UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

NEW ENGLAND DAIRIES, INC.,	:	
	:	
Plaintiff,	:	
	:	
v.	:	Civil Action No. 3:97CV894(CFD)
	:	
DAIRY MART CONVENIENCE STORES, INC. and DAIRY MART, INC.,	:	
	:	
Defendants.	:	

MEMORANDUM OF DECISION

I. Introduction

The plaintiff, New England Dairies, Inc. ("NED") brings this action against defendants Dairy Mart Convenience Stores, Inc. and Dairy Mart, Inc. for breach of a contract whereby Dairy Mart agreed to purchase certain dairy products produced and distributed by NED. The plaintiff maintains that it is a lost volume seller entitled to lost profit damages under Conn. Gen. Stat. § 42a-2-708(2), which incorporates § 2-708(2) of the Uniform Commercial Code ("UCC"). NED also requests reasonable attorney's fees as provided by the contract. Dairy Mart denies that it breached the contract, and disputes NED's status as a lost volume seller, as well as its calculation of damages.

II. Liability for Breach of Contract

A. Findings of Fact

The Court finds the following facts with respect to NED's claim that the defendants breached the contract at issue:

1. Background

At all times relevant to this dispute, NED was a Connecticut corporation in the business of producing and distributing milk and other dairy products to retail stores and institutions.[1] It was headquartered in Hartford, Connecticut. Frank Starvel ("Starvel") was the chief executive officer of NED. Starvel also was the majority controlling shareholder until the December 1997 sale of all of NED's stock to Mid America Dairymen, an entity that later became Dairy Farmers of America.

Dairy Mart, Inc. is a wholly owned subsidiary of Dairy Mart Convenience Stores, Inc. (collectively, "Dairy Mart"). Dairy Mart currently operates a chain of retail convenience stores in Ohio, Kentucky, Michigan, Pennsylvania, Indiana, North Carolina, and Tennessee. Until June 1997, Dairy Mart also had a New England Division consisting of at least 161 stores in Connecticut, Massachusetts, Rhode Island, and parts of New York.

2. Prior negotiations

In 1995, Dairy Mart owned and operated a dairy processing plant in Enfield, Connecticut, where its headquarters also was located. The plant produced and supplied the dairy products required by the stores in Dairy Mart's New England Division. In early 1995, however, Dairy Mart was exploring the possibility of closing the plant, selling the

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[1]In January 1999, New England Dairies, Inc. became New England Dairies, LLC, a Delaware limited liability company. Defendant Dairy Mart Convenience Stores, Inc. also is a Delaware company. At the time the suit was filed, however, NED was a Connecticut corporation and was diverse from both defendants. Therefore, the Court has diversity jurisdiction over this dispute, as diversity jurisdiction is evaluated at the time a suit is filed and is not generally affected by subsequent changes in citizenship. See In re Agent Orange Prod. Liability Litig., 818 F.2d 145, 163 (2d Cir. 1987), cert. denied, 484 U.S. 1004 (1987).

plant's assets, and contracting with an outside vendor to supply the New England Division stores. NED submitted a written proposal to Dairy Mart for NED to supply the stores. At or about the time NED made its written proposal, it communicated to Dairy Mart's Jeff Leedy ("Leedy") that it wanted any resulting contract to be assumed by any prospective buyer of Dairy Mart's New England division stores. Leedy transmitted the proposal to Robert Stein ("Stein"), who was the president of Dairy Mart at the time, along with a handwritten analysis of its terms. His analysis included a statement indicating that NED wanted the "contract to be assumed by a prospective buyer." (Pl.'s Ex. 2.) The proposed pricing and terms were attractive to Dairy Mart, and the parties began negotiating a formal supply agreement.

Dairy Mart's Vice-President and Corporate Counsel, Gregory Wozniak, prepared the first two drafts of the agreement, transmitting them on March 28, 1995 and March 31, 1995 to Joseph E. Silverman ("Silverman"), NED's outside general counsel. Each of these drafts contained a provision requiring Dairy Mart to purchase from NED all of its New England division stores' requirements for specified products at specified prices until the last day of April 2000. (Pl.'s Exs. 4 & 5.) The drafts also contained a provision stating that Dairy Mart's purchase obligation would cease if it no longer operated its New England division stores. (Id.) Finally, the drafts included an assignment clause that provided: "This agreement may not be assigned by either party without the express written consent of the other party, such consent not to be unreasonably withheld." (Id.)

Wozniak's draft was not acceptable to NED for, among other reasons, NED wanted assignment and assumption to be mandatory in the event that Dairy Mart sold the stores in its New England division. Walter "Dub" Garlington ("Garlington"), who was

NED's president at the time, sent a letter to Silverman dated March 27, 1995, that outlined several of his thoughts concerning the Dairy Mart agreement. (Pl.'s Ex. 3.) He wrote: "NED and Dairy Mart need protection for either party selling out so that the new owner assumes this agreement or has the right to buy out the affected party . . . assignability?" (Id.) Silverman rewrote several of the provisions of the Wozniak drafts. For example, his draft expressed the terms of the contract in volume rather than time, and he also included a different assignment clause, which read:

> This agreement may not be assigned or transferred by either party without the written consent of the other party, excepting only as part of the sale or transfer of all or substantially all of the business to which this Agreement relates, in which case any such sale or transfer shall be made specifically subject to the assignee's or transferee's assumption of this Agreement.

(Pl.'s Ex. 6.) The draft retained the provision that called for Dairy Mart's obligation to cease if it no longer operated the New England division stores. On April 6, 1995, a representative of Silverman's office sent a copy of this revised draft to Dairy Mart.

