Saint Louis University Law Journal

Volume 44
Number 4 *Teaching Contracts (Fall 2000)*

Article 20

11-6-2000

Exercising with Neri v. Retail Marine Corp.

Mark Pettit Jr.
Boston University School of Law

EXERCISING WITH *NERI V. RETAIL MARINE CORP.*

MARK PETTIT, JR.*

Teachers of contract law are blessed. We are blessed with first-year students who for the most part are bright, interesting, and eager to learn the subject. We are blessed because contract law gives us lots of doctrine to play with. And, like all teachers of "One Ls," we are blessed because we can see our students progress, and then can shamelessly take credit for their development.

I find that today's law students are quick and creative, and can assimilate large quantities of information. But many of my students have not previously been asked to read, articulate, or reason with the extreme care often necessary for lawyers. The "careful and precise" portion of their brains needs exercise. So I find myself spending increasing amounts of time on what we are fond of calling "skills training." I find statutory construction to be a particularly effective vehicle for this kind of skills training, and I find *Neri v. Retail Marine Corp.*[1] to provide particularly effective exercises in statutory construction.

I began my contracts teaching career with the Dawson and Harvey casebook,[2] and I am currently using the casebook of my colleague, Randy Barnett.[3] Both books, along with several others,[4] use *Neri* as a principal case. I am a contracts teacher in the teach-remedies-first camp. I thus use *Neri*, which deals with remedies for buyer's breach of a contract to buy a boat, as an

* Professor of Law, Boston University School of Law. I owe thanks to my colleagues Daniela Caruso, Ward Farnsworth, Fred Lawrence, Maureen O'Rourke and David Snyder for their comments on an earlier draft, and to research assistants Joel Kress and Brian Song.

1. 285 N.E.2d 311 (N.Y. 1972).

2. JOHN P. DAWSON & WILLIAM BURNETT HARVEY, CASES AND COMMENT ON CONTRACTS (3d ed. 1977).

3. RANDY E. BARNETT, CONTRACTS: CASES AND DOCTRINE (2d ed. 1999).

4. STEVEN J. BURTON, PRINCIPLES OF CONTRACT LAW (1995); MICHAEL L. CLOSEN, RICHARD M. PERLMUTTER & JEFFREY D. WITTENBERG, CONTRACTS: CONTEMPORARY CASES, COMMENTS, AND PROBLEMS (1984); LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW (6th ed. 1996); FRIEDRICH KESSLER, GRANT GILMORE & ANTHONY T. KRONMAN, CONTRACTS: CASES AND MATERIALS (3d ed. 1986); ARTHUR ROSETT & DANIEL J. BUSSEL, CONTRACT LAW AND ITS APPLICATION (6th ed. 1999); ROBERT E. SCOTT & DOUGLAS L. LESLIE, CONTRACT LAW AND THEORY (2d ed. 1993); ROBERT S. SUMMERS & ROBERT A. HILLMAN, CONTRACT AND RELATED OBLIGATION: THEORY, DOCTRINE, AND PRACTICE (3d ed. 1997). This list may not be exhaustive.

introduction to statutory construction in general and to the Uniform Commercial Code ("U.C.C.") in particular. *Neri* presents a treasure trove of interpretive puzzles and problems from the very specific and simple to the very broad and complicated. For those who do not begin their courses with remedies, the case is rich enough to support a productive discussion at any point in the course.

I usually spend two hours working through *Neri*. Rather than present a general description of how I use this case for my skills training purposes and why I believe it is effective, I think it might be more helpful to present an account of my *Neri* class in dialogue form, so that you can judge for yourself whether there is something here that might be useful to you. I certainly do not offer this dialogue as a model class to be copied. We all know that different instructors can use the same case to teach any number of different things, and *Neri* can serve as the basis for discussion of many questions that I do not raise here.

My own goal for the *Neri* discussion is not so much that students understand and retain the substance of the U.C.C. provisions (which might well change by the time they are practicing lawyers), but rather that they improve their skill and build their confidence in interpreting difficult texts. On a more specific level, I want students to begin to learn what it means to work carefully, word by word, through a complicated textual maze, to appreciate the need for precision, to recognize that the bottom line conclusion must be checked to see if it makes sense, and to look to the underlying purposes of the text to resolve ambiguities.

Although what follows is not a verbatim transcript of an actual, single class, it does reflect a reasonably typical exchange, using the device of an above-average but inexperienced student. So here goes.

Instructor: Mr./Ms. [One L], would you please relate the facts of *Neri v. Retail Marine Corp.*?

Student: The Neris entered into a contract with Retail Marine Corporation to buy a boat for the price of $12,587.40. They made an initial deposit of $40, and then soon increased the deposit to $4,250 in order to assure immediate delivery, rather than delivery within four to six weeks as originally specified. Six days after the date of the contract the Neris' lawyer sent a letter to Retail Marine rescinding the contract because Mr. Neri was about to go into the hospital for surgery, and thus it would be "impossible for Mr. Neri to make any payments."

Instructor: Let me interrupt for a minute to ask what you think about Mr. Neri's justification for seeking to rescind the contract. Should his

hospitalization and surgery allow him to cancel his order for the boat and get his deposit back?

