

IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
May 4, 2005 Session

WINGS MANUFACTURING CORP. v. ROY D. LAWSON, ET AL.

**Appeal from the Chancery Court for Coffee County
No. 01-406 L. Craig Johnson, Judge**

No. M2004-00265-COA-R3-CV - Filed August 12, 2005

This case involves the calculation of damages for lost profits arising from a breached contract between two apparel companies. The seller claimed that the trial court failed to take into account the costs it incurred manufacturing the goods, resulting in an excessive award for the buyer. The buyer contended that the trial court was correct in adopting the calculation of damages that the buyer presented. It appears to us that because the buyer never accepted the goods in question, it was not obligated to pay the seller for those goods and was entitled to reimbursement for the \$50,000 the seller wrongfully withdrew from the buyer's letter of credit. We accordingly affirm the trial court.

**Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court
Affirmed**

PATRICIA J. COTTRELL, J., delivered the opinion of the court, in which WILLIAM C. KOCH, JR., P.J., M.S., and FRANK G. CLEMENT, JR., J., joined.

John M. Higgason, Jr., Chattanooga, Tennessee, for the appellant, Wings Manufacturing Corp.

H. Thomas Parsons, Manchester, Tennessee, for the appellee, Roy D. Lawson, d/b/a Lawson Sales Company.

OPINION

I.

The parties to this case are Wings Manufacturing Company of New York and New Jersey ("Wings" or "the manufacturer"), which owns factories overseas for the production of apparel, and Roy D. Lawson ("Mr. Lawson"), owner of Lawson Sales Company of Manchester, Tennessee ("Lawson"), which sells garments to domestic retailers. Lawson's largest account was with the Cracker Barrel Corporation. The present case arose after Cracker Barrel ordered ladies denim overalls, denim shirts, natural denim shirts, and polo shirts from Lawson. Most of these orders were taken in the summer of 1999, for shipment in the fall.

According to the testimony of Mr. Lawson, the agreement with Cracker Barrel included specifications for weight, color, quality, sizes, and time of delivery. Lawson ordered the clothing from Wings Manufacturing on open account and executed purchase orders for the garments.¹ The purchase orders stated at the top, “[t]he merchandise shipped past cancel date, overshipped, not ordered, defective, may be returned at vendor expense, freight in freight out plus a \$25 handling charge per returned shipment.”

The total price Wings was to charge for all four types of garments was \$89,724. Lawson’s obligation of payment was secured in part through a \$50,000 domestic letter of credit. The garments were to be shipped to Eastside Designs, a “fulfillment company” in Lawrenceburg, Tennessee. Eastside was to embroider the garments (some with the logos of the University of Kentucky and the University of Tennessee) and then ship them to various Cracker Barrel gift shops.

Judging from the dates on the numerous invoices in the record, Eastside received the clothing at issue in at least eight separate shipments. At least one shipment arrived two months after the date indicated on Lawson’s purchase order. Eastside’s owner notified Mr. Lawson of receipt of the garments. Mr. Lawson inspected the garments and found that they did not meet the specifications of his contracts.²

Lawson communicated his complaints about the merchandise to Wings by letter and phone call and asked the manufacturer to send him return stickers, so he could ship them back. One such letter dated November 15, 1999, referred to the order for ladies denim overalls and described some of Lawson’s problems with the quality of the merchandise:

Regarding Invoice #36727 for 600 pcs of ladies denim overalls in the amount of \$6,600 our PO #0424 called for a Oct 15 delivery. Upon inspection we found the weight was not correct, the sewing is bad, and the clasps are breaking and buttons are falling off the side. This overall is a second and not first quality that we bought. Please issue a return sticker for these or I will keep them at a reduced price and try to sell them in a secondary market.

Another 576 pairs of overalls were not shipped until January 2, 2000. Lawson asked for a return sticker for these as well, because they should have been shipped in October, and “[s]ince they were past completion, our customer will not accept them.” No return sticker was issued for either shipment of overalls.

¹The purchase orders referenced Jazzman Sportswear Corp., which is a division of Wings Manufacturing.

²The record indicates that some of Mr. Lawson’s objections had to do with defects in the quality of individual garments, and others with the use of fabric of a lighter weight than contracted for. Still others involved slight variations in color between garments in the same lot. According to Mr. Lawson, such variations would have made the entire lot unacceptable to Cracker Barrel.