The following day, the parties discussed this clause during a conference call in which Silverman, an associate at his firm, Garlington, Stein, and Wozniak participated. The issue, however, was not resolved at that time.

At some point during the negotiations, Garlington and Stein had at least one conversation with respect to assignability of the agreement and whether NED would agree to a buyout provision as an alternative to the proposed assignment clause.

3. <u>The Agreement</u>

The "Agreement to Supply Requirements" (the "Agreement") was executed on April 25, 1995. (Pl.'s Ex. 10.) The parties also executed an asset purchase agreement that is not at issue in this case.

In Section 1 of the Agreement, Dairy Mart agreed to cause the stores it operated (defined as the stores Dairy Mart operated rather than the stores it franchised) in Massachusetts, Rhode Island, Connecticut, and New York to purchase their dairy requirements from NED for the term of the Agreement. (Id. ¶¶1, 1a.) Specifically, Dairy Mart stores were required to purchase certain products set forth in Exhibit B exclusively from NED at prices specified in Exhibit A of the Agreement until the volume of Exhibit B product reached 24,700,000 gallons and gallon equivalents. (Id. ¶¶ 1a, 3, 11.) According to Carl Herbein, a certified public accountant and plaintiff's expert, it would take approximately five years for this level of volume to be reached. NED was permitted to adjust the Exhibit A prices, which were different for stores located in New York and stores located in New England, for several reasons, including fluctuations in the price of raw milk according to the Federal Milk Order and fluctuations in price for other raw materials. (Id. ¶¶ 3a-b.) The Agreement also required NED to notify Dairy Mart of any such changes. (Id.)

NED also was obligated to make certain payments to Dairy Mart. First, NED was required to make payments to Dairy Mart totaling $2 million "[a]s an inducement for Dairy Mart to enter into this Agreement with NED to be the exclusive supplier to the Stores of the Products." (Id. ¶ 4.) The initial payment was made at the onset of NED's service to Dairy Mart. The remaining four payments of $400,000 each were to be made as Dairy Mart's purchases from NED attained increments of 4,940,000 gallons. (Id. ¶¶ 4a-b.) According to Mr. Herbein, this would have occurred approximately once a year. Second, NED was obligated to make certain payments to Dairy Mart based on the number of points purchased by Dairy Mart. This discount or rebate was 1.25 cents per point purchased in New York and 1.75 cents per point purchased in New England. (Id. ¶ 4c.)

In addition, paragraph 1a of the Agreement called for Dairy Mart's purchase obligation to cease if it no longer operated its New England division stores. Paragraph 1b obligated Dairy Mart to purchase its dairy requirements from NED with respect to any new stores added to the New England division.

The Agreement states that it "constitutes the entire agreement of the parties, whether written or oral, express or implied." (Id. ¶ 24).

Perhaps most significantly for this litigation, the Agreement contained the assignment clause drafted by Silverman. (Id. ¶ 18.)

4. The breach

The parties operated under the terms of the Agreement from May 1995 through June 20, 1997. NED had to expand its service territory to supply the Dairy Mart stores. According to NED's 1997 customer list, approximately 44 were located in Connecticut, approximately 61 were located in Massachusetts, approximately 40 were located in New York, and approximately 16 were located in Rhode Island.

In late February or early March 1997, NED began hearing rumors that Dairy Mart was planning to sell its New England division stores to DB Marketing Company, Inc. ("DB"), a Providence, Rhode Island-based convenience store operator. On March 6, 1997, Richard Toth ("Toth"), NED's president at the time, telephoned Stein to determine whether the rumor was true. Stein returned the call and confirmed it. On March 10, 1997, Toth wrote to Stein, thanking him for notifying him of the pending sale, confirming his statement as to an expected 1997 closing and asking him for assurances that the supply Agreement would be assigned to DB as part of the sale. On March 14, 1997, Toth twice discussed the assignment clause and the impending sale to DB with Dairy Mart's Leedy, who told him that he believed that the supply Agreement would have to "go to" to DB as part of the sale, and he later confirmed that Wozniak agreed with this interpretation. (Pl's Ex. 12.)

In March 1997, DB and Dairy Mart entered into a purchase and sale agreement for DB to acquire the 156 stores in Dairy Mart's New England division. At that time, DB had about 60 convenience stores: half were in Rhode Island and southern Massachusetts and the rest were in the greater Hartford area. DB's dairy supplier in March 1997 was a milk producer known as Nature's Best. In connection with that transaction, DB reviewed all of Dairy Mart's vendor contracts and was interested in the possibility of contracting with some or all of Dairy Mart's vendors. Dairy Mart asked DB if it would be willing to talk with NED about the possibility of doing business with NED following the acquisition of the Dairy Mart stores. Dairy Mart told DB that NED was a good supplier and suggested that the transition of the 156 stores from Dairy Mart to DB would be facilitated if DB stayed with Dairy Mart's supplier.

On March 25, 1997, NED's counsel sent a letter to Stein seeking prompt written assurance that the sale to DB would not go forward unless the Agreement was assigned to DB. Following this letter, Leedy and Toth had a telephone conversation regarding possible assignment. In this conversation, Leedy told Toth that Dairy Mart was working to get DB to assign the contract. Toth told Leedy that he had not yet received formal recognition by Dairy Mart that the contract had to be assigned to DB for there to be a sale to DB, and Toth said that NED still needed such assurance. NED's counsel sent a similar letter on April 10, 1997 to Wozniak. Representatives from DB and NED met in mid-April regarding the possibility of NED supplying the dairy products for the DB stores.

