IV

Performance and Breach

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PERFORMANCE

We have now concluded our study of the elements of an enforceable commitment. In Part II, we studied the element of mutual assent; in Part III we examined the element of enforceability. We now turn our attention to the matter of performance and breach. In this chapter, we discuss the performance phase of the contract. In Section A, we begin by considering the implied duty to perform one's commitment in good faith. In Section B, we consider implied warranties of merchantability and fitness for a particular use, as well as ways of contracting around such warranties. Having examined the duty of performance, in Chapter 14, we shall discuss different types of breach.

A. THE IMPLIED DUTY OF GOOD FAITH PERFORMANCE

In prior chapters we have run across the concept of *good faith performance.* For example, when discussing the alleged illusory nature of requirements contracts, we discussed the court's view that the quantity demanded must have been incurred in good faith. This concept was also implicated by Judge Cardozo's implying a duty to use best efforts in the case of Wood v. Lucy, Lady Duff-Gordon. Our previous consideration was confined to whether such a duty could fairly be implied when the parties are silent. In this section we examine what the duty of good faith performance *means* and how it may be breached.

The notion that all contracts contain an implied covenant to perform in good faith is commonly traced to the New York Court of Appeals opinion in Kirke La Shelle Co. v. Paul Armstrong Co., 263 N.Y. 79, 188 N.E. 163 (1933), in which it was stated that "in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing." Id. at 167. This principle was applied to the sale of goods by the Uniform Commercial Code §1-203:

> Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

Subsequently, it achieved an even wider application through its incorporation in the Restatement (Second) §205 which reads: "*Every contract*

imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." (Emphasis added.)

What does the obligation of good faith performance entail? The U.C.C. offers the following less than entirely helpful definition in §1-201(19): "'Good faith' means honesty in fact in the conduct or transaction concerned." And §2-103(1)(b) reads: "'Good faith' *in the case of a merchant* means honesty in fact *and* the observance of reasonable commercial standards of fair dealing in the trade." (Emphasis added.) Comment a to Restatement §205 reads, in part:

> The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances.

To gain a better grasp of what the duty of good faith performance requires in context, we shall confine our attention to a particular situation: commercial leases with "percentage of gross sales" rent clauses. You will read several cases in which the courts determine the requirement of this duty in different factual circumstances. You might then also look back to the cases in Chapter 5 (§A2) to see what the duty means in the context of requirements contracts and contracts for exclusive dealings.

When reading these cases ask yourself whether the duty of good faith performance represents a *restriction upon* or an *extension of* contractual freedom. When thinking about this last issue consider the following passage from U.C.C. §1-102(3) (emphasis added):

> The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the *obligations of good faith*, diligence, reasonableness and care prescribed by this Act *may not be disclaimed by agreement* but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

Should the implied duty of good faith be an immutable or a mandatory rule that is nondisclaimable (though subject to standards provided by the parties) as opposed to a default rule that can be varied by agreement? If so, does this necessarily represent a restriction on freedom of contract?

STUDY GUIDE: Can the results in the next three cases, each involving tenants, be reconciled? In the next case, what exactly did the tenant do that it was not supposed to do? Or is this the wrong question to ask? What do these cases reveal about the implied covenant of good faith? Is this duty implied-in-fact or implied-in-law? If the latter, is this a term that is being imposed on the parties without their consent, or is it supplied by the court as a gap-filler that facilitates *the parties' consent? In each of these cases ask yourself why the parties structured their leases the way they did.*

GOLDBERG 168-05 CORP. v. LEVY

Supreme Court of New York, Queens County,
170 Misc. 292, 9 N.Y.S.2d 304 (1938)

STEINBRINK, J.* This is a motion to dismiss the complaint for failure to state facts sufficient to constitute a cause of action.

Plaintiff sues to recover for the alleged breach of a leasehold agreement assigned to the plaintiff by the original lessor. As a first cause of action the following in substance is alleged: By agreement dated September 17, 1929, the plaintiff's assignor agreed to rent certain premises to the defendant Levy for a term expiring September 30, 1938; that the tenant was to pay a minimum rental of $13,800 per year and in addition thereto was to pay the difference between the said sum and ten percent of the gross receipts of the business conducted by the tenant on the leased premises; that it was further provided "in the event that the total gross sales of the Tenant for any one calendar year does not equal $101,000 . . . then the Tenant shall have the right to cancel said lease"; that the defendant Levy took possession of the premises under the said lease on October 10, 1929, and thereafter, with the knowledge and consent of the plaintiff's assignor, permitted the defendant Crawford Clothes, Inc., to occupy the premises "as though the same were occupied by" the defendant Levy, and to conduct therein a retail men's clothing business; that the defendant Levy, as officer, director, and chief stockholder of the defendant Crawford Clothes, Inc., operated and controlled the corporate defendant for his own use. It is then alleged that defendants, although obligated to do so,

> failed and refused to act in a fair and proper manner with relation to their obligations under the terms of the lease . . . by negligently or willfully permitting the said business to become mismanaged and by negligently or willfully diverting the proper channels of trade from said business to another store operated by said defendants, in the vicinity of the premises demised by said defendants from the plaintiff herein, and in general conducting themselves and their agents, servants, and employees in such a manner as to cause a reduction of the gross income of the sales of the demised premises below the amount of $101,000 per year;

that the defendant Levy, on June 1, 1937, gave notice of his intention to terminate the lease as of October 30, 1937, and on and after that day the defendants removed from the premises and refused to pay any further rentals. By reason of the foregoing plaintiff claimed to be damaged in the sum of $25,000.

It is not alleged in the complaint that the agreement sued upon contained an express provision obligating the tenant to refrain from conduct calculated to depress the annual gross receipts of the business

* *Meier Steinbrink* (1880-1967) received his legal training at New York University (LL.B.). Admitted to the New York state bar in 1901, he practiced in New York City (1901-1931), except while serving as special assistant to the Attorney General of the United States (1918, 1922). Steinbrink moved to the bench in 1932 upon his appointment to the Supreme Court of New York, serving later as official referee for several terms (1951-1956) and as special referee from 1957 until his death. — K.T.

below the specified sum of $101,000. "A promise may be lacking, and yet the whole writing may be 'instinct with an obligation' imperfectly expressed." (Wood v. Duff-Gordon, 222 N.Y. 88, 91 [118 N.E. 214]; Alexander v. Equitable Life Assurance Society of United States, 233 N.Y. 300, 306 [135 N.E. 509].) It should be noted that the tenant promised to pay rental in part at least measured by a percentage of gross receipts of the business. This was a promise to use reasonable efforts to bring profits into existence. (Wood v. Duff-Gordon, supra.) The tenant could not avoid liability under the lease by abandoning premises. . . . By the same token he could not avoid liability by a diversion of business to another store which he operated in the same vicinity when such diversion is effected for the sole purpose of bringing the gross receipts below the specified figure and thereby laying the basis for a cancellation of the lease. Such conduct would be in direct violation of the covenant of good faith and fair dealing which exists in every contract. (Kirke La Shelle Co. v. [Paul] Armstrong Co., 263 N.Y. 79 [188 N.E. 163].) . . .

STUDY GUIDE: Do you agree with the majority that the tenant in the next case acted in good faith? Why do you suppose the majority thought that the behavior of this tenant differed from, for example, the tenant in the previous case? Is it simply the defendant's conduct in opening the fur department that is alleged to have been a breach of its duty of good faith, or is something else also needed to show such a breach? Should not the defendant be able to move around its departments as it sees fit? [For those who know Fifth Avenue, this building is now occupied by the women's clothing departments of Bergdorf-Goodman, though the street address has been changed to 754.]

MUTUAL LIFE INSURANCE CO. OF NEW YORK v. TAILORED WOMAN

Court of Appeals of New York,
309 N.Y. 248, 128 N.E.2d 401 (1955)

[The following statement of facts is taken from the Supreme Court opinion (123 N.Y.S.2d 349)]:

On or about June 29, 1939, plaintiff leased to the defendant the basement, first, second and third floors in the building known as No. 742 Fifth Avenue, in the Borough of Manhattan, for a term of ten years commencing October 1, 1939. (This lease will be referred to as the "main lease" and the premises thereby demised as the "main premises.") Paragraph 2 of the lease provides that the premises were to be used by the defendant for the sale, display, and/or the lawful manufacture of wearing apparel, accessories, jewelry and other items used, worn or carried by women and misses, and paragraph 37 provides that ". . . in conjunction therewith there may be other uses herein set forth and which will" (the store) "at all times contain a stock of first class merchandise and the business will be conducted and maintained in a manner substantially similar to the tenant's present store at 729 Fifth Avenue, New York City. . . ."

The lease (paragraph 30) also sets forth an undertaking on the part of the defendant to pay a fixed minimum annual rental and "in addition to said fixed and minimum rental, as additional rental a sum equal to 4 percent of the gross receipts for cash or credit, derived by the tenant . . . in excess of $1,200,000 in each year. . . ." "The term 'gross receipts' of said business, as used herein shall include all sales . . . and shall include all receipts and charges for goods, wares and merchandise sold on, in or from the demised premises. . . ."

in addition to rent

Prior to October 1, 1939, the effective commencement date of this lease, defendant maintained a department for the sale of furs and sold furs in the premises then occupied by it at No. 729 Fifth Avenue and continued after the last-mentioned date to maintain a department for the sale of furs and sold furs in the premises occupied by it at 742 Fifth Avenue down to August 1, 1945.

On or about June 1, 1945, plaintiff leased to the defendant additional space on the fifth floor of the building at No. 742 Fifth Avenue for a term of one year and four months. This lease provided for a fixed rental but did not require the defendant to pay a percentage on sales effected on the fifth floor. (This lease will be referred to as the "fifth floor lease" and the premises as the "fifth floor premises.")

Π leased Δ 5th floor, no addition %

This lease also, as the main lease, authorized the defendant to use the demised premises for "the sale, display of all types of wearing apparel, accessories, worn or carried by women or misses and as workrooms." Paragraph 36 of the fifth floor lease provided that:

> It is hereby understood and agreed that this lease will not have any effect on the lease dated June 29, 1939 between The Mutual Life Insurance Company of New York and The Tailored Woman, Inc., on the store, basement, second and third floor, in the building known as 742 Fifth Avenue. . . .

Δ agreed to not allow Π to agree

On August 1, 1945, and without notice to plaintiff, the defendant discontinued its fur department in the main premises and transferred and removed that department in toto to the fifth floor premises and has ever since there carried on all fur sales as well as sales of the other incidental merchandise which may be included in the category of furs.]

Δ new fur sa.

