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SOCIAL JUSTICE AND DEPOSIT RETURN CALCULATIONS: A STUDY OF SUCCESS AND FAILURE IN COMMERCIAL LAW REFORM

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INTRODUCTION

The time has come to address ambiguity in the interpretation of the Uniform Commercial Code ("UCC") provisions governing the return of deposits to defaulting buyers found in subsections 2-718(2) and (3) of Article 2 governing the sale of goods.[1] In brief, the concern is that ambiguity in the drafting of UCC § 2-718(2) and (3) allows courts to understate the restitution amount returnable to a defaulting buyer who made a deposit on a contract for the sale of goods. This mistaken interpretation allows sellers to retain a premium or penalty, in addition to compensation for actual damages. Recent case law creates the risk that this "penalty" interpretation will become the norm.[2] Although the

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[1] U.C.C. § 2-718 (AM. LAW INST. & UNIF. LAW COMM'N 2018). Section 2-718 appears in the same form today as it appeared when the official version of the U.C.C. was adopted in 1962. Following withdrawal of proposed revisions to U.C.C. Article 2, as discussed in this article, the official version of Article 2 reverted to that promulgated in 1962 but for a few conforming amendments to Article 2 adopted as part of revisions to U.C.C. Article 7 in 2003. Amendments to Article 2 proposed in 2003 were withdrawn in 2011. The U.C.C. was last amended in 2018 but those amendments are not relevant to the matters discussed in this article. The UCC is a joint project of the American Law Institute ("ALI") and the Uniform Law Commission ("ULC"). During the bulk of the legislative history discussed herein, the ULC was known as the National Conference of Commissioners on Uniform State Laws ("NCCUSL").

[2] *See infra* Part I text accompanying notes 14–33. The troubling cases appear in New York. This raises particular concerns. New York decisions command added respect around the country in commercial matters because the court system includes the Commercial Division, which handles complicated commercial cases as part of the

maximum dollar amount of the penalty is, at most, $500 in any one case, the "penalty" interpretation nonetheless raises social justice concerns that must be addressed.

Empirical studies show that many Americans are unable to pay an unexpected $500 debt.[3] Twenty-five percent of American families have less than $400 in savings.[4] More broadly, in 2017, forty percent of adults report that they or their families had trouble meeting at least one basic need for food, health care, housing or utilities.[5] Though $500 may appear small in a legal setting—given the myriad court costs, legal fees, and expenses associated with any case—social science research shows that the loss of this amount would create real economic hardship for many individuals and families.

Given this economic reality, stewardship of the law requires that sellers not be overcompensated for their losses unless the parties have otherwise agreed to an enforceable liquidated damages clause.[6] As explained below, neither the language nor the history of UCC § 2-718(2) and (3) require the imposition of a penalty or premium as part of the UCC's scheme of default rules. Significantly, a proposed amendment to the UCC that would have addressed this problem was abandoned.[7]

Supreme Court of the State of New York. The respect extends beyond those cases specifically handled by the Commercial Division.

[3] Maggie McGrath, *63% Of Americans Don't Have Enough Savings to Cover a $500 Emergency*, FORBES (Jan. 6, 2016), https://www.forbes.com/sites/maggiemcgrath/2016/01/06/63-of-americans-dont-have-enough-savings-to-cover-a-500-emergency.

[4] THE PEW CHARITABLE TRUSTS, THE ROLE OF EMERGENCY SAVINGS IN FAMILY FINANCIAL SECURITY: WHAT RESOURCES DO FAMILIES HAVE FOR FINANCIAL EMERGENCIES? 6 (2015), http://www.pewtrusts.org/~/media/assets/2015/11/emergencysavingsreportnov2015.pdf.

[5] MICHAEL KARPMAN ET AL., MATERIAL HARDSHIP AMONG NONELDERLY ADULTS AND THEIR FAMILIES IN 2017 2 (2018), https://www.urban.org/sites/default/files/publication/98918/material_hardship_among_nonelderly_adults_and_their_families_in_2017.pdf.

[6] *See* U.C.C. § 2-718(1). An argument for substantive law reform that limits deposit retention and liquidated damages clauses in consumer contracts—regardless of any purported agreement—is beyond the scope of this article. For some types of transactions, a state consumer protection law may apply. *See, e.g.*, UNIF. CONSUMER CREDIT CODE § 2.504 (UNIF. LAW COMM'N 1968); *see also* Robert L. Jordan and William D. Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387, 441 (1968) (discussing home solicitation credit sales).

[7] *Recommendation of the Permanent Editorial Board for the Uniform Commercial Code to Withdraw the 2003 Amendments to UCC Articles 2 and 2A from the Official Text of the Uniform Commercial Code*, *reprinted in* 65 CONSUMER FIN. L.Q. REP. 150 (2011). *See generally* Scott J. Burnham, *Thoughts on the Withdrawal of Amended Article 2*, 52 S. TEX. L. REV. 519 (2011).

The following tells a story of how the mechanics of current law reform have failed to address problems of particular concern to low-income people. This failure occurs in the shadow of prior successes that made the law of deposit returns fairer, but not perfect. In an age of increasing income inequality, it is important to understand and address this phenomenon. The law-making process that generated the law appears powerless to fix it. This circumstance raises the larger question of how to address these types of problems without derailing large meritorious projects.

Essentially, there is a fundamental design failure on two levels: first, the usage of the law in actual cases does not track the practice envisioned by the UCC drafters; and second, the traditional amendment process for the UCC is not capable of dealing with problems revealed by the operation of the law in action when it differs from the usage anticipated by its structure.

As to the actual usage of the law, it will be shown, in deposit return cases, that the UCC appears to be functioning like a civil code, not like the "common law" code envisioned by its creators.[8] In practice, courts and parties tend to apply the law following a surface reading of the statute, as is done in a civil law system.[9] Use of the UCC as a civil code, treating it as though it is complete and gapless, partly explains the erroneous judicial decisions relating to deposit return calculations and why the common law structure of decision and precedent has failed to correct these injustices.[10]

Regarding the amendment process, despite enormous effort, the traditional law revision procedures orchestrated through the ALI and the ULC failed to address the first system-design failure

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[8] *See, e.g.*, John E. Murray, Jr., *An Effective Article 2 of the Uniform Commercial Code: Who is Responsible?*, 11 DUQ. BUS. L.J. 123 (2009) (confirming that "[t]here has never been any doubt that the Uniform Commercial Code, especially Article 2, was not designed as a civil code").

[9] *See generally* Gunther A. Weiss, *The Enchantment of Codification in the Common-Law World*, 25 YALE J. INT'L L. 435 (2000) (explaining the simple dichotomy between civil law and common law, while suggesting the reality is more complex). "The ideal was that the code could answer all legal questions and that it would not be necessary to fall back on judges' opinions, customs, or scholarly wisdom." *Id.* at 456.

[10] A surface reading of the statute should suffice in a civil law system because its ideal form is complete and gapless. "It is often claimed that codification has no gaps. Then, it is said, the judge's role is limited to mechanical application of the code, and the judge is, in Montesquieu's words, only the 'mouthpiece' of the code." *Id.* at 458.

when they withdrew the proposed amendment to Article 2.[11] The cumbersome amendment process itself constitutes a second system-design failure.

Primary blame for the failure to enact revised Article 2 rests with state legislatures, influenced by special interests concerned with matters unrelated to deposit return calculations.[12] The shortcomings of the ALI and ULC rest with a structural inability to deal with important, but technical, fixes outside of the grand amendment. When the UCC operates as a civil code, the conventional apparatus of a Permanent Editorial Board comment, ideally suited to certain types of technical corrections, will not suffice as a second-best solution if the intended audience does not read it.[13]

Accordingly, the case is made for a populist takeover of the amendment process, state by state, to correct the social injustice of deposit return calculations where established institutions of reform have failed.[14] Based on the research presented here, the most important state for an amendment is New York, since that jurisdiction is both influential and the one in which case law has advocated for the "penalty" interpretation.

This Article proceeds as follows: Part I describes case law which uses a "penalty" interpretation for § 2-718(2) and (3). Part II describes case law in which courts do not apply a penalty. Part III offers a penalty-free interpretation for § 2-718(2) and (3)

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[11] *See* Burnham, *supra* note 7, at 525–27. The failure was not a result of capture of the ALI or the ULC by special interest groups. *See generally* Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569, 585–86 (1998).

[12] *See* William H. Henning, *Amended Article 2: What Went Wrong?*, 11 DUQ. BUS. L.J. 131, 133–34 (2008).

[13] The Permanent Editorial Board ("PEB") is composed of members from the ALI and the ULC. It prepares commentaries and advises its member organizations on further changes needed to the UCC. Its activities with respect to the UCC are governed by an agreement dated July 31, 1986, as amended January 18, 1998, among the ALI, ULC, and PEB. *Permanent Editorial Board for the Uniform Commercial Code: Agreement Describing the Relationship of the American Law Institute, the National Conference of Commissioners on Uniform State Laws, and the Permanent Editorial Board with Respect to the Uniform Commercial Code* (July 31, 1986), https://www.ali.org/media/filer_public/54/d2/54d2249e-61df-4c33-bba7-b539bf8a5b99/agreement-peb-ucc.pdf.

[14] The North Carolina legislature is unique in addressing this problem, albeit limited to the context of layaway plans. N.C. GEN. STAT. § 25-2-718(2)(c). *See* HAWKLAND, UNIF. COM. CODE SERIES, LOCAL CODE VARIATIONS, 2017-2018 EDITION 366–69 (2017). The North Carolina variation is discussed in Part VI. In fact, the North Carolina legislature appears to have botched the amendment. *See infra* Part VI notes and accompanying text.

that remains true to the statutory language. These three parts make extensive use of numerical examples and explanations. Although the presentation may seem dense in parts, an appreciation of the numbers is essential to understanding both the problem and the solution.

Part IV describes the drafting history of § 2-718(2) and (3) to support the preferred interpretation. Understanding how we got here motivates the impetus for reform by revealing the complete lack of justification for the penalty interpretation. Part V explains that correcting the penalty interpretation has the potential to positively impact the lives of many low-income individuals, people for whom $500 is by no means a small calculation quibble. Here, structural concerns and system-design failures are discussed as important factors in favor of reform. The Article concludes in Part VI with a defense of a populist agenda for a non-uniform amendment to the UCC, including an appendix offering the simple statutory fix for proposal to state legislatures. It describes the kind of theory of legislation required to advocate for change despite the risk that such a change poses for uniformity in the law.

I. THE ARITHMETIC, CASE LAW, AND STATUTORY CONSTRUCTION CREATING A PENALTY

The recent cases adopting the "penalty" interpretation arise in New York. *Gongora v. Eye Gallery of Scarsdale* is a recent example.[15] In that case, Gongora brought a small claims action to recover a $750 deposit that she provided to Eye Gallery of Scarsdale toward the purchase of a pair of eyeglasses for a total purchase price of $1,380.[16] At trial, defendant proved actual damages of $250 from Gongora's breach, representing the cost of lenses which Eye Gallery could not resell.[17]

For reasons not explained, the small claims court dismissed the action, apparently allowing defendant Eye Gallery of Scarsdale to retain the entire $750 deposit.[18] The appellate court reversed, directing entry of judgment of $224 for Gongora as restitution.[19] This allowed defendant Eye Gallery to retain $526 of the deposit, rather than the full $750 amount allowed by the trial court.

[15] 51 Misc. 3d 140(A), 37 N.Y.S.3d 207 (2d Dep't 2016).
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.*

The court properly[20] began its analysis by noting that UCC § 2-718 governed the treatment of the deposit:

> Section 2-718 of the Uniform Commercial Code provides, in pertinent part, that, in the absence of a contractual provision with respect to the liquidation or limitation of damages and the return of deposits,
>
> > "(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds . . .
> > (b) . . . twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.
> > (3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes
> > (a) a right to recover damages under the provisions of this Article other than subsection (1), and
> > (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract."[21]

Pursuant to subsection (2)(b), the court determined that defendant could retain a base amount of $276.[22] The result of the twenty percent or $500 calculation under (2)(b) is hereafter called the "**base retention amount**." This $276 represents twenty percent of the value of total performance owed by Gongora—0.2 x $1,380, the value of total performance for which the buyer was obligated. Per the statute, the defendant's entitlement extends to the smaller $276 amount, rather than to the larger $500 amount. Considering subsection (2)(b) *in isolation*, defendant should return the balance of the deposit—$474—to Gongora as a restitution amount. However, subsection (2)(b) does not function in isolation.

Pursuant to subsection (3)(a), the base retention amount increases by damages, which the seller may recover under Article 2 because these damages are an offset, or reduction, to the restitution amount owed to the buyer.[23] If the total retention

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[20] The eyeglasses satisfy the UCC definition of a "good." *See* U.C.C. § 2-105(1) (AM. LAW INST. & UNIF. LAW. COMM'N 2018) (A good includes "all things . . . which are movable at the time of identification to the contract for sale."). Thus, eyeglasses fit under the UCC's scope of coverage. *See* U.C.C. § 2-102 (AM. LAW INST. & UNIF. LAW. COMM'N 2018) (specifying Article 2 coverage for "transactions in goods").

[21] *Gongora*, 51 Misc. 3d 140(A), 37 N.Y.S.3d 207.

[22] *Id.*

[23] Article 2 generally provides for damages available to a seller, with the special case of damages available upon a buyer's insolvency contained in section 2-702. *See generally* U.C.C. §§ 2-703–2-710 (AM. LAW INST. & UNIF. LAW. COMM'N 2018).

amount for the seller increases by proof of damages, the restitution amount owed to the buyer decreases. On one reading of the statute, the total amount a seller may retain is determined pursuant to an *additive* formula: base retention amount plus damages equals total retention amount. Using the additive method of computation, the base retention amount is the premium or penalty kept by the seller above actual damages.

As the appellate court noted, the buyer's restitution amount decreases because it is subject to a reduction by "offset" under subsection (3)(a) to the extent that the seller establishes "a right to recover damages under the provisions of this Article other than subsection (1)."[24] Subsection (1) is not relevant here because that subsection deals with contracts in which the parties have specified a liquidated sum as damages. The appellate court noted that defendant did not prove any damages other than the $250 loss related to the lenses, nor had it established that Gongora received any other amount or benefit by reason of the contract, so subsection (3)(b) did not apply.[25]

The additive method used by the appellate court in *Gongora* required that subsection (2)(b) and subsection (3)(a) be applied in two separate and unrelated steps. Under subsection (2)(b), the first step determines a base retention amount for the seller. That base retention amount is equal to the lesser of twenty percent of the value of total performance and $500. Having determined the base retention amount under subsection (2)(b), the next calculation determines whether the seller may establish the right to recover damages under another section of Article 2.

The base retention amount is added to the actual damage amount to which the seller may establish a right, creating a total retention amount for the seller. The restitution amount owed to the buyer is simply the amount of the deposit minus this total retention amount. On the additive method, the computation of the base retention amount has no impact on the actual damage amount to which the seller may establish a right under another provision of Article 2.

Separate sections provide for damages available to a buyer. *See* U.C.C. §§ 2-711–2-717 (AM. LAW INST. & UNIF. LAW. COMM'N 2018). It is the former seller-directed sections to which the UCC refers when it refers to "a right to recover damages under the provisions of this Article other than subsection (1)." U.C.C. § 2-718(3)(a) (AM. LAW INST. & UNIF. LAW. COMM'N 2018).

[24] U.C.C. § 2-718(3)(a).

[25] *Gongora*, 51 Misc. 3d 140(A), 37 N.Y.S.3d 207.

The *Gongora* appellate court arguably applied the law correctly to the facts, considering each twist and turn in the statute. In allowing the retention of a penalty amount exceeding actual damages, the court cited the old precedent of *Feinberg v. Bongiovi*[26] to support its computation. In *Feinberg*, the plaintiff ordered wood from defendant, placing down a deposit of $400.[27] The contract price for the wood ordered was $895.[28] The court computed twenty percent of the contract price at $179, which is less than $500.[29] This created a base retention amount of $179. However, the seller had incurred a cost of $50 relating to a notification given to the woodcutter.[30] The notification charge appears to be the only damage incurred by the seller, though the court does not expressly say so.