Student: It's unfortunate that Mr. Neri has to go to the hospital, and I feel sorry for him, but I don't think he should be let off from his contract. After all, it's not really Retail Marine's problem.

Instructor: I see. So if I order a pair of shoes from you, and before you deliver them *my legs are amputated* I still have to pay you for the shoes? After all, it's not your problem.

Student: I think that's the way the system works.

Instructor: But is that the way the system should work?[5] If you were making the rules, would you make me pay for the shoes?

Student: I don't think I would make you pay as a personal matter, but I think I should have the legal right to make you pay.

Instructor: Does the *Neri* court agree with you, that Mr. Neri still has a legal obligation to buy the boat?

Student: I don't think that the court discusses it.

Instructor: Does that mean that we do not know what the court's position is?

Student: Well, since the court goes right to the question of the proper damages for breach, I guess the court assumes that Mr. Neri was bound by the contract.

Instructor: I think that's right. We will be studying the subject of changed circumstances at some length at the end of the course, but in the meantime be alert for situations in which a party might argue that his or her performance should be excused because of unexpected events. I do have a poem expressing how Mr. Neri might have felt.[6]

5. It seems to me that in recent years students have become less willing to express their own views about what the law should be. I view this perceived trend as unfortunate, and I wonder if other law teachers have the same perception.

6. During my first year of teaching Contracts, one of my students handed me a poem that he had written about the case we were discussing that day. It was clever, and I read it to the class. That started a practice in my classes of students writing poems and (gulp!) songs to be read or sung (!) by me from the podium. I have been amazed by the creativity of my students. I think

Neri's Lament
Mr. Merchant
Don't be mean.
I've just found cancer
On my spleen.

I know I said
I'd buy your boat,
But I'm afraid
My loan won't float.

The Code is with you,
This is true.
I know—I've read it
Till I'm blue.

But look, the thing is,
I can't pay.
In fact, I'm dying
More each day.

So please return
My deposit, whole.
And light a candle
For my soul.[7]

[Applause]
Now please resume your statement of the facts.

Student: Okay. At the time it received the letter from the Neris' lawyer, Retail Marine had already received delivery of the boat from the manufacturer. So Retail Marine refused to refund the Neris' deposit.

Instructor: So who sued whom for what?

that the poems and songs help greatly to reduce the tension that naturally results when an instructor asks a series of difficult questions to non-volunteers, as I do. It is hard to be too terrified of an instructor who earlier had made a fool of himself trying to sing contracts words to a Britney Spears song.

7. Written by David Bohanan, Boston University School of Law class of 1990.

Student: The Neris sued to recover their deposit. Then Retail Marine counterclaimed for breach of contract and sought damages of $4,250, which is the same amount as the deposit.

Instructor: Why did Retail Marine counterclaim for $4,250, when it already had the $4,250?

Student: I don't know. Maybe Retail Marine just wanted a court to confirm that it was legally entitled to keep the money.

Instructor: I am not sure about the answer either, although your explanation seems to be a likely possibility. Now, what were the results in the courts below?

Student: Retail Marine won summary judgment below on the Neris' liability for breach. Then there was a trial on the issue of Retail Marine's damages, and the court awarded . . . .

Instructor: Before we get to the award, what items of damages did Retail Marine attempt to prove and recover at trial?

Student: Lost profit of $2,579, ...

Instructor: What does lost profit mean? How would you calculate it?

Student: What Retail Marine would make on the deal?

Instructor: Right. And how would you calculate it?

Student: I guess I would subtract the cost of the boat to Retail Marine from the money that Retail Marine would receive.

Instructor: Very good. We might say gross revenue minus expenses, but you have the right idea. Now what else did Retail Marine attempt to recover at trial?

Student: Incidental expenses of $674 for storage, upkeep, finance charges and insurance and $1,250 for attorneys' fees.

Instructor: Notice that these amounts add up to $4,503, and that Retail Marine originally counterclaimed for only $4,250. Apparently, once Retail Marine had to go through the expense of a trial, it was no longer content

simply to keep the deposit as full payment of damages. Did Retail Marine get a judgment for $4,503?

Student: No. After the trial, the trial court awarded Retail Marine only $500 on its counterclaim and directed that the Neris get back $3,750 of their deposit. Retail Marine then appealed to the Appellate Division, which affirmed without writing an opinion. Retail Marine was then given leave to appeal to the New York Court of Appeals, which modified the lower court order.

Instructor: So we are looking at the opinion of the Court of Appeals, the highest court in the state of New York. Before we get to the reasoning of the Court of Appeals, let's talk about how the trial judge reached the conclusion that Retail Marine could keep only $500. What law did the trial court look to?

Student: Section 2-718(2)(b) of the Uniform Commercial Code.

Instructor: But why the U.C.C.? The Neris' purchase appears to be a consumer transaction, not a commercial transaction.

Student: But it is still a sale of a good.

Instructor: Exactly right. Remember that Article 2 of the U.C.C. applies to consumer transactions for the sale of goods unless specifically displaced by a consumer protection law.[8] Okay. Now why did the trial judge start with section 2-718?

Student: Because it seems to apply to the situation.