Desmond, J.* The facts of this controversy, and the issues, are set forth and discussed in the Appellate Division opinion. We will limit ourselves to a statement of our views on the principal questions of law.

Since plaintiff is suing for additional percentage rental under the 1939 ten-year lease of the lower three floors of 742 Fifth Avenue, New York City, it must base its claim on the covenants of that lease. Two only of those covenants are pertinent. We take them up in turn. The 4 percent percentage rental was to be paid on all sales made "on, in, and from the demised premises." After, by separate leases made in 1945, defendant had taken over from plaintiff part of the fifth floor (and the eighth floor, not involved

* *Charles S. Desmond* (1896-1987) studied at Canisius College (A.B., A.M.) and the University of Buffalo (LL.B.) and was admitted to the bar of New York in 1920. He practiced privately for 20 years in Buffalo before being appointed judge on the New York State Supreme Court in 1940. Within a year, he moved to the New York State Court of Appeals, serving from 1941 to 1966, and spending his last six years on that bench as Chief Judge (1960-1966). Desmond also served as a member of the law faculty at Cornell University and the State University of New York, and as lecturer at various law schools. — K.T.

here), defendant made it a practice to pay commissions, on fur sales made on the fifth floor, to salespeople on the lower floor who sent customers to the fifth-floor fur department. We think it not unreasonable to hold, with the Appellate Division, that such sales were, within the lease's intent, made "from" the main store and so subject to percentage rent. Such sales may be considered "main store" sales, as if a clerk in response to a telephone call took merchandise to a customer's home, and there effected a sale. It would be going too far, though, to hold that all fur sales were made "from" the lower store simply because, as hereinafter more fully explained, the fur department was moved up to the fifth floor after that floor had been "integrated" with the main store.

By the other language (of the 1939 percentage lease) which we find pertinent, the tenant promised that the store it would conduct in the lower three floors would "at all times contain a stock of first class merchandise" and would "be conducted and maintained in a manner substantially similar to the Tenant's present store at #729 Fifth Avenue" (that is, the store across the street from which defendant was moving). That verbiage is to be read with the purpose clause (of that same 1939 lease) which prescribed the sale of all kinds of women's apparel and accessories. Here, again, we agree with the Appellate Division that no more was intended than an agreement that there should be conducted, on the three lower floors of 742 Fifth Avenue, under the percentage lease, a woman's clothing shop of the same general character as defendant's store across the street. If plaintiff had desired further restrictions as to kinds of merchandise, etc., it should have insisted on them. Absent fraud or trickery (and the findings properly say there was none), defendant could carry on its business in the way that suited it so long as it did not deviate from those very broad and general lease specifications.

In 1945, defendant, needing more space, bought out a custom-made dress business which had been conducted in part of the fifth floor by another concern and made with plaintiff a new lease of that space at a flat no-percentage rent. Again, the lease terms went no further as to purpose than to state that the added space was to be used for the sale of female wearing apparel and accessories and for workrooms. The fifth floor custom-made dress department was not successful and was soon discontinued. Defendant then made such physical changes in the building that two elevators, which had theretofore served the first three floors from inside the main store, now could be, and were, used to carry passengers inside the store not only to and from the first three floors but to and from the fifth floor, also (and the eighth floor, although that is not important here). The result was that the first, second, third and fifth floors were, as the phrase goes, "integrated" into one store fronting on Fifth Avenue and served by elevators reached through the main store from the Fifth Avenue entrances. Formerly, the fifth floor could be reached by the use of two other elevators only, to which elevators entrance was from the side street lobby on the 57th Street side of the building. Then defendant moved its fur department to the fifth floor, and thereafter paid no percentage rent on fur sales.

Trial Term held that plaintiff did not acquiesce in these changes. The Appellate Division held that it did. The question of fact is a close one but, acquiescence or not, we think the undisputed facts forbade a recovery here by plaintiff of more than the percentage on certain fur sales, hereinbefore

described as made on the fifth floor, but "from" the lower floors. There is nothing in the main lease to forbid the moving of the fur department and when plaintiff made the second, or fifth floor, lease, it again failed to include any restrictions as to particular kinds of merchandise to be sold in one or the other part of the building. It is clear enough that plaintiff did not contemplate, when it leased the fifth and eighth floors for a flat rental, that the fifth floor would be "integrated" with the lower floors into one store but such lack of foresight does not create rights or obligations. True, the second lease said that it would "not have any effect" on the earlier lease but the effect of the two leases, read together and enforcing both, was that defendant had the right to sell all kinds of women's apparel, etc., in any part of the four floors, so long as no other use was made of the premises. As we see it, defendant merely exercised that right when it moved the fur department. As to changing the elevator doors, if that were a violation of any implied covenants (certainly not of an express covenant) redress could be had by injunction or, perhaps, by the landlord putting the elevator doors back as they had been and charging the expense to the tenant. But such violations (if they were violations) could not result in a liability for additional rent not promised in the lease. Except as to the fur sales to customers sent upstairs, there were no additional sales "on, in or from" the premises covered by the percentage lease, even though certain activities with respect to furs continued to be carried on in the lower store.

In the view we take of the case, it is unnecessary to engage in interesting but unproductive computations or speculations as to whether or not the new "integrated" store actually produced more percentage rent for plaintiff than if the fur department and the elevators had not been changed. It is the fact, though, that plaintiff proved no loss in that respect.

In deciding this case as we do, we are not moving away from the good old rule that there is in every contract an implied covenant of fair dealing (Kirke La Shelle Co. v. [Paul] Armstrong Co., 263 N.Y. 79 [188 N.E. 163]). Defendant, as we see it, was merely exercising its rights. Nor do we reject such authorities as Cissna Loan Co. v. Baron (149 Wash. 386 [270 P. 1022]), which penalize unconscionable diversion of business from percentage-lease premises to others. The present case does not fit into that pattern.

The judgment should be affirmed, without costs.

Burke, J.* (dissenting). The defendant is liable for additional percentage rental under the 1939 ten-year lease of the premises 742 Fifth Avenue, New York City, for sales of furs made on the fifth floor, as they were sales made on, in and from the main premises. . . .

The plaintiff alleges two causes of action. The first cause of action is based upon the theory that the fur sales were made "on, in or from" the main premises. All of the activities of the defendant from the initiation of the alterations to the actual sales were designed to hold out to the public that the fur department was part of the premises 742 Fifth Avenue. The physical

* *Adrian P. Burke* (1904-2000) was educated at Holy Cross College (A.B.) and Fordham University (LL.B.) and practiced law in New York City. He worked in the district attorney's office (1941-1953) and as City Counsel for the City of New York in 1954, when he was elected judge on the Court of Appeals in New York. He retired from the bench in 1974. — K.T.

layout, the advertising, the window displays, the storage of the furs, and the use of the main store personnel characterized the fur department as an integral part of the main store operations. The second cause of action seeks damages upon the theory that if fur sales were not made "on, in or from" the main premises, nevertheless, the defendant, in removing the fur department from the main premises, violated express and implied covenants of the main lease against diversion of sales. It is implicit in every percentage rental agreement that the tenant has an obligation to conduct its business with regard for the landlord's interest in the tenant's gross receipts. "A promise may be lacking, and yet the whole writing may be 'instinct with an obligation,' imperfectly expressed." (Wood v. Duff-Gordon, 222 N.Y. 88, 91 [118 N.E. 214]. . . .) Unless a percentage rental agreement is so interpreted, the percentage requirement would have no meaning.

The question to be resolved is whether under the terms of the leases and the proof adduced at the trial, the plaintiff is entitled to recover on one or both causes of action. Both causes of action are well founded.

There is no doubt that the sales were made "on, in or from" the main premises. The evidence shows that the furs were delivered to the basement of the main store, prepared for display there, stored in the basement of the main store, packed and shipped out from the main store premises. The entire fur business was administered and conducted in the Fifth Avenue premises, yet the defendant would have us construe the leases so as to permit it to operate a fur department as part of a main store in a space with an address different from the address set forth in the lease of that space, doing a business with average annual gross receipts of over $600,000, for a fixed rental of $3,800 a year free from the percentage provisions of the main store lease. The leases fail to disclose such an authorization. The 742 Fifth Avenue lease limited the exclusive use of the entrances and elevators to three floors and basement. The 1 West 57th Street lease prohibited alterations without consent, and also prohibited any interference with the premises 742 Fifth Avenue.

We can perceive no distinction between the customer who was sent to the fifth floor fur department by salespeople on the lower floors, and the customers who responded to the advertisements or displays that proclaimed that the defendant's fur department was located at 742 Fifth Avenue. All these customers were patrons of the Fifth Avenue Tailored Woman store, and were attracted to that store by the advertisements and window displays using the Fifth Avenue address. Therefore, it necessarily follows that the terms of the lease of 742 Fifth Avenue must apply to all transactions taking place at that address.

Moreover in every contract there is an implied covenant that neither party shall do anything which shall have the effect of injuring or destroying the right of the other party to receive the fruits of the contract. (Kirke La Shelle Co. v. [Paul] Armstrong Co., 263 N.Y. 79 [188 N.E. 163].) The defendant cannot make a virtue of a violation of the lease. It made alterations without the written consent of the landlord of 1 West 57th Street. It violated the prohibition in paragraph 36 of the 1945 lease that the said lease was not to have any effect on the lease dated June 29, 1939, between the Mutual Life Insurance Co. of New York and the Tailored Woman, Inc. (1) by

moving its fur department to the fifth-floor space from a lower floor, and (2) by advertising that the fifth-floor space described in the lease as space in the building known as 1 West 57th Street was located at 742 Fifth Avenue. The consequence of these violations was to bring about the condition wherein the defendant was using a Fifth Avenue address and sales space for the sale of furs at a rental rate of a side-street office salesroom.

Furthermore, under the terms of the 742 Fifth Avenue lease, the defendant agreed to maintain a business substantially similar to that which it had maintained at 729 Fifth Avenue, where the defendant had a fur department. As a result of the removal of the fur department to the fifth floor, the plaintiff was deprived of a substantial portion of the fruits of the contract. By excluding the fur sales from the calculations required by the percentage terms of the lease, the defendant excluded almost 20 percent of the average gross receipts collected at the premises 742 Fifth Avenue. Such an act constitutes an unreasonable diversion of business from a percentage leased premises to a fixed rental premises.

The intent of tbe parties as expressed in the two leases was that the fifth-floor space at 1 West 57th Street would be operated independently of the main premises. For example, the landlord by lease restricted the use of the elevators in 1 West 57th Street by providing that they would operate only until 1:00 P.M. on Saturdays and 6:00 P.M. on business days, whereas the elevators in 742 Fifth Avenue were within the absolute control of the defendant and could operate until 6:00 P.M. or later on Saturdays, business days and legal holidays only to the third floor.