The *Feinberg* computation of the restitution amount followed the *Gongora* pattern: deposit amount—$400—minus total retention amount—$229—equals a restitution amount of $171. A few months after *Gongora*, the additive method was used in *McCann v. McSorley*.[31] In *McCann*, plaintiff made a deposit of $1,800 toward a $3,320 purchase order of canvas slipcovers.[32] After plaintiff repudiated his order, the court computed restitution:

> [S]ubstantial justice (see UDCA 1804, 1807) requires that plaintiff be awarded his $1,800 deposit, less $500 (which is the smaller amount pursuant to UCC 2-718[2][b]), and less $600 in damages that defendant established pursuant to UCC 2-718(3)(a), for a total award in the principal sum of $700 in favor of plaintiff on his cause of action.[33]

Starting with *Feinberg* and extending to the recent decisions of *Gongora* and *McCann*, New York courts have employed a consistent approach—the additive method—to determine the restitution amount owed to a defaulting buyer who has made a

[26] 110 Misc. 2d 379, 442 N.Y.S.2d 399 (Dist. Ct. Suffolk Cnty. 1981).
[27] *Id.*
[28] *Id.* at 380, 442 N.Y.S.2d at 399.
[29] *Id.*
[30] *Id.*
[31] 53 Misc. 3d 48, 39 N.Y.S.3d 583 (2d Dep't 2016).
[32] *Id.* at 49, 39 N.Y.S.3d at 585.
[33] *Id.* at 51, 39 N.Y.S.3d at 586.

deposit. This calculation method creates a premium or penalty in most cases.[34] This consistency, however, violates binding precedent in New York, as explained in Part II.

II. CASE LAW WITH NO PENALTY OR PREMIUM

Courts do not universally apply the additive method to compute deposit return amounts under UCC § 2-718(2) and (3). Most courts simply perform the calculation without including a penalty, by implication rejecting the additive method, but unfortunately often without any explanation of the statutory basis for the calculation.

The courts in *Gongora*, *Feinberg*, and *McCann* were erroneous in their application of the additive method; indeed, this methodology is directly contrary to the method utilized by the New York Court of Appeals in the case of *Neri v. Retail Marine Corp*.[35] The courts in *Gongora*, *Feinberg*, and *McCann* might have followed the calculation method used by the highest court in New York, but they did not.[36]

In *Neri*, the plaintiffs agreed to purchase a boat for the price of $12,587.40, making a deposit of $4,250.[37] The trial court allowed the defendant seller to keep $500 and directed it to return the balance of the deposit, or $3,750, to plaintiff.[38] The trial court treated subsection (2)(b) as a stand-alone provision, ignoring the possibility contained in subsection (3)(a) that the restitution amount might be reduced to the extent that a defendant can show damages under another section of Article 2.

[34] A premium or penalty will not exist if the actual damages proved equal or exceed the total amount of the deposit.

[35] 30 N.Y.2d 393, 334 N.Y.S.2d 165 (1972).

[36] The Court of Appeals interpreted subsection (3)(a) to provide an "alternative" to the retention of $500 under subsection (2)(b), at least strongly implying—if not outright holding—that use of the additive method is improper. This makes the cases of *Gongora*, *Feinberg*, and *McCann* harder to understand because the Court of Appeals is binding precedent. A Missouri court cited *Neri* and the alternative approach with approval; however, it remanded the case for further proceedings. Anheuser v. Oswald Refractories Co., Inc., 541 S.W.2d 706, 712 (Mo. Ct. App. 1976).

[37] *Neri*, 30 N.Y.2d at 396, 334 N.Y.S.2d at 166–67.

[38] *Id.* at 397, 334 N.Y.S.2d at 167.

The record showed defendant suffered damages of $3,253, consisting of $2,579 in lost profits[39] and incidental damages of $674.[40] The court computed the restitution amount due to plaintiff as follows: deposit amount—$4,250—minus actual damages—$3,253—equals a restitution amount of $997. Significantly, the court did not allow defendant to retain an additional penalty as was permitted in *Gongora*, *Feinberg*, and *McCann*—no base retention amount for the seller was included in the calculation. Had it done so, plaintiff would have been entitled to a smaller restitution amount of $497 because the penalty would have equaled $500—that is, 0.2 x $12,587.40 = $2,517.48—which is greater than $500, so $500 would have been used as the base retention amount.

The *Neri* court applied UCC § 2-718, but explained little else:

> As above noted, the trial court awarded defendant an offset in the amount of $500 under paragraph (b) and directed restitution to plaintiffs of the balance. Section 2-718, however, establishes, in paragraph (a) of subsection (3), an *alternative* right of offset in favor of the seller, as follows: '(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes (a) a right to recover damages under the provisions of this Article other than subsection (1)'.[41]

The *Neri* court stated that subsection (3)(a) is an "alternative" but did not explain why it is not "additive," as lower New York courts would later construe the statute.[42] The statutory language, however, appears to contemplate that subsections (2)(b) and (3)(a) work together and not in the alternative.

The calculation method used in *Neri*, however, is consistent with *dicta* in a prior New York Court of Appeals case in which the Court describes the operation of § 2-718(2) and (3):

> That does not necessarily mean, however, that [the seller] would be entitled to retain as against [the buyer] only $500 of the $217,279.66 which was [the buyer]'s part payment on these contracts. The Uniform Commercial Code allows the seller actual damages where liquidated damages have not been stipulated . . . . Manifestly, if [the buyer] defaulted on these

[39] The *Neri* case is most famous for its explanation of when and why lost profits may form an element of damages under Article 2 for a lost volume seller and appears in many contracts casebooks. *See* Mark Pettit, Jr., *Exercising with* Neri v. Retail Marine Corp., 44 ST. LOUIS L.J. 1487 (2000) (naming casebooks which use *Neri*).

[40] *Neri*, 30 N.Y.2d at 401, 334 N.Y.S.2d at 171.

[41] *Id.* at 397, 334 N.Y.S.2d at 168 (emphasis supplied).

[42] *Id.*

> contracts, [the seller] was entitled to retain as against [the buyer] so much of the $217,279.66 part payment as would be necessary to offset its damages due to a falling market plus incidental damages, such as extra transportation, storage, legal expense, and other items to which it was subjected by [the buyer]'s default.[43]

It is clear that the Court of Appeals does not endorse the additive method because it makes no mention of a base retention amount to which actual damages are added. The court simply states that actual damages would be satisfied out of the prior payments.[44]

The *Neri* case is not unique in failing to allow a seller to retain both a penalty and its actual damages. In a Florida case, *Honsberg v. Lystra*,[45] the court apparently rejected the additive method. In *Honsberg*, plaintiffs made a $10,000 deposit towards the purchase of a mobile home costing a total of $28,000.[46] The trial court determined actual damages of $4,826.26, leaving a deposit balance of $5,173.74.[47] The appellate court ordered this balance returned to the breaching buyer as restitution.[48]

Note that if the Florida appellate court had followed the additive method used in *Gongora*, *Feinberg*, and *McCann*, the court would have first identified a base retention amount for the seller—which, on these facts, would have been $500. Then it would have added the actual damages to the base retention amount, arriving at a total retention amount of $5,326.26. Subtracting this from the deposit of $10,000, the restitution amount should have been $4,673.74, and not $5,173.74.

Unfortunately, the *Honsberg* court does not explain how its calculation complies with § 2-718. It simply states that the contract was "not a provision for liquidated damages."[49] Because the *Honsberg* contract did not contain a liquidated damages clause, subsection (2)(b) would seem to apply, allowing the seller to keep the base retention amount. This would put the additive method in play, had the court adopted it.

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[43] Procter & Gamble Distrib. Co. v. Lawrence Am. Field Warehousing Corp., 16 N.Y.2d 344, 354–55, 266 N.Y.S.2d 785, 792–93 (1965).

[44] *Id.*, 266 N.Y.S.2d at 793.

[45] 410 So. 2d 661 (Fla. Dist. Ct. App. 1982).

[46] *Id.* at 662.

[47] *Id.*

[48] *Id.*

[49] *Id.*

The relevant provision of the *Honsberg* contract stated:

> 5. Upon failure or the refusal of the purchaser to complete said purchase within 30 days of contract date, or an agreed extension therefor for any reason (other than cancellation on account of increase in price) the cash deposit may have such portion of it retained *as will reimburse the dealer for expenses and other losses* including attorney fees occasioned by purchaser's failure to complete said purchase. In the event a used car, trailer or mobilehome [sic] has been taken in trade, the purchaser hereby authorizes the dealer to sell said property, at public or private sale, and to deduct from the proceeds thereof a sum equal to the expenses and losses incurred, or suffered, by the dealer by reason of purchaser's failure to complete the transaction. *Dealer shall have all the rights of a seller, upon breach of contract, under the Uniform Commercial Code 2–708, 2–710, 2–718*, of the Uniform Sales Act (as applicable).[50]

The court analyzed paragraph 5 of the contract as follows: "This is not a provision for liquidated damages. It is, in fact, exactly the opposite. Simply put, paragraph 5 says that the deposit shall constitute a fund securing to the seller the actual amount of damages he sustains by reason of buyers' failure or refusal to complete the purchase."[51]

There are two ways to read *Honsberg* in light of this contract section and the court's statement. A proponent of the additive method might say that the additive method is still an appropriate calculation in Florida, despite *Honsberg*, because the actual contract language should be interpreted to limit the use of the deposit to only that which will reimburse the "dealer for expenses and other losses."[52] On this reading, because the contract language itself limits the retention amount to actual damages, it overrides any generally applicable statutory method allowing for a penalty in addition to actual damages—or so the proponents of the additive method might argue.

The problem with this reading of *Honsberg* is that the contract states at the end of paragraph 5 that "Dealer shall have all the rights of a seller, upon breach of contract, under the Uniform Commercial Code 2-708, 2-710 and 2-718 . . . ."[53] If § 2-718 is properly read by *Gongora*, *Feinberg*, and *McCann* to provide the aggrieved seller with a premium or penalty, then the dealer in

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50 *Id.* (emphasis added).

51 *Id.*

52 *Id.*

53 *Id.*

Honsberg should have received it per the express contract language referencing § 2-718, notwithstanding the earlier mention in that clause of "dealer for expenses and other losses."[54] Seen this way, the contract language makes clear that the deposit will be used to secure payment of actual damages, but it does not say that this is the exclusive use to which the deposit may be applied. Indeed, quite the opposite is true by its reference to § 2-718.

While the matter is not clear given the brevity of the court's remarks, the reading of *Honsberg* pursuant to which the court rejects the additive method is preferred because, if the court read § 2-718 to require the additive method, the contract language would give the dealer the benefit of the premium or penalty by virtue of paragraph 5's express reference to § 2-718. That is to say, *Honsberg* is consistent with *Neri* and not simply inapplicable to the question.

Interestingly, a more recent federal district court applying Florida law did not use the additive method either: "In total, Validsa suffered $40,764,093.30 in damages. After considering the $44,580,576.00 in advances that Defendants paid Validsa, the Court finds that Defendants are entitled to recover $3,816,482.70."[55]

While the district court did not use the additive method, the $500 premium or penalty which it declined to include in its calculation is most likely a mere rounding error given the very large deposit and damages. In the absence of an explanation for the calculation, we can infer that the court did not approve of the additive method; however, it is difficult to place much credence on this case, considered in insolation, since $500 in the context of such large figures is quite insignificant. Similarly, courts outside Florida also have used the alternative approach and, in so doing, have apparently rejected the additive method.[56]

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[54] *Id.*

[55] Validsa, Inc. v. PDVSA Servs. Inc., No. 08-21682-CV, 2010 WL 411019, at *12 (S.D. Fla. Jan. 29, 2010), *aff'd*, 424 Fed. App'x 862 (11th Cir. 2011) (emphasis omitted). Defendants would have recovered $500 less if the court had applied the additive method.

[56] *See* Anheuser v. Oswald Refractories Co., 541 S.W.2d 706 (Mo. Ct. App. 1976) (applying Missouri law); Madsen v. Murrey & Sons Co., 743 P.2d 1212 (Utah 1987) (applying Utah law); Conister Trust Ltd. v. Boating Corp. of America, No. M1998-00949-COA-R3-CV, 2002 WL 389864, (Tenn. Ct. App. Mar. 14, 2002) (applying Tennessee law); Bowen v. Gardner, 425 S.W.3d 875 (Ark. Ct. App. 2013) (applying Arkansas law).

III. A THIRD PATH: THE CONTEXT SENSITIVE INTERPRETATION

The revelation of two different readings for UCC § 2-718(2) and (3) is not new to the academic literature. Professor Pettit noted the problem in a law review article illustrating how *Neri* might be used in teaching an introductory contracts course.[57] Though the article is styled as a dialogue—and no definitive conclusion is reached other than to note the ambiguity—it appears that Pettit favors the additive method because it better accounts for the statutory language. In his view, the choice is between the additive method and a reading which treats the statute as requiring application of either subsection (2)(b) or subsection (3)(a), but not both. Call this second option the "alternative" approach, as was done in *Neri*.[58]

Under the alternative approach, a seller must either accept the base retention amount computed under subsection (2)(b) or, alternatively, retain only that portion of the deposit that represents an offset for its actual damages under subsection (3)(a). If those were the only two possible interpretations, the additive method tracks the language better than the alternative approach as a matter of statutory construction.

As drafted, there is no indication that one should apply either subsection (2)(b) or subsection (3)(a), *but not both*; indeed, to provide an "offset" to the restitution amount in subsection (2)(b), as required by subsection (3)(a), the two subsections must work together, not separately. The alternative approach, while creative, does not track the statute well for this reason—though one can look to the *Neri* case as precedent. Indeed, the cases that apply the alternative approach rather than the additive method need to explain better why a base retention amount is not included, as apparently required by subsection (2)(b).

There is, however, a third way to read the statute which, in most cases, does not result in the retention of a premium or penalty. Call this calculation method the "context-sensitive" method. This approach generally produces the same result as the alternative approach arithmetically. It differs, however, in its explanation for how that result is achieved, while giving a more natural reading to the statutory language.

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[57] *See* Pettit, *supra* note 39, at 1497.

[58] *See supra* text accompanying note 39.

The context sensitive method computes the damages that a seller has "a right to recover" under subsection (3)(a) *after and in light of* the prior computation of the basic retention amount under subsection (2)(b). For example, if one computes a basic retention amount of $500 under subsection (2)(b), this $500 amount is considered when computing the amount of actual damages that a seller has a right to recover under subsection (3)(a). The amount of damages computed under subsection (3)(a) includes only damages in excess of the base retention amount. A seller holding a deposit that exceeds its actual damages cannot prove a right to recover more. This is because subsection (2)(b) does not create an absolute or abstract entitlement in the seller.

The context sensitive method treats damages provable under Article 2 as reduced by the basic retention amount because one should not double count—and prove as damages—an amount for which provision already has been made. To illustrate using the facts of *Feinberg*, with a base retention amount of $179, the woodcutter could not prove an additional $50 in damages under another part of Article 2 because that element of damages is already covered by the $179 base retention amount. While in possession of $179, the woodcutter has no additional right to recover under another part of Article 2.

The context sensitive method has the benefit of tracking the statutory language and yet, in most cases, will not result in the seller retaining a premium or penalty. The only circumstance in which a premium or penalty might be retained in the context sensitive method is a case in which the base retention amount exceeds the amount of actual, provable damages.[59] However, it does not force a court to pick between application of subsection (2)(b) and subsection (3)(a)—both sections are applied—and one can achieve the *Neri* result without having to agree that subsection (3)(a) is an "alternative" to subsection (2)(b).

Using the facts of *McCann*, we can illustrate the elimination of the penalty or premium. There, the base retention amount was $500, and the actual damages were $600, with a total deposit of $1,800.[60] In the context sensitive method, the seller would retain its base retention amount of $500 under subsection (2)(b). However, the seller would, in light of that retention, only be able to establish a right to recover an additional $100 as damages, and

[59] In such a case, subsection (2)(b) operates as a statutorily created liquidated damages clause, as explained in *infra* Part IV at text accompanying note 129.

[60] McCann v. McSorley, 53 Misc. 3d 48, 39 N.Y.S.3d 583 (2d Dep't 2016).

not $600. The additional $100 in damages is offset under subsection (3)(b), reducing the restitution amount, and increasing the retention amount to $600. The seller is compensated for its actual losses, but not more, on these facts.

We can use the facts of *Feinberg* to illustrate the case of premium or penalty retention using the context sensitive calculation method. In *Feinberg*, the base retention amount was computed at $179.[61] The actual damages were $50.[62] Using the context sensitive computation method, the seller would simply retain the base retention amount of $179 without an increase for the actual damages. The interpretive theory is that, in light of the retention of $179, the seller could not establish any damages under another section of Article 2. Yet, a premium or penalty is still retained because the base retention amount of $179 is greater than the actual damages of $50. A similar result obtains in *Gongora* because the base retention amount of $276 exceeds the actual damages of $250. Although, on those facts, the premium is reduced to a mere $26. The context sensitive method has the salutary effect of eliminating penalties and premiums in many cases, while reducing it, oftentimes substantially, in others.

An expansive use of the context sensitive approach in a case like *Feinberg* might apply the offset more broadly, allowing the proof of actual damages to serve as an offset to reduce the base retention amount to $50. This expansive approach requires that the contemplated offset might be positive or negative. Allowing the offset to be a negative number is a less natural reading of the term "offset." The expansive use of the context sensitive method produces a lower retention amount for the seller than the alternative approach because, in the alternative approach, the seller simply elects to retain the higher base retention amount.