Instructor: Right. Lawyers and judges usually look for the section that deals most specifically with the factual situation being considered. Let's look at section 2-718(2) carefully. Did the trial judge construe this section correctly? It says: "Where the seller justifiably withholds delivery of goods because of the buyer's breach . . . ." Is this our case?

Student: Yes, because the court ruled for Retail Marine on liability, and Retail Marine never delivered the boat to the Neris.

8. For some reason, my students all too often assume that Article 2 of the U.C.C. does not apply to consumer transactions, or, even worse, that it applies only to contracts between merchants. Professor Burnham's similar experience inspired him to write an article. S*ee* Scott J. Burnham, *Why Do Law Students Insist that Article 2 of the Uniform Commercial Code Applies Only to Merchants and What Can We Do About It?*, 63 BROOK. L. REV. 1271 (1997).

Instructor: " . . . the buyer is entitled to restitution of any amount by which the sum of his payments . . . ." What is the sum of the Neris' payments?

Student: $4,250.

Instructor: " . . . exceeds (a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1) . . . ." We will soon study so-called liquidated damages clauses in contracts, but there is no mention of such a clause here, so we can disregard this language for now. " . . . or (b) in the absence of such terms, twenty percent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller." What is the value of the total performance for which the buyer is obligated?

Student: Would that be the contract price of $12,587.40?

Instructor: Yes. So which is smaller, 20% of $12,587.40 or $500?

Student: $500.

Instructor: So did the trial court construe section 2-718(2)(b) correctly?

Student: Yes.[9]

Instructor: Did the Court of Appeals agree that section 2-718 was the correct starting point for deciding this case?

Student: Yes. The court says specifically that "[t]he issue is governed in the first instance by section 2-718 . . . ."[10]

Instructor: So why did the Court of Appeals modify the trial court's award? What did the trial judge do wrong?

Student: The trial judge did not look at the seller's remedy in section 2-718(3).

9. Occasionally, a student will read the language to be 20% of total value of performance or 20% of $500 (*i.e.*, $100), but, as Professor Nordstrom has pointed out, if that is what the drafters intended, it would seem that they would have simply said $100. *See* ROBERT J. NORDSTROM, HANDBOOK OF THE LAW OF SALES 556 n.1 (1970). I generally do not raise this issue unless a student wants to make the argument.

10. *Neri*, 285 N.E. 2d at 313.

Instructor: Right. The trial judge stopped reading section 2-718 too soon. Let's look at the language of section 2-718(3). "The buyer's right to restitution under subsection (2) is subject to offset . . . ." What does "subject to offset" mean?

Student: I think it means subject to subtraction of what follows.

Instructor: That sounds right to me. " . . . subject to offset to the extent that the seller establishes (a) a right to recover damages under the provisions of this Article [that is, Article 2 of the U.C.C.] other than subsection (1) [of § 2-718], and (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract." Let's consider (b) first, to get it out of the way. Did the Neris receive any direct or indirect benefits by virtue of this contract?

Student: Well, they did not receive the boat, or anything else that I can see.

Instructor: I agree. So we can concentrate on (a): Can Retail Marine establish a right to recover damages under other provisions of Article 2? What other provisions should seller be looking at? Seller's remedies are listed in section 2-703. Let's take a look at section 2-703. Since Retail Marine did resell the boat, seller might want to look at section 2-706.[11] Indeed, there is an argument that if 2-706 applies, then seller cannot do better under section 2-708.[12] I don't want to take the time to discuss that argument now, but I can discuss it after class with anyone who is interested. Seller could also try section 2-709, but an examination of that section suggests that it would not apply in this case. In any event, the Court of Appeals looks to section 2-708, and so let us turn to that section.

> (1) Subject to subsection (2) [which we will get to soon] and to the provisions of this Article with respect to proof of market price (Section 2-723) [which you would have to check, but which I do not want to take the time to explore now], the measure of damages for non-acceptance or repudiation by the buyer [which seems to be what happened in *Neri*] is the difference between the market price at the time and place for tender and the unpaid contract price together with any

11. Occasionally I work through the damages calculations under U.C.C. § 2-706 to show why Retail Marine prefers U.C.C. § 2-708.

12. This argument was considered and rejected in *R.E. Davis Chem. Corp. v. Diasonics, Inc.*, 826 F.2d 678, 682 (7th Cir. 1987) (citing Robert J. Harris, *A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared*, 18 STAN. L. REV. 66, 101 n.174 (1965)). *But see* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 7-7 (4th ed. 1995).

> incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

Okay, do we know "the market price at the time and place for tender"?

Student: I don't see that amount mentioned in the opinion.

Instructor: Do we have any information about what the boat was worth on the retail market?

Student: Well, we know that the Neris agreed to pay $12,587.40 for the boat, and that it was sold four months later to somebody else for the same price.

Instructor: That's right. Although these two sale prices do not necessarily mean that the market price was exactly the same, they do provide some good evidence of the market price. So let's assume that the market price is $12,587.40, remembering that market price is a fact to be proved at trial. Now what is the "unpaid contract price"?

Student: I think that would be the full contract price, which is the $12,587.40, less the amount of the down payment, which is $4,250. Let's see. That comes out to $8,337.40.

Instructor: So what is the difference between the market price and the unpaid contract price?