The rent fixed for the fifth-floor space reflects the restrictions imposed on doing business in an off-street office salesroom space which is not serviced on Saturday afternoons or on legal holidays. Such restrictions are not incompatible with the use permitted by the 1 West 57th Street lease, i.e., the sale and display of women's wearing apparel. Such uses are commonly so restricted. In this very case the former tenant on the fifth floor was engaged in the women's wearing apparel business. The limitation of the use of the elevators to five and one-half days as well as the necessity of sharing the use of the elevators with the other tenants in 1 West 57th Street make it clear that any permitted diversion of business from the main store was intended to be confined to a five and one-half day operation with all the inconvenience of sharing public elevators. Naturally these conditions in themselves forbid the transfer of a major department from the main store to the off-street office salesroom.

Since the defendant, in order to avoid the restrictions of the 1 West 57th Street lease, elected, in violation of the provisions of the leases, to operate part of the fifth floor as an integral part of the main premises and to make fur sales on, in and from the main premises, it has subjected the gross receipts collected from these operations to the percentage rental terms of the main store lease. Such a conclusion is supported by the evidence, by a commonsense interpretation of the leases, and by the prevailing law in other jurisdictions. . . .

The judgment of the Appellate Division should be reversed and the judgment of the Trial Term reinstated. . . .

Judgment affirmed.

layout, the advertising, the window displays, the storage of the furs, and the use of the main store personnel characterized the fur department as an integral part of the main store operations. The second cause of action seeks damages upon the theory that if fur sales were not made "on, in or from" the main premises, nevertheless, the defendant, in removing the fur department from the main premises, violated express and implied covenants of the main lease against diversion of sales. It is implicit in every percentage rental agreement that the tenant has an obligation to conduct its business with regard for the landlord's interest in the tenant's gross receipts. "A promise may be lacking, and yet the whole writing may be 'instinct with an obligation,' imperfectly expressed." (Wood v. Duff-Gordon, 222 N.Y. 88, 91 [118 N.E. 214]. . . .) Unless a percentage rental agreement is so interpreted, the percentage requirement would have no meaning.

The question to be resolved is whether under the terms of the leases and the proof adduced at the trial, the plaintiff is entitled to recover on one or both causes of action. Both causes of action are well founded.

There is no doubt that the sales were made "on, in or from" the main premises. The evidence shows that the furs were delivered to the basement of the main store, prepared for display there, stored in the basement of the main store, packed and shipped out from the main store premises. The entire fur business was administered and conducted in the Fifth Avenue premises, yet the defendant would have us construe the leases so as to permit it to operate a fur department as part of a main store in a space with an address different from the address set forth in the lease of that space, doing a business with average annual gross receipts of over $600,000, for a fixed rental of $3,800 a year free from the percentage provisions of the main store lease. The leases fail to disclose such an authorization. The 742 Fifth Avenue lease limited the exclusive use of the entrances and elevators to three floors and basement. The 1 West 57th Street lease prohibited alterations without consent, and also prohibited any interference with the premises 742 Fifth Avenue.

We can perceive no distinction between the customer who was sent to the fifth floor fur department by salespeople on the lower floors, and the customers who responded to the advertisements or displays that proclaimed that the defendant's fur department was located at 742 Fifth Avenue. All these customers were patrons of the Fifth Avenue Tailored Woman store, and were attracted to that store by the advertisements and window displays using the Fifth Avenue address. Therefore, it necessarily follows that the terms of the lease of 742 Fifth Avenue must apply to all transactions taking place at that address.

Moreover in every contract there is an implied covenant that neither party shall do anything which shall have the effect of injuring or destroying the right of the other party to receive the fruits of the contract. (Kirke La Shelle Co. v. [Paul] Armstrong Co., 263 N.Y. 79 [188 N.E. 163].) The defendant cannot make a virtue of a violation of the lease. It made alterations without the written consent of the landlord of 1 West 57th Street. It violated the prohibition in paragraph 36 of the 1945 lease that the said lease was not to have any effect on the lease dated June 29, 1939, between the Mutual Life Insurance Co. of New York and the Tailored Woman, Inc. (1) by

moving its fur department to the fifth-floor space from a lower floor, and (2) by advertising that the fifth-floor space described in the lease as space in the building known as 1 West 57th Street was located at 742 Fifth Avenue. The consequence of these violations was to bring about the condition wherein the defendant was using a Fifth Avenue address and sales space for the sale of furs at a rental rate of a side-street office salesroom.

Furthermore, under the terms of the 742 Fifth Avenue lease, the defendant agreed to maintain a business substantially similar to that which it had maintained at 729 Fifth Avenue, where the defendant had a fur department. As a result of the removal of the fur department to the fifth floor, the plaintiff was deprived of a substantial portion of the fruits of the contract. By excluding the fur sales from the calculations required by the percentage terms of the lease, the defendant excluded almost 20 percent of the average gross receipts collected at the premises 742 Fifth Avenue. Such an act constitutes an unreasonable diversion of business from a percentage leased premises to a fixed rental premises.

The intent of the parties as expressed in the two leases was that the fifth-floor space at 1 West 57th Street would be operated independently of the main premises. For example, the landlord by lease restricted the use of the elevators in 1 West 57th Street by providing that they would operate only until 1:00 P.M. on Saturdays and 6:00 P.M. on business days, whereas the elevators in 742 Fifth Avenue were within the absolute control of the defendant and could operate until 6:00 P.M. or later on Saturdays, business days and legal holidays only to the third floor.

The rent fixed for the fifth-floor space reflects the restrictions imposed on doing business in an off-street office salesroom space which is not serviced on Saturday afternoons or on legal holidays. Such restrictions are not incompatible with the use permitted by the 1 West 57th Street lease, i.e., the sale and display of women's wearing apparel. Such uses are commonly so restricted. In this very case the former tenant on the fifth floor was engaged in the women's wearing apparel business. The limitation of the use of the elevators to five and one-half days as well as the necessity of sharing the use of the elevators with the other tenants in 1 West 57th Street make it clear that any permitted diversion of business from the main store was intended to be confined to a five and one-half day operation with all the inconvenience of sharing public elevators. Naturally these conditions in themselves forbid the transfer of a major department from the main store to the off-street office salesroom.

Since the defendant, in order to avoid the restrictions of the 1 West 57th Street lease, elected, in violation of the provisions of the leases, to operate part of the fifth floor as an integral part of the main premises and to make fur sales on, in and from the main premises, it has subjected the gross receipts collected from these operations to the percentage rental terms of the main store lease. Such a conclusion is supported by the evidence, by a commonsense interpretation of the leases, and by the prevailing law in other jurisdictions. . . .

The judgment of the Appellate Division should be reversed and the judgment of the Trial Term reinstated. . . .

Judgment affirmed.

STUDY GUIDE: In what sense did Stop and Shop act in good faith? Or is the point of this case that it did not act in bad *faith? Once again, what does this mean? Is not the closing of a store entirely a more serious action than that of shifting departments from one floor to another? Why then does the court refuse to find a lack of good faith? What does the court mean by "business judgment"? How is it relevant to the duty of good faith performance? Why does it matter whether or not the fixed rent is significantly below the fair rental value of the property?*

STOP & SHOP, INC. v. GANEM

Supreme Judicial Court of Massachusetts, 347 Mass. 697, 200 N.E.2d 248 (1964)

WHITTEMORE, J.* The defendants in this bill for declaratory relief are lessors under a percentage lease. They have appealed from the final decree in the Superior Court that ruled that the lease does not expressly or impliedly require the plaintiff, as lessee, to use the demised premises for any particular purpose or to keep the premises open and there engage in the supermarket business. Except for brief testimony which is reported, the facts were stipulated. . . .

The lease, dated August 24, 1953, demised a lot and building at 154 Merrimack Street, Haverhill, for thirteen years and six months from September 1, 1953, for "the minimum rental" of $22,000 a year and the further rent of 1 1/4 percent "of all gross sales" above $1,269,230.60 "made by the Lessee on the leased premises during each twelve month period." But the percentage rent was to be paid only if sales at the demised premises and at premises in Lawrence exceeded $3,000,000 a year. The lease recites that the Lawrence premises were leased to the plaintiff by the lessors of the Haverhill premises and certain other owners under a percentage lease containing a like limitation on the payment of percentage rent. The record shows no other facts relative to the Lawrence premises or the business conducted therein. The other lessors of the Lawrence premises, by stipulation in, and order of, this court, have now become parties, and all parties have stipulated that the issues may be determined as though the owners of the Lawrence premises were not concerned. We may, therefore, order declaratory relief on the present record. . . .

The lease required that the lessee should pay the amount of the increases in the annual real estate taxes and should receive the amount of the decreases therein, measured on the 1946 figure.

The lease does not state the purposes for which the premises are to be used. Nothing therein in terms requires that the premises be used for any

* *Arthur Easterbrook Whittemore* (1896-1969) was educated at Harvard University (A.B., LL.B.) and was admitted to the Massachusetts bar in 1922. He practiced law with a Boston law firm (1922-1955), during which time he also spent two years in the state attorney general's office (1942-1944), then joined the bench of the Supreme Judicial Court of Massachusetts in 1955, where he served until his death. Whittemore also served in the infantry of the U.S. Army (1917-1919). — K.T.

purpose or bars the opening by the lessee of places of business competitive to the lessee's business in the demised premises. The lease does, however, require the lessee to use suitable cash registers to record all sales, to keep accurate books, to furnish statements of gross sales on demand, and at the end of each yearly period to furnish such a statement certified by a certified public accountant. The testimony showed that when the lease was made the plaintiff was engaged in the supermarket business and that the lessors knew it. The premises prior to August 24, 1953, had been used for the conduct of a market.

The plaintiff had occupied the premises as a supermarket through 1962. It had paid percentage rent in 1956 ($2,288.15) and in 1957 ($377.21) but in no other year, and had paid excess taxes in each year. The plaintiff intended to cease operating a supermarket in the premises shortly after January 1, 1963, but to continue to pay the minimum rent and any excess real estate taxes and otherwise to conform to the lease. The defendant lessors had threatened suit to compel the continued operation of a supermarket or, alternatively, for damages.