While appealing as a matter of justice, the more expansive reading of the context sensitive method creates the odd circumstance of penalizing the seller for failing to demonstrate actual damages equal to at least the base retention amount. As nothing compels a seller to attempt to prove actual damages, it places a seller in a better position for having proved nothing. *Santos v. DeBellis*[63] illustrates this fact pattern. In *Santos v.*

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[61] Feinberg v. Bongiovi Contracting, 110 Misc. 2d 379, 380, 442 N.Y.S.2d 399 (Dist. Ct. Suffolk Ctny. 1981).

[62] *Id.*

[63] 28 Misc. 3d 48, 901 N.Y.S.2d 457 (2d Dep't 2010). The fact pattern of the mobile home purchase illustrates that even low-income persons make some large dollar

DeBellis, the plaintiff made a $6,000 deposit on the purchase of a $33,000 mobile home and then defaulted on the purchase.[64] The defendant did not prove any actual damages.[65] The court allowed the defendant to retain $500 and required the return of $5,500 to the plaintiff.[66]

While the context sensitive method tracks the statutory language well—until one applies an expansive reading—it is particularly appealing considering the odd and haphazard results of the additive method. In *Gongora*, the seller was overcompensated for its loss by $276, an amount exceeding its actual damages and, indeed, amounting to more than fifty percent of the total recovery for the seller. In *McCann*, the seller was overcompensated by $500, an amount equal to forty-five percent of the total recovery. Alarmingly, in *Feinberg*, the seller was overcompensated by $179, a figure that represents a massive seventy eight percent of the total recovery. All three of these cases present instances of unjust enrichment; moreover, the results of each case are at odds with the general theory of contract damages, that an innocent party should be compensated for its loss, but no more.[67]

Beyond the avoidance of unjust results that violate basic principles of contract law, four additional considerations support the context sensitive method. First, the UCC expressly rejects the imposition of penalties in the immediately preceding subsection, § 2-718(1), when the statute states that a liquidated damages provision will not be enforced if it amounts to a penalty.[68] Consider how nonsensical it would be to expressly disallow a penalty in

purchases that might trigger the loss of $500 as a penalty. Mobile home and automobile purchases often bring the full $500 penalty into play. Indeed, a low-income person might well make a mobile home purchase in an attempt to obtain more affordable housing. Further, while at first blush an expensive eyeglass purchase as in *Gongora* may not generate immediate sympathy, increasing costs of medical-related expenses make the $500 penalty a genuine social justice issue as well.

[64] *Id.* at 49, 901 N.Y.S.2d 457.

[65] *Id.* at 48, 901 N.Y.S.2d 457.

[66] *Id.* at 49, 901 N.Y.S.2d 457.

[67] *See* E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1159 (1970).

[68] U.C.C. § 2-718(1) (AM. LAW INST. & UNIF. LAW COMM'N 2018). Among other circumstances, a liquidated damages formula creates a penalty when it always awards the non-defaulting party more than actual damages. *See* Lake River Corp. v. Carborundum Co., 769 F.2d 1284, 1290 (7th Cir. 1985).

§ 2-718(1) and then to subsequently provide for a penalty by operation of subsections 2-718(2) and (3) which immediately follow.

Second, UCC § 1-305 states that penal damages are not allowed "except as specifically provided in [the Uniform Commercial Code] or by other rule of law."[69] While the operation of subsections 2-718(2) and (3) could represent an instance in which the drafters of the UCC intended to apply a penalty, notwithstanding the fact that penalties are generally disfavored for liquidated damages, a perfectly natural reading of the statutory language exists which does not create these inconsistent results.

Third, consider a case in which the actual damages exceed the deposit amount. In that case, the seller will be permitted to bring a lawsuit for the shortfall. The deposit simply functions as an offset or credit against the damages that may be proved in excess of the deposit. The seller does not retain an extra $500 in this case, suggesting that the base retention amount does not create an independent entitlement. This is a natural methodology. Importantly, the context sensitive method simply mirrors this general approach by allowing the proof of damages only to the extent that those damages exceed the base retention amount. One might analogize the base retention amount as a kind of security out of which damages are paid, just as the overall deposit functions as a kind of security out of which damages may be paid.

Fourth, a leading treatise on the UCC contains a description of the deposit return calculations that can support the context sensitive method:

> Section 2-718(3) then provides that if the seller is entitled to recover additional damages, that is, no enforceable liquidated damages provision under Section 2-718(1), the seller can offset those damages against the amount the buyer has already paid. This is in addition to the *minimal amount of damages* stated in Section 2-718(2)(b).[70]

[69] U.C.C. § 1-305 (AM. LAW INST. & UNIF. LAW COMM'N 2018) (alterations in original).

[70] *See* HAWKLAND ET AL., 2 HAWKLAND UCC SERIES, § 2-718:2 (2019) (emphasis added) [hereinafter HAWKLAND]. Note the bias implicit in the characterization of the subsection (2)(b) amount as "minimal." Such an amount is not minimal for a large number of individuals and families. *See infra* Part V text accompanying note 157.

The treatise editors cite the additive method cases without comment or criticism. However, the language of the treatise summary is consistent with the context sensitive method.

The treatise refers to the amount recovered under subsection (2)(b) as a "minimal amount of damages." The amount recovered under subsection (3)(a) is described as "additional damages." Though the treatise uses the language of "addition" in its description, note that the treatise description contemplates *adding damages to damages*. When adding damages to damages, one should not double count.

The problem with the additive method used in *Gongora*, *Feinberg*, and *McCann* is that the base retention amount is simply treated as a generic amount to which the seller is entitled. Then damages are separately computed pursuant to subsection (3)(a) to which the base retention amount is added. However, if you treat the base retention amount as representing *minimal damages*—at least in cases for which damages exceed the base retention amount[71]—then those minimal damages should not be included a second time when computing the *additional damages* recoverable pursuant to subsection (3)(a).

The capstone in support of the context sensitive method comes from an analysis of the legislative history behind § 2-718 which is described below in Part IV.

IV. WHERE DID THE TWENTY PERCENT OR $500 FORMULATION COME FROM?

The interpretive procedure followed here disregards the statement often prefacing draft versions of the UCC: "Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal."[72] Part IV

[71] When damages do not exceed the base retention amount, the base retention amount functions like a statutorily created liquidated damages amount. *See infra* Part IV text accompanying note 130.

[72] *See, e.g.*, REVISION OF UNIFORM COMMERCIAL CODE ARTICLE 2 – SALES (AM. L. INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. ST. LAWS 1999). Karl Llewellyn likely would have stopped analysis with Part III. He was against a deep dive into legislative history as a mode of analysis for the UCC, preferring to use only the final draft and its official annotations. *See* 1 AM. L. INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. ST. LAWS, UNIFORM COMMERCIAL CODE DRAFTS xvi (Elizabeth Slusser Kelly ed. 1984) ("He did not want litigators to look behind the terminology of the Code to the discussions and versions which preceded the final Code language.").

ignores this edict by considering proposed statutory language, related reporters' commentary, notes, annotations, prior statutes, and the like.

The reason for this interpretive approach is simple—§ 2-718(2) is an awkwardly drafted provision. While it can be interpreted in isolation, a fuller understanding of the section can be attained when one looks at where it came from and why it was drafted. This requires consideration of its history, rather than merely considering the final statutory language and official comments.

There is a rich and deep literature about the theory of interpretation of legal materials.[73] However, reference to an interpretive theory in this case would be unhelpful, primarily for three reasons. First, the suggested context sensitive method is available from a surface reading of the statute.[74] Second, justification for use of the context sensitive method to apply the statute to facts makes no appeal to any specific canons of statutory construction.[75] Third, the purpose behind the legislative review that follows amounts to negative assurance—there is nothing in the legislative history to suggest another interpretation. This review does not aim to search outside the statutory text for interpretive clues.[76]

Section 2-718 as currently enacted derives from two separate legislative processes: the New York legislature's effort to harmonize the treatment given to defaulting sellers and defaulting

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[73] *See, e.g.*, William Baude & Stephen E. Sachs, *The Law of Interpretation*, 130 HARV. L. REV. 1079, 1081 (2017); William N. Eskridge, Jr., *The New Textualism and Normative Canons*, 113 COLUM. L. REV. 531, 531 (2013) (reviewing ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS (2012)).

[74] This is not a case in which appeal must be made to a matter outside the statutory text, risking implementing a policy not approved by the legislature. *See* Peter A. Alces & David Frisch, *Commenting on "Purpose" in the Uniform Commercial Code*, 58 OHIO ST. L.J. 419, 440 (1997).

[75] Except, perhaps, for a principle to avoid doing inconsistent things—hardly a rule of thumb worthy of its own legal category.

[76] *See* Alces & Frisch, *supra* note 74, at 432–34. What matters for this exercise is whether the analysis is persuasive and informative. Does it make one more confident in the recommended application of the statute, or less confident? Whether the approach is an exercise in "construction" or "interpretation," textualist or purposivist, or something else altogether, are categories of questions of only secondary importance. If labels matter, perhaps call the approach followed here "legal voyeurism"—being curious about the statute beyond the plain meaning of the text.

buyers in sale of goods transactions under New York law;[77] and the effort, led by Karl Llewellyn, to revise the Uniform Sales Act.[78] The project to revise the Uniform Sales Act, also under the direction of Llewellyn, evolved into the creation of Article 2 of the UCC.[79] What follows is a story of an initial legislative success which vastly improved the treatment of deposits for defaulting buyers. Yet, in the current law reform structure, the system is incapable of moving forward with further improvements.

The particular concern over treatment of deposits originated in New York.[80] The revised Uniform Sales Act project sought to address the treatment of deposits, following New York's lead.[81] The treatment of deposits by Llewellyn's team carried over from the revised Uniform Sales Act process to the drafting of Article 2.[82]

In 1952, New York finally enacted an amendment to its Personal Property Law in the form of § 145-a, to remove the inconsistency between treatment of sellers and buyers in sale of goods transactions.[83] A note to the 1952 session law explained:

> Under the Sales Act (Personal Property Law, § 125 (1)), if a seller of goods fails to deliver all of the goods contracted for, he may nevertheless recover for the goods delivered which the buyer keeps. But if a buyer defaults after paying part of the price, he may not recover the price he has paid even where it exceeds the damages caused to the seller by the default, and even though the buyer has received no benefit from the transaction. The purpose of the amendment is to remove this inconsistency between the remedies of a buyer of goods who defaults after part performance and a seller of goods who defaults after part performance.[84]

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[77] New York commissioned a study of the law governing restitution at the direction of Edwin W. Patterson. *See* STATE OF NEW YORK: REPORT OF THE LAW REVISION COMMISSION FOR 1942, at 195 (N.Y. 1942).

[78] *See* REPORT AND SECOND DRAFT, THE REVISED UNIFORM SALES ACT (1944), *reprinted in* UNIFORM COMMERCIAL CODE CONFIDENTIAL DRAFTS (Elizabeth Slusser Kelly ed. 1995) (listing Karl Llewellyn as the Reporter).

[79] *See* U.C.C. cmt. at 3 (AM. LAW INST. & NAT'L. CONF. OF COMM'RS ON UNIF. STATE LAW, Proposed Final Draft 1950) (listing Karl Llewellyn as the Reporter).

[80] *See* STATE OF NEW YORK, REPORT OF THE LAW REVISION COMMISSION FOR 1943, S. 227-229, Assemb. 215-217, at 23 (N.Y. 1943).

[81] *See infra* text accompanying note 113.

[82] *See infra* text accompanying note 121.

[83] Act of April 19, 1952, ch. 823, 1952 N.Y. Laws 1789.

[84] *Id.* (noting in margin "Personal Property Law, s. 145-a added"). The purpose, as stated, does not refer to a premium or penalty; rather, it contemplates a return to the buyer of the amount of the deposit in excess of damages sustained by the seller.

The inconsistency in treatment for sellers and buyers arose from an amendment to New York law in 1911—which created the provision in the New York Sales Act § 125(1)—allowing a recovery for a defaulting seller.[85] Statutory fixes, however, were needed to maintain consistent treatment for both sellers *and* buyers because common law—particularly as strictly applied by New York courts—did not allow a defaulting party to maintain a suit for recovery of unjust enrichment in a sale of goods transaction, in quasi-contract or as restitution.[86]

Though the fix for sellers preceded the fix for buyers by over forty years, this may not be a simple case of the merchant lobby taking care of its own concerns first. Rather, the problem for buyers became more acute with the rise of layaway plans, a practice which arose after World War I and continued as a popular method to purchase goods, at least until the widespread use of credit cards.[87] In a layaway plan, the buyer makes a series of deposits with a seller for application towards the purchase price. When the amount deposited equals the purchase price, payment for the good is complete, and the seller delivers the good to the buyer.

At common law, if the buyer never completed its series of deposits towards the purchase price, the amounts previously paid were forfeit. In our modern world of Amazon, eBay, and large big box retailers, the practice may seem foreign or quaint to some, given the almost instant availability of a product, though remnants of the practice exist today, particularly for lower income groups.[88]

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[85] This occurred as part of the adoption by New York of the Uniform Sales Act in 1911. The model Uniform Sales Act was promulgated in 1906. *See* Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 799 (1958) (listing predecessor legislation to the UCC).

[86] *See* REPORT OF THE LAW REVIEW COMMISSION FOR 1942, *supra* note 77, at 195. RESTATEMENT (SECOND) OF CONTRACTS § 374 (AM. LAW INST. 1981) recognizes a right to restitution for defaulting parties. The position of the ALI regarding every type of restitution now is found in RESTATEMENT THIRD, RESTITUTION AND UNJUST ENRICHMENT (AM. LAW INST. 2011). RESTATEMENT (SECOND) OF CONTRACTS § 374 cmt. a (AM. LAW INST. 1981) blandly and briefly refers to UCC § 2-718(2): "The case of defaulting buyer of goods is governed by Uniform Commercial Code § 2-718(2), which generally allows restitution of all but an amount fixed by that section."

[87] *See* Will Kenton, *Layaway*, INVESTOPEDIA (last updated June 25, 2019), https://www.investopedia.com/terms/l/layaway.asp.

[88] Layaway plans experience a resurgence in economic hard times. *See* Louis Hyman, *Laid Flat by Layaway*, N.Y. TIMES (Oct. 11, 2011), https://www.nytimes.com/2011/10/12/opinion/wal-marts-layaway-plan.html. (describing layaway plans as not being in the best interest of consumers). Layaway plans lock in a price, avoid the need

New York law made a distinction between deposits given for different purposes. A deposit given for application towards the *price* of the good was forfeit when a buyer breached, creating a particular problem for layaway plans, but also potentially applicable to other transactions.[89] In contrast, a buyer might recover a deposit made as *security*, after satisfaction of damages owed to the seller for the breach.[90] Courts often simply used the term "deposit" to refer to a deposit made as security and referred to a deposit made toward the purchase price as a "down" or "part payment."[91]

The theory behind the distinction between a deposit for the price and a deposit for security was that, by its very nature, a security deposit was made to satisfy damages, but not more.[92] In practice, courts had difficulty determining the purpose behind deposits in many cases,[93] though not in the case of layaway plans. Because payment of the price is the very purpose for the layaway plan, such plans were particularly vulnerable to application of the common law rule.

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for credit, and assure the availability of the product. One niche area where reserving a product may be important is women's fashions in which product designs change each year. A layaway reserves a fashion item that may not be available at a later date. I am grateful to Professor Francis Hill for this example. However, layaway plans currently are available at large retailers, such as Walmart, for all types of products, and with a particular emphasis on Christmas shopping. *See Layaway, Returns in 2019. See you then!* WALMART (last visited July 19, 2019), https://www.walmart.com/cp/Layaway/1088466. For general shopping needs, use of a layaway plan may be a matter of necessity and not of convenience—for example, if a low-income person does not have access to a credit card. Layaway plans may be subject to specific state or local legislation. *See Offering Layaways*, FEDERAL TRADE COMMISSION (last visited Aug. 25, 2019), https://www.ftc.gov/tips-advice/business-center/guidance/offering-layaways#4.

[89] Bisner v. Mantell, 92 N.Y.S.2d 825, 827 (City Ct. of Troy 1949) (discussing a layaway plan).

[90] Petito v. Aiello, 181 Misc. 371, 371, 47 N.Y.S.2d 447, 447 (2d Dep't 1944) (per curiam).

[91]

> The law is well settled that the only time that a recovery is allowed is when the money paid in was in the nature of a deposit and not where it was made as part payment. There can be no question but what the money paid in by the plaintiff was part payment for the merchandise.

Bisner, 92 N.Y.S.2d at 829.

[92] Chaude v. Shepard, 122 N.Y. 397, 402 (1890).

[93] STATE OF N.Y., REPORT OF THE LAW REV. COMM'N, S. 50-65, Assemb. 87-65, at 95–98 (1952). *See also* Amtorg Trading Corp. v. Miehle Prtg. Press & Mfg. Co., 206 F.2d 103, 106 (2d Cir. 1953) ("This attempted distinction between part performance and a security deposit seems as impractical and unjustified as the Law Revision Commission states it to be.").