On April 17, 1997, NED sued Dairy Mart for anticipatory breach of contract. On that day, Starvel called Stein to tell him of the litigation. According to his memorandum of that day, Stein told Starvel that it had been his intention all along that the Agreement would be assigned, but that he wanted DB to do it on their own volition rather than being forced. (Pl.'s Ex. 14.) Stein maintains that he merely expressed to Starvel that he would assist NED in entering into an agreement with DB to supply its dairy requirements. Representatives from DB and NED met again in mid-May 1997, but no agreement ever was reached.

DB completed its acquisition of the Dairy mart stores on June 20, 1997. DB did not assume the Agreement.

B. Conclusions of Law

Pursuant to paragraph 19, the Agreement will be interpreted under Connecticut law.

The provision of the Agreement principally at issue is the assignment clause, paragraph 18. Dairy Mart does not dispute that the sale of its stores to DB was completed without DB assuming the contract with NED, but maintains that its failure to insist on assumption did not constitute a breach. Thus, a determination of whether Dairy Mart breached the contract will depend on the interpretation of the assignment clause in light of the other provisions of the contract, as well as evidence of the circumstances surrounding the Agreement. NED essentially argues that the clause required Dairy Mart to condition any sale of its stores on an assignment of the contract to the purchaser and on the purchaser's assumption of Dairy Mart's obligations under the contract. Dairy Mart maintains that the assignment clause was not mandatory and that it did not require Dairy Mart to insist on assignment and assumption of the contract in the event that it sold its stores serviced by NED.

A contract is to be interpreted as a whole, with all relevant provisions to be considered together, and it must be construed to effectuate the intent of the contracting parties. Barnard v. Barnard, 570 A.2d 690, 696 (Conn. 1990).

> In ascertaining intent, we consider not only the language used in the contract but also the circumstances surrounding the making of the contract, the motives of the parties and the purposes which they sought to accomplish. . . . The intention of the parties to a contract is to be determined from the language used in light of the situation of the parties and the circumstances connected with the transaction. The question is not what intention existed in the minds of the parties but what intention is expressed in the language used. . . . This is so where the parties have their agreement in writing . . . In interpreting contract items, we have repeatedly stated that the intent of the parties is to be ascertained by a fair and reasonable construction of the written words and that the language used must be accorded its common, natural, and ordinary meaning and usage where it can be sensibly applied to the subject matter of the contract.

Id. (citations and quotations omitted). "A contract is ambiguous under Connecticut law if its meaning regarding the point at issue is not clear simply from reading it, and a trier of fact interpreting the document is thus forced to choose between two or more possible meanings." Travelers Indem. Co. v. Scor Reinsurance Co., 62 F.3d 74, 78 (2d Cir. 1995).

Here, the assignment clause at issue is ambiguous because it has at least two possible meanings. The clause states:

> This agreement may not be assigned or transferred by either party without the written consent of the other party, excepting only as part of the sale or transfer of all or substantially all of the business to which this Agreement relates, in which case any such sale or transfer shall be made specifically subject to the assignee's or transferee's assumption of this Agreement.

The first phrase, "This Agreement may not be assigned or transferred by either party without the written consent of the other party," makes it clear that both parties are prevented from assigning their duties under the contract without the consent of the other party, and both NED and Dairy Mart appear to agree on this interpretation.

The parties' dispute appears to begin with the next phrase: "excepting only as part of the sale or transfer of all or substantially all of the business to which this Agreement relates." Dairy Mart maintains that this phrase, which provides an exception to the general rule, is permissive. In other words, it maintains that it is missing a key word: that in the event of the sale of either of the parties' business, that party *may* (not *must*) assign the contract to the purchaser. However, another plausible interpretation of the phrase is that it *requires* that the party seeking to sell its business assign the contract to the purchaser, an interpretation that would have obligated Dairy Mart to assign the Agreement to DB.

Finally, the third phrase of the assignment clause describes the sale or transfer situation: "in which case any such sale or transfer shall be made specifically subject to the assignee's or transferee's assumption of the Agreement." NED focuses on this clause, arguing that it indicates that if a sale should occur, the seller would have a duty to make the sale specifically subject to the assignee's assumption of the Agreement, and that failure to do so would result in a breach. This interpretation is plausible, given that "[i]n the absence of an express contract provision, an assignee is not required to assume the original responsibilities of the assignor." ICC Performance 2 Ltd. P'ship v. Pollack, No. CV 94313596, 1997 WL 200795, at *2 (Conn. Super. Ct. Apr. 16, 1997) (quotation and citation omitted); see also Lachmar v. Trunkline LNG Co., 752 F.2d 8, 9-10 (2d Cir. 1985) (stating that under New York law "the assignee of rights under a bilateral contract is not bound to perform the assignor's duties under the contract unless he expressly assumes to do so"). Thus, NED would not receive full protection from a clause that required only assignment; such a clause would permit the assignee to choose not to assume Dairy Mart's duties under the Agreement and thus the assignment clause would be useless to NED. In contrast, Dairy Mart maintains while assumption may be mandatory if a party chooses to assign the contract in the event of a sale, it was not required to insist that DB assume the contract since it did not choose to assign it as part of the sale. Thus, there are two possible interpretations of this provision, rendering it ambiguous.

