

RENDERED: SEPTEMBER 8, 2006; 2:00 P.M.
NOT TO BE PUBLISHED

Commonwealth Of Kentucky
Court of Appeals

NO. 2005-CA-000628-MR
AND
NO. 2005-CA-000656-MR

SIDNEY COAL COMPANY, INC.

APPELLANT/CROSS-APPELLEE

v. APPEAL FROM HARLAN CIRCUIT COURT
HONORABLE RON JOHNSON, JUDGE
ACTION NO. 02-CI-00396

THRIFT BIT SERVICE, INC.

APPELLEE/CROSS-APPELLANT

OPINION
AFFIRMING IN PART,
REVERSING IN PART,
AND REMANDING

** ** * * *

BEFORE: COMBS, CHIEF JUDGE; TAYLOR, JUDGE; KNOPF,¹ SENIOR JUDGE.
KNOPF, SENIOR JUDGE: Sidney Coal Company, Inc. (Sidney) appeals
from a judgment by the Harlan Circuit Court awarding appellee
Thrift Bit Service, Inc. (Thrift Bit) damages in a contract
dispute. From September 1996 through May 2001, Thrift Bit sold
Sidney re-tipped drill bits pursuant to a series of short-term

¹ Senior Judge William L. Knopf sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

contracts. When Sidney did not enter into a new purchase contract with Thrift Bit after May 2001, Thrift Bit brought this action against Sidney for the value of unreturned bit bodies for re-tipping which had accumulated over the years they had done business.

The trial court awarded damages to Thrift Bit for the replacement cost of all of the unreturned bits except for those during the 1999 contract period. Sidney argues the trial court erred in interpreting the contracts between the parties and in awarding damages to Thrift Bit. Thrift Bit cross-appeals, arguing that the trial court erred by excluding the bit deficit for the 1999 contract period. We conclude that the trial court properly considered evidence of the parties' course of performance, course of dealing and the usage of trade to interpret the contract. However, we also find that Thrift Bit was only entitled to recover damages for the 2000 contract year. Hence, we affirm in part, reverse in part and remand for additional findings and entry of a new judgment.

This Court will not set aside a trial court's findings of fact unless they are clearly erroneous. CR 52.01. On the other hand, the construction and interpretation of a contract, including questions regarding ambiguity, are questions of law to be decided by the court. First Commonwealth Bank of Prestonsburg v. West, 55 S.W.3d 829, 835 (Ky.App. 2000).

Consequently, our review of such matters is *de novo*. Id. at 835-836.

Sidney first argues that the trial court erred by considering evidence of course of performance, course of dealing and usage of trade to supplement the contract. Sidney correctly points out that the first two contracts were silent on the issue of returning the used bit bodies. Furthermore, all of the contracts gave Sidney title to the drill bits. Sidney thus contends that the contract cannot reasonably be interpreted to require it to return used bit bodies which it owned.

While Sidney raises a valid point, we agree with the trial court that the express terms of all but the 1999 contract permitted resort to course of performance, course of dealing and usage of trade to interpret this contract. As the trial court noted, KRS 355.2-202 provides that a contract's terms *may be explained or supplemented* by course of dealing or usage of trade, or course of performance. Evidence of course of performance and usage of trade is inadmissible only if the agreement expressly excludes them in terms "carefully negating" their introduction. Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3 (4th Cir. 1971); D. Leibson & R. Nowka, The Uniform Commercial Code of Kentucky, 3d ed., § 2.02(2)(a).

Although the purchase agreements stated that they constituted the "complete and final agreement" of the parties,

they did not specifically exclude resort to course of performance or usage of trade. And while the contract professedly gives Sidney title to the drill bits, the contract does not discuss what was to be done afterward with the used bit bodies. Thrift Bit introduced substantial evidence showing the common usage of trade in the industry provides that the buyer generally returns used bit bodies for re-tipping. Moreover, the course of performance and dealing between these parties followed that practice. Therefore, the trial court properly considered such evidence to interpret the contracts. A&A Mechanical Inc. v. Thermal Equipment Sales, Inc., 998 S.W.2d 505, 509-10 (Ky.App. 1999).

Nevertheless, we conclude that Thrift Bit was not entitled to recover for all of the bit bodies which Sidney has failed to return since 1996. Thrift Bit and Sidney did business pursuant to five separate and discrete contracts. Thrift Bit's claim under the 1996 contract was untimely; it failed to mitigate its damages under the 1997 and 1998 contracts; and the 1999 contract expressly provided that Sidney would not be responsible for return of any bit bodies. Therefore, Thrift Bit is limited to its damages arising only under the 2000 contract.

First, we find that Thrift Bit's claim for damages arising from the 1996 contract is barred by the four-year statute of limitations set out in KRS 355.2-725. The trial

court concluded that Thrift Bit's cause of action did not accrue until April 1999, when Sidney challenged the language on the bid sheet specifically requiring return of the bit bodies. But while the parties' business relationship was ongoing, each year's contract was distinct. Furthermore, Thrift Bit admits that Sidney received more bits than it had returned during each contract year, including the 1996 contract. Therefore, Thrift Bit's cause of action for the deficit accrued upon the expiration of each contract. For the 1996 contract, the cause of action accrued on May 21, 1997. Thus, Thrift Bit's May 21, 2002 complaint for the deficit accruing under the 1996 contract was untimely.

Although Thrift Bit's claims under the subsequent contracts are timely, we agree with Sidney that Thrift Bit failed to mitigate its damages under the 1997 and 1998 contracts. It is well-established that a party claiming damages for a breach of contract is obligated to use reasonable efforts to mitigate its damages occasioned by the other party's breach. Smith v. Ward, 256 S.W.2d 385, 388 (Ky. 1953). In this case, however, Thrift Bit's conduct actually caused it to incur more damages.