The defendant lessors filed a counterclaim which alleged that the plaintiff beginning in 1956 had opened two competing stores in Haverhill, one within one-half mile and the other within about one mile of the demised premises. The prayers of the counterclaim were (1) that the lease be reformed to provide that the plaintiff continuously operate the premises as a supermarket, (2) that the plaintiff be ordered to pay to the defendants as part of the rent of the demised premises 1 1/4 percent of gross sales from all the plaintiff's stores in Haverhill in excess of $1,269,230.60, and (3) for general relief. An interlocutory decree sustained the plaintiff's demurrer to the counterclaim "with leave to amend denied." The lessors took no appeal from that decree.

Other facts are referred to later in the opinion.

1. The issue presented by the bill for declaratory relief is whether there is in the lease an implied covenant to continue operations. . . . The counterclaim presents the issue whether the lessee may open competing stores and then discontinue operations. We consider first the issue under the bill.

The controlling principles are well established. An omission to specify an agreement in a written lease is evidence that there was no such understanding. . . . Covenants will not be extended by implication unless the implication is clear and undoubted. . . . Justice, common sense and the probable intention of the parties are guides to construction of a written instrument. . . .

> Since the governing principle . . . is the justifiable assumption by one party of a certain intention on the part of the other, the undertaking of each promisor in a contract must include any promises which a reasonable person in the position of the promisee would be justified in understanding were included.

Williston, Contracts (rev. ed.) §1293, p. 3682. . . .

The plaintiff contends that notwithstanding the interest of the lessors in having the premises operated so as to give it the benefit of possible percentage rent, the absence of an express requirement to operate together

with a more than nominal minimum rent exclude the implication of a covenant to continue operations.

This may state too broad a rule. For even if there is a more than nominal minimum rent, other circumstances such as that the fixed rent is significantly below the fair rental value of the property might justify the conclusion that the parties intended that the lessors have the benefit of the percentage rent throughout the term.

The record does not show the fair rental value of the demised premises. An apparently substantial minimum rent in an apparently complete written lease, in the absence of a showing of disparity between the fixed rent and the fair rental value, gives ground for the inference that fixed rent and the lessee's self-interest in producing sales were the only assurance of rent that the lessor required. . . . Other circumstances may give rise to the same inference. . . . In cases where the minimum rent was not substantial continued operation has been held contemplated. . . .

In Smiley v. McLauthlin, 138 Mass. 363, this court held that where rent under a lease of a brick yard was to be computed on the basis of bricks made with no provision for minimum rent, there was no implied covenant that the lessee would operate the yard. The opinion stressed the extrinsic circumstances attending the making of the lease. "The premises leased were not a brick yard in operation, equipped for work, but barren, unoccupied land. The parties did not know the amount of clay on the land, nor whether brick could be made on the land at a profit. . . . The lease, applied to the subject matter, furnishes indications that the parties regarded the enterprise as experimental, and that any stipulation binding the lessee to work the yard was purposely omitted." Id. [138 Mass.] at 365. The questions may be asked whether the parties did not intend a contract, and if so whether an implied covenant at least to try to operate the brick yard was the only consideration given by the lessee. Compare Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88 [118 N.E. 214]. . . .

The minimum rent in this lease appears to be substantial. The figure of $22,000 is obviously not nominal in a lease that fixes as a base real estate tax figure the 1946 tax of $3,744.90. The total of real estate taxes for 1954 was $5,127.71. This roughly indicates the valuation for tax purposes of the demised premises at about the time the lease was made.

The burden of showing a disparity between fixed rent and fair rental value such as to furnish ground for implying a covenant to operate would be on the lessors. . . .

There is in this record no basis for implying a covenant to continue to operate beyond that time when in the business judgment of the lessee operations at the demised location[1] should cease. The lessors have not shown that "a reasonable person in the position of the . . . [lessors] would be justified in understanding" (Williston, Contracts [rev. ed.] §1293) that such a covenant was intended and hence implied.

The percentage rent provision of course gave the lessors an interest in the lessee's operations of the demised premises as a retail store. We assume, without deciding, that such interest could be protected against certain acts

1. As to discontinuance in connection with opening another store adjacent, or nearly adjacent, to the demised premises, see point 2.

of the lessee, as for example, discontinuance of operations for spite or to inflict harm. Such issues are outside this record for there is no intimation that the plaintiff has acted or proposes to act in respect of the leased premises otherwise than as its sound business judgment dictates in fairly promoting its retail business in Haverhill. . . .

[2.] The lessee, being free to disregard the effect on the lessors of its business decisions in respect of stopping operations, was free also to open stores elsewhere. We assume, without deciding, that had the lessee opened a competing store in the same location as the demised premises, that is adjacent, or nearly so, there might have been a basis for requiring it to regard the lessors' interest under the percentage rent provision in its conduct of the two stores. In such a case the lessee's acts would affirm the business advantage of remaining at the very place at which it had committed itself as tenant of the lessors. . . . But, on the allegations, this is plainly not such a case. At most we may infer that there is some overlap of the potential customer area of the two new stores with the demised premises.

The lessors do not contend that the counterclaim is to be read to allege that the lessee acted for other than sound business reasons or for the purpose of depreciating the worth of the demised premises rather than for the affirmative advantage of doing business elsewhere. In the circumstances we do not construe the allegation of sales of merchandise at lower prices as averring such a purpose. The counterclaim does not recite a policy of the lessee of setting unfair prices designed to draw customers from the demised premises or of unfair competition with the business in the demised premises. We intend no suggestion of the rule to be applied in such a case.

The defendants have not suggested that they could show such unfair competition, or that, the implications they contend for not being found in the lease, there was error in ordering the demurrer sustained "with leave to amend denied."

3. The interlocutory decree sustaining the demurrer and the final decree (construed as including a dismissal of the counterclaim) are affirmed.

So ordered.

STUDY GUIDE: In the next excerpt, notice the court's sensitivity to the fact that an implied rather than an expressed covenant is at issue. Why does this make a difference?

FOOD FAIR STORES, INC. v. BLUMBERG, COURT OF APPEALS OF MARYLAND, 234 MD. 521, 200 A.2D 166 (1963): PRESCOTT, J.* . . . Although percentage leases are generally governed by the rules of law applicable to ordinary leases, the peculiar features of provisions making

* *Stedman Prescott* (1896-1968) received his legal training at Georgetown University (LL.B.). Admitted to the Maryland bar in 1924, he entered the practice of law in Rockville (1924-1938), serving briefly as state's attorney for Montgomery County (1930) and as a state senator (1934). In 1938, Prescott joined the Sixth Judicial Circuit of Maryland serving as associate judge from 1938-1955 and as Chief Judge from 1955 to 1956. He left the circuit court to accept appointment to the Court of Appeals of Maryland in 1956. He retired from the bench in 1966, after spending the last two years of his term as Chief Judge of that court. Prescott also served in the U.S. Army during World War I. — K.T.

rental dependent in some way upon the percentage of income from, or gross sales of, business on the leased premises frequently present difficult questions of construction, which render such leases in the nature of agreements sui generis. . . . Considerable case law involving the construction of such leases has developed in recent years.

It has been held that where the percentage lease provides no minimum guaranteed rental or a purely nominal guarantee, the tenant is under an implied obligation to conduct the business in good faith. . . . It has also been held that if the guaranteed rental provides the landlord an adequate return on his investment and the percentage rental feature is in the nature of a bonus, there is no obligation upon the tenant as to the manner of conducting the business not expressed in the lease. . . . And it has been further held that the tenants under percentage leases were, or were not, under an implied obligation as to the manner of conducting tenants' businesses, depending upon the intention of the parties, as expressed by the provisions of the particular leases, interpreted with a due consideration of the circumstances surrounding the execution of the lease contracts. . . .

However, the construction and application of the percentage features of the leases have depended largely upon the specific wording of the individual leases, and the character and nature of the questions involved have varied widely, due to the circumstances of each particular case. Hence, it would serve no useful purpose to attempt to formulate a comprehensive set of rules of construction applicable to all cases of percentage leases.

For the purposes of the decision herein, we need only state that in every contract there exists an implied covenant that each of the parties thereto will act in good faith and deal fairly with the others. . . . And we adopt the principle expressed by the Louisiana Court in Selber Bros. v. Newstadt's Shoe Stores [194 La. 654] 194 So. 579, and thereafter, in substantially the same wording, by the Court of Appeals of California in Professional Building of Eureka v. Anita Frocks, Inc. [178 Cal. App. 2d 276] 2 Cal. Rptr. 2d 914:

> Whether that doctrine [whether the lessor under a percentage lease guaranteeing a minimum rental has cause to complain when the business is conducted in such a way that it will not produce additional rent consisting of percentages of gross sales] is applicable to a given case depends upon the intention with which the parties entered into the contract of lease, as expressed in the contract, construed in the light of the circumstances in which the contract was made.

Applying the above principles to the allegations contained in the lessors' bill of complaint, we reach the conclusion that lessors cannot prevail. There is no allegation of a wilful intent on the part of the lessees to divert sales from lessors' store, nor was there an abandonment of the business. There is nothing in the record that showed a lack of good faith or fair dealing by the lessees. They were engaged in a highly competitive business (this feature thereof being very generally known) in a quickly growing community. The bill alleges that lessees expanded their business by opening two additional stores in the area and anticipated a third. There is nothing unusual in the large chain stores which sell food products in supermarkets adding to the number of their stores, when circumstances permit.

. . . We are dealing here only with an alleged *implied* covenant. There was, of course, no legal obstacle to prevent an express covenant being placed in the lease, so as to provide for lessors' contentions here. After considering the nature of lessees' business and the terms of the leases and after construing them in the light of the circumstances surrounding the parties at the time the leases were made, we are unable to conclude the parties impliedly covenanted that the lessees would not expand their business in the area of lessors' store. What the Supreme Court of Pennsylvania said in Dickey v. Phila. Minit-Man Corp. [377 Pa. 549] 105 A.2d 580, is, we think, apposite here:

> If an implied covenant, as claimed by [the lessors] should be held to arise in such cases what would be the extent of the restriction thereby imposed upon the lessee[s]? Would it extend to each and every act on [their] part that might serve to reduce the extent of [their] business and thereby the percentage rental based thereon? Would it forbid [them], for example, if operating a retail store, from keeping it open for a fewer number of hours each day than formerly? Would it forbid [them] from dismissing salesmen whereby [their] business might be reduced in volume? Would it forbid [them] from discontinuing any department of [their] business even though [they] found it to be operating at a loss? It would obviously be quite unreasonable and wholly undesirable to imply an obligation that would necessarily be vague, uncertain and generally impracticable.

STUDY GUIDE: Does the theory enunciated by Judge Posner in the following excerpt illuminate the doctrine of good faith performance being applied in the lease cases we have just read? This case concerned the termination of a franchise by the franchisor, another specific type of contract in which the use of the concept of good faith has grown in recent years.