Student: That would be $12,587.40 minus $8,337.40, which would bring us back to $4,250, the amount of the down payment.

Instructor: Now section 2-708(1) says that we add incidental damages and directs us to section 2-710. What did the Court of Appeals say about Retail Marine's incidental damages?

Student: The Court of Appeals said that the trial judge was wrong in denying Retail Marine's claim for $674 in incidental damages for storage, upkeep, finance charges and insurance for the boat for the time between when the Neris should have paid and when the boat was resold.

Instructor: Good. So let's add $674 to our calculation of damages under section 2-708(1). That gives us $4,250 plus $674, or $4,924. Now the last clause of section 2-708(1) says: " . . . but less expenses saved in consequence of the buyer's breach." Did Retail Marine save any expenses because of the Neris' breach?

Student: I don't think so, since they already paid for and received the boat.

Instructor: It does seem that Retail Marine saved little or nothing because of the breach. So let's assume that there were no expenses saved. That leaves us with a damages figure under section 2-708(1) of $4,924. Do you find that amount troubling?

Student: I can't say that I do, although I'm sure I should since you asked the question.

Instructor: Isn't $4,924 more than Retail Marine was asking for, even including $1,250 for attorneys' fees? Furthermore, notice that Retail Marine's main argument was that it should receive damages under section 2-708(2), and section 2-708(2) applies only when the measure of damages under section 2-708(1) is inadequate for the seller. It seems that $4,924 is more than adequate for Retail Marine in this case. Something must be wrong with our calculation under section 2-708(1). Do you have any idea what we did wrong?

Student: I'm afraid I don't have a clue.

Instructor: Well, notice that we calculated the difference between the market price and the unpaid contract price as the amount of the down payment. If the down payment were higher, the difference between the market price and unpaid contract price would rise by the same amount. So the higher the down payment, the greater the damages for the seller under section 2-708(1). Isn't that just exactly the opposite of how it should be? The more money the seller receives from the buyer, the less his damages should be.

Student volunteer: Maybe we should disregard the word "unpaid" before "contract price."

Instructor: That is interesting, because that is exactly the suggestion of some commentators analyzing the interaction between sections 2-708 and 2-718, and we will look at the reasons for that suggestion later. But the word "unpaid" is not the source of the problem with our calculations under section 2-708(1). We are making a very fundamental mistake in construing section 2-708(1). The mistake is not one that you would make if you were a lawyer representing either party here. But I should say that many, if not most, of my students make the same error. The error, although fundamental, is quite understandable. The key to understanding the problem is to recognize that our method of calculation gives more damages to the seller when the down

payment goes up and seller's damages should thus be less. Can anyone correct our error?

Student volunteer: Should we be subtracting market price from unpaid contract price, rather than the other way around?

Instructor: *Bingo!* We have inverted the minuend and the subtrahend.[13] Think about the purpose of section 2-708. The purpose is to compensate the seller's loss. When does the seller have a loss? When the unpaid contract price is greater than the market price. That is, the seller is hurt by the buyer's breach if the seller would have received more from the buyer's completing performance than the seller can get by selling to someone else on the market. So for seller's damages we subtract market price from unpaid contract price.

Notice that it's the other way around for the buyer when the seller breaches. The buyer is hurt when the buyer has to pay more on the market than the amount remaining unpaid on the contract. So for buyer's damages we subtract unpaid contract price from market price.

Lawyers simply refer to the contract/market differential for both buyer's and seller's damages and assume that it is obvious how to do the subtraction. The drafters of section 2-708 thought that it was too obvious to require an explanation of how to do the subtraction. And it would be obvious to you if you were handling a real case and could see the real loss of your client. But it was not obvious to us because we were reading the language very literally, as I was insisting that we do.

There is a valuable lesson in the problem we just worked through. Although it is imperative that lawyers read statutes very carefully and very literally, it is also vital to read statutory language with an appreciation of the purposes underlying the statutory language. If you do not do so, you can make some very embarrassing mistakes.

Let me provide some simple numbers to make sure that we now all understand how and why the contract/market differential works.

[On the blackboard:]

13. Apparently elementary school teachers no longer use these terms. Most of my students have never heard these words, and they view my use of them as still further evidence of how archaic their instructor really is. Professor Harris used these terms in his analysis of seller's damages, but that was in 1965. *See* Harris, *supra* note 12, at 79.

No Down Payment

Contract Price	Market Price	Buyer's Damages	Seller's Damages
$500	$600	?	?
$500	$400	?	?

$50 Down Payment

Contract Price	(Unpaid)	Market Price	Buyer's Damages	Seller's Damages
$500	$450	$600	?	?
$500	$450	$400	?	?

Let's fill in the blanks using these numbers. First, with no down payment, if the contract price is $500 and the market price is $600 and the seller breaches, what are the buyer's damages?

Student: Well, that is market price of $600 minus unpaid contract price of $500, or $100.

Instructor: Right. Buyer is hurt when the market goes above the contract price. Buyer can take the $500 not paid to the seller and the $100 in damages and buy the same item on the market. What are seller's damages?

Student: That would be the unpaid contract price of $500 minus the market price of $600, or minus $100.