As is typical with the common law, applicable legal principles trailed behind the commercial reality and so, in the evolving economic world, the common law was failing to deliver just results when problems arose with layaway plans. Forfeiture of the deposit occurred even if it provided an unjust enrichment to the seller.

This outcome posed a particular problem in New York State because New York courts were slow to recognize equitable actions to disgorge unjust enrichment.[94] To remedy this unjust result, the New York State legislature had started to consider enacting a statute to correct the problem prior to 1942. The attempt to amend the law in 1942 failed, but this effort influenced the draft of an amendment to the Uniform Sales Act promulgated in 1944 that would morph into the initial draft of the UCC, as explained below.[95]

The drafting problem which creates the possibility of the additive method interpretation for § 2-718(2) and (3), allowing the seller to retain a penalty, results from language in the statute allowing the seller to retain a portion of the deposit equal to twenty percent or $500 of the purchase price, whichever is smaller. No issue would arise had the provision simply allowed the seller to retain an amount equal to its actual damages, but no more.

A proposed amendment to § 2-718 would have simplified the treatment of liquidated damages and deposits to do exactly that.[96] This proposed amendment was advanced in 1999 and continued in the failed 2003 proposed revision to Article 2, but was ultimately withdrawn in 2011[97]—the provision providing for a base retention amount equal to the lesser of twenty percent of the purchase price

[94] The allowance of a suit in quasi-contract for a breaching party was uneven across subject matter areas, appearing prominently in famous early employment cases such as *Britton v. Turner*, 6 N.H. 481, 486–88 (1834), though not universally followed, even in the employment area. *See* Hansell v. Erickson, 28 Ill. 257, 258–59 (1862). Professor Patterson discussed *Britton v. Turner* in his report to the New York Law Revision Commission, noting it as the minority view and suggesting that it would not be the common law of New York. *See* REPORT OF THE LAW REVIEW COMMISSION FOR 1942, *supra* note 77, at 212–19.

[95] *See infra* text accompanying notes 110–114.

[96] Miller, *A True Story*, *supra* note 97, at 161.

[97] The failure to amend Article 2 has generated much academic commentary. *See, e.g.*, Fred H. Miller, *What Can We Learn from the Failed 2003-2005 Amendments to UCC Article 2?*, 52 S. TEX. L. REV. 471 (2011) [hereinafter Miller, *What Can We Learn*]. A brief description of proposed amendments to § 2-718 appears in Fred H. Miller's *Uniform Commercial Code Article 2 on Sales of Goods and the Uniform Law Process: A True Story of Good v.?*, 11 DUQ. BUS. L.J. 143, 161–62 (2009) [hereinafter Miller, *A True Story*].

and $500 was eliminated in the proposed amendment.[98] This alteration raises a question about the origin of this provision and its intended purpose: where did it come from? One might surmise that it had a purpose other than covering actual damages because covering actual damages is so easy. To answer this conundrum, we must look to limitations in the common law and drafting history.

The particular twenty percent formulation as used in New York was drafted to correct a deficiency in common law damage calculations, particularly the inability to recover lost profits. A significant part of the rationale for allowing the seller to retain up to twenty percent of the purchase price without a showing of actual damage was the notion that such a retention would accomplish a form of rough justice, compensating the seller for actual losses, which might be difficult or impossible for the seller to prove in court. Central to the set of real but unprovable damages were damages for lost profits; they were real in commercial reality but not yet real in a court of law.

> The Commission recognized that allowing return of all payments in excess of actual provable damages resulting from the breach might be inequitable to the non-defaulting seller. In a number of situations involving consumer goods, such as automobiles and refrigerators that are price fixed by the manufacturer, the seller may be limited to only nominal damages, inasmuch as the contract and market price of the item at time of default would necessarily be the same.[99] It is clear that the seller has suffered harm as a result of the default. Either he loses profit on the goods, or the expense of making the sale to the defaulter or resale to a new buyer. The solution in price-fixed items rests in changing the judicial rule for computing standardized damages, or in allowing the seller to retain a portion of the payment to indemnify him for the expenditure of time and effort necessitated by resale. The New York legislature adopted the latter solution, permitting the seller to retain twenty percent of the contract price.[100]

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[98] *See* U.C.C. § 2-718 (AM. LAW INST. & UNIF. LAW. COMM'N 2003) (withdrawn 2011).

[99] For completeness, one might add that the contract price and any resale price of fixed price items would be the same as well. It would be typical for the nondefaulting seller to resell the goods. Traditional damage theory would have allowed damages based on a differential between the contract price and the market price, or resale price, of the good that the defaulting buyer had failed to purchase.

[100] Calvin W. Corman, *Restitution for Benefits Conferred by Party in Default Under Sales Contract*, 34 TEX. L. REV. 582, 596–97 (1956).

By allowing a seller to retain up to twenty percent of the purchase price, the law allowed for the practical recovery of a form of damages that neither the common law nor statutory law had yet recognized. The retention of the partial payments thus operated, albeit imperfectly, to correct for a failure of the law to theorize the elements of damage in a modern economy. New York Personal Property Law § 145-a did not place a cap on the absolute dollar amount which might be retained by the seller.[101] The $500 cap found in the UCC was a later addition.[102]

Problems with proof of damages explain why, under the law existing at the time, it was thought necessary to draft a complex provision rather than a simple one that directed the seller to return the amount by which the deposit exceeds actual damages. It is perhaps unsurprising that pre-UCC law did not address the lost profit damages suffered by a lost volume seller. Until the development of a modern economy, which produced an inexhaustible supply of inventory, a seller would not have suffered a loss if it resold a product for a price equal to or greater than the price agreed to be paid by the defaulting buyer. Only with the development of a capitalist system that mass produced large volumes of inventory did the concept of lost profits emerge as a significant concern within the legal system. It is these fixed price, mass-produced commodity-consumer goods which became the subject of layaway plans after World War I.

The problem with the operation of a twenty-percent holdback to account for damages not provable under outdated judicial rules for computing damages in a simpler age is that passage of the UCC changed the judicial rules for computing standardized damages. Now, lost profit damages for a volume seller are available under § 2-708(2),[103] and a broad range of other incidental damages are available to the seller as well.[104] In light of the UCC's reform of the judicial rules for computing standardized damages to better account for seller losses in a modern economy, allowing a twenty percent holdback to cover damages—in addition to the additional damages provable following these reforms—risks a double count,

[101] N.Y. Pers. Prop. Law, ch. 823, sec. 1, § 145-a, Laws of New York, 823 (1952).

[102] The $500 limitation appeared in the 1944 version of the Uniform Revised Sales Act from which the UCC's treatment of liquidated damages and deposits was derived. *See supra* note 84.

[103] U.C.C. § 2-708(2) (AM. LAW INST. & UNIF. LAW COMM'N 2018).

[104] For example, both U.C.C. § 2-708(1) and U.C.C. § 2-708(2) provide that "incidental damages" be added to any calculation. "Incidental damages" for a seller are defined in U.C.C. § 2-710 (AM. LAW INST. & UNIF. LAW COMM'N 2018).

in effect creating the premium or penalty resulting from the additive method. Such a penalty is not needed under current law to account for actual, but unprovable, damages. Those damages are now provable under separate sections of the UCC.

Thus, it should be clear that the use of the twenty-percent formula in New York was not employed for the creation of a penalty. Unless another rationale can be found for the inclusion of the twenty percent or $500 formulation in § 2-718(2) of the UCC, its inclusion would appear to be an error as retention of twenty percent is no longer needed to compensate the non-defaulting seller.[105]

Such a rationale does exist. The twenty percent or $500 formulation in the pre-history of the UCC was used for an entirely different purpose. It created a safe harbor exempting a small liquidated damages amount from a reasonableness test.[106] The two different purposes behind the twenty percent—or twenty percent or $500—formulation helps to understand some of the confusion found in the language finally adopted.

A. Legislative History

In 1942, the New York Law Revision Commission recommended[107] amending the New York Personal Property Law as follows:

> § 145-a. When buyer in default entitled to restitution. 1. Where the seller fails or refuses to deliver the goods, and is justified therein by the buyer's repudiation or default in performance of the contract, but the buyer has conferred a net benefit on the seller by the payment of money or the transfer or delivery of property in part performance, and the net benefit exceeds twenty per cent of the value of the total performance for which the buyer is obligated under the contract, the buyer has a right to obtain restitution for the amount of such net benefit in excess of such

[105] In fairness, until interpretation of UCC § 2-708(2) in cases such as *Neri* confirmed a volume seller's entitlement to lost profits, it was not clear that the UCC had implemented such a complete change in judicial rules for damage computation. Indeed, strong textual arguments can be made that *Neri* and its progeny are wrongly decided. *See* John M. Breen, *The Lost Volume Seller and Lost Profits Under U.C.C. § 2-708(2): A Conceptual and Linguistic Critique*, 50 U. MIAMI L. REV. 779, 780–82, 787, 789–90, 791–92 (1996). Nevertheless, under the conventionally accepted interpretation, allowing a twenty percent retention to cover lost profits results in a clear double count in the additive method.

[106] *Id.* at 798.

[107] This point was amplified in the Law Revision Commission's 1943 report. *See* REPORT OF THE LAW REVISION COMMISSION FOR 1943, *supra* note 80, at 9–10.

> twenty per cent. Net benefit shall be determined by deducting from the amount of such payment, or the value of the property transferred or delivered, the amount or value of the benefits, if any, received by the buyer or a third party beneficiary by reason of the contract, and the amount of the damages to which the seller is entitled by reason of the buyer's default.[108]

There are several things to note about this simply drafted proposal. Proposed § 145-a is an additive methodology, as we saw in *Gongora*, *Feinberg*, and *McCann*. Damages suffered by the seller reduce the amount of restitution owed to a defaulting buyer—by reducing the net benefit received by the seller—which is arithmetically equivalent to the simple addition of the damages amount to a fixed twenty percent of the purchase price. This is because the proposed language contemplates that the seller retain twenty percent no matter what the circumstances.[109] If we adopt the fiction that twenty percent of the purchase price represents actual but unprovable lost profits present in every case, then the addition of other provable damages to reduce "net benefits" will not result in double counting or overpayment. Further, it is significant that the proposed amendment did not attempt to address, in any way, the treatment of agreements to liquidate damages.

Nevertheless, New York did not enact the proposed amendment in 1942, and thus did not enact the "net benefit" formulation of the rule. It was, however, the motivation for the treatment of deposits in the revision to the Uniform Sales Act. In late 1941, The Conference of Commissioners on Uniform State Laws met in Indianapolis. This meeting generated a report and a second draft of The Revised Uniform Sales Act.[110] That draft

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[108] REPORT OF THE LAW REVISION COMMISSION FOR 1942, *supra* note 77, at 185 (1942). A note explained: "Its purpose is to modify the harshness of the existing rule under which the buyer loses all and at the same time afford to the seller a measure of reasonable protection against default by the buyer." *Id.* The proposal reappeared in the next year's report under the section *Acts and Recommendation relating to Recovery for Benefits Conferred by Party in Default under Contract.* REPORT OF THE LAW REVISION COMMISSION FOR 1943, *supra* note 80, at 19, 23 (1943).

[109] REPORT OF THE LAW REVISION COMMISSION FOR 1943, *supra* note 80, at 23 (1943).

[110] REPORT AND SECOND DRAFT, THE REVISED UNIFORM SALES ACT (1944), *reprinted in* 1 UNIFORM COMMERCIAL CODE DRAFTS (Elizabeth Slusser Kelly ed. 1984).

tackled the same problem addressed by proposed § 145-a in New York, but it did so using very different language. It proposed a new § 64[111] that provided, in relevant part, as follows:

> **Section 64.** (New to Sales Act.) *Liquidated Damages and Deposits.*
> (1)(a) The particularized terms of the contract may fix liquidated damages for breach by either party in any amount which is not unreasonable. In estimating what is reasonable, the court may take into account the delay and inconvenience actually caused by the breach, or incident to remedy, as well as the difficulty in proof of damage and the convenience of administration of remedy.
> (b) A clause fixing an unreasonable amount as agreed damage is a penalty, and void.
> (2)(a) Any down or part payment, or "deposit", made upon a contract to sell or a sale, is deemed to be made for security and shall in the event of breach by the buyer be limited to serving as security. This subsection applies, whether or not such payment or deposit is agreed to be applied upon the price, and irrespective of any provision for its forfeiture, and whether it is in the form of money, check, goods, or otherwise.[112]

In the comments to new Section 64, specific reference is made to the New York Law Revision Commission's bill on the matter of sales of goods, simply stating that "[t]he better cases have refused to follow the view that a contract-breaker is barred from all remedy by the mere fact of breach."[113] Section 64 had no antecedents in the Uniform Sales Act of 1906, the proposed Federal sales act, or the first draft of the Revised Uniform Sales Act issued in 1940.[114] The difference in the drafting approaches taken by New York State's law revision commission and the NCCUSL, under the direction of Llewellyn, were stark.

In proposed new Section 64, any down or part payment, or "deposit," is treated as "security."[115] As security, it would be applied to cover actual damages and not a penalty. A premium would only be possible if the contract fixed liquidated damages, and then only at a reasonable level. A comment makes clear that whether the agreed measure of damages is reasonable within this section is a question for the court.[116]

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111 *Id.* at 557–58.
112 *Id.* at 557.
113 *Id.* at 558.
114 *Id.* at 280 (Finder and Table of Comparable Sections).
115 *Id.* at 557–58.
116 *Id.* at 558.

This drafting approach both confronts and uses the New York common law distinction between a payment for the price and a security deposit. By deeming all deposits—whether made for the price or as security—to have been made as security, the language would require payment of restitution for any amount by which the deposit exceeded damages.

Additionally, there is no equivalent of a base retention amount—no twenty percent to which a non-defaulting seller is entitled without question or calculation. There is no cumulative or additive "net benefit" formulation at all. The explanation for this distinction rests with the difference in purposes behind the New York legislative effort and the revisions to the Uniform Sales Act.

The motivation in New York was to correct a very specific inconsistency and not to create a more general reform of contract law or even damage theory. In contrast, the revision of the Uniform Sales Act was designed to reform and modernize the entirety of sales law, including remedies. Thus, using language in the revised Uniform Sales Act that treated all deposits as security did not risk undercompensating the nondefaulting seller. The nondefaulting seller would be taken care of by the modernized Uniform Sales Act which would create all the damage remedies needed in the industrialized economy.

Furthermore, the revised Uniform Sales Act addresses liquidated damages as well as deposit returns in the same section, an important addition, though one that introduces added complexity. In the Uniform Revised Sales Act draft of 1944, we find § 124. It reads, in relevant part, as follows:

> (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.
> (2) A "deposit" or "down" or part payment of more than 20 per cent of the price or $500, whichever is smaller, made as security and to be forfeited on breach, is so forfeited only to the extent that it is a reasonable liquidation of damages . . . .[117]

[117] UNIFORM REVISED SALES ACT (Sales Chapter of Proposed Commercial Code), *Proposed Final Draft No. 1*, 75–76 (AM. LAW INST. Apr. 27, 1944) *reprinted in* 2 UNIFORM COMMERCIAL CODE DRAFTS (Elizabeth Slusser Kelly ed. 1984). The Uniform

Note that this draft appears to take a step backwards in coverage from the prior proposed § 64 considered in 1942. On its face, § 124 addresses liquidated damages only and not the more general case of a deposit in the absence of a liquidated damages specification. This drafting is not additive or cumulative because all it does is create a safe harbor for retention of a deposit in an amount up to twenty percent or $500, whichever is smaller, *but only* if the deposit was "made as security and to be forfeited on breach."[118] If the proposed retention of the deposit is larger than this small amount, then it can only be retained or not "forfeited" to the extent that it is "a reasonable liquidation of damages."[119] Thus, the early drafting attempts in the UCC history use the twenty-percent or $500 formulation to test a liquidated damages clause, the situation now addressed by § 2-718(1) and not the circumstances of § 2-718(2) and (3).

In operation, this clause exempts the retention of small dollar amounts from the requirement that retention of the small amount be a reasonable liquidation of damages evaluated by a court. If the amount is small enough, it may be retained even if it is a penalty insofar as it allows recovery of an amount in excess of actual damages. One might imagine the drafters were motivated by considerations of efficiency by not allowing parties to litigate the question of whether retention of a small amount constituted a "reasonable liquidation of damages."

When contrasted with the current version of § 2-718, the scope of the early formulation is much broader. Subsection (1) of the current § 2-718 is the provision which addresses those agreements which contain a liquidated damages amount. There, no liquidated amount may function as a penalty. In theory, a court might examine even small amounts at risk. Subsection (2)(b) of the current § 2-718 addresses a wholly different situation, in which a deposit is made for some unspecified reason—security, evidence of ability to pay, seriousness of intent to complete a transaction, and so forth—but the contract is silent on liquidated damages. The draft of § 124 did not address this situation at all.