This ambiguity is not entirely resolved when the assignment clause is considered in conjunction with the other provisions of the Agreement, as well as the circumstances surrounding the contract and the motivations of the parties. The agreement made NED the exclusive supplier of dairy products for Dairy Mart, and NED understandably was motivated to protect its exclusive rights in the event that Dairy Mart sold its stores. Further, the Agreement was a large undertaking for NED. It required that NED supply dairy products for a fairly long period of time, and it makes sense that NED would want its commitment to continue for the life of the contract, given the preparation the contract required, such as the addition of additional delivery routes. At the same time, Dairy Mart's motivation may also be inferred from the circumstances. It was closing its dairy processing plants, consolidating its operations, and it is possible that it was anticipating a future sale. Agreeing to a contract with NED that made assignment and assumption by a potential purchaser mandatory may have inhibited such a transaction from occurring.

Dairy Mart argues that the contract as a whole—and in particular paragraph 1a—supports its construction. That paragraph provides that Dairy Mart's undertaking to purchase its dairy requirements from NED extended only "so long as [the Stores] continue to be operated by Dairy Mart and/or its subsidiaries." Dairy Mart maintains that this provision indicates that the assignment clause was permissive because it encompasses both possible scenarios: if it chose to assign the contract and when it chose not to assign the contract. In other words, if Dairy Mart elected not to assign the Agreement to the purchaser of the stores, then it would be under no further obligation to NED because it no longer owned the stores. Similarly, if it elected to make the Agreement a part of any such sale, it would assign the Agreement to its purchaser and be obligated to cause its purchaser to assume the Agreement (and, presumably, its own obligation would cease). However, this provision also is consistent with NED's interpretation. Assuming that assignment was mandatory, if the stores were no longer operated by Dairy Mart, the contract would have been assigned to a different company and that company would have assumed Dairy Mart's obligations. The fact that paragraph 1a states that Dairy Mart's obligations would cease under those circumstances is consistent with mandatory assumption.

Given this ambiguity and the fact that the Agreement was an integrated contract, <u>see</u> ¶ 24, the Court may look to extrinsic evidence to aid in interpretation of the assignment clause. <u>Associated Catalog Merchandisers, Inc. v. Chagnon</u>, 557 A.2d 525, 529 (Conn. 1989). "Although the parol evidence rule prohibits the introduction of evidence that varies or contradicts an exclusive written agreement; . . . that rule does not bar the use of extrinsic evidence to aid in the interpretation of contractual language." <u>Hare v. McClellan</u>, 662 A.2d 1242, 1251 (Conn. 1995) (quotations and citations omitted); <u>see also</u> <u>Scinto v. Sosin</u>, 721 A,2d 552, 563 (Conn. App. Ct. 1998) (stating that the rule "does not prevent the introduction to evidence to show the facts and circumstances existing at the time of the execution" (quotation omitted)); Travelers Indem. Co., 62 F.2d at 78. Thus, a court may admit extrinsic evidence to interpret ambiguous provisions of contracts, among other reasons. HLO Land Ownership Assocs. Ltd. P'Ship. v. City of Hartford, 727 A.2d 1260, 1265 (Conn. 1999) (citing Jay Realty, Inc. v. Ahearn Dev. Corp., 453 A.2d 771, 773 (Conn. 1983)); Hare, 662 A.2d at 1251.[2] As part of its examination of extrinsic evidence, courts may look to the parties' actions and declarations subsequent to the agreement. See Hydro-Hercules Corp. v. Gary Excavating, Inc., 353 A.2d 714, 718 (Conn. 1974); 29A Am. Jur. 2d Evidence § 1141 (1994). However, the evidence must be relevant to the interpretation of the ambiguous provision. Travelers Indem. Co., 62 F.3d at 78.

During negotiations, NED's insistence on a mandatory assignment/assumption clause was made known to Dairy Mart on several occasions: its communication to Leedy prior to the first draft of any agreement that it would require such a clause; the discussion of the change in the assumption clause in the Silverman draft during the telephone conference call; and in the conversation between Garlington and Stein. The evidence revealed that Dairy Mart crafted the initial drafts and that these requirements imposed no mandatory assumption requirement. NED noticed the rejection of its insistence on the mandatory clause and responded accordingly. Conversely, Dairy Mart objected to the revised assignment clause but nevertheless signed the Agreement. Thus, even if Dairy

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The defendants' argument is centered around their assertion that paragraph 18 is missing a term. While the Court instead views this provision as ambiguous, parol evidence also is admissible "to add a missing term in a writing which indicates on its face that it does not set forth the complete agreement." Jay Realty, Inc., 453 A.2d at 773.

Mart was unclear of the meaning of the assumption clause in the Silverman draft, it had been notified of NED's intention in drafting it and the mandatory nature of the clause. Further, if the clause were intended to be permissive, NED would lack a motivation for insisting on its conclusion. Thus, Dairy Mart was aware that assignment was mandatory, and that it should have insisted that DB assume the contract.

In addition, there are Dairy Mart's admissions during the time when it was working to persuade DB to assume the contract, and in particular, the admission of Leedy and through Leedy, the admission of Wozniak, its general counsel at the time. In conversations with NED's Toth, Leedy admitted that paragraph 18 obligated Dairy Mart to make its sale to DB subject to DB's assumption of NED's contract and that he was not the only one who understood this, that Wozniak had told him that this was his understanding as well.