Lawson only received authorization to return the 3,434 polo shirts, which were apparently in the worst condition, with rotting fabric around the necks. Lawson accordingly shipped the polo shirts back to Wings. Lawson was ultimately able to sell the overalls, denim shirts, and natural denim shirts on the secondary market, but only for a fraction of the price that it would have received from Cracker Barrel. In the case of the overalls, the price was \$4 per pair.

II. COMPLAINT AND COUNTER-COMPLAINT

After shipping all the garments, Wings Manufacturing drew down the entire amount of Lawson's \$50,000 letter of credit. On September 18, 2001, Wings filed suit in the Chancery Court of Coffee County against Roy D. Lawson d/b/a Lawson Sales Company for the balance on its account, in the amount of \$15,686 (\$89,724 minus \$50,000, and minus the \$24,038 contract price for the polo shirts).

Lawson filed an Answer, followed by a Counter-Complaint for breach of contract. Lawson claimed that Wings had wrongfully drawn on the letter of credit and that its failure to furnish goods that met the agreed-upon specifications had resulted in both a loss of profits and the destruction of Lawson's contractual relationship with Cracker Barrel. Mr. Lawson and his company asked for total damages of \$200,000. During trial, this allegation of damages was increased to \$277,000.

On October 6, 2003, the trial court conducted a trial on Wings' Complaint and Lawson's Counter-Complaint, during which forty-eight exhibits were admitted into evidence. These included numerous purchase orders, invoices, letters between Lawson and Wings, and two denim shirts, one of which was literally falling apart. Three witnesses testified: Lewis Pillarella, national sales manager for Wings Manufacturing, Rodney Baggett, owner of Eastside Designs, and Roy Lawson.

Mr. Pillarella described the operations of Wings Manufacturing, the business relationship between Wings and Lawson, and the transactions from which this case arose. He acknowledged the validity of most of Lawson's complaints about the quality of the garments at issue,³ but indicated that on some of the complaints his company decided to give Lawson the benefit of the doubt in order to preserve the business relationship. He also testified that he had never inquired into whether the garments were pre-sold and that he was unaware that Cracker Barrel was the intended end purchaser.

Mr. Baggett testified that after he received the garments on behalf of Lawson, he could tell that they were not first quality. After Mr. Lawson confirmed that they were not to be embroidered, Mr. Baggett put the garments into storage pending their shipment or sale, where some of them stayed for over two years. He testified that his cost for storing the goods was \$2,000. The record indicates that Lawson paid the cost.

³For example, he admitted that the purchase orders for the denim shirts specified a weight of 6.5 ounces, and that the shirts that were shipped were 5 ounces.

Mr. Lawson testified that he and his wife had started Lawson Sales Company in 1983 and had begun selling to Cracker Barrel in 1996. The peak year for business with Cracker Barrel was 1998, when Lawson sold about \$520,000 worth of merchandise to the retailer. After the failure of the contracts at issue, Cracker Barrel found other suppliers and drastically reduced the volume of its business with Lawson.

At the conclusion of testimony and closing argument, the court announced its decision from the bench. The court found that Wings had indeed breached its contracts with Lawson and that Lawson was accordingly entitled to damages for its lost profits, but was not entitled to damages for the loss of future contracts with Cracker Barrel because such damages were too speculative. The court declined to put a figure on Lawson's lost profits, but asked the parties to submit memoranda showing their calculations on the matter.

Both parties relied upon essentially the same figures in their memoranda, but reached very different conclusions as to the magnitude of the damages Lawson was entitled to collect. Wings indicated a net lost profit of \$14,545 and a storage cost of \$2,000, for total damages of \$16,545. Lawson's initial memorandum recited total damages of \$96,450. The major factor in the disparity between the figures was the treatment (or the lack of treatment) of the cost of goods sold. This included the \$50,000 that Wings drew from Lawson's letter of credit and the unpaid balance of \$15,686 on the agreed-upon total purchase price.

The court reviewed the parties' memoranda and reopened the proof because it found that the parties did not include in the calculation of lost profits the anticipated embroidery costs, which would have been an additional element in Lawson's cost of goods. A new memorandum by Lawson made that adjustment, resulting in a damages figure of \$82,896.60, which the court adopted in its Findings of Fact and Final Order of January 5, 2004. This appeal followed.