Instructor: Right. But since courts do not generally deal in negative damages, we'll simply say that seller's damages are zero. Now what if the market price goes down to $400?

Student: Then buyer's damages would be zero, and seller's damages would be $100.

Instructor: Now we've got it! Seller is hurt when the market goes below the contract price. Seller can take the $400 from the resale and the $100 in damages and end up with the $500 originally expected.

Now let's look at the situation when there has been a down payment so that we can understand why the word "unpaid" is in the equations before

"contract price." If buyer made a $50 down payment and the market price went up to $600, what would buyer's damages be?

Student: Market price of $600 minus unpaid contract price of $450, or $150.

Instructor: Yes. Now we have to make sure that buyer gets his $50 back in addition to the $100 so he can buy on the market for $600 and still come out as well as if the original seller had performed. Now we can also see that seller's damages are zero when the market goes up. What are the answers if the market goes down to $400?

Student: Buyer's damages would be market price of $400 minus unpaid contract price of $450, or minus $50. Zero.[14] Seller's damages would be unpaid contract price of $450 minus market price of $400, or $50.

Instructor: Very good. Do these answers make sense?

Student: Let's see. Buyer is not hurt because buyer can buy for $400 and has paid seller $50, and buyer expected to pay $500. Seller is hurt because now she can get $400 on the market and has the original buyer's $50 down payment, but she is still $50 short of the $500 she expected.

Instructor: Excellent. I think we have beaten the contract/market differential into the ground. Let's go back to *Neri*. Notice that we have not reached the real issue in the case yet. What are Retail Marine's damages under section 2-708(1)?

Student: Zero, because unpaid contract price of $8,337 minus market price of $12,587.40 equals minus $4,250. Even adding $674 for incidental damages, seller's damages are in negative territory.

Instructor: That makes sense. We can now understand why Retail Marine thinks that damages under section 2-708(1) are inadequate, and wants the court to use section 2-708(2). Let's look at the language of section 2-708(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 . . . ." Is there another way to say that?

14. I rarely interrupt here to point out that the buyer can recover the $50 down payment upon breach by the seller even if the buyer benefits from the breach. *See* U.C.C. § 2-711(1). We discuss at some length elsewhere how the concept of restitution can trump the concept of expectation, and the arguments for and against such a trumping effect.

Student: I don't know what you mean.

Instructor: Well, how might Fuller and Perdue have phrased this idea of inadequacy? Inadequate to do what?

Student: Protect the expectation interest?

Instructor: Exactly. If the contract/market differential is inadequate to protect the seller's expectation interest, returning to the language of section 2-708(2), " . . . then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer . . . ." We know from our earlier statement of the facts that Retail Marine offered proof that its lost profit was $2,579. But how do we know if section 2-708(1) is inadequate? Can we generalize about when a court should award lost profit damages under section 2-708(2)? By the way, we have now finally arrived at the main issue in the case.

Student: Well, the court talks about using section 2-708(2) when the seller has an unlimited or inexhaustible supply of standard-priced goods.

Instructor: Do you agree with the court's description you've just quoted of when section 2-708(1) is inadequate and lost profit should be awarded?

Student: It sounds good to me.

Instructor: But does any seller really have an unlimited supply of anything? No supply is infinite. Can you think of a better way to phrase what the court is getting at?

Student: How about when seller has more goods to sell than there are buyers for those goods?

Instructor: When supply exceeds demand?

Student: Yes.

Instructor: I think that is a good beginning. We might phrase the idea like this: When a seller's supply of interchangeable goods exceeds the demand for those goods, a breach by a buyer and a resale to someone else at the same price would not make the seller as well off as if the buyer had not breached. It is frequently said that, but for the buyer's breach, seller would have sold two boats rather than one (or fifty instead of forty-nine).

Let's say that you and I entered into a contract for the sale of my 1973 American Motors Hornet[15] for $600, and you then breached. I then sold my Hornet to another student for $600. In that case, except perhaps for costs incident to finding another buyer, I am just as well off with the other buyer's $600 as I would have been with your $600. But if I have a fleet of Hornets to sell, I can argue that if you had not breached I would have sold one more Hornet. Although Article 2 of the U.C.C. applies only to goods, a similar argument could be made for dentists' appointments or hotel rooms.

I should tell you that there is a good deal of controversy, especially in the academic literature, about when a lost profit measure of damages should be used. Some commentators and courts think that the seller must prove not only the ability to produce a supply exceeding demand but also that it would have been profitable to produce additional goods before being entitled to lost profits.[16] Other commentators have even greater reservations about the lost-profit idea.[17] We will have to leave this debate to courses in commercial law.

So, returning to the text of section 2-708(2), Retail Marine seems to be entitled to recover lost profit of $2,579 plus incidental damages of $674. But what about the last phrase of section 2-708(2): "due allowance for costs reasonably incurred and due credit for payments or proceeds of resale"? The Neris argue that the proceeds of resale were $12,587.40, and they are not getting due credit for them! What does the court say in response to this argument?