Accordingly, based upon the language of paragraph 18, interpreted in light of the contract as a whole, the circumstances in which it was made, and the extrinsic evidence of the parties intent, the Court concludes that assignment to DB and assumption by DB was mandatory.[3] Therefore, by failing to insist on such terms in its contract with DB, Dairy

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It should be noted that the Court is mindful of the rule of contract interpretation providing that ambiguous provisions shall be construed against the drafter. Rund v. Melillo, 772 A.2d 774, 778 (Conn. App. Ct. 2001). However,

> [T]he rule that expressions will be interpreted against the party selecting and using them applies only where, after the ordinary rules of construction have been applied, the agreement is still ambiguous. The rule does not justify the taking or adopting of an isolated clause in dispute without examining the entire contract, the relations of the parties, their intention, and the circumstances under which they executed the contract.

17A Am. Jur. 2d Contracts § 348 (1991).

Mart breached the Agreement with NED.

III. Damages

A. Findings of Fact

The Court makes the additional following findings of fact with respect to damages.[4]

1. Gross margin

Dairy Mart's breach caused NED to lose the Dairy Mart business and the profits that business would have generated. NED's gross margin (or, in other words, gross profit) for each product sold to Dairy Mart is equal to the price of each product multiplied by the volume of the product supplied, minus standard cost of producing the product. This calculation is somewhat complicated given the variation in prices and volume under the Agreement.

The prices for NED products under the Agreement were variable, as NED was required to adjust its pricing as costs for certain raw materials fluctuated. (Pl.'s Ex. 10, ¶¶ 3a-b.) Products also were priced differently depending on whether they were to be supplied to Dairy Mart's New York or New England stores. (Id. at Exh. A.) At the time of the breach, June 1997 prices were in effect.

The composition of the products purchased by Dairy Mart, and thus the volume of the products, varied monthly because demand for dairy products is seasonal. The Agreement expressed volume in terms of "points." One point is equal to one quart. 1996 was the only full year in which the contract was performed.

[4] Certain of the findings of fact set forth in the previous section also apply to the calculation of damages.

Standard costs are target costs established by the company for each type of product produced by ND. The standard cost for each product included the cost of the container, the cost of the ingredients, and the costs of the raw materials that are included in the product. At the time of the breach, June 1997 standard costs for NED products were in effect.

In 1996–the only full year under the Agreement–the total gross margin for all Dairy Mart products was $2,852,019.[5] Subtracting the value of the .2% of products sold to Dairy Mart but returned because they were damaged–$18,671–yields a figure of $2,833,348.

2. Variable costs

Variable costs attributable to the Dairy Mart business included certain production and distribution expenses, as well as the overtime paid to employees in all of NED's departments.

As to production-related variable costs, 20.51% of such expenses is attributable to Dairy Mart because the Dairy Mart business required 20.51% of NED's production capacity. There are two exceptions to this calculation. The Dairy Mart business required the addition of two new employees: one in the production department (representing a 3% increase in that department), and one in the maintenance department (representing a 17% increase in that department). In addition, all overtime paid to employees in the production, maintenance, and laboratory departments is attributable to the Dairy Mart business. This is because NED generally compensated for the addition of the Dairy Mart business by requesting that existing employees work additional hours rather than by hiring

[5]The Court again notes that June 1997 prices are used here.

new employees. Thus, one hundred percent of the costs associated with the addition of the new employees and the overtime paid to employees is attributable to the Dairy Mart business. NED's total yearly production expenses, including Dairy Mart payroll and benefits and all overtime expenses, based on June 1997 prices were $827,508. Total yearly production expenses attributable to Dairy Mart alone (including one hundred percent of Dairy Mart payroll and benefits and all overtime expenses, and 20.51% of all other production expenses) were $436,140.

As to distribution-related variable costs, 20.51% of such expenses is attributable to Dairy Mart because the Dairy Mart business required 20.51% of NED's production capacity. Again, there are two exceptions to this calculation. The Dairy Mart business required the addition of six employees: three in the delivery department (representing an increase of 7%), and three in the shipping department (representing an increase of 10%). In addition, all overtime paid to employees to in the delivery and shipping departments is attributable to the Dairy Mart business, as NED generally compensated for the addition of the Dairy Mart business by requesting that existing employees work additional hours rather than by hiring new employees. Total yearly production expenses, including Dairy Mart payroll and benefits and all overtime expenses, based on June 1997 prices were $2,516,374. Total yearly distribution expenses attributable to Dairy Mart alone (including one hundred percent of Dairy Mart payroll and benefits and all overtime expenses, and 20.51% of all other distribution expenses) were $924,001.

In addition, the overtime costs of $9,842 incurred in the shipping, accounting, and data processing departments are attributable to the Dairy Mart business.

3. <u>Other costs and expenses attributable to Dairy Mart</u>

Under paragraph 4c of the Agreement, NED was obligated to make certain discount payments to Dairy Mart. For the products that would have been delivered over the lifetime of the Agreement, or approximately 39 months based upon the number of points typically purchased in a year, would have totaled $877,562, or $270,019 a year.

NED also was obligated to make certain incentive payments of $400,000 pursuant to paragraph 4 of the Agreement. These payments would have been made approximately on an annual basis.

4. Incidental damages

NED leased certain delivery vehicles to service the Dairy Mart business. When Dairy Mart breached the Agreement, those vehicles were idle for a certain amount of time before they were returned to Edart, the company from which they were leased.

NED laid off eight individuals as a result of the loss of the Dairy Mart business.

NED continued to service some of the Dairy Mart franchise stores even after the loss of the Dairy Mart business. Annually, NED retained sales to the former Dairy Mart franchise stores, now owned by DB, in the amount of 1,360,750 points. This was 7.91% of NED's Dairy Mart business. NED had a certain amount of Dairy Mart labeling and packaging materials on hand at the time of the breach.