THE ORIGINAL GREAT AMERICAN CHOCOLATE CHIP COOKIE CO. v. RIVER VALLEY COOKIES, LTD., UNITED STATES COURT OF APPEALS, SEVENTH CIRCUIT, 970 F.2D 273 (1992): POSNER, Circuit Judge: . . . Illinois, like other states, requires, as a matter of common law, that each party to a contract act with good faith, and some Illinois cases say that the test for good faith "seems to center on a determination of commercial reasonability." Dayan v. McDonald's Corp., 125 Ill. App. 3d 972, 993, 81 Ill. Dec. 156, 171, 466 N.E.2d 958, 973 (1984). . . . The equation, tentative though it is ("seems to center on"), makes it sound as if, contrary to our earlier suggestion, the judges have carte blanche to declare contractual provisions negotiated by competent adults unreasonable and to refuse to enforce them. We understand the duty of good faith in contract law differently. There is no blanket duty of good faith; nor is reasonableness the test of good faith.

Contract law does not require parties to behave altruistically toward each other; it does not proceed on the philosophy that I am my brother's keeper. That philosophy may animate the law of fiduciary obligation, but parties to a contract are not [illegible] fiduciaries. . . . [illegible] is a franchise. . . . [illegible] to avoid taking [illegible]

vulnerabilities that arise when contractual performance is sequential rather than simultaneous. . . . Suppose *A* hires *B* to paint his portrait to his satisfaction, and *B* paints it and *A* in fact is satisfied but says he is not in the hope of chivvying down the agreed-upon price because the portrait may be unsaleable to anyone else. This, as we noted in Morin Building Products Co. v. Baystone Construction, Inc., 717 F.2d 413, 415 (7th Cir. 1983), would be bad faith, not because any provision of the contract was unreasonable and had to be reformed but because a provision had been invoked dishonestly to achieve a purpose contrary to that for which the contract had been made. . . .

RESTATEMENT (SECOND) OF CONTRACTS

§205. DUTY OF GOOD FAITH AND FAIR DEALING

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§1-203. OBLIGATION OF GOOD FAITH

Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

Official Comment

This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act. . . . The concept, however, is broader than any of these illustrations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. . . .

§2-103. DEFINITIONS AND INDEX OF DEFINITIONS

(1) In this article unless the context otherwise requires. . . .

(b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable standards of fair dealing in the trade.

Reference: Barnett, §5.1
Farnsworth, §7.17
Calamari & Perillo, §11.38
Murray, §93

STUDY GUIDE: We conclude this discussion of good faith by briefly considering the distinction between the duty of good faith performance and the duty to negotiate *in good faith. Why do you suppose that a duty of good faith performance is routinely implied, while a duty to negotiate in good faith is highly controversial?*

TEXACO v. PENNZOIL, COURT OF APPEALS OF TEXAS, HOUSTON (1ST DIST.), 729 S.W.2D 768 (1987): . . . Texaco claims that Instruction No. 5 to Special Issue No. 1 (intent to be bound) . . . improperly emphasizes Pennzoil's "duty to negotiate" theory.

Instruction No. 5 states:

> Every binding agreement carries with it a duty of good faith performance. If Pennzoil and the Getty entities intended to be bound at the end of the Getty Oil board meeting of January 3, they were obliged to negotiate in good faith the terms of the definitive merger agreement and to carry out the transaction. . . .

Texaco . . . argues that Instruction No. 5 is a misstatement of the law because it erroneously converts the post-contractual duty of "good-faith performance" into a pre-contractual duty of "good-faith negotiation." It urges that this instruction abrogates its defense (to the tort of interference with prospective contractual relations) by erasing the distinction between pre-contractual and post-contractual conduct. . . .

Under New York law, there exists a duty of good faith and fair dealing that is read into every contract and requires a party not to act in a manner that defeats the purpose of the agreement. . . .

> Where the parties are under a duty to perform that is definite and certain the courts will enforce a duty of good faith, including good faith negotiation, in order that a party not escape from the obligation he has contracted to perform.

Teachers Insurance Annuity Association of America v. Butler, 626 F. Supp. 1229, 1231-32 (S.D.N.Y.), *stay granted*, 803 F.2d 61 (2d Cir. 1986).

In the instant case, the "duty of good faith performance" language contained in Instruction No. 5 is stated to arise *from the parties' agreement.* It is worded clearly, instructing the jury that a duty of good faith performance on the part of the Getty entities and Pennzoil arose post-contractually, i.e., only if the jury found an intent to be bound on January 3. Thus, Instruction No. 5 is not a misstatement of the law. . . .

B. IMPLIED AND EXPRESS WARRANTIES

The scope of performance is often defined by a warranty. When parties are silent, contract law supplies some warranties by default. Two provided by the Uniform Commercial Code are the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. After considering the difference between these two implied warranties, we shall examine how

parties may contract around them, either by adding an express warranty in addition to or in place of an implied warranty or by expressly disclaiming the implied warranties.

1. Implied Warranties of Merchantability and Fitness for a Particular Purpose

STUDY GUIDE: In Chapter 5, we read the portion of the U.S. Court of Appeals opinion in Step-Saver Data Systems v. Wyse Technology that concerned whether an express limitation on a warranty had become part of the agreement under U.C.C. §2-207. We now consider that portion of the trial court's opinion which concerned the plaintiff's claim that the defendant had breached its implied warranties of merchantability and fitness for a particular purpose. How does the court distinguish between these two types of implied warranties? The facts of the case appear in Chapter 5.

STEP-SAVER DATA SYSTEMS, INC. v. WYSE TECHNOLOGY

United States District Court, Eastern District of Pennsylvania, 752 F. Supp. 181 (1990)

BRODERICK, J.*

. . . Step-Saver alleges error in the Court's refusal to charge the jury on the implied warranty of merchantability. . . . Step-Saver failed to produce any evidence that the implied warranty of merchantability was violated.

In Step-Saver's request for the Court to charge the jury on the implied warranty of merchantability, it appeared that there was a failure on Step-Saver's part to differentiate between the warranty of merchantability and the warranty of fitness for a particular purpose. As stated in White and Summers, Uniform Commercial Code, §9-9, p. 357-58 (2d ed. 1980),

> Those unfamiliar with the differences between the warranty of merchantability (fitness for the *ordinary* purposes for which such goods are used) and the warranty of fitness for a *particular* purpose often confuse the two; one can find many opinions in which the judge used the terms "merchantability" and "fitness for a particular purpose" interchangeably. Such confusion under the Code is inexcusable. Sections 2-314 and 2-315 make plain that the warranty of fitness for a particular purpose is narrower, more specific, and more precise. . . .

* *Raymond J. Broderick* (1914-2000) was educated at the University of Notre Dame (A.B.) and the University of Pennsylvania (J.D.). Broderick left his position as counsel for the U.S. Rural Electrification Administration (1938-1941) to serve in the Office of Naval Intelligence (1941-1942) and as a Lieutenant Commander in the U.S. Naval Reserve (1942-1946) before returning to private practice. He also held office as Commissioner of the Plymouth Township (1952-1954), Lieutenant Governor of Pennsylvania (1967-1971), and President of the Senate of Pennsylvania (1967-1971). In 1971, he was appointed judge of the U.S. District Court for the Eastern District of Pennsylvania. — K.T.

Note the conditions that are not required by the implied warranty of merchantability but that must be present if a plaintiff is to recover on the implied warranty of fitness for a particular purpose:

(1) The seller must have reason to know the buyer's particular purpose.
(2) The seller must have reason to know that the buyer is relying on the seller's skill or judgement to furnish appropriate goods.
(3) The buyer must, in fact, rely upon the seller's skill or judgement.

Section 2-314(2) of the Uniform Commercial Code states that to be merchantable, goods must be at least such as

(a) pass without objection in the trade under the contract description; and
(b) in the case of fungible goods, are of fair and average quality within the description; and
(c) are fit for the ordinary purposes for which such goods are used; and
(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
(e) are adequately contained, packaged, and labeled as the agreement may require; and
(f) conform to the promises or affirmations of fact made on the container or label if any.

U.C.C. §2-314(2).

The warranty of merchantability does not require that the goods be "outstanding or superior." They need only be "of reasonable quality within expected variations and for the ordinary purposes for which they are used." Anderson, 3 Uniform Commercial Code, §2-314:29 at 136. . . . Acceptance in the trade, in addition to being an express requirement for merchantability under the Uniform Commercial Code, has long been a reliable barometer for determining whether a particular product is merchantable. Merchantability "includes as an element the warranty that the goods will pass in the trade without objection under the contract description." Anderson, §2-314:31 at 138.

Step-Saver was thus obliged at trial to demonstrate not only the existence of the warranty (which is implied in virtually every transaction), but also the fact that the warranty was breached and that the breach was the proximate cause of the loss sustained by the buyer. Step-Saver put forth no evidence as to any defect in packaging or unusual variations in quality, much less any evidence that the Wyse-60 terminals would not be acceptable as computer terminals in the trade. Wyse introduced uncontroverted evidence that over one million Wyse-60 terminals have been sold since their introduction in April, 1986. The Wyse-60 terminal has exceeded all other terminals in its class in sales. Furthermore, before deciding on the configuration of the Step-Saver multi-user systems, Step-Saver put the Wyse-60 through a two part testing program. Step-Saver employees conducted comparison tests of the Wyse-60 terminal and at least two other terminals whose performance was found to be inferior to that of the Wyse-60. Step-Saver's second stage of testing was the "bench-testing" of individual terminals and systems prior to installation at customer locations, again with no indication of problems. The only defect alleged was incompatibility

with certain software programs selected by Step-Saver, including Multi-Link Advanced, Benchmark and WordPerfect. No evidence was presented to suggest that compatibility with those programs was a criterion of merchantability according to the usage of the computer terminal trade. There were hundreds of other software programs used with such terminals. Thus, the evidence clearly established that the Wyse terminals met or exceeded the ordinary standards of the trade at the time of their installation at customer locations by Step-Saver personnel. The evidence in this case clearly supported the Court's ruling that Step-Saver failed to present evidence of a breach of the implied warranty of merchantability.

B. FITNESS FOR A PARTICULAR PURPOSE

Step-Saver further alleges that the Court erred in instructing the jury that in order to find liability for a violation of the implied warranty of fitness for a particular purpose the jury must find that Wyse "*was aware* of Step-Saver's *specific applications*" of the Wyse-60 terminals.