Student: The court says that the language "due credit for payments or proceeds of resale" is inapplicable here. The court cites authorities for the proposition that this phrase refers only to the resale value of scrap or components when the seller stops production.[18]

Instructor: We might have hoped that the drafters would have drafted more clearly if this is what they intended by the words "due credit for . . . proceeds of resale." But we might also agree that the phrase cannot mean that the buyer

15. In fact, my wife and I owned a 1973 Hornet for fifteen years before it died in 1988 of terminal rust. I continue to use the Hornet as the basis for numerous class hypotheticals, thus reinforcing the students' view of their instructor as a creature from another epoch.

16. *See* Charles J. Goetz & Robert E. Scott, *Measuring Sellers' Damages: The Lost-Profits Puzzle*, 31 STAN. L. REV. 323 (1979); WHITE & SUMMERS, *supra* note 12, § 7-14. *See also* R.E. Davis Chem. Corp. v. Diasonics, Inc., 826 F.2d 678 (7th Cir. 1987).

17. *See* Robert E. Scott, *The Case for Market Damages: Revisiting the Lost Profits Puzzle*, 57 U. CHI. L. REV. 1155 (1990). *See also* Morris G. Shanker, *The Case for a Literal Reading of U.C.C. Section 2-708(2) (One Profit for the Reseller)*, 24 CASE W. RES. L. REV. 697 (1973).

18. *See Neri*, 285 N.E.2d at 314 n.2 (citing 1956 N.Y. LAW REV. COMM. 397; 1955 1 N.Y. LAW REV. COMM. 761; N.Y. U.C.C. LAW § 2-708 (McKinney 1993); 1 WILLIAM F. WILLIER & FREDERICK M. HART, BENDER'S UNIFORM COMMERCIAL CODE SERVICE §2-708; Harris, *supra* note 12, at 104).

gets to credit the resale price against the seller's damages in all cases. That would completely vitiate the effect of section 2-708(2).

Section 2-708 does not refer to attorneys' fees. How does the court rule on Retail Marine's claim for $1,250 of attorneys' fees?

Student: The court denies recovery of attorneys' fees.

Instructor: Retail Marine claimed attorneys' fees under section 1-106 of the U.C.C. Notice that Retail Marine can argue that without recovering attorneys' fees, they will not be "put in as good a position as if the other party had fully performed." Nevertheless, most American courts deny attorneys' fees to prevailing parties unless there is a specific authorization in the relevant statute. Ask yourself whether you agree with the idea that attorneys' fees are not generally recoverable in contracts cases.

So it looks like Retail Marine emerges from section 2-708(2) with lost profit of $2,579 plus incidental damages of $674, or a total of $3,253. Let's return to section 2-718 to do the final calculation of how much money Retail Marine can keep, and how much it has to return to the Neris. What is the answer?

Student: Well, as you just said, damages were $3,253, so Retail Marine keeps this amount and returns the rest to the Neris. So $4,250 deposit minus $3,253 in damages equals $997 to be returned to the Neris.

Instructor: Is that the result reached by the Court of Appeals?

Student: Yes.

Instructor: Does anyone disagree with the court's calculations under section 2-718? Look at the relationship of sections 2-718(2) and 2-718(3). Did the court get that right? Another way to phrase the question is this: What happened to the $500 that we came up with when we construed the language of section 2-718(2)? Does anyone see what I am getting at here?

Student volunteer: Section 2-718(3) says that the buyer's right to restitution under subsection (2) is subject to offset by the seller's right to recover damages under other sections of Article 2. We calculated the buyer's right to restitution under section 2-718(2) as the deposit minus the $500. Then we should subtract the section 2-718(3) damages from that result.

Instructor: Thank you. That is exactly the argument that I was looking for. Under your analysis how much money would the Neris get back?

Same student (no longer a volunteer): Let's see. Under section 2-718(2), the buyer's right to restitution is the down payment of $4,250 less $500, or $3,750. Next we subtract the section 2-718(3) damages that were calculated to be $3,253. So the Neris get back only $497 of their $4,250 deposit.

Instructor: Very good. So we have two possible results under section 2-718: $997 or $497 going back to the Neris. Which is the right answer?

Student: Now I think $497.

Instructor: That answer does seem to me to be more consistent with the language of section 2-718. Section 2-718(3) says: "The buyer's right to restitution under subsection (2) is subject to offset . . . ." The buyer's right to restitution under section 2-718(2) is not the entire sum of the buyer's payments, but rather that sum minus 20% of the value of the total performance or $500. Once we calculate that figure, we offset, or subtract, what damages we get under section 2-718(3).

Student volunteer: But the language says it is the buyer's *right* to restitution, not the *amount*, that is subject to offset.

Instructor: That is an interesting argument—and one that had not occurred to me. Let me think about it for a moment. [Pause] Okay, I think your point is a good one, but I still think the language "subject to offset" is difficult to reconcile with the interpretation that sections 2-718(2) and 2-718(3) operate as separate alternatives. Notice that this is what the interpretive debate comes down to. Is section 2-718(3) an alternative to section 2-718(2), as the New York Court of Appeals says in *Neri*, or are the subsections cumulative, as I am suggesting the words "subject to offset" seem to denote?