5. Calculations

Gross Dairy Mart margin, minus the costs and expenses outlined above yields a yearly Dairy Mart lost profit of $1,463,565. When 7.91% of this figure (or $115,768) is subtracted for the amount of Dairy Mart business that NED retained, $400,000 for the yearly incentive payments, and $270,019 for discount payments, NED's yearly lost profit is $677,778.

6. Production capacity

With the addition of the Dairy Mart business, NED was operating at 97-98% of its capacity. In approximately July 1995, NED lost the business of a Long Island dairy distributor known as Terrace Dairy ("Terrace"), and NED's plant utilization dropped to 83-84%, where it remained until June 1997. Immediately following the breach, NED's production capacity was 66-67%.

However, NED acquired two substantial pieces of business in the second half of 1998. The first business was Terrace, a company that had previously been a customer of NED. In a transaction that closed on June 30, 1998, NED acquired a 44% interest in Terrace. At the same time, NED and Terrace entered into a long-term supply agreement whereby NED supplied Terrace's dairy requirements. NED's owner, DFA, financed the $1.5 million acquisition. The annual volume of the Terrace Dairy business was approximately 14 million points. The Terrace business used 16-17% of NED's production capacity, and raised NED's plant utilization to approximately 82%. Terrace produced annual sales for NED in the amount of $6.5 million. NED's gross margin reports indicated that NED was making an annual profit on the Terrace Business of approximately $700,000.

In 1998, NED also acquired Meola Dairy ("Meola"), a small dairy in Worcester, Massachusetts. The acquisition of Meola closed on September 30, 1998. Meola's annual sales volume was $5 to $6 million. The Meola business was profitable to NED, but not as profitable as the Terrace business. After the acquisition, NED closed Meola's plant and moved the business to the NED plant in Hartford. NED gradually introduced this volume into its plant, and by the end of November 1998 the Meola plant was closed and all the

Meola business was being serviced out of NED's Hartford plant. The Meola business added 18 million points of production to NED's plant. Servicing this new business required 15% of NED's production capacity. With the additions of Terrace and Meola, and the consolidation of the Meola business into NED, by the end of November 1998 NED was operating at approximately 97% capacity.

Lost profits until November 1998 (or for 17 months of the Agreement), when NED could no longer be considered a lost volume seller, equal $960,194.

B. Conclusions of Law

The parties in this case have stipulated that damages are governed by UCC § 2-708. Dairy Mart, however, argues that NED is not entitled to lost profits as a measure of damages because it did not first show that the damages method under Section 2-708(1) is inadequate.

1. Lost volume seller

Section 42a-2-708 of the Connecticut General Statutes provides:

> (1) Subject to subsection (2) and to the provisions of section 42a-2-723 with respect to proof of market price, the measure of damages for non-acceptance or repudiation by the buyer is the difference between market prices at the time and place for tender and the unpaid contract price together with any incidental damages provided in section 42a-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 section 42a-2-710, due allowance for cost reasonably incurred and due credit for payments or proceeds of resale.[6]

[6] The phrase, "and due credit for payments or proceeds of resale," has been held not to apply to lost volume sellers. Trienco, Inc. v. Applied Theory, Inc., 794 P.2d 1239, 1241 (Or. Ct. App. 1990); Van Ness Motors, Inc. v. Vikram, 535 A.2d 510, 511 (N.J. Super. Ct. App. Div. 1987); Snyder v. Herbert Greenbaum & Assoc.,

Conn. Gen. Stat. § 42a-2-708. One of the categories of sellers entitled to damages under § 2-708(2) is the lost volume seller. 1 James J. White & Robert S. Summers, Uniform Commercial Code § 7-9 (4th ed.). "A lost volume seller is one who has the capacity to perform the contract which was breached as well as other potential contracts, due to their unlimited resources or production capacity." Bill's Coal Co. v. Board of Public Utils., 887 F.2d 242, 245 (10th Cir. 1989); see also Nederlandse Draadindustrie NDI B.V. v. Grand Pre-Stressed Corp., 466 F. Supp. 846, 854 (E.D.N.Y. 1979) (commenting that the plaintiff, a lost volume seller and manufacturer, had sufficient capacity to supply not only the materials required by the defendant under the contract at issue, but also additional materials that were sold to third-parties). "A lost volume seller can have two expectations, a profit from the breached contract and a profit from one or more other contracts that the seller can perform simultaneously with the breached contract." Gianetti v. Norwalk Hosp., 779 A.2d 847, 852 (Conn. App. Ct. 2001). Whether a plaintiff is a lost volume seller is a question of fact. Id.[7]

Here, NED has shown by a preponderance of the evidence that it is a lost volume seller. After Dairy Mart breached the Agreement and NED lost the Dairy Mart business, NED's production capacity was 66-67%. The Dairy Mart business had represented 20.51% of NED's production capacity. NED retained 7.91% of the Dairy Mart business in the form of franchise stores following the breach, which represents 1.62% of NED's total production capacity. Thus, NED actually lost 18.89% of its production capacity as a

Inc., 380 A.2d 618, 625-26 (Md. Ct. Spec. App. 1977).

[7]Although a plaintiff's lost volume seller status is a question of fact, the Court will discuss its reasoning in this section because its explanation of damages is dependent on its interpretation of several points of law.

result of the breach. Thus, while NED's production capacity was not, in a strict sense, unlimited, it did have the capacity to enter into other supply agreements even if Dairy Mart had not breached the Agreement at issue here: in the event Dairy Mart had not breached the contract, NED still would have had roughly 15% production capacity that it could have filled through other contracts. Thus, NED could have performed a second contract simultaneously with the Dairy Mart Agreement. In fact, the evidence showed that NED did enter into such a contract with Terrace and Meola, and that each of the contracts was profitable. See Gianetti, 779 A.2d at 852. Thus, NED is a lost volume seller under Section 2-708(2), and lost profits are the appropriate measure of damages in this case.