This allegation is a misstatement of the charge given by the Court. The Court charged the jury as follows:

> In order to prove the implied warranty of fitness, Step-Saver must prove by a preponderance of the evidence, that Wyse, at the time of the sale to Step-Saver, had reason to know of the particular purpose for which the Wyse-60 terminals were being purchased by Step-Saver and that Step-Saver relied on Wyse's skill and judgement to select or furnish suitable terminals.

The Court's charge was correct. Furthermore, the interrogatory to which the jury answered "NO" reads:

> Has Step-Saver proved by a preponderance of evidence that defendant Wyse Technology at the time of the sale to Step-Saver had reason to know of the particular purpose for which the Wyse-60 terminals were purchased and that Step-Saver relied on Wyse's skill or judgement, creating an implied warranty of fitness, and that the implied warranty of fitness was breached and that the breach was a proximate cause of damage to Step-Saver? . . .

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§2-314. IMPLIED WARRANTY: MERCHANTABILITY; USAGE OF TRADE

(1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this Section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

§2-315. IMPLIED WARRANTY: FITNESS FOR PARTICULAR PURPOSE

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

§2-714. BUYER'S DAMAGES FOR BREACH IN REGARD TO ACCEPTED GOODS. . . .

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

REFERENCE: Murray, §101(B), (C), and (D)

2. Express Warranties

You will recall from Chapter 1 that in Shaheen v. Knight, the court refused to *imply* a "warranty of cure," although it said that "[a] doctor and his patient . . . are at liberty to contract for a particular result." In Hawkins v. McGee, Dr. McGee was alleged to have *expressly* warrantied the results of the operation. For this reason, we were not concerned with whether the injuries sustained by George Hawkins were foreseeable. In this way Dr. McGee's liability had been expanded by his consent. Express warranties are extremely common. They entail a promise to make good for losses within their scope, whether or not such losses were foreseeable, uncertain, or avoidable.

STUDY GUIDE: Pay attention to why the court finds some of the seller's statements to constitute a warranty and not others. Why draw a distinction between statements of fact *and statements of opinion or "puffing"? We shall return to this distinction in Chapter 16 when discussing the defense of misrepresentation.*

ROYAL BUSINESS MACHINES, INC. v. LORRAINE CORP.

United States Court of Appeals, Seventh Circuit, 633 F.2d 34 (1980)

BAKER, District Judge.*

This is an appeal from a judgment of the district court entered after a bench trial awarding Michael L. Booher and Lorraine Corp. (Booher) $1,171,216.16 in compensatory and punitive damages against Litton Business Systems, Inc. and Royal Business Machines, Inc. (Royal). The judgment further awarded Booher attorneys' fees of $156,800.00. It denied, for want of consideration, the recovery by Royal of a $596,921.33 indebtedness assessed against Booher earlier in the proceedings in a summary judgment. The judgment also granted Royal a set-off of $12,020.00 for an unpaid balance due on computer typewriters.

The case arose from commercial transactions extending over a period of 18 months between Royal and Booher in which Royal sold and Booher purchased 114 RBC I and 14 RBC II plain paper copying machines. In mid-August 1976, Booher filed suit against Royal in the Indiana courts claiming breach of warranties and fraud. On September 1, 1976, Royal sued Booher on his financing agreements in the district court and also removed the state litigation to the district court where the cases were consolidated.

The issues in the cases arise under Indiana common law and under the U.C.C. as adopted in Indiana, Ind. Code §26-1-2-102 et seq. (1976). The contentions urged by Royal on appeal are that:

(1) substantial evidence does not support the findings that Royal made certain express warranties or that it breached any express warranty and, as a matter of law, no warranties were made; and

(2) substantial evidence does not support the findings that Royal breached the implied warranties of merchantability and fitness for a particular purpose. . . .

We reverse and remand for a new trial on the grounds set forth in this opinion.

**Harold Albert Baker* (1929-†) was educated at the University of Illinois (A.B., J.D.). Admitted to the bar in 1956, he practiced in Champaign, Illinois (1956-1978), prior to being appointed to his current post as Chief Judge of the U.S. District Court for the Central District of Illinois in 1978. Baker has also served in the U.S. Navy, as a member of the faculty of the College of Law, University of Illinois (1972-1978), and as senior counsel to the Presidential Commission on CIA Activities within the United States (1975). — K.T.

EXPRESS WARRANTIES

We first address the question whether substantial evidence on the record supports the district court's findings that Royal made and breached express warranties to Booher. The trial judge found that Royal Business Machines made and breached the following express warranties:

(1) that the RBC Model I and II machines and their component parts were of high quality;
(2) that experience and testing had shown that frequency of repairs was very low on such machines and would remain so;
(3) that replacement parts were readily available;
(4) that the cost of maintenance for each RBC machine and cost of supplies was and would remain low, no more than 1/2 cent per copy;
(5) that the RBC machines had been extensively tested and were ready to be marketed;
(6) that experience and reasonable projections had shown that the purchase of the RBC machines by Mr. Booher and Lorraine Corporation and the leasing of the same to customers would return substantial profits to Booher and Lorraine;
(7) that the machines were safe and could not cause fires; and
(8) that service calls were and would be required for the RBC Model II machine on the average of every 7,000 to 9,000 copies, including preventive maintenance calls.

Substantial evidence supports the court's findings as to Numbers 5, 7, 8, and the maintenance aspect of Number 4, but, as a matter of law, Numbers 1, 2, 3, 6, and the cost of supplies portion of Number 4 cannot be considered express warranties.

Paraphrasing U.C.C. §2-313 as adopted in Indiana, . . . an express warranty is made up of the following elements: (a) an affirmation of fact or promise, (b) that relates to the goods, and (c) becomes a part of the basis of the bargain between the parties. When each of these three elements is present, a warranty is created that the goods shall conform to the affirmation of fact or to the promise.

The decisive test for whether a given representation is a warranty or merely an expression of the seller's opinion is whether the seller asserts a fact of which the buyer is ignorant or merely states an opinion or judgment on a matter of which the seller has no special knowledge and on which the buyer may be expected also to have an opinion and to exercise his judgment. . . . General statements to the effect that goods are "the best," . . . or are "of good quality," . . . or will "last a lifetime" and be "in perfect condition," . . . are generally regarded as expressions of the seller's opinion or "the puffing of his wares" and do not create an express warranty.

No express warranty was created by Royal's affirmation that both RBC machine models and their component parts were of high quality. This was a statement of the seller's opinion, the kind of "puffing" to be expected in any sales transaction, rather than a positive averment of fact describing a product's capabilities to which an express warranty could attach. . . .

Similarly, the representations by Royal that experience and testing had shown that the frequency of repair was "very low" and would remain so lack the specificity of an affirmation of fact upon which a warranty could be predicated. These representations were statements of the seller's opinion.

The statement that replacement parts were readily available is an assertion of fact, but it is not a fact that relates to the goods sold as required by Ind. Code §26-1-2-313(1)(a) and is not an express warranty to which the goods were to conform. Neither is the statement about the future costs of supplies being 1/2 cent per copy an assertion of fact that relates to the goods sold, so the statement cannot constitute the basis of an express warranty.

It was also erroneous to find that an express warranty was created by Royal's assurances to Booher that purchase of the RBC machines would bring him substantial profits. Such a representation does not describe the goods within the meaning of U.C.C. §2-313(1)(b), nor is the representation an affirmation of fact relating to the goods under U.C.C. §2-313(1)(a). It is merely sales talk and the expression of the seller's opinion. See Regal Motor Products v. Bender, 102 Ohio App. 447, 139 N.E.2d 463, 465 (1956) (representation that goods were "readily saleable" and that the demand for them would create a market was not a warranty). . . .

On the other hand, the assertion that the machines could not cause fires is an assertion of fact relating to the goods, and substantial evidence in the record supports the trial judge's findings that the assertion was made by Royal to Booher.[2] The same may be said for the assertion that the machines were tested and ready to be marketed. See Bemidji Sales Barn v. Chatfield, 312 Minn. 11, 250 N.W.2d 185 (1977) (seller's representation that cattle "had been vaccinated for shipping fever and were ready for the farm" constituted an express warranty). See generally R. Anderson, Uniform Commercial Code §2-313:36 (2d ed. 1970) (author asserts that seller who sells with seal of approval of a third person, e.g., a testing laboratory, makes an express warranty that the product has been tested and approved and is liable if the product was in fact not approved). The record supports the district court's finding that Royal represented that the machines had been tested. . . .

As for finding 8 and the maintenance portion of Number 4, Royal's argument that those statements relate to predictions for the future and cannot qualify as warranties is unpersuasive.[3] An expression of future capacity or performance can constitute an express warranty. In Teter v. Schultz, 110 Ind. App. 541, 39 N.E.2d 802, 804 (1942), the Indiana courts held that a seller's statement that dairy cows would give six gallons of milk per day was an affirmation of fact by the seller relating to the goods. It was

2. Michael Booher testified at trial that in February or March of 1975 he called the service department at Royal Typewriter Company and spoke with either Bruce Lewis, national service manager, or with Joe Miller. Booher testified that he told the Royal representative that he had received a report of a fire in an RBC I machine at a customer's office. Booher then testified, "They told me that that couldn't happen." (Tr. Vol. IV, pp. 457-59.) For a discussioo of whether the assertions about fires, maintenance, and service calls became part of the basis of the bargain, see infra. . . .

3. In Number 4, the trial court found that the appellant warranted that the cost of maintenance for each RBC machine and cost of supplies was and would remain low, no more than 1/2 cent per copy, and in Number 8 that service calls were and would be required for the RBC Model II machine approximately every 7,000 to 9,000 copies.

not a statement of value nor was it merely a statement of the seller's opinion. . . .

Whether a seller affirmed a fact or made a promise amounting to a warranty is a question of fact reserved for the trier of fact. . . . Substantial evidence in the record supports the finding that Royal made the assertion to Booher that maintenance cost for the machine would run 1/2 cent per copy and that this assertion was not an estimate but an assertion of a fact of performance capability.[4]

Finding Number 8, that service calls on the RBC II would be required every 7,000 to 9,000 copies, relates to performance capability and could constitute the basis of an express warranty. There is substantial evidence in the record to support the finding that this assertion was also made.[5]

While substantial evidence supports the trial court's findings as to the making of those four affirmations of fact or promises, the district court failed to make the further finding that they became part of the basis of the bargain. Ind. Code §26-1-2-313(1) (1976). While Royal may have made such affirmations to Booher, the question of his knowledge or reliance is another matter.[6]

4. Michael Booher testified at trial that Mr. Gavel, a Royal representative, told Booher in April 1974, at a meeting in Booher's Indianapolis office, that cost for service on the RBC I machine would be a half cent. (Tr. Vol. III, pp. 294-98.) Booher further testified that in July 1974, at a meeting in Chicago sponsored by Royal, he was told by Jack Airey, a Royal representative, that maintenance costs for the RBC II machine would be the same as on the RBC I, except that service costs should actually be a little less due to the reliability of the machine. (Tr. Vol. III, pp. 320-21.)