Assuming that there is ambiguity in the language (perhaps because of the use of "right" to restitution rather than "amount" of restitution), which interpretation makes more sense as a policy matter? Should sections 2-718(2) and 2-718(3) be viewed as alternatives or cumulative? In other words, should the $500 be viewed as a minimum damages figure or as a figure to be added to actual damages in every case? If the $500 figure is a minimum (this assumes the alternative approach), then if actual damages are $300, the seller can keep $500 of the deposit. But if actual damages are $600, seller can keep only $600. Under the cumulative approach, if actual damages are $300, seller can keep $800; if actual damages are $600, seller can keep $1,100.

To answer which approach is better, we might want to ask first: What is the purpose of the $500 (or 20%) provision in section 2-718(2)? Why should sellers be able to keep these amounts, even if they can prove no damages, when buyers make deposits?

Student: To discourage buyers from breaching?

Instructor: Well, deterring breach is a plausible answer. But we know that the general rule of contract damages at common law is compensation, not deterrence or punishment of the breacher. The U.C.C. generally reaffirms this principle. Why should the U.C.C. depart from this principle when the buyer has made a down payment? Is the buyer who has made a deposit more likely to breach than one who has not made a deposit? Is a buyer who breaches after making a deposit more worthy of punishment?

Student: I don't think so. Actually, a buyer who has made a deposit seems less likely to breach than one who has not made a deposit. I also don't see any reason why a buyer who has paid some money to the seller should be worthier of punishment for breach.

Instructor: Is there any other reason you can think of for allowing sellers to keep a down payment even if the seller has no provable damages?

Student: Maybe the seller required a down payment in the first place because the seller thought it would be difficult or expensive to prove actual damages. And the buyer knew that the deposit was non-refundable.

Instructor: Good answer! But as to your point that the buyer knew that the deposit was non-refundable, we will soon see, when we study liquidated damages clauses, that generally parties cannot enforce agreements to set recoveries above anticipated compensatory damages. I like your idea that the deposit may be an attempt to compensate the seller for damages that are real, but difficult or expensive to prove. If that were the justification for the $500 (or 20%) provision of section 2-718(2), would that argue for the cumulative approach or the alternative approach?

Student: I'm not sure. If the problem is that it's too expensive to prove minor damages, then maybe the alternative approach makes more sense. But if the actual damages are expected always to be greater than the provable damages, then I guess the cumulative approach better addresses this problem.

Instructor: Excellent. I don't think I can add anything to what you've said. The fact is that we do not know for certain what the exact purpose of the 20%-or-$500 rule was. In some places prior to the U.C.C., a breaching buyer could not recover any money paid to a seller, regardless of the amount of the seller's damages. The 20%-or-$500 rule may have been a compromise.

Now, there is one final problem that I want to discuss before ending our analysis of sections 2-718 and 2-708.[19] It has to do with the interaction of those two sections. It is a problem resulting from the language of those sections that the drafters apparently did not see. Does anyone see a problem here?

[No response.]

Remember that earlier in our discussion someone suggested that we disregard the word "unpaid" before "contract price" in section 2-708(1). I said then that some commentators had made just that suggestion, but for a different reason. Well, this reason is what I am looking for now. Does this give anyone a clue as to what the problem is?

[No response.]

Okay. I recognize that it is difficult to see this argument without an illustration, especially since the problem is not really presented by *Neri* itself.[20]

Consider the following situation:[21] Seller and buyer enter into a contract for the sale of a used car for $5,000. Buyer pays $2,000 down and then breaks the contract. Seller sells the car to somebody else for $4,200. Assume that this was a reasonable resale, that there are no incidental damages or savings from breach, that there is no liquidated damages clause, and that seller does not have a section 2-708(2) lost profit argument.

First, how much of the $2,000 down payment should seller keep if our only goal were to protect seller's expectation interest?

Student: Well, if the buyer had performed, the seller would have received $5,000 for the car. Now the seller has received $2,000 from the breaching buyer and $4,200 from the second buyer. So the seller should return $1,200 and keep $800.

Instructor: That seems pretty straightforward. We want the seller to keep just enough so that she gets a total of $5,000 for her car. Let's run the numbers through sections 2-718 and 2-708. Starting with section 2-718(2), what is the sum of buyer's payments?

Student: $2,000.

19. Sometimes I do not even begin a discussion of the following problem concerning the interaction of U.C.C. §§ 2-718 and 2-708. If it has been a long, difficult process to get to this point, I often decide that it is better to forgo this final issue.

20. In most of my classes, nobody does see the problem at this point. There have been a few exceptions. One student came to my office to point out the problem before we had reached it in class.

21. This hypothetical, right down to the numbers used, comes from the excellent discussion in NORDSTROM, *supra* note 9, § 184. Although this discussion is thirty years old, I have not found a better one in any subsequent case or commentary.

Instructor: What is 20% of the value of buyer's total performance?

Student: Twenty percent of $5,000, or $1,000.

Instructor: So $500 is smaller. What then is the bottom line?

Student: Two thousand dollars exceeds $500 by $1,500, so buyer gets back $1,500 and seller keeps $500 under section 2-718(2).

Instructor: Next we go to section 2-708(1) via 2-718(3). What is the market price at the time and place for tender?

Student: If we use the resale price as the market price, then $4,200.

Instructor: Recognizing that the market price is a question of fact, let's proceed on the assumption that the market price is indeed $4,200. What is the unpaid contract price?