Commercial Code project began as proposals to revise the Uniform Sales Act. *See* Robert Braucher, *supra* note 85, at 799–800.

[118] UNIFORM REVISED SALES ACT (Sales Chapter of Proposed Commercial Code), *Proposed Final Draft No. 1*, 76 (AM. LAW INST. Apr. 27, 1944) *reprinted in* 2 UNIFORM COMMERCIAL CODE DRAFTS (Elizabeth Slusser Kelly ed. 1984).

[119] *Id.*

Section 124 remained the same in what appears to be a subsequent confidential version of the draft sales law prepared no earlier than 1945.[120] By 1950, the drafts of the revised sales law had morphed into the UCC and started to resemble the now familiar structure of Article 2. In the 1950 version, § 2-720 addressed the liquidation or limitation of damages and deposits.[121] Even though the form and numbering of the sales law had been reworked, the language remained identical to that of the original proposed § 124. However, the 1950 version of the Code, for the first time, includes a brief comment which tries to explain the purpose of the twenty percent or $500 formulation.[122] It briefly states:

> Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under subsection (1). A special exception is made in the case of small amounts (20% of the price or $500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for performance. *Subsection (2) is applicable to any deposit or down or part payment*.[123]

Even though the text of the proposed law seems to be limited in its application to a deposit that "is to be forfeited on breach"—that is, to a deposit for which an agreement as to liquidated damages has been reached—at some point, the drafters intended to give the clause broader applicability by having it apply to any deposit or down payment or part payment.[124] It appears

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[120] DRAFT UNIFORM REVISED SALES ACT *reprinted in* 2 UNIFORM COMMERCIAL CODE CONFIDENTIAL DRAFTS 88 (Kelly & Puckett eds. 1995) (noting draft was not prepared prior to 1945).

[121] UNIFORM COMMERCIAL CODE, PROPOSED FINAL DRAFT, TEXT AND COMMENT EDITION 267–68 (AM. LAW INST. & NCCUSL 1950); U.C.C. § 2-720 (Am. Law Inst. & NCCUSL 1950).

[122] *Compare id. with* DRAFT UNIFORM REVISED SALES ACT, *reprinted in* 2 UNIFORM COMMERCIAL CODE CONFIDENTIAL DRAFTS 88 (Kelly & Puckett eds. 1995).

[123] U.C.C. § 2-720 cmt. 2 (AM. LAW INST. & NCCUSL 1950) (emphasis added).

[124] This drafting quirk was noted by Professor Patterson in his written evaluation of the Uniform Commercial Code for the New York Law Revision Commission. STATE OF NEW YORK, 1 LAW REVISION COMMISSION REPORT, STUDY OF THE UNIFORM COMMERCIAL CODE 705 (1955). A propensity to change the meaning of statutory language in a comment was commonplace. *See* Erwin Surrency, *Research in the Uniform Commercial Code*, 1962 U. ILL. L.F. 404, 408; Robert Braucher, *Report on Article 2–Sales by Certain Members of the Faculty of the Harvard Law School*, 6 BUS. LAW 151, 152–3 (1951); *The Uniform Commercial Code: Major Differences Between Massachusetts and Pennsylvania,* 71 HARV. L. REV. 679, 686 (1958).

that, in 1950, the drafters of the UCC recognized that, when the drafting moved from § 64 to § 124 in the revised Uniform Sales Act, protection for some deposits had been inadvertently lost in translation. Despite the limiting language, the idea all along was to protect all deposits by treating them as made for security.

The 1957 version gave express operative effect to the idea that the section should apply to any deposit in § 2-718, which governs liquidation or limitation of damages and deposits.[125] The numbering and form of the section remained the same in the 1958 version, including the comment which originally appeared in 1950, albeit a comment describing a differently drafted section.[126] No change was made in the 1962 version to § 2-718 or the relevant comment.[127] Section 2-718 remains today the same as it appeared in 1962.[128]

Some "post" legislative history from the withdrawn attempt to amend Article 2 provides some idea of how the drafting institutions viewed § 2-718.[129] A Reporter's Note to revised Article 2 in 1999 characterized current subsection (b) as a "statutory liquidated damages" clause:

> [Reporter' s Note – Subsection (b) also drops the statutory liquidated damages clause that operates in the absence of an express liquidated damages provision. In the current law, this provides that "in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller."][130]

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[125] UNIFORM COMMERCIAL CODE, 1957 OFFICIAL EDITION, 62–63 (Am. Law Inst. & Unif. Law Comm'n 1957).

[126] UNIFORM COMMERCIAL CODE, 1958 OFFICIAL TEXT WITH COMMENTS, 212–13 (Am. Law Inst. & Unif. Law Comm'n 1958).

[127] UNIFORM COMMERCIAL CODE, 1962 OFFICIAL TEXT WITH COMMENTS, 213–15 (Am. Law Inst. & Unif. Law Comm'n 1962).

[128] UNIFORM LAWS ANNOTATED, MASTER EDITION, VOLUME 1C, UNIFORM COMMERCIAL CODE, 642–43 (2012).

[129] Use of failed revised Article 2 as a resource to interpret the existing Article 2 is endorsed in the literature. *See* David Frisch, *Amended U.C.C Article 2 as Code Commentary*, 11 DUQ. BUS. L.J. 175, 177 (2009); *accord* Hawkland at § 2-718:3 (noting that "[i]n 2011, the [ULC and ALI] withdrew . . . the amendments to Article 2 . . . . These proposed amendments may help inform interpretation and application of current law"). The retrospective does provide insights here, despite the metaphysical oddity of explaining a prior event by reference to a later event. It might be justified by observing that the later comments nevertheless took place within the same interpretive community—namely, the ALI and the ULC. It does shed light on how these two institutions viewed their own prior work product.

[130] *See* DISCUSSION DRAFT, REVISION OF UNIFORM COMMERCIAL CODE ARTICLE 2—SALES, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 112 (Dec. 1999).

Characterization of § 2-718(b) as a "statutory liquidated damages clause" is significant. A liquidated damages clause operates *in lieu of* a traditional damages calculation—not *in addition to* it.

> Once a liquidated damage clause has been shown to be part of the agreement, it represents the exclusive remedy available to the aggrieved party, who may not seek other damages or other legal remedies. This was the well settled rule at common law and is almost certainly the rule under section 2-718.[131]

The characterization of § 2-718(2)(b) as a statutory liquidated damages clause for those who did not draft one does not support the additive method. Rather, it supports the alternative approach of *Neri* and the context sensitive method recommended here.

In the 2003 version of the Amendments to § 2-718(3), the commentary was changed to read: "The statutory liquidated-damages deduction from the breaching buyer's restitution remedy has also been eliminated."[132] This comment was in line with viewing the twenty percent or $500 formulation as a form of statutory liquidated damages, though it does not explicitly state that the provision was intended to function in place of an express liquidated damages clause.

B. How Should This Legislative History Be Evaluated?

Notably, the drafting process of the UCC involved two distinct and influential groups, amongst others: "Downtown" or Wall Street business lawyers in New York City, who either participated in, or were familiar with, the New York Law Revision Commission process to fix the asymmetry between treatment of defaulting sellers and defaulting buyers; and "uptown," or academic lawyers, primarily at Columbia Law School, led by Karl Llewellyn, who undertook efforts to revise the Uniform Sales Act, which morphed

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[131] Roy Ryden Anderson, *Liquidated Damages under the Uniform Commercial Code*, 41 SW. L.J. 1083, 1104 (1987).

[132] UNIFORM LAWS ANNOTATED, UNIFORM COMMERCIAL CODE APPENDIX-ARTICLE 2. SALES (Am. Law Inst. & Unif. Law Comm'n 2003) (Amendments Proposed in 2003 and Withdrawn from the Official Text in 2011).

into the UCC.[133] Section 2-718 is a product of drafting efforts and compromise between these two different groups with overlapping but still distinct concerns and experiences.

A review of the drafting process indicates that none of the antecedents to current § 2-718(2) and (3) were aimed at providing a penalty or a premium to a non-defaulting seller. At most, in New York, the retention of twenty percent was designed to strike a fair balance by allowing the nondefaulting seller to retain something for his troubles.[134]

Under the enacted amendment to New York Personal Property Law § 145-a, the retention of a deposit equal to twenty percent of the purchase price might inadvertently result in overcompensation to a nondefaulting seller; however, this outcome was not its aim.[135] Section 145-a, like its "net benefits" precursor in 1942, simply included the twenty percent retention rate as a quick fix to correct a common law deficiency with the calculation of damages. The downtown lawyers used the base retention amount idea to avoid undercompensation for nondefaulting sellers. They opted for a quick fix because reforming the law of damages was not their charge. Instead, their narrow task was to provide restitution to defaulting buyers.

As for the revised Uniform Sales Act process, initially the uptown lawyers wanted a modern law, so when they became aware of the problems associated with restitution of deposits with which New York was struggling, they wanted to counter the archaic common law distinction between a part payment and a security deposit.[136] However, they were not worried about shortcomings in the common law theory of damage recovery because, as part of

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[133] *See* Allen R. Kamp, *Downtown Code: A History of the Uniform Commercial Code 1949-1954*, 49 BUFF. L. REV. 359 (2001); Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code: 1940-49*, 51 S.M.U. L. REV. 275 (1998). For a general overview of the drafting process, see William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1 (1967).

[134] *See* REPORT OF THE LAW REVISION COMMISSION FOR 1943, *supra* note 80, at 19–23; *accord* 1 LAW REVISION COMMISSION REPORT, *supra* note 124, at 704 (describing New York's twenty-percent retention as compensation for risk, incidental expenses, the burden of making a deal, and being ready to perform). Significantly, in comparing the proposed UCC and New York law, Professor Patterson noted that in New York, a seller was not required to prove the elements of damage—which, after all, was the very point of the twenty percent formulation. *Id.* at 704–05.

[135] *Id.* at 704–05.

[136] Kamp, *supra* note 133, at 371.

their process, they were drafting the damages rules that would govern.[137] No base retention amount was needed as a quick fix for the uptown lawyers.

Another consideration was at play here; the uptown lawyers were not very interested in problems associated with restitution of deposits. They did not identify the problem—it was not their "baby"—but they were prepared to address it. Karl Llewellyn and the other uptown lawyers were very interested in problems of unconscionability, reasonableness, good faith, and the like,[138] and they were interested in the treatment of liquidated damages clauses because of the interplay with these concepts. They were interested in questions such as the following: when should a court refuse to enforce a liquidated damages clause for being unreasonable or for being unconscionable? Should a court test for reasonableness only at the execution of the contract or again, later, at the time of default? Is proposing a penalty related to bad faith? The questions were interesting.[139] Additionally, interwoven into the mix were considerations about judicial economy.[140] After all, a liquidated damages clause is used to avoid a damages calculation—and thus eliminate the need for judicial time—but little or nothing is saved if consideration of a damages calculation is simply replaced by consideration of whether the liquidated

[137] *Id.* at 372.

[138] *See, e.g.*, Richard Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 STAN L. REV. 621, 627–30 (1975) (discussing the UCC's use of concepts such as commercial reasonableness, good faith, and unconscionability); Arthur Allen Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967); Imad D. Abyad, Note, *Commercial Resonableness in Karl Llewellyn's Uniform Commercial Code Jurisprudence*, 83 VA. L. REV. 429 (1997). *See generally* WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT 291, 360 (2d ed. 2012).

[139] Retesting a liquidated damages amount after the time of contract formation caused a great deal of consternation. *See* STATE OF NEW YORK, 1 LAW REVISION COMMISSION REPORT, STUDY OF THE UNIFORM COMMERCIAL CODE 580–82, 704 (1955).

[140] Llewellyn favored rules and practices that had a positive effect of saving costs, such as by providing clarity and avoiding litigation, and he recognized the role of a cost-benefit form of analysis. *See* Karl Llewellyn, *What Price Contract? An Essay in Perspective*, 40 YALE L.J. 704, 724 n.45 (1931) (raising the idea that sometimes the speed of judicial administration outweighs the chance of injustice to the litigants). He was interested in standardized contracts because "[t]hey materially ease and cheapen selling and distribution." *Id.* at 731. Llewellyn criticized opponents of the UCC by stating: "[they] do not seem to understand a balance sheet." Karl N. Llewellyn, Statement to the Law Revision Commission, A Simple Case on Behalf of the Code, NEW YORK LAW REVISION COMM'N, RECORD OF HEARINGS ON THE UNIFORM COMMERCIAL CODE 27 (1954) *reprinted in* TWINING, *supra* note 138, at 586, 597.

damages amount should be enforced. The purpose of the formula, in the hands of the uptown lawyers, was to relieve a court from having to test small amounts for reasonableness, or so it seems.[141] To the extent one can look to the "deep background" motives of Karl Llewellyn and the other uptown lawyers, this was not a case in which the UCC was attempting to overturn the general contract law presumption against premiums or penalties.

The difference in focus and in the tasks appointed for the uptown lawyers and the downtown lawyers explains why, when the revised Uniform Sales Act progressed from § 64 to § 124, the twenty percent or $500 formulation remained but was used for the entirely different purpose of creating a liquidated damages safe harbor. Literally, in this transition, protection for an ordinary deposit was dropped entirely. What is completely clear, again, is that initial use of the twenty percent or $500 formula by the uptown lawyers was not aimed at providing for a penalty or a premium.

Rather, the formula was used to render enforceable—without a reasonableness test—a prior agreement on payment of an amount that might result in a penalty but only as a byproduct of foregoing the reasonableness test. When the uptown lawyers previously focused on problems specific to restitution of deposits in § 64, no formula was used; instead, all deposits were treated as having been made as "security."[142]

The drafting complexity arose when the uptown lawyers introduced the formula for one purpose, and then repositioned it for another purpose later in the drafting process. In the final drafting of the UCC, the twenty percent or $500 formulation ceased to be a safe harbor to protect express liquidated damages clauses. Rather, it morphed into a statutory liquidated damages clause, covering small amounts, for those parties who had not agreed to liquidated damages.[143] However, this statutory liquidated damages clause had an odd "heads I win, tails you lose" quality. A nondefaulting seller could accept the statutory liquidated damages amount when convenient; however, unlike a traditional liquidated damages clause, the nondefaulting seller

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141 No comment was included on § 124 to the Uniform Revised Sales Act when it was first introduced. *See* DRAFT UNIFORM REVISED SALES ACT, *reprinted in* 2 UNIFORM COMMERCIAL CODE CONFIDENTIAL DRAFTS 88 (Kelly & Puckett eds. 1995).

142 *See supra* text accompanying note 115.

143 This is why the later annotations and comments to the UCC refer to subsection (2)(b) as statutory liquidated damages.

was not bound by, or limited to, collection of that amount if greater damages might be proved. This structure was needed when the $500 cap was introduced. Had the statutory liquidated damages amount simply been set at twenty percent, one might have attempted to limit nondefaulting sellers to that amount.[144]

This analysis shows that there is no historical basis to interpret UCC § 2-718(2) and (3) as a case in which the drafters of the UCC made an exception to allow for a penalty or a premium.[145] Accordingly, UCC § 1-305 should not be used to justify application of the additive method for interpretation of § 2-718(2) and (3). Moreover, the legislative history review discloses nothing to challenge the conclusion that courts should apply the context sensitive method advanced in Part III.[146] Indeed, the narrative strengthens the conviction that the context sensitive method of computation is correct.

To summarize the results so far, *Gongora*, *Feinberg*, and *McCann* were wrongly decided and are not simply cases of courts ignoring the binding precedent of *Neri*. *Neri* was correctly decided on the substantive outcome, but wrong in the details of its statutory construction—perhaps a case of no harm, no foul. UCC § 2-718(2) and (3) should be applied, to the extent possible, to provide for actual damage recovery and no more. In cases where the nondefaulting seller's damages are less than the base retention amount, the odd statutory liquidated damages clause must be given effect in deference to the statutory language and to legislative history suggesting the intent to create a statutory liquidated damages clause. Homage to the statutory language means that some nondefaulting sellers will be overcompensated in small amounts, but that seems to be the point of the language because the statute strikes a balance, tolerating a modest bit of unjust enrichment in exchange for judicial economy in small cases.

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[144] Such an effort at substantive regulation might well have failed, however. While the original UCC drafting process contemplated a fair amount of substantive regulation, over time substantive regulation was replaced with an emphasis on default rules to be used in the absence of agreement.

[145] *See* U.C.C. § 1-305(a) (AM. LAW INST. & UNIF. LAW COMM'N 2018) ("The remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law.").

[146] *See supra* notes 57–71 and accompanying text.

V. THE MULTIPLYING EFFECTS OF A "SMALL CALCULATION QUIBBLE"

The "penalty" interpretation of § 2-718(2) and (3) has the potential for causing widespread difficulties in the populace. The problem cries out for a correction for four reasons.