Gavel testified by deposition taken on May 27, 1977, which was admitted into evidence at trial, that he told Booher that service costs for the RBC I machine would be half a cent (Gavel Dep., p. 28). He further testified in reference to the costs quoted to dealers on the RBC II machines that "(n)obody ever implied they were estimates," (Gavel Dep., p. 110).

5. Michael Booher testified at trial that at the Chicago meeting Royal representatives, Jack Airey and Roland Schultz, told him that the RBC II machines would require "a service call, a customer-related call about every nine thousand copies, and that we would have preventative maintenance calls about every twenty to twenty-one thousand copies. . . ." (Tr. Vol. III, p. 325.)

6. The requirement that a statement be part of the basis of the bargain in order to constitute an express warranty "is essentially a reliance requirement and is inextricably intertwined with the initial determination as to whether given language may constitute an express warranty since affirmations, promises and descriptions tend to become a part of the basis of the bargain. It was the intention of the drafters of the U.C.C. not to require a strong showing of reliance. In fact, they envisioned that all statements of the seller become part of the basis of the bargain unless clear affirmative proof is shown to the contrary. See Official Comments 3 and 8 to U.C.C. §2-313." Sessa v. Riegle, 427 F. Supp. 760, 766 (E.D. Pa. 1977), *aff'd without op.*, 568 F.2d 770 (3d Cir. 1978).

Cf. Woodruff v. Clark County Farm Bureau Coop. Assn., 153 Ind. App. 31, 286 N.E.2d 188 (1972) where the court stated: "Whether such assertions (statements by the seller) constituted express warranties and whether (the buyer) *relied* upon these assertions are material issues of fact to be determined by the trier of fact." 286 N.E.2d at 199 (emphasis added [by the court]); Stamm v. Wilder Travel Trailers, 44 Ill. App. 3d 530, 358 N.E.2d 382 (1976) (reliance necessary in order to give rise to an express warranty).

"[F]or all practical purposes it is suggested that no great change was wrought by the Code. Whether one speaks of reliance or basis of the bargain, little difference exists between the two. In neither case should the statement be required to have been the sole factor leading the buyer to purchase. In either case, the statement should, at least, be one of such factors. What is really crucial is whether the statement was made as an affirmation of fact, the goods did not live up to the statement, and the defect was not so apparent that the buyer could not be held to have discovered it for himself." Bender's U.C.C. Service, Dusenberg & King, Sales and Bulk Transfers §6.01, n.2 (Matthew Bender & Co. 1980).

This case is complicated by the fact that it involved a series of sales transactions between the same parties over approximately an 18-month period and concerned two different machines. The situations of the parties, their knowledge and reliance, may be expected to change in light of their experience during that time. An affirmation of fact which the buyer from his experience knows to be untrue cannot form a part of the basis of the bargain. . . . Therefore, as to each purchase, Booher's expanding knowledge of the capacities of the copying machines would have to be considered in deciding whether Royal's representations were part of the basis of the bargain. The same representations that could have constituted an express warranty early in the series of transactions might not have qualified as an express warranty in a later transaction if the buyer had acquired independent knowledge as to the fact asserted.

The trial court did not indicate that it considered whether the warranties could exist and apply to each transaction in the series. Such an analysis is crucial to a just determination. Its absence renders the district court's findings insufficient on the issue of the breach of express warranties.

Since a retrial on the questions of the breach of express warranties and the extent of damages is necessary, we offer the following observations. The court must consider whether the machines were defective upon delivery. Breach occurs only if the goods are defective upon delivery and not if the goods later become defective through abuse or neglect. . . .

In considering the promise relating to the cost of maintenance, the district court should determine at what stage Booher's own knowledge and experience prevented him from blindly relying on the representations of Royal. A similar analysis is needed in examining the representation concerning fire hazard in the RBC I machines. The court also should determine when that representation was made. If not made until February 1975, the representation could not have been the basis for sales made prior to that date. . . .

For the foregoing reasons the judgment of the district court is reversed, and the cause is remanded for a new trial on the remaining issues outlined herein. Each party is to bear its own costs.

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§2-313. EXPRESS WARRANTIES BY AFFIRMATION, PROMISE, DESCRIPTION, SAMPLE

(1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

STUDY GUIDE: In the previous case, the court stated that: "An affirmation of fact which the buyer from his experience knows to be untrue cannot form a part of the basis of the bargain." The next case critically examines the meaning of this principle. Does the court reject this proposition? The court distinguishes between tort and contract conceptions of warranties. What is the difference between these two conceptions and why would each lead to a different approach to reliance on a warranty? Is there a difference in this regard between an implied and an express warranty? Do you see any similarity between this debate and that surrounding promissory estoppel? Is there a difference between compensating for detrimenal reliance and protecting a person's right to rely on the commitment of another?

CBS, INC. v. ZIFF-DAVIS PUBLISHING CO.

Court of Appeals of New York,
75 N.Y.2d 496, 554 N.Y.S.2d 449, 553 N.E.2d 997 (1990)

HANCOCK, JR., J.*

A corporate buyer made a bid to purchase certain businesses based on financial information as to their profitability supplied by the seller. The bid was accepted and the parties entered into a binding bilateral contract for the sale which included, specifically, the seller's express warranties as to the truthfulness of the previously supplied financial information. Thereafter, pursuant to the purchase agreement, the buyer conducted its own investigation which led it to believe that the warranted information was untrue. The seller dismissed as meritless the buyer's expressions of disbelief in the validity of the financial information and insisted that the sale go through as agreed. The closing took place with the mutual understanding that it would not in any way affect the previously asserted position of either party. Did the buyer's manifested lack of belief in and reliance on the truth of the warranted information prior to the closing relieve the seller of its obligations under the warranties? This is the central question presented in the breach of express warranty claim brought by CBS Inc. (CBS) against Ziff-Davis Publishing Co. (Ziff-Davis). The courts below

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concluded that CBS's lack of reliance on the warranted information was fatal to its breach of warranty claim and, accordingly, dismissed that cause of action on motion under CPLR 3211(a)(7). We granted leave to appeal and, for reasons stated hereinafter, disagree with this conclusion and hold that the warranty claim should be reinstated.

I

The essential facts pleaded — assumed to be true for the purpose of the dismissal motion — are these. In September 1984, Goldman Sachs & Co., acting as Ziff-Davis's investment banker and agent, solicited bids for the sale of the assets and businesses of 12 consumer magazines and 12 business publications. The offering circular, prepared by Goldman Sachs and Ziff-Davis, described Ziff-Davis's financial condition and included operating income statements for the fiscal year ending July 31, 1984 prepared by Ziff-Davis's accountant, Touche Ross & Co. Based on Ziff-Davis's representations in the offering circular, CBS, on November 9, 1984 submitted a bid limited to the purchase of the 12 consumer magazines in the amount of $362,500,000. This was the highest bid.

On November 19, 1984 CBS and Ziff-Davis entered into a binding bilateral purchase agreement for the sale of the consumer magazine businesses for the price of $362,500,000. Under section 3.5 of the purchase agreement, Ziff-Davis warranted that the audited income and expense report of the businesses for the 1984 fiscal year, which had been previously provided to CBS in the offering circular, had "been prepared in accordance with generally accepted accounting principles" (GAAP) and that the report "present[ed] fairly the items set forth." Ziff-Davis agreed to furnish an interim income and expense report (Stub Report) of the businesses covering the period after the end of the 1984 fiscal year, and it warranted under section 3.6 that from July 31, 1984 until the closing, there had "not been any material adverse change in Seller's business of publishing and distributing the Publications, taken as a whole." Section 6.1 (a) provided that "all representations and warranties of Seller to Buyer shall be true and correct as of the time of the closing," and in section 8.1, the parties agreed that all "representations and warranties . . . shall survive the closing, notwithstanding any investigation made by or on behalf of the other party." In section 5.1 Ziff-Davis gave CBS permission to "make such investigation" of the magazine businesses being sold "as [it might] desire" and agreed to give CBS and its accountants reasonable access to the books and records pertaining thereto and to furnish such documents and information as might reasonably be requested.

Thereafter, on January 30, 1985 Ziff-Davis delivered the required Stub Report. In the interim, CBS, acting under section 5.1 of the purchase agreement, had performed its own "due diligence" examination of Ziff-Davis's financial condition. Based on this examination and on reports by its accountant, Coopers & Lybrand, CBS discovered information causing it to believe that Ziff-Davis's certified financial statements and other financial reports were not prepared according to GAAP and did not fairly depict Ziff-Davis's financial condition.

In a January 31, 1985 letter, CBS wrote Ziff-Davis that,

> "[b]ased on the information and analysis provided [to it, CBS was] of the view that there [were] material misrepresentations in the financial statements provided [to CBS] by Touche Ross & Co., Goldman, Sachs & Co. and Ziff-Davis." In response to this letter, Ziff-Davis advised CBS by letter dated February 4, 1985 that it "believe[d] that all conditions to the closing . . . were fulfilled," that "there [was] no merit to the position taken by CBS in its [Jan. 31, 1985] letter" and that the financial statements were properly prepared and fairly presented Ziff-Davis's financial condition. It also warned CBS that, since all conditions to closing were satisfied, closing was required to be held that day, February 4, 1985, and that, if it "should fail to consummate the transactions as provided . . . Ziff-Davis intend[ed] *to pursue all of its rights and remedies as provided by law.* (Emphasis added.)

CBS responded to Ziff-Davis's February 4, 1985 letter with its own February 4 letter, which Ziff-Davis accepted and agreed to. In its February 4 letter, CBS acknowledged that "a clear dispute" existed between the parties. It stated that it had decided to proceed with the deal because it had "spent considerable time, effort and money in complying with [its] obligations . . . and recogniz[ed] that [Ziff-Davis had] considerably more information available." Accordingly, the parties agreed "to close [that day] on a mutual understanding that the decision to close, and the closing, [would] not *constitute a waiver of any rights or defenses either of us may have*" (emphasis added) under the purchase agreement. The deal was consummated on February 4.