Student: Five thousand dollars total price minus $2,000 down payment, or $3,000.

Instructor: Which is the minuend and which is the subtrahend?

Student: I have no clue, but we should subtract the market price from the unpaid contract price.

Instructor: Why?

Student: Because the seller is damaged only if the unpaid contract price exceeds the market price.

Instructor: So what is the result?

Student: Since $3,000 minus $4,200 is a negative number, seller keeps only the $500 from section 2-718(2).

Instructor: Notice that this result falls short of protecting the seller's expectation interest. That cannot have been the intention of the drafters. What is the problem?

Student: I don't know.

Instructor: Look at the figure for unpaid contract price that we used in section 2-708(1). We said it was $3,000, $5,000 minus the $2,000 down payment. But after giving effect to section 2-718(2), is this buyer still $2,000 out-of-pocket?

Student: Oh, now I see. If buyer is getting $1,500 back under section 2-718(2), his down payment should be only $500 and the unpaid contract price should be $4,500.

Instructor: What is the calculation under section 2-708(1) using that analysis?

Student: Unpaid contract price of $4,500 minus market price of $4,200, or $300. So the buyer's right to restitution is reduced by $300, down to $1,200. Seller gets to keep $800.

Instructor: That would be the correct amount to protect the seller's expectation interest, according to our previous calculation. But notice also that we still have the problem of whether the subparts of section 2-718 are alternative or cumulative. If alternative, then the section 2-718(3) damages of $300 are less than the $500 damages under section 2-718(2), and the buyer's right of restitution would remain at $1,500. So we have not completely eliminated the problem by raising the unpaid contract price from $3,000 to $4,500. That is why some commentators have suggested disregarding the word "unpaid" in section 2-718(1), when there is a down payment and sections 2-718 and 2-708 are interacting.[22] What would the result be if we disregarded the word "unpaid"?

Student: Under section 2-708(1), you would subtract the market price of $4,200 from the contract price of $5,000 and get $800.

Instructor: Right. The suggestion is that to avoid double-counting the down payment, we should disregard the word unpaid when we construe section 2-708(1) after reaching a result under section 2-718(2). Notice that if there is no down payment, and no resort to section 2-718, then "unpaid" must be included in section 2-708(1) to avoid overcompensating the seller.

We still have the old problem of whether the parts of section 2-718 are cumulative or alternative. But now we have the right numbers to choose from. The alternative approach would allow seller to keep $800, and thus get her full

22. *See* NORDSTROM, *supra* note 9, § 184. *See also* Madsen v. Murrey & Sons Co., 743 P.2d 1212 (Utah 1987).

contract/market differential. The cumulative approach would allow seller to keep the $800 and the $500 from section 2-718(2). Are there any questions?

Student: Which approach do most courts use, the alternative approach or the cumulative approach?

Instructor: As we know, the *Neri* court used the alternative approach without any consideration of the cumulative approach. I have not been able to find any case that actually discusses the choice between the two approaches. Maybe someone in this class will make new law in this area someday.

Well, that brings us to the end of our discussion of *Neri*, section 2-718 and section 2-708. I realize that some of the analysis that we have gone through may be difficult for some of you. This was our first intensive exercise in the alien territory of statutory construction. We will have other opportunities to sharpen our skills in reading statutes. For now, be sure to go over your class notes carefully, and try to follow each step that we took in class. If you have any questions, please come to see me. Are there any other questions?

Student: Can we go on to the next case? My head hurts.

Instructor: Yes, we can. But let's close out *Neri* with a song.

Neri and the U.C.C.
[Sung to the tune of "Charlie and the MTA" by the The Kingston Trio][23]

Let me tell you the story of a man named Neri
On a tragic and fateful day.
He put thousands in his pocket to put down on deposit
On a boat he would sail away.

Chorus: But was his money returned?
No. It never returned.
On the deal he got quite burned. Poor old Neri . . .
He will wander the halls
Outside the courts of justice.
The U.C.C., he never will learn.

23. Although a student, Kevin Batt, Boston University School of Law class of 1996, wrote the words to this song, most current students have not heard of The Kingston Trio and are not familiar with this song. In fact, I used to think I was funny by referring to Lord Mansfield's three kinds of covenants in *Kingston v. Preston*, 98 Eng. Rep. 606 (1773), as "The Kingston Trio." I stopped making this comment a few years ago, after belatedly realizing that almost nobody knew what I was talking about.

After paying the deposit, he felt strangely spasmodic,
and by morning he felt quite ill.
To the dealer his lawyer wrote: "Go on. Just keep the boat."
The dealer said: "He pays the bill."

Chorus: And was his money returned?
No, it was never returned.
A contract, you shall not spurn. Poor old Neri . . .
He will wander the halls
Outside the courts of justice.
The U.C.C., he never could learn.

Neri thought he would win when the learned judge said:
"Just look in Section Seven-One-Eight."
But, on further perusal, sir, I fear you're bamboozled.
Seven-Zero-Eight rules your fate.

Chorus: And was his money returned?
No, it never returned.
Double profits the dealer shall earn. Poor law students . . .
We will wander the halls
Outside the courts of justice.
The U.C.C., we never shall learn.