III. BREACH AND REMEDIES

In its brief, Wings asserts there was insufficient proof it had breached the contract with Lawson by delivering goods that did not conform to the quality requirements and failing to meet the delivery dates. This argument was not pursued at oral argument.⁴ In any event, we have reviewed the record and find that the proof established breach by Wings. We affirm the trial court's holding that Wings breached the agreements as to all four types of garments by failing "to deliver goods by the contracted dates in some instances, and in some instances by the delivery of defective goods which did not meet the necessary and agreed upon standards as to quality and color."

The trial court correctly noted that because this case involves a transaction in goods between merchants, it is governed by the sales provisions of the Uniform Commercial Code (U.C.C.), Tenn. Code Ann. § 47-2-101 *et seq.* Under the U.C.C., the remedies available to a buyer for a breach of

⁴Counsel for Wings acknowledged that "for all practical purposes," the only real question on appeal was the calculation of damages.

contract by the seller depend in part on whether the buyer has accepted or rejected the goods. Acceptance is a term of art within the U.C.C. *Trinity Industries, Inc. v. McKinnon Bridge Co., Inc.*, 77 S.W.3d 159, 175 (Tenn. Ct. App. 2001). Mere receipt of ordered goods does not constitute acceptance. Tenn. Code Ann. § 47-2-606(1) provides:

Acceptance of goods occurs when the buyer:

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their nonconformity; or

(b) fails to make an effective rejection (§ 47-2-602(1)), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

Upon acceptance the buyer must pay for the accepted goods at the contract rate. Tenn. Code Ann. § 47-2-607(1). *Trinity Industries, Inc.*, 77 S.W.3d at 175. A seller is generally not entitled to recover the price of goods that are not accepted or that are rightfully rejected. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 7-2 (5th Ed. 2000).

Lawson did not accept the goods in question. It rightfully contends that the receipt of the garments by Eastside Designs did not constitute acceptance on its part. The proof showed that when the shipments arrived at the embroidery firm, Mr. Baggett could tell that the garments were not first quality. He informed Mr. Lawson, who inspected the garments and instructed Mr. Baggett not to embroider them.

Further, the record contains seven letters from Mr. Lawson or his employees to different representatives of Wings, detailing complaints about the garments that were sent and asking for authorization to ship them back to the seller. It was only after failing to receive those authorizations and after notice to Wings that Lawson sold the garments on the secondary market. Under the circumstances, such an act in accordance with remedies available to buyers whose seller is in breach does not constitute acceptance through treatment inconsistent with the seller's ownership.

IV. THE QUESTION OF DAMAGES

Wings contends that the proof of damages was insufficient because Lawson never produced a single document or purchase order from Cracker Barrel or any other buyer and "apparently the Trial Court simply accepted his [Mr. Lawson's] word" as to the existence or terms of such contracts.

Mr. Lawson testified as to the details of the agreements between his company and Cracker Barrel,⁵ and such testimony constitutes competent evidence which the court may consider. The value of such testimony obviously hinges on the witness's credibility, a matter which the trial court is in the best position to judge. *Town of Alamo v. Forcum-James Co.*, 327 S.W.2d 47, 49 (Tenn. 1959); *Union Planters National Bank v. Island Management Authority, Inc.*, 43 S.W3d 498, 502 (Tenn. Ct. App. 2000). Wings did not attempt to impeach Mr. Lawson's testimony, and the trial court found him to be a credible witness.

Mr. Lawson also submitted a detailed eighteen page document entitled "Analysis by Salesman" which documented his company's garment shipments to several hundred Cracker Barrel stores in the years 1999 and 2000. For each shipment, the document included the order number, the number of items in the order, and the total price. Wings' attorney was given the opportunity to cross-examine Mr. Lawson about the sales analysis, but chose not to. The trial court found the evidence regarding Lawson's dealings with Cracker Barrel credible and unrefuted.⁶

Although Mr. Pillarella testified that he did not know the identity of the customer to whom Lawson intended to sell the garments it purchased from Wings, there can be no doubt that Wings was aware that these garments were intended for resale and that they had to be of the specified quality to be suitable for that purpose. Thus, even without knowing the exact terms of Lawson's contract with Cracker Barrel, Wings had reason to know that its failure to provide goods in conformance with its contracts with Lawson would result in a loss of profits to Lawson.