Thrift Bit's usage-of-trade evidence focused on the "special nature" of the product. To keep the price of the drill bits down for the buyer and to be cost effective and make a

profit for the seller, the buyer is expected to return used bit bodies for repeated re-tipping and reuse. Although Sidney returned approximately 80% of the bit bodies that it received, Thrift Bit admits that Sidney accrued a deficit of unreturned bit bodies during each year of the contract. Thrift Bit could have addressed this deficit either by annually invoicing Sidney for the used bit bodies not returned, or by adjusting its subsequent year price quotation to reflect the additional costs incurred, or by declining to accept another bid without an express agreement from Sidney to return the bits. Thrift Bit took none of these options. Instead, Thrift Bit allowed Sidney to accrue a growing deficit of unreturned bit bodies and failed to take any timely action to minimize its losses. Consequently, Thrift Bit is not entitled to recover damages for those years.

We further agree with the trial court that Thrift Bit clearly was not entitled to damages under the 1999 contract. Beginning in 1998, Thrift Bit's price quotation sheet to Sidney included the following language: "The above prices are quoted with the agreement that our bit bodies will be returned". Sidney's purchasing agent did not object to the inclusion of the language in 1998. Thrift Bit's 1999 price quotation included the same language, along with a provision stating, "User is responsible for return of old bit bodies". Sidney's purchasing agent struck both clauses out when responding to the 1999

quotation sheet and Thrift Bit modified the second clause to provide "User is not responsible for return of bit bodies". This term was specifically accepted by Thrift Bit's agent, Johnny Blanton.

Thrift Bit contends that Sidney's attempted repudiation was ineffective because it did not alter its course of performance during that period. Nevertheless, 355.2-208(2) provides that "[t]he express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (KRS 355.1-205)". Given the express term incorporated into the 1999 contract, the trial court correctly concluded that the express terms of the contract control over the parties' course of performance, and the court properly subtracted from Thrift Bit's damages the cost of the bit bodies which Sidney did not return from April 1999 to February 2000. Consequently, we must reject Thrift Bit's cross-appeal.

This leaves only the damages arising from the 2000 contract. As noted above, the trial court properly considered course of performance, course of dealing and usage of trade to interpret the contract. Furthermore, Thrift Bit price quotation

sheet for that year included the provision "[t]he above prices are quoted with the agreement that our bit bodies will be returned", and Sidney did not object to the inclusion of the term. Given this explicit provision in the contract, the trial court did not err by allowing Thrift Bit to recover damages for the bit bodies which Sidney failed to return that contract year.

Sidney next contends that the trial court applied the wrong measure of damages. But contrary to Sidney's argument, there was no requirement that Thrift Bit lose money or become insolvent due to the non-performance under the contract in order to recover. Rather, the amount recoverable is the amount Thrift Bit's expectation damages of what it would have made had the contract been fully performed. See Leibson & Nowka, The UCC of Kentucky, 3d ed., § 2.06(6)(b)(i). Such damages approximate for the profits which the seller would have made if the contract had been performed as anticipated.

In this case, the course of dealing by the parties requiring Sidney to return the spent bit bodies allowed Thrift Bit to sell the re-tipped bodies at a lower price. When Sidney failed to return the all the spent bits, Thrift Bit was required to replace the unreturned bit bodies. Sidney could reasonably foresee these damages as evidenced by its prior efforts to return bit bodies to Thrift Bit. This measure of contract damages appears to be the only standard that fits the parties'

situation. Therefore, we affirm the trial court's method of calculating damages.

However, neither the record nor the trial court's findings allow us to conclusively determine the amount of damages to which Thrift Bit was entitled. The parties stipulated that Thrift Bit sold 2,028,800 bits to Sidney between September 1996 and May 2001. Sidney returned 1,615,236 bit bodies to Thrift Bit, leaving a deficit of 413,264. Of this latter amount, the parties agreed that Sidney failed to return 13,195 bit bodies from 1996 to May 28, 1998, and 93,187 bit bodies for the contract period from April 19, 1999 to February 8, 2000.

This leaves 306,882 bit bodies for the 1998 and 2000 contract periods. We have determined that Thrift Bit is only entitled to recover damages for unreturned bit bodies from the 2000 contract period. Unfortunately, the record does not clearly indicate how many bit bodies were not returned during that last contract period. Therefore, we must remand this matter to the trial court for additional findings and entry of a new judgment.

Upon remand, the trial court shall determine the difference between the number of drill bits which Thrift Bit provided Sidney during the 2000 contract year and the number of bit bodies which Sidney returned for that period. The trial

court further found that Sidney is entitled to a credit of one-half of one-percent, reflecting bit bodies which are normally lost or destroyed in the course of use. This allowance is reasonable and supported by substantial evidence. Upon determining the number of bit bodies for which Sidney is liable, the trial court shall allow Thrift Bit to recover its costs for replacing the unreturned bits, which the parties stipulated to be \$.67 per bit.

Accordingly, the judgment of the Harlan Circuit Court is affirmed in part, reversed in part, and remanded for additional findings and entry of a new judgment as set forth in this opinion.

COMBS, CHIEF JUDGE, CONCURS.

TAYLOR, JUDGE, CONCURS IN RESULT.

BRIEF FOR APPELLANT/CROSS-
APPELLEE:

H. Kent Hendrickson
Rice, Hendrickson & Williams
Harlan, Kentucky

BRIEF FOR APPELLEE/CROSS-
APPELLANT:

V. Katie Gilliam
Gilliam & Payne Attorneys,
PLLC
London, Kentucky