A. Summary of Reasons to Care About the Problem

First, proposed changes to the UCC that would have fixed the problem were withdrawn by the ALI and the ULC. This problem has had a solution since at least 1999.[147] Stewardship of the law requires follow-through to insure the law produces a just result, particularly for those of modest means, once a case of injustice is identified.

Second, the penalty interpretation of UCC § 2-718(2) and (3) serves no countervailing purpose, particularly in light of the interpretation's potential to adversely impact large numbers of persons. Imposing a penalty in the absence of any justification whatsoever is unreasonable. Some might argue a cautious interpretation of a provision such as § 2-718 because it does, in some cases, result in an overcompensation mandated by statute without even the fig leaf of the agreement of the parties on a liquidated amount. Llewellyn captured this idea best when he said, "where the reason stops there stops the rule."[148] Indeed, economic theory disfavors enforcement of penalties because penalties discourage efficient breaches in which social utility is increased.[149] To be sure, one might keep the twenty percent or $500 formulation for the purpose of judicial economy—resulting in a small amount of overcompensation—to discourage litigation over small amounts, but there is no justification when damages exceed the base retention amount. Stewardship of the law requires prudence to err on the side of caution.

Third, the penalty interpretation may cause actual harm by creating a prevailing sense that the legal system produces unfair results, particularly among the large percentage of the population who face economic hardships. Misapplication of the law contributes in a case like this, at least in a small way, to a

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[147] A draft amendment to Article 2 was first approved in 1999.

[148] *See* TWINING, *supra* note 138, at 210.

[149] *See, e.g.*, Lake River Corp. v. Carborundum Co., 769 F.2d 1284, 1289 (1985) (Posner, J.). An efficient breach creates a Pareto optimal outcome. *See* Larry A. Dimatteo, *A Theory of Efficient Penalty: Eliminating the Law of Liquidated Damages*, 38 AM. BUS. L.J. 633, 636–37 (2001).

breakdown in respect for the rule of law. This issue is a problem for a statute like the UCC, which is drafted to rely on open-ended and general standards, such as good faith, reasonableness, and unconscionability. The structure of the UCC already requires courts to engage in *ad hoc* reasoning, which is difficult to fit within general rules.[150] When general standards of a law are applied in such a way that it results in an unjust outcome, confidence in the law is jeopardized. Individuals have no reason to trust the application of general principles when the law gets the details so very wrong. Stewardship of the law requires taking steps to strengthen respect for the rule of law, not senselessly sowing random seeds of discontent.[151]

Fourth, the law has an expressive function by reflecting a society's values.[152] In these economic times, with problems of growing income inequality, the law should not express the retrograde idea that a nondefaulting seller is allowed to retain premiums or penalties out of a defaulting buyer's deposits, particularly without any countervailing reason justifying a penalty; naked unjust enrichment will not suffice as a rationale. Concern over the expressive message of the law is always paramount. Stewardship of the law requires ensuring that the law conveys a message that appeals to the good of society.

B. Evaluation of Social Science Data Supporting the Need for a Change and the Difficulties Assessing the Scope of the Problem

Studies show that many Americans live paycheck to paycheck[153] and would have trouble making an unexpected $500 payment—the very amount of the maximum computation error at

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[150] Employing words like "reasonable" in a statute invites ad hoc reasoning. "The word *reasonable*, effective in small doses, has been administered by the bucket, leaving the corpus of the Code reeling in dizzy confusion." David Mellinkoff, *The Language of the Uniform Commercial Code*, 77 Yale L.J. 185, 185–86 (1967). *See generally* ROBERTO UNGER, LAW IN MODERN SOCIETY 197 (1976) (discussing problems with general rules).

[151] *Cf.* ROBERTO M. UNGER, KNOWLEDGE AND POLITICS 84 (1975) ("[T]o be effective as a means of order, the laws must deserve and win the allegiance of the citizenry.").

[152] *See generally* Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021 (1996).

[153] Quentin Fottrell, *Half of US Working Families Are Living Paycheck to Paycheck*, N.Y. POST (Apr. 5, 2017, 2:46 P.M), http://nypost.com/2017/04/05/half-of-us-working-families-are-living-paycheck-to-paycheck/.

issue in these cases.[154] A study published in 2015 found that twenty-five percent of families had less than $400 in savings.[155] More broadly, in 2017, forty percent of adults report that they or their families had trouble meeting at least one basic need for food, health care, housing, or utilities.[156] Similarly, over twenty percent of Americans report they have no retirement savings.[157]

Therefore, what some might minimize as a small calculation quibble is actually not a small amount for a significant portion of the population. While there is a lack of case law regarding this issue, the absence of court decisions could very well be reflective of the high transaction costs that keep most cases from being litigated. When the policy cannot be supported by data, those associated with law reform should consider avoidance of corrosive impacts as a matter of reasonable system design. People lose respect for a legal system that produces results that treat them unfairly.

Some might argue that this data, standing alone, do not show a problem widespread enough to merit attention. The response is complex and requires an appeal to structural observations about how the legal system itself can mask the importance of underlying social problems.

It is unrealistic to assume that the legal system itself, through a simple count of publicly available decisions, reveals the full extent of injustices occurring in the real world. Examination of case law serves as an imperfect window into matters of societal concern. Given the small amounts at stake in any individual case, scant lawyer or judicial time will be spent analyzing and correcting for an easy and straightforward—though wrong—application of the statute.

Transaction costs alone explain why individual cases in this area receive little attention. Significantly, the UCC does not provide for recovery of attorney fees or penalty judgments to induce private attorneys to function in the public interest in lieu

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[154] McGrath, *supra* note 3.

[155] THE PEW CHARITABLE TRUSTS, *supra* note 4, at 6 ("The typical household has $3,800 in liquid savings, but a quarter of households have more than $17,000, and another quarter has less than $400.").

[156] MICHAEL KARPMAN ET AL., *supra* note 5.

[157] *1 in 3 Americans Have Less Than $5,000 in Retirement Savings*, THE NORTHWESTERN MUTUAL LIFE INS. COMPANY (May 8, 2018), https://news.northwesternmutual.com/2018-05-08-1-In-3-Americans-Have-Less-Than-5-000-In-Retirement-Savings.

of a state actor.[158] Moreover, the UCC does not contain class action provisions, which might operate to aggregate small individual claims into a single matter of sufficient size to attract the attention of private attorneys.[159] Even if the UCC contained class action provisions, individualized consideration of transaction damages would not satisfy traditional requirements for class certification in deposit return cases.

Further, many cases in which this problem is addressed may never become decisions that are available and easily accessed through Lexis or Westlaw. Many consumers victimized by an excessive retention of a deposit probably never bring a lawsuit. Even if a lawsuit is brought, the case may settle. If the case goes to judgment, that judgment may not result in a written order of decision published in an electronic database. The publicly available decisions merely suggest a deeper problem that traditional social science data fails to identify directly. Nevertheless, this argument has a foundational basis: (1) a large segment of the population may be adversely impacted by an incorrect application of the law; (2) those affected will include low-income individuals, without access to credit, for whom a $500 loss is significant; and (3) retaining a penalty creates an unjust enrichment. The best course in such a case is for the steward of law to err on the side of caution and make the correction.

C. The Problem of Design Failures

Recognition that the structure of the UCC itself, and the process for its amendment, jointly operate to disadvantage lower income groups, among others, creates a call for action. The power structure created the problem with the drafting of the law, and the power structure has an amendment process ill-suited to clean up after its mistakes. The reality runs counter to the conventional, and often incorrect, view of statutes. On the conventional view, a court aims to implement legislative will when interpreting a

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[158] *See* Caroline Edwards, *Article 2 of the Uniform Commercial Code and Consumer Protection: The Refusal to Experiment*, 78 ST. JOHN'S L. REV. 663, 668, 717–18 (2004). Indeed, the expense of filing a small claims case itself might function as a deterrent to bringing suit in the first instance. In Miami-Dade County, Florida, for example, the filing fee is a sliding scale that can be as much as $300. Additional fees are required for issuance of a summons and service of process by a sheriff. *See* *Small Claims Court – How to File a Claim*, HARVEY RUVIN CLERK OF THE COURTS, MIAMI-DADE COUNTY, FLORIDA, http://www.miami-dadeclerk.com/property_small_claims.asp (last visited July 31, 2019).

[159] Edwards, *supra* note 158, at 720.

statute, and when a court produces an incorrect result, it can easily be remedied by statutory amendment.[160] The problem arises when a non-majoritarian decision of consequence is not merely transitory. Stewardship of the law requires correction of these design failures.

1. Design Failure Number 1: UCC Operating Like a Civil Law System

Examining the case law, particularly the disconnect between *Neri* and the later New York State cases, leads to conjecture about how this area of law operates. The theory is that, at least in an area of the law constrained by transaction costs, our legal system, and particularly statutes like the UCC, operates much more like a traditional civil law system than like a common law system.[161] The UCC, though a statute, was not designed to work like a traditional civil code.[162] A traditional civil law system is a system in which the mode of analysis relies on the reading of a code or a statute, largely in isolation, divorced from the consideration of precedents and, perhaps, other secondary materials.[163] In such a system, a premium is placed on clear drafting and straightforward application of statutory language, which § 2-718 lacks.[164]

An ambiguity differs from an open or general term. The claim is not made here that the drafters of the UCC intentionally created ambiguities, like that found in § 2-718.[165] The drafters did, however, intentionally use open and general terms which

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[160] *See* Harry H. Wellington, *The Nature of Judicial Review*, 91 YALE. L.J. 486, 487 (1982) (noting the conventional view and its shortcomings).

[161] Weiss, *supra* note 9.

[162] It is generally accepted that the UCC is not designed to be a classical civil law code. *See* John E. Murray, Jr., *Revised Article 2: Eliminating the "Battle" and Unconscionability*, 52 S. TEX. L.R. 593, 594 (2011). It is sometimes called a "common law code" because it allows and depends on case law development. *Id*. *See also* Caroline N. Brown, *Restoring Peace in the Battle of the Forms: A Framework for Making Uniform Commercial Code Section 2-207 Work*, 69 N.C. L. REV. 893 (1991) ("The drafters envisioned Article 2 as a fabric of statutory law that takes its essential character from its framework of common law and commercial reality"); Lewis A. Grossman, *Langdell Upside-Down: James Coolidge Carter and the Anticlassical Jurisprudence of Anticodification*, 19 YALE J.L. & HUMAN. 149, 215–16 (2007).

[163] Weiss, *supra* note 9.

[164] A literal reading of Article 2 often is not possible; rather, one comes to understand Article 2's meaning only after appreciation of its purposes. *See generally* Eugene F. Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 VILL. L. REV. 213, 219–21 (1966).

[165] The most famous UCC drafting ambiguity appears in § 2-207, which addresses the "battle of the forms." This ambiguity also was addressed in revised Article 2. *See* Murray, *supra* note 162, at 601.

anticipated later court involvement in the ongoing development of commercial law.[166] Indeed, the UCC depends upon case law development to flesh out open terms like "reasonable" and "unconscionable" to fill gaps and adapt to changing commercial practices.[167]

The UCC's system design depends on significant *ex post* examination. Llewellyn was explicit about the need for court involvement:

> Technical language and complex statement cannot be wholly avoided. But they can be reduced to a minimum. *The essential presupposition of so reducing them is faith in the courts to give reasonable effect to reasonable intention of the language.*
> Semi-permanent Acts must envisage and must encourage *development* by the courts.[168]

This set-up created the environment in which a lower value was placed on language precision because any ambiguities would be addressed as a byproduct of the expected court involvement in applying open and general terms. Moreover, another UCC design feature devalued statutory drafting precision. By agreement, parties may vary most UCC provisions.[169] Recognition of contractual freedom allows parties to simply contract around drafting problems in the statutory language. In contrast, a civil code places a greater premium on drafting precision both because its terms are not applied against a backdrop of precedent and because more of its provisions are mandatory.[170]

In the realm of the low dollar case, however, the text of the statute assumes a primacy not present in larger cases. If the parties and the court do not have the resources to consult the case law or to reflect on the intricacies of the drafting, the system envisioned for the proper functioning of the UCC breaks down. If

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[166] The drafters trusted courts to sensibly apply general terms to specific circumstances. Miller, *A True Story, supra* note 97, at 144 n.6 (2009).

[167] *See* Miller, *What Can We Learn*, *supra* note 97, at 471–72.

[168] Memorandum from Karl N. Llewellyn to the Executive Committee on Scope and Program, National Conference of Commissioners on Uniform State Laws, *Re: Possible Uniform Commercial Code*, *reprinted in* TWINING, *supra* note 138, at 580, 582 (emphasis in original).

[169] UCC § 1-302(a) (AM. LAW INST. & UNIF. LAW COMM'N 2018).

[170] Weiss, *supra* note 9. In contrast, the drafting of Article 2 often is criticized. *See, e.g.*, William H. Henning, *Amended Article 2: What Went Wrong?*, 11 DUQ. BUS. L.J. 131 (2009) (describing the drafting of original Article 2 as "confusing and even sloppy").

this conjecture is correct, it provides support for a statutory amendment as the solution, as this Article argues, rather than other corrective action.

The conjecture is motivated by the anecdotal observation of the case law examined above. Even though *Neri* is one of the most famous contract cases in the United States, it was not considered by the court in *Feinberg*. Though *Gongora* did cite to *Feinberg*, the court did not mention the *Neri* case, despite its notoriety and even though it would appear to be binding precedent. *McCann* did not cite to *Neri*, *Feinberg*, or *Gongora*. Nor, for that matter, did *Santos*.

Even the cases that use the alternative approach are short on use of authority. The *Neri* court failed to note its own prior dicta in *Proctor & Gamble Distributing Corp.* that would have supported a decision to reject the additive method to compute a final restitution amount. *Honsberg* did not cite to any authority; neither did *Madsen v. Murrey & Sons Co., Inc.*, nor did *Bowen v. Gardner*. To be sure, *Anheuser* considered *Neri*, and *Conister* considered both *Murrey* and *Anheuser*, illustrating that all is not lost.

In such a milieu, one should worry whether parties will consult official comments to the UCC, the drafting history of a code section, a Permanent Editorial Board comment, or other secondary sources. None of the cases, whether additive method or alternative approach, even recognize the possible drafting ambiguity inherent in § 2-718(2) and (3). Most courts simply perform a calculation without explaining the relationship of the statute to that calculation. Later cases, which might have picked up on the ambiguity in § 2-718 noted by Professor Pettit,[171] predictably fail to cite to secondary authority.

Moreover, the secondary literature that might help, if consulted, is in disarray. Though one can put the *Hawkland* treatise to good use as discussed in Part III, its analysis is incomplete because it does not discuss the interpretive options identified by Professor Pettit in 2000, nor does it cite to *Neri*. An early law review article applied the additive method without considering alternatives.[172] The *Anderson* treatise is hopelessly brief, managing an inconsistency nonetheless.[173] In one section,

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[171] *See* Pettit, *supra* note 39, at 1496–97.

[172] Robert J. Nordstrom, *Restitution on Default and Article Two of the Uniform Commercial Code*, 19 VAND. L. REV. 1143, 1172–73 (1966).

[173] 4A Part II ANDERSON U.C.C. § 2-718:45 (3d ed.) (2017).

Anderson cites to both *Honsberg* and *Feinberg* without noting the different calculation methods used.[174] Moreover, it too misses *Neri*. Further, in another section, *Anderson* cites to a number of alternative approach cases, without addressing the additive method of *Feinberg*,[175] missing *Neri* a second time, while nevertheless citing to *Proctor & Gamble*.[176] The *Quinn's* treatise fails to notice the difference between the additive method and the alternative approach while citing to only two cases, *Feinberg* and *Anheuser v. Oswald Refractories Co., Inc*.[177] To the extent a court or a litigant bothered to look, the secondary literature would not help with the core analytical issue. At worst, consulting the secondary literature might lead to the use of the additive method.

2. Design Failure Number 2: The Cumbersome Amendment Process

A system which requires two institutions, the ALI and the ULC, to gear up the machinery of change and then engage fifty state legislatures, is designed to address broad reform.[178] Technical fixes tag along for the ride on those rare occasions when this engine is started. One reason the UCC was drafted using general terms that invite court development is the recognition that the formal and cumbersome amendment process is unlikely to respond rapidly to changing circumstances, new developments, and the like.

Llewellyn had the notion, starting with the proposed Federal Sales Act, of a "grand codificatory act":

> A *codificatory* Act covering a large body of private law must not be treated as ordinary legislation. It is not ordinary legislation. It is not legislation capable of easy or frequent amendment; errors in it, if any, are rather to be suffered than amended, over

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[174] *Id.*

[175] *Id.* at § 2-718:48.

[176] Procter & Gamble Distrib. Co. v. Lawrence Am. Field Warehousing Corp., 16 N.Y.2d 344, 354–55, 266 N.Y.S.2d 785, 792–93 (1965).