Wings' real objection seems to be to the lack of corroborating evidence as to the precise amounts Cracker Barrel was to pay Lawson for the garments. The trial court specifically found Mr. Lawson's unrefuted testimony sufficient and credible to establish those amounts.

Findings of fact by the trial court in civil cases are presumed on appeal to be correct unless the evidence preponderates otherwise. Tenn. R. App. P. 13(d). Mr. Lawson testified at length as to his dealings with Cracker Barrel and as to the terms of the contracts at issue in the present case. Mr. Pillarella's testimony confirmed that many of the garments Wings shipped were either defective or did not meet the requirements of its own contract with Lawson. The evidence does not preponderate against the trial court's finding that Lawson was damaged by Wings' breach of contract and suffered an ascertainable loss of profits.

V. THE CALCULATION OF DAMAGES

Under Tenn. Code Ann. § 47-2-711(1), a buyer who rightfully rejects or justifiably revokes acceptance may cancel the contract and recover so much of the price as has been paid. *See Seaton*

⁵There was no objection to this testimony at trial.

⁶Because the relationship was essentially year-to-year, however, the trial court denied Lawson's request for damages for three years of business with Cracker Barrel which it claimed it lost due to Wings' breach. The trial court found this future business too speculative and limited damages to the specific orders that were not fulfilled.

v. Lawson Chevrolet-Mazda, Inc., 821 S.W.2d 137, 138 (Tenn. 1991). The buyer also may “cover and have damages under the next section as to all the goods affected...” Tenn. Code Ann. § 47-2-711(1)(a). Under Tenn. Code Ann. § 47-2-711(3), the buyer retains a security interest on any goods in its possession for “any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller.” The buyer may also be entitled to incidental and consequential damages which are described in Tenn. Code Ann. § 47-7-715 as follows:

(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 delay or other breach.

(2) Consequential damages resulting from the seller's breach include:

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller.

The only incidental damages that appear to be present in this case are the \$2,000 in costs the buyer incurred for storing the rejected goods. Lost profits fall under the category of consequential damages. *Kultura, Inc. v. Southern Leasing Corp.*, 923 S.W.2d 536, 539 (Tenn. 1996); *First Tennessee Bank v. Hurd Lock & Mfg.*, 816 S.W.2d 38, 42 (Tenn. Ct. App. 1991). “Where the seller knows, or has reason to know that the buyer is in the business of resale, lost profits resulting from breach are foreseeable and usually recoverable.” JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 6-6 (5th Ed. 2000). As discussed earlier, Wings knew or had reason to know that Lawson intended to re-sell the garments it ordered from Wings.

After the trial court ruled that Wings had breached its contract and that Lawson was entitled to damages, both parties were asked to present their calculations as to the magnitude of the loss of profits or damages in general. In those submissions, both parties appear to have combined in various ways the elements of lost profits, mitigation of damages, and payment of the contract price where

the seller breaches.⁷ Treating the items separately in conformity with their treatment under the U.C.C. will help clarify the amount, if any, due to Lawson.

The most transparent method for calculating Lawson's damages is by a series of distinct steps. The first step is to calculate the profits that Lawson would have obtained if all parties had performed their contracts in accordance with their terms. This will result in Lawson's lost profits. To determine Lawson's damages, however, the figure for gross lost profits must be adjusted by reducing that number by the amount Lawson received from the sale of the nonconforming garments on the secondary market, *i.e.*, its efforts at mitigation. The third step is to add to the consequential damages of lost profits any incidental damages, herein the storage cost incurred by Lawson. Finally, issues surrounding the \$50,000 partial payment to Wings, through its draw on Lawson's letter of credit, as well as the portion of the original contract price that had not been paid by Lawson and that was sought by Wings, must be determined to arrive at the final amount due Lawson for the breach by Wings.

A. Lost Profits and Incidental Damages

The record indicates that if Lawson had been able to ship all four types of contracted-for garments⁸ to Cracker Barrel, and if Cracker Barrel had found them all acceptable, Lawson would have received proceeds from the agreements with Cracker Barrel in the total amount of \$152,970. To calculate Lawson's lost profits, we must subtract from that figure the cost of the goods, *i.e.*, the amount Lawson would have been required to pay for conforming goods to provide to Cracker Barrel.

