a seller who elects to not resell the goods can still recover as

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(SECOND) OF CONTRACTS § 350 cmt. c, illus. 5.

100. RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. c, illus. 5.

101. *Id.*

102. U.C.C. § 2-715(1) & cmt. 2.

103. *See supra* notes 46-48 and accompanying text.

104. RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. c, illus. 7.

105. U.C.C. § 2-708(1); RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. c, illus. 7. The specific numbers used in the illustration are the opportunity for the seller to resell the goods for \$9000, \$1000 less than the original contract price. RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. c, illus. 7.

incidental or consequential damages the probable transaction costs that would have been incurred to arrange a resale.<sup>106</sup>

Illustration 6 to section 350 applies the same principle demonstrated by illustration 5, that of allowing recovery of only the extra cost of a covering transaction when the buyer fails to cover, more broadly to a labor services contract that is outside the scope of the U.C.C.<sup>107</sup> That illustration, however, again deals with a breach by the seller in a narrow manner focusing only on the buyer's extra cost of cover that closely parallels illustration 5, and so also does not shed light on whether the probable transaction costs of covering for a buyer who chooses not to cover after a seller breach are recoverable.<sup>108</sup>

There are numerous additional illustrations provided for section 350,<sup>109</sup> but none of those illustrations address the transaction cost questions noted above, nor the more complicated situation of secondary mitigation efforts that are not undertaken. Indeed, neither those illustrations nor the reporter's note to section 350 provide any guidance regarding the situation presented by a buyer (or seller) of goods or services that, by entering into secondary mitigation financing arrangements, could have reasonably avoided the risk of further consequential damages.<sup>110</sup> Nor do these provisions address consequential damages resulting from cash shortfall problems caused by an excessive cost of covering (or for a seller, by inadequate resale proceeds), after a breach, by obtaining alternative financing of the shortfall as a secondary mitigation measure.<sup>111</sup> Clearly a person who fails to arrange for such financing should then be denied those avoidable consequential damages if any of those risks come to fruition. But is that person then entitled to offset the probable costs of such financing arrangements from this reduction in damages, or even recover those probable financing costs if no consequential damages later eventuate? The issue here at common

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106. RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. c, illus. 7.

107. *Id.* § 350 illus. 5–6. The specific numbers used in that illustration are that a substitute employee could be hired by the buyer of services for \$11,000, \$1000 more than the contract price, and that by failing to do so, the buyer's "crop is lost." *Id.* § 350 illus. 6. The reporter's note to section 350 of the *Restatement (Second) of Contracts* claims that illustration 6 is "based on" illustration 1 of the Comment to section 336 of the *Restatement (First) of Contracts*. *Id.* § 350 reporter's note. There is indeed some similarity between the two illustrations, but the earlier illustration in fact addresses only the matter of the denial of avoidable consequential damages, and does not specifically address the narrower question here being considered of the recoverability of probable mitigation expenses that were not actually incurred by the injured party. *Id.* § 350 illus. 6.

108. *Id.* § 350 illus. 6.

109. There are a total of twenty-three illustrations provided to that section. *Id.* § 350 cmts. b–h, illus. 1–23.

110. *Id.*; *id.* reporter's note.

111. *Id.*

law is not complicated by the U.C.C.'s hazy distinction between "incidental" and "consequential" damages, or by its restrictive definition of "incidental" damages.<sup>112</sup> As a result these probable financing costs may potentially be recoverable even if regarded as consequential damages. But there is still no clear guidance provided by the *Restatement (Second) of Contracts* on this question.

For the reasons discussed above in the U.C.C. Article 2 context,<sup>113</sup> courts at common law are also not likely to be unduly troubled by the minor uncertainty presented by estimates of the probable costs of secondary mitigation financing efforts, given the relative precision with which such short-term financing costs can generally be established.<sup>114</sup> However, the existence of any applicable prejudgment interest statutes will present the same issues discussed above in the U.C.C. Article 2 context as to the possibility of duplicative recoveries, both in instances where secondary mitigation financing measures are undertaken and when they are not.

## V. CONCLUSION

This Article has considered whether a person that fails to make reasonable efforts to mitigate damages after a breach of contract will still be able to offset against the reduction in her damages for failure to mitigate the probable cost of those mitigation efforts that were not undertaken. I first considered whether as a matter of policy such an offset should be allowed so as to prevent both an undeserved windfall damages reduction for the breacher, and undercompensation of the injured party, given the potential difficulties allowance of such an offset would create.<sup>115</sup> I then considered the current law applicable to this question, first with regard to sale of goods contracts governed by U.C.C. Article 2,<sup>116</sup> and then with regard to other contracts governed primarily by general common law principles as articulated in the *Restatement (Second) of Contracts*.<sup>117</sup>

In my analysis I have drawn what I hope to be a useful distinction between "primary" efforts to directly mitigate the damages resulting from a contract breach, and "secondary" financing-type mitigation efforts intended to avoid the risk of further consequential losses that may

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112. See U.C.C. § 2-715 (AM. LAW INST. & UNIF. LAW COMM'N 2017).

113. See *supra* text accompanying notes 57-58.

114. See *supra* text accompanying notes 57-58.

115. See *supra* Part I.

116. See *supra* Part III.

117. See *supra* Part IV.

result from the cash shortfall caused by the remaining, non-avoidable losses until they are reimbursed.<sup>118</sup> I have also considered the possible significance of the presence of applicable prejudgment interest statutes for this question.<sup>119</sup>

I noted at the outset of this Article that I believe that on both fairness and efficiency grounds the probable costs of either primary or secondary mitigation efforts that are not undertaken by the injured person should still as a matter of policy be recoverable as an offset against any reduction in damages for failure to mitigate.<sup>120</sup> The policy arguments against allowing such recovery concededly have some force, but I do not regard them as sufficient to justify denying that recovery. As a matter of law, there is some textual basis in the U.C.C. for allowing recovery of the probable costs associated with both primary and secondary mitigation efforts that are not undertaken, at least with respect to buyer's consequential damages.<sup>121</sup> I have concluded, however, that beyond this circumstance both the U.C.C. and common law are unclear as to whether recovery of probable mitigation costs that were not actually expended should be allowed, particularly with regard to secondary mitigation efforts that are not undertaken.<sup>122</sup> There does appear to be somewhat more latitude for courts allowing such recoveries in cases governed by common law principles when they are not working under the strictures of U.C.C. Article 2.

Given the balance of policies that I have discussed, courts applying the U.C.C. or common law principles should in my opinion allow a person who fails to reasonably mitigate damages to recover the probable costs of those mitigation efforts even though those costs were not incurred. I would hope that the courts could find a plausible rationale consistent with applicable statutes and other law that would both clarify this issue and enable them to reach the result that I favor, allowing a person to recover the probable costs of mitigation efforts even if those costs are not incurred.

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118. *See supra* Part II.A.

119. *See supra* Parts II.B, III.A.2.

120. *See supra* Part I.

121. *See supra* note 46 and accompanying text.

122. *See supra* Parts III.B–IV.