[177] 2 QUINN'S UCC COMMENTARY & LAW DIGEST § 2-718[A][10] (Rev. 2d ed.) (2018).

[178] For a description of the coordination between the ALI and the ULC on a project like the revision to Article 2, see Peter A. Alces & Chris Byrne, *Is it Time for the Restatement of Contracts, Fourth?*, 11 DUQ. BUS. L.J. 195–96 (2009).

> very considerable periods. Such a codificatory Act is in a peculiar sense *permanent* legislation; it enters into the commercial structure of the country.[179]

In Llewellyn's vision, a grand codificatory act relied essentially on development and explication by courts, using a common law methodology.

> If ever there was legislation which is *declaratory of principle*, which is in essence and intent the laying down of rules *to be developed by the courts* as common law rules are themselves developed by the courts, and molded to the succession of unforeseen circumstances, this proposed Bill is such legislation.[180]

When the revision of sales law moved from a focus on a federal sales act to state law, Llewellyn continued to view the state law as the same sort of grand codificatory act that amounted to semi-permanent legislation.[181]

The abandonment of the federal sales act process, however, compounded the problem. No longer would a single federal law be able to set the tone for uniformity among the several states. Passage of a grand codificatory act now required parallel action in all the states. The United States Supreme Court case of *Erie v. Tompkins* made the uniformity problem even more acute.[182] Following *Erie*, the federal courts no longer would be able to set an example in diversity cases by declaring a federal common law of sales.[183]

This design feature, relying on the twin pillars of generality and a common law-like stewardship by judges, can be a systemic strength given the nature of the amendment process. It transforms into a weakness when transaction costs deter parties and courts from engaging with legal developments external to the text of the statute itself. The grand codificatory act simply does not work when courts and parties do not consult the

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[179] K. N. Llewellyn, *The Needed Federal Sales Act*, 26 VA. L. REV. 558, 561 (1940) (emphasis in original) (describing the proposed federal sales act as a codificatory act); *accord* Miller, *What Can We Learn*, *supra* note 97, at 472 (noting that the design of the UCC mitigates the need for frequent amendments).

[180] Llewellyn, *supra* note 179, at 561–62 (emphasis in original).

[181] Memorandum from Karl N. Llewellyn to the Executive Committee on Scope and Program, National Conference of Commissioners on Uniform State Laws, *Re: Possible Uniform Commercial Code*, *reprinted in* TWINING, *supra* note 138, at 582–83 (describing state uniform sales law as semi-permanent legislation).

[182] 304 U.S. 64, 78 (1938).

[183] *See* Hiram Thomas, *The Federal Sales Bill as Viewed by the Merchant and the Practitioner*, 26 VA. L. REV. 537, 539 (1940).

supplementary material generated by the system. Changes in law need to appear in the text of the statute to influence decisions in small cases. The amendment process needs to provide for small and technical changes which may nevertheless have a significant impact. The statutory amendment process, at least to date, does not feature this adaptiveness.

The amendment process for the UCC, however, has tended to think big, with changes focused on comprehensive amendments to entire articles or the inclusion of a new article altogether. Familiar examples include the conceptual rethinking of Article 8, which led to a significant rewrite of the law governing investment securities, the addition of Article 2A to cover leases, and the failed attempt at a large scale amendment to Article 2 governing sales. The process of drafting a model act includes—and indeed may properly prioritize—the normative function of stating what the law should be. Disagreement over the normative directions of the law doomed revised Article 2.[184] Revised Article 2 was too big to succeed. And yet, very few sections of the proposed revisions attracted serious opposition.[185] A new, scaled back revision to Article 2 led by the ALI and the ULC, however, does not seem to be in our immediate future.

The failure of the Article 2 revision process likely has a fairly traditional explanation found in political science literature. In the legislative process, interest groups exert pressure on legislators who are concerned with reelection. Political processes systematically undervalue large diffuse group preferences and overvalue small cohesive group preferences. Thus, a focused business group has an advantage over scattered interests, such as consumers.[186] Groups like the ALI and the ULC likely were not captured by business interests in this case, at least not on the large number of beneficial amendments, which provoked no controversy. Desired model legislation was produced on many points. However, a traditional capture story, coupled with indifference to a whittled

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[184] Henry Deeb Gabriel, *The 2003 Amendments of Article Two of the Uniform Commercial Code: Eight Years or a Lifetime After Completion*, 52 S. TEX. L. REV. 487, 494, 495 (2011) (identifying opposition to the treatment of deferred terms and scope as the core problems).

[185] *Id.* at 494.

[186] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 128 (1965); *see also* RUSSELL HARDIN, COLLECTIVE ACTION 38–49 (1982); TODD SANDLER, COLLECTIVE ACTION: THEORY AND APPLICATIONS 63–94 (1992).

down project, played out in the various state legislatures.[187] Many beneficial technical amendments were not enacted for the simple reason that they were contained in a much larger amendment. Interest groups objected to some aspects of the large amendment, but not to the technical improvements.

Given the focus of the ALI and the ULC on large, sweeping projects, concerns affecting ordinary people were lost as collateral damage when lobbyists successfully opposed the large amendment to Article 2, which contained the needed technical fix. Perhaps a failure to appreciate the potential impact of a $500 loss prevented the elites from realizing what was lost when the amendment process failed. This failure was not simply a lost opportunity to address concerns over the treatment of deferred terms or information and computer programs;[188] it was a lost opportunity to make the statute more just in its operation for ordinary people.

This example reveals that the design failure of the grand amendment process comes with serious costs imposed when a grand project fails. All the beneficial yet not controversial changes are lost. The impact of these costs is cushioned when courts and parties fall back upon case law decisions to resolve uncertainties associated with the statutory text. This safety net fails, however, when transaction costs cause parties and courts to use the UCC like a civil code, ignoring precedent and other supplemental sources.

To be sure, minor adjustments sometimes appear in pronouncements from the Permanent Editorial Board ("PEB"). While a PEB comment on the topic would not hurt, it is not clear that the pronouncement would filter down to the courts in small matters, particularly if small cases are administered like civil law cases.

[187] Gabriel, *supra* note 184, at 494 (suggesting that most opposition had been eliminated in the drafting process but that left revised Article 2 with no champion). To be sure, the UCC process is not immune to capture and influence at the drafting stage; for example, witness the split of the Uniform Computer Information Transactions Act (UCITA) into a separate project. *See* Brian D. McDonald, *The Uniform Computer Information Transactions Act*, 16 BERKELEY TECH. L.J. 461, 462 (2001).

[188] Opposition to Revised Article 2's attempt to address "information," which includes computer software, by industry groups appears to be one reason for the failure of the amendment, among many, even though the revision process dropped treatment of software licensing in 1999. *See* Miller, *What Can We Learn*, supra note 97, at 474.

VI. THE WAY FORWARD

Llewellyn himself stated that a byproduct of the grand codificatory act is that "errors in it, if any, are rather to be suffered than amended, over very considerable periods" of time.[189] While the idea of suffering over a very considerable period of time may be descriptively accurate, as a normative matter, it is questionable whether it is acceptable to wait.[190] It is sometimes said that justice delayed is justice denied. What should be done about a problem for which a correction was proposed through the amendment process by 1999, included in a reconstituted amendment in 2003, which was withdrawn in 2011?[191] The end of 2019 approaches. It did not seem to help that the ambiguity was identified in the academic literature in at least 2000.[192] No correction is pending through the usual channels of law reform, which is not surprising. Stewardship of the law requires that some step be taken in light of growing income inequality.

A restatement project does not seem like the answer, though it would not hurt. Restatements of law exhibit a trend toward downsizing the scope of the project undertaken. In the commercial law field, a current example is the project on the Restatement of Consumer Contracts ("RCC"), which is proceeding in lieu of a new restatement of the entire field of contracts.[193] Unfortunately, that project does not address deposit return calculations.[194] The problem with enlisting the draft RCC in the corrective effort rests with the purely statutory nature of this problem. It is a UCC drafting problem. The rationale the draft RCC uses for addressing certain contract formation issues in consumer contracting is that the problems addressed are, first and foremost, common law issues

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[189] Llewellyn, *supra* note 179, at 561.

[190] Sometimes Llewellyn and other legal realists, as well as the UCC project itself, are accused of being amoral. To be sure, Llewellyn and others advocated for the UCC on the grounds that it was largely non-political in character. *See* Danzig, *supra* note 138, at 627–28. This stance does not, however, create an argument for inaction when an injustice has been identified.

[191] U.C.C. 2003 AMENDMENTS TO ARTICLE 2 (AM. LAW INST. & UNIF. LAW COMM'N 2017) (Amendments Proposed in 2003 and Withdrawn from the Official Text in 2011).

[192] *See* Pettit, *supra* note 39, at 1488, 1503.

[193] Letter from Nat'l Consumer Law Ctr. to Am. Law Inst. Council Members (Jan. 10, 2018), https://www.nclc.org/images/pdf/udap/13-ali-comments-council-draft-4.pdf [hereinafter draft RCC].

[194] *Id.*

and not UCC issues, though clearly they are related to the UCC.[195] No plausible case can be made that the deposit return calculation problem is anything other than statutory.

Following the rules for restatements would be straightforward if one focused a new restatement project on statutory consumer issues.[196] First, the meager case law shows a majority rule following the alternative approach. Second, the trend follows the additive method, which should not be followed because of the third and fourth considerations. Third, the rule that best leads to coherence in the law is the alternative approach or the context sensitive method because it follows the general rule for damages computation, which aims at compensation for loss, rather than a provision for premium or penalty. Fourth, the alternative approach or the context sensitive method is the more desirable rule, particularly in times of increasing income inequality, because it reduces outcomes producing unjust enrichment.

There is no reason to think a restatement would receive the required attention, so perhaps this is not a true missed opportunity. This Article may be a success at multiple levels: if it leads courts to apply a context sensitive method to deny a premium or a penalty, if it leads to a correction in a future restatement, or if it leads to a PEB Commentary. Perhaps the best solution is the alternative of pushing for individual amendment to § 2-718, orchestrated on a state by state basis, without national coordination through the ALI and ULC. The facts lead to the conclusion, very reluctantly, that state by state amendment is the best course for this problem.

As preface, the suggestion to replace fifty gridlocked state legislative processes with fifty other potentially gridlocked processes—but without elaborate institutional support—may appear crazy or romantic. In defense, one can make a practical case for a unique non-uniform amendment in New York alone,

[195] In fact, a good case can be made that the Draft RCC mischaracterizes a UCC issue as a common law issue in order to allow consideration of contract formation issues for which statutory reform has failed. That, however, is another project for another day.

[196] The justification for such an examination of statutes impacting consumers could be grounded in the Restatement Second treatment of the statute of frauds. For an outline of the requirements for a restatement, see AM. LAW INST., A HANDBOOK FOR ALI REPORTERS AND THOSE WHO REVIEW THEIR WORK 4–6 (2015) (presenting excerpt of the Revised Style Manual approved by the ALI Council in January 2015).

which would effectively redirect that jurisdiction away from the recent, but misguided, case law. Effort should be spent in New York, at the very least.

At a more theoretical level, one can understand the second design failure of the cumbersome amendment process as not a core failure, at least from the perspective of Llewellyn. Creating a grand codificatory act did not have, as part of its purpose, the creation of a legal device that would be responsive to an ongoing democratic process. Indeed, Llewellyn told us repeatedly that any of the various uniform sales acts, federal or state, would rarely be amended. These projects, in this sense, are conceived as antidemocratic, even though the product of an initial democratic process. This setup leaves open space for a democratic or popular response to the codificatory act, if needed. Justice lives outside the grand gesture.

Llewellyn, together with Hart and Sacks, were part of a handful of scholars who seriously studied the legislative process.[197] "Hart and Sacks were preeminently concerned with the law as a vehicle of growth and with legislatures as maximizers of social utilities."[198] For them, ideally, the lawmaker would actively shape society for its betterment. In such a view, a lawmaker should not sit around for decades allowing constituent suffering due to a drafting error in a grand codificatory act.

In contrast, for Llewellyn, the primary task for the lawmaker was to use a kind of situation sense to identify patterns and practices appropriate to particular situations. The life situations of a particular time and place suggest contours for an appropriate law—law that was immanent in a particular fact-situation. The lawmaker merely needs to articulate it. Indeed, for Llewellyn, it was probably of secondary importance—or, perhaps, even a bother—that legislators performed this role.[199] The legislator's role was passive, not active. The fine tuning and the promotion of

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[197] *See* HENRY M. HART, JR. & ALBERT M. SACKS, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW, at iii (1958).

[198] Danzig, *supra* note 138, at 624.

[199] *Id.* It is not germane to the point made here to engage in the debate over whether, and to what extent, Danzig is correct about the degree of amorality in Llewellyn's approach. *See* Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465, 468 n.13 (1987) (disputing Danzig's characterization of Llewellyn's thought). What is required is that a moral stance be taken against the prospect of a long and extended period of suffering. *See, e.g.*, HART & SACKS, *supra* note 197, at 102–07 (arguing that the promotion of human welfare should be a part of legal decision making).

justice would be left to common law-trained judges in courts. Despite the gridlock of established legislative avenues for amendment,[200] if one adopts the Hart and Sacks view of the purpose of lawmaking—as requiring consideration of moral imperatives rather than of anthropological observations—it suggests legislators push for change, against the odds and through nonstandard means, even if standing alone. Sometimes, uniformity may be a false god standing in the way of progress.

Though non-uniform amendments to the UCC generally are disfavored as conflicting with the mission of the UCC to be "uniform,"[201] some states have adopted non-uniform amendments without any negative impact.[202] Importantly, this step is recommended only after the uniform amendment process has failed. Indeed, the first stated purpose of the UCC is to "simplify, clarify, and modernize the law governing commercial transactions."[203] This purpose is frustrated when the traditional amendment process fails. Given this failure, one might accept some shortcomings associated with non-uniformity, though as discussed below, non-uniformity poses no real risks in this case. Indeed, promotion of the first value of "clarity" may require subordination of the value of "uniformity."[204]

The need for a non-uniform amendment process to fix UCC § 2-718(2) and (3) is not related to the usual set of problems infecting a uniform law process. When a uniform law process fails effectively to protect consumer interests, the failure is in part attributed to the absence of effective consumer representation in the uniform law process.[205] However, that does not appear to be

[200] This study shows that law reform takes a long time. The original amendment to protect defaulting buyers took over forty years and that was in a single state—New York. The initial UCC project took over twenty years, depending on how one counts. The failure of revised Article 2 took over twenty years.

[201] *See* U.C.C. § 1-103(a)(3) (AM. LAW INST. & UNIF. LAW COMM'N 2018); Murray, *supra* note 162, at 594 ("The need for uniformity in a commercial law statute is a sine qua non of its existence."); *accord* W. DAVID SLAWSON, BINDING PROMISES: THE LATE 20TH-CENTURY REFORMATION OF CONTRACT LAW 138 (1996).

[202] This goes against the stated purpose in UCC § 1-103(a)(3) "to make uniform the law among the various jurisdictions."

[203] U.C.C. § 1-103(a)(1).

[204] This is particularly true when the hope exists that uniformity may be restored by widespread adoption of the non-uniform amendment. The ALI and the ULC may have a vast apparatus designed to achieve uniformity, but they do not have a monopoly on uniformity.

[205] *See* Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83,

the case here as Revised Article 2 contained the technical fix required to eliminate the penalty. The problem, rather, was that a good provision was eliminated when the overall Article 2 revision project failed.

A large and complex literature discusses problems of uniform law projects, which are beyond the present task to engage fully.[206] However, a brief defense of a non-uniform amendment is warranted.

In a taxonomy of non-uniform UCC amendments, three different types stand out as unlikely to create the sort of differences which destroy the rationale for a uniform code. In the first camp are amendments to fix obvious problems, particularly where case law developed a solution.[207] "Obvious problems" are problems caused by poor drafting, not those created by use of flexible and open-textured terms. Often, case law uncovers these types of ambiguity. If the non-uniform amendment operates in parallel to a developed case law solution, there is little room for conflict or confusion. The Massachusetts amendment to UCC § 2-207 governing the battle of the forms is of this type.[208] Massachusetts amended its version of § 2-207(2) expressly to cover both "different" and "additional" terms,[209] a move generally arrived at by case law.[210] This type of small fix merely steers parties and courts in the right direction without the need to consider precedent

126 (1993). Consumer group opposition—because the revision did not go far enough—may have been part of the problem.

[206] *See, e.g.*, F. Stephen Knippenberg & William J. Woodward, Jr., *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519, 2524 (1990).

[207] For a discussion of types of amendments faced by the UCC editorial board early in the adoption process, see Robert Braucher, *The Uniform Commercial Code—A Third Look?*, 14 W. RES. L. REV. 7, 11 (1962). Professor Braucher writes, "First and easiest is the correction of obvious error. Second is the resolution of ambiguity disclosed by judicial decision." *Id.*

[208] MASS. GEN. LAWS. ch. 106, § 2-207 (1991).