The main component of that cost is the \$89,724 purchase price Lawson agreed to pay Wings for the four types of garments if they had conformed to the contract's specifications. Contrary to the supposition underlying some of the calculations by the parties, the proper amount is not what Lawson actually paid or what Wings obtained through the letter of credit; instead, it is the amount Lawson agreed to pay Wings for conforming goods.

The second component in calculation of costs attributable to Lawson had the contracts been fulfilled is the \$13,559 that Lawson would have paid in embroidery costs to provide Cracker Barrel the garments it ordered. Together, these two components total \$103,283 in costs Lawson would have incurred to deliver conforming goods to Cracker Barrel. Subtracting this amount from the total expected in proceeds from Cracker Barrel leaves a profit of \$49,687 that Lawson could have

⁷Consequently, it is impossible without extended discussion to reconcile the parties' calculations with ours. The basic amounts attributable to the components is not really in dispute, only how they should figure in the calculation.

⁸The calculation supplied by Wings does not include the defective polo shirts because Wings took them back and did not charge Lawson for them. That act, however, is not relevant to the calculation of lost profits. The question is how much Lawson would have made in profit if Wings had supplied conforming goods. The fact that Wings did not charge Lawson for the polo shirts does not mean that Lawson did not suffer damage in that it was unable to make the anticipated profit it would have realized if Wings had supplied shirts in accordance with the contract. We agree with the trial court that the polo shirts were correctly included in the lost profit calculation.

made on the four types of garments covered by the contracts at issue here. Consequently, Lawson's lost profit was \$49,687.

Lawson mitigated its damages by selling the overalls, denim shirts, and natural denim shirts on the secondary market for a total of \$18,797, thus reducing its consequential damages to \$30,890. However, Lawson also incurred \$2,000 in storage costs that are properly considered incidental damages. Adding that amount brings Lawson's total damages to \$32,890.

B. Buyer's Liability For Non-Conforming Goods

The question that is at the core of this appeal is the effect on the final judgment of Wings' \$50,000 draft on Lawson's letter of credit. Wings argues that Lawson's dissatisfaction with the manufacturer's performance may have entitled it to recover lost profits, but did not relieve it of the obligation to pay full price for the garments it received. It accordingly contends that Wings is entitled to keep the \$50,000 and that Lawson still owes for the unpaid balance of \$15,686.

To the contrary, since Lawson rightfully rejected the goods shipped by Wings, it was not required to pay for those goods, but instead was entitled to return them to Wings at the manufacturer's expense. Lawson's remedy for lost profits would not have been affected by such action. Lawson did in fact attempt to obtain authorization from Wings to ship the garments back to Wings, but Wings only authorized return of the polo shirts. Lawson then sold the remaining garments on the secondary market, after notice of intent to do just that, without objection from Wings. The amounts received by Lawson from these sales has been accounted for in the calculation of damages with the effect of reducing Wings' liability.

Lawson is entitled to the \$50,000 that was drawn from its letter of credit. One of the primary purposes of a letter of credit is to reduce the risk to a seller of non-payment by a buyer. Of course, the buyer's obligation to pay is dependent upon the seller's compliance with the contract. Payment under the circumstances present here does not cut off the buyer's remedies against the seller for failure to deliver conforming goods. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 18-1 (5th Ed. 2000). We have found that because Lawson never accepted the goods, Wings was not entitled to payment for them, but only to their return or to credit for their sale on the secondary market. Adding the \$50,000 inappropriately drawn from the letter of credit to the \$32,890 that we have already calculated as Lawson's damages, we find that Lawson is entitled to a total judgment of \$82,890.

This is the same figure that Lawson ultimately reached in its calculations, although arrived at differently, and the same figure the trial court adopted in its final order. Wings argues that the effect is to deprive it of compensation for its manufacturing costs. That is simply the result of application of the buyer's remedies. Wings was not entitled to be paid for goods that did not meet the contract requirements; a buyer has no obligation to pay for rejected goods. Lawson acted in accordance with its obligations under the U.C.C. Wings was given credit in the calculation of Lawson's damages for the proceeds of the sale of the goods by Lawson.

VI.

We affirm the judgment of the trial court, and we remand this case to the Chancery Court of Coffee County. The costs on appeal are taxed to the appellant, Wings Manufacturing Company.

PATRICIA J. COTTRELL, JUDGE