2. Time span during which NED is entitled to lost profits

When a seller has more orders than it can fill such that it could not have supplied a defendant buyer as well as an alternate buyer, it is not a lost volume seller. Ragen Corp. v. Kearney & Trecker Corp., 912 F.2d 619, 627-28 (3d Cir. 1990). For this reason, NED only can be considered a lost volume seller for a limited period of time: through November 1998, or for 17 months after the breach.

From a production standpoint, by the end of November 1998 NED had replaced the Dairy Mart business and more importantly, had used up nearly all of the excess capacity it had even while it was servicing the Dairy Mart stores. In 1996, the last full year that NED had the Dairy Mart business, NED produced 95,622,700 points of dairy products, 20.51% of which were for Dairy Mart. With the additions of the Terrace and Meola business in 1998—and even with the loss of two other accounts—NED anticipated that in 1999 it would sell 106,717,100 points of dairy products. As Mr. Toth testified, by the end of November 1997, NED was operating at 97% capacity. A necessary prerequisite for a manufacturer to be a lost volume seller is capacity sufficient to have performed two sales. Advanced Medical, Inc. v. Arden Medical Sys., Inc., 955 F.2d 188, 201 (3d Cir. 1992). Therefore, by the end of November 1998, NED lacked the capacity to service the Dairy Mart stores in addition to its existing business.

The evidence also shows that the Terrace and Meola accounts were profitable. NED's annual lost profit on the Dairy Mart business was $677,778, and thus the Terrace Business, with an annual profit of $700,000, did indeed replace the Dairy Mart business. Whatever profit NED made on the Meola business it could have made while servicing Dairy Mart, and the business from Terrace replaced in full the loss of the Dairy Mart business. Accordingly, NED is not entitled to lost profits after November 1998.

Accordingly, under U.C.C. § 2-708, NED's only recourse after November 1998 would be damages under § 2-708(1). However, NED failed to introduce any evidence with respect to the market price for its products in November 1998, and thus there is no evidence in the record from which the market-contract differential could be determined. NED failed to sustain its burden of proof with respect to its damages under 2-108(1) and it is therefore entitled to damages only through November 1998. An award of damages for the period after November 1998 would also not be appropriate because it would put NED in a better position than it would have been had Dairy Mart performed.

3. Calculation of lost profits

As to lost profits, they must be proved with reasonable certainty, Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin, 717 A.2d 724, 736 (Conn. 1998), and "mere uncertainty as to the amount of lost profits may be dispelled by the same degree of proof as is required in other civil actions, that is, the amount may be determined approximately upon reasonable inferences and estimates." Torosyan v. Boehringer Ingelheim Pharms., Inc., 662 A.2d 89, 105 (Conn. 1995) (quoting West Haven Sound Dev. Corp. v. West Haven, 514 A.2d 734, 742 (Conn. 1986)). They may be calculated by extrapolating from past profits, but a plaintiff cannot recover for the mere possibility of making a profit. Beverly Hills Concepts, 717 A.2d at 736. Further, a plaintiff's prior experience in the same business has been held to be probative of lost profits, "as has a plaintiff's experience in the same enterprise subsequent to the interference." Id. "[L]ack of prior profitability does not *necessarily* prohibit a trial court from awarding future lost profits, although it serves as a strong indicator that future profits are uncertain." Id. at 739.

"All the reported cases are in agreement that profit (including reasonable overhead) is the equivalent of net profit plus overhead, or of gross profit including overhead." Bead Chain Mfg. Co. v. Saxton Prods. Inc., 439 A.2d 314, 320 (Conn. 1981). "Net profit can be defined as the gross amount that would have been received pursuant to the business less the cost of running the business. . . . To determine the cost of operating a business, the factors of production must be analyzed. One important factor of production is labor." Gordon v. Indusco Mgmt. Corp., 320 A.2d 811, 819 (Conn. 1973). Damages for breach of contract are measured as of the date of the breach. Willow Springs Condo. Assoc., Inc. v. Seventh BRT Dev. Corp., 717 A.2d 77, 108 (Conn. 1998).

In support of its lost profit argument, NED relies upon the expert report of Mr. Herbein. The Court agrees that Mr. Herbein's report provides a basis for a proper damages calculation in this case, and in fact it is the source of many of the Court's conclusions regarding lost profits. Dairy Mart makes much of the fact that Mr. Herbein's analysis uses data from two different years: 1996 volume figures and 1997 prices. However, Mr. Herbein has provided a sound rationale for doing so. As explained above, demand for dairy products is seasonal, and thus an accurate picture of the volume of products supplied to Dairy Mart requires one to examine an entire year's output. Since 1996 is the only full year that the contract was performed, it was reasonable for Mr. Herbein to base his volume estimates on these figures. Similarly, it was reasonable for Mr. Herbein to use June 1997 prices, as damages are to be determined as of the date of the breach. Given that demand is, of course, affected in part by prices, it is possible that the use of figures from two different years could result in a certain lack of precision in the damages estimate. However, the Court finds that Mr. Herbein's method successfully estimates damages with reasonable certainty.