[209] The model version of the UCC does not include the word "different" in § 2-207(2) governing a battle of the forms situation. Massachusetts added the term "different" in its version of the UCC to clarify the ambiguity created when § 2-708(1) refers to "different" and "additional" terms but § 2-207(2) refers only to "additional" terms. *See generally* John L. Utz, *More on the Battle of the Forms: The Treatment of "Different" Terms Under the Uniform Commercial Code*, 16 UCC L.J. 103 (1983) (describing the drafting problem created by omission of the word "different"). Michigan and Montana follow Massachusetts in adding the word "different." *See* MICH. COMP. LAWS ANN. § 440.2207 (West 2019); MONT. CODE ANN. § 30-2-207(2) (West 2019); HAWKLAND, *supra* note 14, at 181.

[210] *See, e.g.*, Northrop Corp. v. Litronic Indus., 29 F.3d 1173, 1175 (7th Cir. 1994).

and secondary authority.[211] Such an amendment should reduce future transaction costs. It does not lead to unfair surprise or the type of inconsistency, which might cause problems for interstate transactions or the national economy.

In the second camp are non-uniform amendments, which address matters of particularly local concern.[212] An example is the non-uniform amendment in Nebraska to address sales of grain by non-merchants.[213] Another is non-uniform amendments relating to cooperative homes in New York.[214] These changes actually reflect a strength of having fifty different state laws rather than a single federal sales act as originally planned for the UCC.[215] Importantly, the local nature of the transactions addressed in deposit return cases means that the non-uniformity is unlikely to interfere with interstate transactions or the operation of a national economy. This statement is true even though the local

[211] Not everyone would agree with this characterization of the small statutory fix. Some suggest that the change contravenes the "knock out" rule developed in most jurisdictions. *See* Burnham, *supra* note 7, at 526 n.29. Generally, that is an argument for another day, though *Ionics, Inc. v. Elmwood Sensors, Inc.* may support the view that the drafting change is minor. 110 F.3d 184, 188–89 (1st Cir. 1997), *overturning* Roto-Lith, Ltd. v. F.P. Bartlett & Co., 297 F.2d 497 (1st Cir. 1962). If not, we may have an unfortunate instance of a clarifying amendment which fails to clarify. *See* Braucher, *supra* note 207, at 11 ("Third, amendments which do not clarify have sometimes been made for the purpose of clarification.").

[212] *See, e.g.*, Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 141 (1996) (suggesting that one cost of uniform laws may be the elimination of beneficial local variation). Professor Braucher called a local variation of this sort "regrettable" but indicated that it posed "no problem for the national sponsors." Braucher, *supra* note 207, at 10.

[213] Nebraska included a change to the UCC Article 2 statute of frauds, § 2-201, to specifically address the case of transactions between a merchant and a buyer or seller of grain who is not a merchant. *See* NEB. REV. STAT. ANN. U.C.C. § 2-201(2)(b) (2019). South Dakota adopted a similar non-uniform amendment. *See* HAWKLAND, *supra* note 14, at 181.

[214] These appear in New York's version of Article 9 and not Article 2. Oddly, New York law treats co-op shares as "goods" under Article 2 pursuant to case law decision. Silverman v. Alcoa Plaza Associates, 37 A.D.2d 166, 323 N.Y.S.2d 39 (1st Dep't 1971).

[215] To be complete, a federal sales act would not have applied to most small transactions which are intrastate because the federal government would not have had authority under the commerce power of the United States Constitution to regulate those transactions. *See* George C. Bogert, *The Proposed Federal Sales Act*, 26 VA. L. REV. 572, 584 (1940). Rather, the hope for the federal sales act process was that states would pass parallel legislation out of concerns to conform. *See* Llewellyn, *supra* note 179, at 562 (expressing the hope that new state legislation would conform to a federal sales act). There is no reason, in principal, why a state law could not act as a role model for other state laws, just as the proponents of the federal sales act project anticipated a federal law would act as a model for intrastate transactions governed by state law.

nature of the transaction arises solely because it is intrastate—in most cases—and not because of some unique aspect of the local economy such as a concentration of farming or cooperative home ownership.

In the third camp are non-uniform amendments, which address public policy concerns of a particular state. An example is Florida's decision to eliminate UCC § 2-725 of Article 2, which governs the statute of limitations. In most jurisdictions, the model version of Article 2 , which permits the shortening of a statute of limitations for suit in a sale of goods transaction, was adopted.[216] Florida, however, has a public policy against shortening the statute of limitations.[217] Accordingly, Florida's version of Article 2 simply omits § 2-725 altogether.

In this example, uniformity may be a negative by promoting a "race to the bottom" structure in the law by allowing business interests to avoid liability for breach of warranty claims to an extent deemed unfair.[218] Rather than yield to this "race to the bottom," the Florida legislators followed their better angels, declining to place uniformity ahead of justice concerns, or so one might surmise. Interestingly, this view of the Florida public policy is indirectly supported by proposed revisions to Article 2, which would have prevented the shortening of the statute of limitations in a consumer transaction.[219] Such a non-uniform provision might be justified by appeals to fairness, whether or not grounded in considerations of efficiency. In short, justice trumps uniformity.[220]

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[216] *See, e.g.*, N.Y. U.C.C. § 2–725 (McKinney 2019).

[217] *See* Burroughs Corp. v. Suntogs of Miami, Inc., 472 So. 2d 1166, 1167–68 (Fla. 1985).

[218] *See* Janger, *supra* note 11, at 579–80; *cf*. William L.Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 665–66 (1974) (introducing the idea of a "race to the bottom").

[219] U.C.C. § 2-725 (AM. LAW INST. & UNIF. LAW COMM'N, Proposed Amendments to Article 2 Sales 2002) (Amendments Proposed in 2002 and Withdrawn from the Official text in 2011).

[220] Different statutes of limitation, however, have a dark side: they invite parties to negotiate over which state's version of the UCC applies to a transaction. Professor Burnham has noted the irony of parties negotiating over which state's Uniform Commercial Code will provide the law. Burnham, *supra* note 7, at 526. Public policy should have priority over uniformity even when it creates a downside. Addressing deposit return calculations is one of those fortunate cases where a tradeoff need not be made. Another example where justice appears to have prevailed over uniformity is the Connecticut UCC, in which that state's legislature addressed electronic devices which disable car ignitions—a technique used in subprime auto lending to facilitate repossessions and to "encourage" payments known as "electronic self-help." *See* CONN. GEN. STAT. ANN. § 42a-9-609 (2001). *See generally* Michael Corkery & Jessica Silver-Greenberg, *Miss a Payment? Good Luck Moving That Car*, N.Y. TIMES

An amendment to UCC § 2-718 to eliminate the premium or penalty is firmly in the third "public policy" camp even though elements of a technical amendment and a local amendment are present. Adoption of a public policy to eliminate the default rule creating the penalty has particular appeal in the current economic environment on fairness and justice grounds. A state could decide to eliminate the premium or penalty without doing violence to the general project of creating uniformity in state law while promoting a more efficient and just law in this case. Several reasons support this view.

First, on the analysis contained above, an amendment to UCC § 2-718 to eliminate the premium or penalty is merely a technical amendment, reaffirming what the law already provides as elucidated by the context sensitive method. However, in New York, where the fix is most needed, it does more work even though, arguably, it is technically just confirming *Neri*. The amendment is promajoritarian in that it reaffirms legislative intent.

Second, the interpretation of the law needs to change in form, but not in substance, to prevent courts from making a mistaken application of law, particularly in small matters due to the transaction cost limitations. In the small case, courts may treat the UCC like a civil code, applying the law by a surface read of the statute. In this milieu, in practice, the commercial code is not functioning in a common law system with a robust body of precedent as envisioned by its authors. Were the law functioning as designed, courts would have corrected the problem in New York by now. Reducing mistakes should lower transaction costs.

Third, in Florida, Missouri, Tennessee, and Utah, the amendment is merely protective of results under existing case law, guarding against a future court treating the UCC like a civil code and arriving at the wrong result or being led astray by errant secondary literature.[221] In New York, an amendment will provide a course correction to prevent lower courts from using the additive method against the binding precedent of *Neri*. Elsewhere, the change is simply good statutory hygiene.

Fourth, the cases in which the change matters are local, intrastate transactions involving consumers or small businesses. These matters are cases where non-uniformity does not matter greatly.

(Sept. 24, 2014, 9:33 PM), https://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/ (discussing starter interrupt devices).

[221] *See supra* notes 55–56.

Fifth, the change clarifies a calculation consistent with the general theory of contract damages and does not work a change in doctrine. Consider, for example, eliminating the requirement that consideration support an amendment to a contract.[222] In so doing, it reinforces the evolution of contract damages towards recognizing restitution rights, an evolution specifically intended to prevent unjust enrichment. Indeed, the original New York law revision process which resulted in today's UCC § 2-718 was motivated to prevent buyers from unjustly enriching sellers and to provide equal treatment between defaulting buyers and defaulting sellers.

Contrast the three relatively benign examples of non-uniformity offered above with non-uniform changes to the scope of the UCC. For example, the Oklahoma exclusion of "information" from the definition of "goods"[223] to deny computer software licenses coverage under Article 2—when UCC case law generally goes the other way[224]—is destructive of uniformity of an important kind, going against case law and complicating conflict of law rules.[225] This observation is true even though the Oklahoma amendment may be correct, and case law wrong, as a matter of statutory construction.[226]

Given the failure of the revision project for Article 2, a populist program of revision may be necessary to save the UCC from obsolescence.[227] Careful selection of clauses for a populist revision

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[222] *See* U.C.C. § 2-205 (AM. LAW INST. & UNIF. LAW COMM'N 2018).

[223] OKLA. STAT. ANN. tit. 12A, § 2-105 (West 2006).

[224] Holly K. Towle, *Enough Already: It Is Time To Acknowledge That UCC Article 2 Does Not Apply to Software and Other Information*, 52 S. TEX. L. REV. 531, 532 (2011).

[225] The annotations to the Oklahoma law suggest that, if a transaction includes goods and information, the UCC may not apply to the information portion of the contract.

> More specifically, if a transaction is not fully within Article 2 but includes information and goods, the article does not apply to the part involving information, including informational rights in it and creation or modification of it, or, as indicated above, to the media on which the information is contained.

OKLA. STAT. ANN. tit. 12A, § 2-105 cmt. 1 (2006). This annotation invites application of the "gravamen" test to a mixed transaction. In other types of mixed transactions, a court typically applies the predominate purpose test. This non-uniform amendment muddles up conflict of law rules used to determine choice of law in hybrid or mixed transactions.

[226] Towle, *supra* note 224, at 534, 536.

[227] *See* Burnham, *supra* note 7, at 530 (suggesting that, absent amendment, Article 2 may become as quaint and obsolete as the Field Code); *accord* Miller, *A True*

may update and clarify the code without causing a failure of its overall mission to create uniformity in the law, providing a stop-gap until the engines of institutional reform reawaken.

CONCLUSION

The answer to Professor Murray's question of who is responsible for an effective Article 2 of the Uniform Commercial Code may well be, "we are."[228] But "we" does not necessarily mean the ALI and the ULC, as suggested by Professor Murray.[229] Rather, in the case of small drafting matters, an alternative "we" might be an effort led by contract law professors in each state advocating for law reform, perhaps enlisting an army of students in a teachable moment. A grassroots effort might achieve a positive change in law where more formal avenues of law reform have failed for almost twenty years.[230] Widespread success would show that the ULC does not have a monopoly on uniformity.

Story, *supra* note 97, at 143 (fretting over "the irreversible erosion of perhaps the most significant state law in U.S. history").

[228] Murray, *supra* note 8, at 129.

[229] In a best case scenario, the ALI and the ULC would initiate a radically downsized UCC amendment process to identify, pass, and push to ratify the non-controversial UCC revisions lost when the grand amendment failed. This is not a simple case of institutional players playing badly. Quite the contrary. The ALI and ULC made available several needed amendments reforming damage awards to make the calculations more just. In this camp, I would include not only the proposed changes to § 2-718, but also the revisions increasing the dollar amount for application of the statute of frauds and allowing a seller to recover consequential damages. Providing consequential damages for a seller historically equalized the treatment for sellers and buyers, much as the long ago efforts aimed to equalize treatment of deposits for defaulting buyers and defaulting sellers begun in 1942 in New York. A system which only addresses the grand amendment is designed to produce costly failures when failure occurs.

[230] Enlisting the academic community was part of Llewellyn's strategy for passage of the UCC. *See* Wiseman, *supra* note 199, at 486 (noting "Llewellyn's next step was to mobilize the academic legal community for modernization"). Persons interested in this project should understand its modest goals. The change will not prevent consumers from paying a premium when they sign an agreement containing a liquidated damages clause. Clarifying application of UCC § 2-718 (2) and (3) imposes no mandatory restrictions on the substance of a contract. The "reform" suggested here does not limit the discretion of a business by setting boundaries to permitted contract terms. Most consumer layaway plans offered by major retailers include liquidated damages clauses. They are not subject to default rules. The default rules governing deposit returns apply when a non-defaulting seller has failed to make appropriate plans or to draft a more complete agreement. This is likely to occur in more informal settings or in single transactions, rather than in programmatic ones. For a description of cases in which businessmen may fail to make appropriate plans, see Stewart Macaulay, *The Use and Non-Use of Contracts in the Manufacturing Industry*, 9 PRAC.

Three options exist for accomplishing an amendment to UCC § 2-718, depending on the substantive result desired. One simple approach would be to adopt the version of § 2-718 contained in the 2003 Revised Article 2. This option has the advantage, from the standpoint of a defaulting buyer, of eliminating entirely the possibility of a deposit being used to pay any premium or penalty. Further, it has the blessing of the ALI and the ULC. It has the disadvantage in live cases of requiring a trial to determine actual damages when the existing language might lead a non-defaulting seller simply to accept the statutory amount. Additionally, it works a change in the law in those cases where the base retention amount exceeds actual damages.

A second option is to follow the lead of North Carolina and add a subsection (2)(c) to § 2-718(2). The North Carolina version reads: "at the election of the seller in the case of a layaway contract, the aggregate payments received by seller from buyer under the contract or fifty dollars ($50.00), whichever is smaller."[231]

The North Carolina amendment was passed in 1993.[232] The section addresses only the context of a layaway plan, though its express terms do not limit its application to consumers.[233] As applied, subsection (c) operates to create a new base retention amount in the maximum amount of $50 for layaway plans. This provision makes the penalty or premium a small issue even for persons of modest means. The problem with the actual drafting is that it includes the troublesome phrase, "at the election of the seller," making it hard to determine what this language is for, unless it is to neuter the provision.[234] No rational seller would limit itself to a $50 retention if it had the option of a $500 retention under (2)(b). If this language were eliminated, and application of

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LAW. 13, 14–18 (1963). Nevertheless, the correction will help some and move the expressive function of the law toward justice and fairness.

[231] N.C. GEN. STAT. ANN. § 25-2-718(2)(c) (West 1993).

[232] Act of July 14, 1993, ch. 340 (S.B. 709), 1993 N.C. Sess. Laws (amending the North Carolina UCC to clarify and modify the law on layaway contracts).

[233] The addition to North Carolina General Statutes § 25-2-718(2)(c) operates in conjunction with a definition of "layaway contract" added to North Carolina General Statutes § 25-2-106:

> A "layaway contract" means any contract for the sale of goods in which the seller agrees with the purchaser, in consideration for the purchaser's payment of a deposit, down payment, or similar initial payment, to hold identified goods for future delivery upon the purchaser's payment of a specified additional amount, whether in installments or otherwise.

N.C. GEN. STAT. ANN. § 25-2-106(1) (West 1993).

[234] N.C. GEN. STAT. ANN. § 25-2-718(2)(c) (West 1993).

subsection (2)(c) were mandatory for layaway plans, consumers would be protected. Properly drafted, such an approach addresses the bulk of the social justice concerns raised by current UCC § 2-718(2) and (3). Given the statute's drafting, and the absence of case law or helpful official comment, it is hard to discern the state of the law or whether persons of modest means currently are protected in North Carolina. The point, however, is that such a drafting approach could be made to work.

The third option, recommended here, merely clarifies existing law to eliminate the additive method as a calculation option. This option has the benefit of eliminating the premium or penalty in the most egregious cases while retaining an incentive for a seller to merely accept the basic retention amount without going to trial. This approach has the further benefit of reaffirming the law as it was intended to be applied while changing nothing else; in other words, it leaves the small statutory liquidated damages provision intact, eliminating the need to argue over whether it promotes judicial economy. Thus, as a practical matter such an amendment should be easily sold to state legislatures. The suggested amendment language appears below.

SUGGESTED AMENDMENT TO SECTION 2-718 OF THE UNIFORM COMMERCIAL CODE:

* * *

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds . . .

(b) . . . twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover **<u>damages in excess of the amount retained under subsection (2)(b)</u>** under the provisions of this Article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

* * *