Nevertheless, some adjustments are necessary to Mr. Herbein's analysis. First, as explained above, NED is entitled to lost profit damages only through November 1998. Second, Mr. Herbein assumed that the overtime worked by NED employees was a fixed cost that should not reduce the profits that would have been earned by NED under the agreement. However, this overtime is properly characterized as a variable cost attributable to the Dairy Mart business. As Mr. Herbein testified, NED was able to absorb the Dairy Mart business in 1995 by taking on a disproportionately low number of new employees and asking its entire workforce to work overtime. Mr. Herbein, however, did not expense all of this overtime against the Dairy Mart gross margin in calculating NED's damages. Some of the overtime he did not attribute at all to the Dairy Mart business–that incurred in NED's Sales, Accounting and Data Processing departments. Then, only 20.51% of the overtime NED incurred in its Production, Maintenance, Laboratory, Shipping and Delivery departments was allocated against the Dairy Mart business. Accordingly, the variable expenses associated with the Diary Mart business must be increased by 79.49% of the overtime incurred in NED's Production, Maintenance, Laboratory, Shipping and Delivery departments and by any overtime that incurred in NED's Sales, Accounting and Data Processing Departments. Calculations of overtime expenses are set forth in the findings of fact.

The Court also does not agree with Mr. Herbein's estimates of incidental damages. Such damages are set forth in Conn. Gen. Stat. § 42a-2-710, which is equivalent to UCC § 2-710. It provides:

> 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.

Conn. Gen. Stat. § 42a-2-710.

The incidental expenses attributed by Mr. Herbein to the breach were not proper. First, NED claims that it is entitled to incidental damages in the amount of $215,440 relating to certain tractor and trailer leases with respect to delivery vehicles that were idled as a result of Dairy Mart's breach of the Agreement. There are two components to this amount as set forth in Mr. Herbein's expert report: $65,190 for lease payments and $150,250 for an early termination fee. Mr. Toth also testified that NED incurred some costs for the lease and termination fee. However, NED did not present any evidence indicating how long it continued to pay the truck leases or any evidence of the actual early termination fee. Thus, NED did not meet its burden of proof with respect to this category of incidental damages because it did not prove by a preponderance of the evidence that

NED actually incurred expenses in these amounts.

Second, NED claims that it is entitled to incidental damages in the amount of $32,541 for additional unemployment compensation paid as a result of Dairy Mart's breach of the Agreement. However, while it is clear that Dairy Mart laid off eight employees, there was no evidence regarding how long these employees collected unemployment compensation or the amount of unemployment compensation tax incurred as a result. Thus, NED did not meet its burden of proof with respect to these damages.

Third, NED claims that it is entitled to incidental damages in the amount of $15,067 with respect to certain Dairy Mart labeling and packaging material it had on hand at the time of the breach. At the time he prepared his analysis, Mr. Herbein was not aware that after the sale of the Dairy Mart stores, NED had continued to service certain Dairy Mart stores owned at the time by DB. Mr. Herbein admitted that if these labels and packaging materials were put to use for the Dairy Mart stores served by NED after June 20, 1997, then NED did not suffer the claimed incidental damage. Based on the evidence presented at trial, it is just as likely that these labels were subsequently used by NED as it is that they were not and, accordingly, NED did not meet its burden of proof with respect to this category of incidental damages.

Finally, the defendants argue that NED failed to mitigate damages. The defendants have the burden of proving that the plaintiff failed to mitigate its damages. Town of Newington v. General Sanitation Serv. Co., 491 A.2d 363, 366 (Conn. 1985). However, the doctrine of mitigation of damages is not applicable here. "The philosophical heart of the lost volume theory is that the seller would have generated a second sale irrespective of the buyer's breach. It follows that the lost volume seller cannot possibly mitigate damages. For this reason, the majority of both courts and commentators have recognized the illegitimacy of the mitigation argument." Gianetti, 779 A.2d at 852-53 (quotation omitted). In other words, "[t]he key to when plaintiffs can keep the monetary benefits of the contract, undiminished by the doctrine of mitigation of damages, lies in whether the plaintiffs could have and would have entered a second contract simultaneously with the breached contract, in which event, the second contract is not a substitute for the first." Id. at 852. Thus, while Dairy Mart argues that NED is not entitled to damages because it failed to mitigate its damages, this generally is not requirement for a lost volume seller in the sense of selling the rejected goods to others. Nevertheless, "the lost volume seller has the obligation to sell the goods under the original contract if the original buyer has found a substitute buyer." 4A Ronald A. Anderson, Uniform Commercial Code § 2-708(2):43 (1997). Here, however, DB cannot be considered a substitute buyer, as their acquiescence to the contract would have undoubtedly required a change in the terms of the contract, which NED was not required to do.

IV. Conclusion

As stated above, gross Dairy Mart margin (which equals the price of the products multiplied their volume minus their standard cost), minus the costs and expenses outlined above yields a yearly Dairy Mart lost profit of $1,463,565. When 7.91% of this figure is subtracted for the Dairy Mart franchise business that NED retained, as well as $400,000 for the yearly incentive payments, and the discount payments, NED's yearly lost profit is $677,778. Accordingly, given that NED is entitled to lost profit damages as a lost volume seller until November 1998, NED is awarded total damages of $960,194.

The parties have not addressed the issues of attorney's fees and statutory prejudgment interest under Conn. Gen. Stat. § 37-3a. Accordingly, the plaintiff may move in a post-judgment motion for an award of attorney's fees and/or interest, and the Court will consider any memoranda submitted by the parties on whether either is appropriate.

SO ORDERED this __4th__ day of February, 2002 at Hartford, Connecticut.

__________/s/____________
Christopher F. Droney
United States District Judge