CBS then brought this action claiming in its third cause of action . . . that Ziff-Davis had breached the warranties made as to the magazines' profitability. Based on that breach, CBS alleged that "the price bid and the price paid by CBS were in excess of that which would have been bid and paid by CBS had Ziff-Davis not breached its representation and warranties." Supreme Court granted Ziff-Davis's motion to dismiss the breach of warranty cause of action because CBS alleged "it did not believe that the representations set forth in Paragraphs 3.5 and 3.6 of the contract of sale were true" and thus CBS did not satisfy "the law in New York [which] clearly requires that this reliance be alleged in a breach of warranty action." Supreme Court also dismissed CBS's fourth cause of action relating to an alleged breach of condition. The Appellate Division, First Department, unanimously affirmed for reasons stated by Supreme Court. There should be a modification so as to deny the dismissal motion with respect to the third cause of action for breach of warranties.

II

In addressing the central question whether the failure to plead reliance is fatal to CBS's claim for breach of express warranties, it is necessary to examine the exact nature of the missing element of reliance which Ziff-Davis contends is essential. This critical lack of reliance, according to Ziff-Davis, relates to CBS's disbelief in the truth of the warranted financial information which resulted from its investigation *after* the signing of the agreement and

prior to the date of closing. The reliance in question, it must be emphasized, does not relate to whether CBS relied on the submitted financial information in making its bid or relied on Ziff-Davis's express warranties as to the validity of this information when CBS committed itself to buy the businesses by signing the purchase agreement containing the warranties.

Under Ziff-Davis's theory, the reliance which is a necessary element for a claim of breach of express warranty is essentially that required for a tort action based on fraud or misrepresentation — i.e., a belief in the truth of the representations made in the express warranty and a change of position in reliance on that belief. Thus, because, prior to the closing of the contract on February 4, 1985, CBS demonstrated its lack of belief in the truth of the warranted financial information, it cannot have closed in reliance on it and its breach of warranty claim must fail. This is so, Ziff-Davis maintains, despite its unequivocal rejection of CBS's expressions of its concern that the submitted financial reports contained errors, despite its insistence that the information it had submitted complied with the warranties and that there was "no merit" to CBS's position, and despite its warnings of legal action if CBS did not go ahead with the closing. Ziff-Davis's primary source for the proposition it urges — that a change of position in reliance on the truth of the warranted information is essential for a cause of action for breach of express warranty — is language found in older New York cases such as Crocker-Wheeler Elec. Co. v. Johns-Pratt Co. (29 App. Div. 300 [51 N.Y.S. 793], *aff'd*, 164 N.Y. 593 [58 N.E. 1086].).

CBS, on the other hand, maintains that the decisive question is whether it purchased the express warranties as bargained-for contractual terms that were part of the purchase agreement (see, e.g., Ainger v. Michigan Gen. Corp., 476 F. Supp. 1209, 1225 [S.D.N.Y. 1979], *aff'd*, 632 F.2d 1025 [2d Cir. 1980]). It alleges that it did so and that, under these circumstances, the warranty provisions amounted to assurances of the existence of facts upon which CBS relied in committing itself to buy the consumer magazines. Ziff-Davis's assurances of these facts, CBS contends, were the equivalent of promises by Ziff-Davis to indemnify CBS if the assurances proved unfounded. Thus, as continuing promises to indemnify, the express contractual warranties did not lose their operative force when, prior to the closing, CBS formed a belief that the warranted financial information was in error. Indeed, CBS claims that it is precisely because of these warranties that it proceeded with the closing, despite its misgivings.

As authority for its position, CBS cites, inter alia, Ainger v. Michigan Gen. Corp. (supra) and Judge Learned Hand's definition of warranty as

> an assurance by one party to a contract of the existence of a fact upon which the other party may rely. It is intended precisely to relieve the promisee of any duty to ascertain the fact for himself; *it amounts to a promise to indemnify the promisee for any loss if the fact warranted proves untrue, for obviously the promisor cannot control what is already in the past.*

(Metropolitan Coal Co. v. Howard, 155 F.2d 780, 784 [2d Cir. 1946] (emphasis added) . . .).

We believe that the analysis of the reliance requirement in actions for breach of express warranties adopted in Ainger v. Michigan Gen. Corp.

(supra) and urged by CBS here is correct. The critical question is not whether the buyer believed in the truth of the warranted information, as Ziff-Davis would have it, but "whether [it] believed [it] was purchasing the [seller's] promise [as to its truth]." (Ainger v. Michigan Gen. Corp., supra, at 1225; . . . CPC Intl. v. McKesson Corp., 134 Misc. 2d 834 [513 N.Y.S.2d 319] (Sup. Ct., N.Y. County).) This view of "reliance" — i.e., as requiring no more than reliance on the express warranty as being a part of the bargain between the parties — reflects the prevailing perception of an action for breach of express warranty as one that is no longer grounded in tort, but essentially in contract. . . . The express warranty is as much a part of the contract as any other term. Once the express warranty is shown to have been relied on as part of the contract, the right to be indemnified in damages for its breach does not depend on proof that the buyer thereafter believed that the assurances of fact made in the warranty would be fulfilled. The right to indemnification depends only on establishing that the warranty was breached. . . .

If, as is allegedly the case here, the buyer bas purchased the seller's promise as to the existence of the warranted facts, the seller should not be relieved of responsibility because the buyer, after agreeing to make the purchase, forms doubts as to the existence of those facts. . . . Stated otherwise, the fact that the buyer has questioned the seller's ability to perform as promised should not relieve the seller of his obligations under the express warranties when he thereafter undertakes to render the promised performance. . . .

Ziff-Davis repeatedly cites and the dissent relies upon language contained in the Appellate Division's opinion in Crocker-Wheeler Elec. Co. v. Johns-Pratt Co. (supra) which dealt with a claimed breach of an express warranty pertaining to the fitness of insulating material for a certain use. The court held that there was no actionable express warranty claim because the seller *made no warranty with respect to use of the material.* The language which Ziff-Davis quotes as a categorical proposition that should control the case before us — i.e., "[i]t is elementary that, in order to entitle the plaintiff to maintain an action for breach of an express warranty, *it must be established that the warranty was relied on*" (emphasis added) — is contained in dictum (29 App. Div., at 302 [51 N.Y.S. 793]).[7]

Viewed as a contract action involving the claimed breach of certain bargained-for express warranties contained in the purchase agreement, the case may be summarized this way. CBS contracted to buy the consumer magazine businesses in consideration, among other things, of the reciprocal promises made by Ziff-Davis concerning the magazines' profitability. These reciprocal promises included the express warranties that the audited reports for the year ending July 31, 1984 made by Touche Ross had been prepared according to GAAP and that the items contained therein were fairly presented, that there had been no adverse material change in the business after July 31, 1984, and that all representations and warranties would "be true and correct as of the time of the closing" and would "survive the closing, notwithstanding any investigation" by CBS.

7. We note that this dictum has been criticized (see, 8 Williston, Contracts §973, at 501 [3d ed.]) and to the extent *Crocker-Wheeler* can be broadly read to require the rule of "reliance" urged by Ziff-Davis in this case it is not to be followed.

Unquestionably, the financial information pertaining to the income and expenses of the consumer magazines was relied on by CBS in forming its opinion as to the value of the businesses and in arriving at the amount of its bid; the warranties pertaining to the validity of this financial information were express terms of the bargain and part of what CBS contracted to purchase. CBS was not merely buying identified consumer magazine businesses. It was buying businesses which it believed to be of a certain value based on information furnished by the seller which the seller warranted to be true. The determinative question is this: should Ziff-Davis be relieved from any contractual obligation under these warranties, as it contends that it should, because, prior to the closing, CBS and its accountants questioned the accuracy of the financial information and because CBS, when it closed, did so without *believing in* or *relying on* the truth of the information?

We see no reason why Ziff-Davis should be absolved from its warranty obligations under these circumstances. A holding that it should because CBS questioned the truth of the facts warranted would have the effect of depriving the express warranties of their only value to CBS — i.e., as continuing promises by Ziff-Davis to indemnify CBS if the facts warranted proved to be untrue (see, Metropolitan Coal Co. v. Howard, supra, at 784).[8] Ironically, if Ziff-Davis's position were adopted, it would have succeeded in pressing CBS to close despite CBS's misgivings and, at the same time, would have succeeded in *defeating* CBS's breach of warranties action because CBS harbored these *identical misgivings*.[9]

We agree with the lower courts that CBS's fourth cause of action, for breach of section 6.1(f) of the purchase agreement, was properly dismissed inasmuch as section 6.1(f) was a condition to closing, not a representation or warranty, and was waived by CBS.

The order of the Appellate Division should be modified, with costs to the appellant, by denying the motion to dismiss the third cause of action for breach of warranty and the order should be otherwise affirmed.

BELLACOSA, J.* (dissenting). The issue is whether a buyer may sue a seller, after consummating a business transaction, for breach of an express warranty

8. In this regard, analogy to the Uniform Commercial Code is "instructive." While acceptance of goods by the buyer precludes rejection of the goods accepted (see, U.C.C. 2-607 [2]), the acceptance of nonconforming goods does not itself impair any other remedy for nonconformity (see, U.C.C. 2-607 [2]), including damages for breach of an express warranty (see, U.C.C. 2-714; see generally, 1 White and Summers, Uniform Commercial Code §10-1, at 501-502 [Practitioner's 3d ed.] . . .).

9. We make but one comment on the dissent: in its statement that our "holding discards reliance as a necessary element to maintain an action for breach of an express warranty" (dissenting opn., at 506 [at 455 of 554 N.Y.S.2d, at 1003 of 553 N.E.2d]) the dissent obviously misses the point of our decision. We do not hold that no reliance is required, but that the required reliance is established if, as here, the express warranties are bargained-for terms of the seller.

* *Joseph W. Bellacosa* (1937-†) received his legal training at St. John's University (J.D.). Upon graduation, he served as law secretary to the New York Courts, Appellate Division (1963-1970); professor of law and assistant dean at St. John's University (1970-1975); chief clerk to the New York Court of Appeals (1975-1983); and chief administrator of the courts of the State of New York (1985). In 1985, Bellacosa was appointed judge on the New York Court of Claims, serving until his current appointment as judge on the Court of Appeals of New York in 1987. — K.T.

on which the buyer chose not to rely. The holding discards reliance as a necessary element to maintain an action for breach of an express warranty. Predictability and reliability with respect to commercial transactions, fostered by 90 years of precedent, are thus sacrificed. I respectfully dissent and would affirm the order of the Appellate Division unanimously affirming Supreme Court's application of the sound and well-settled rule.

Plaintiff CBS contracted to purchase defendant Ziff-Davis's consumer magazine group pursuant to an Asset Purchase Agreement (APA). CBS specifically negotiated *the right to rely* on its own accountant's representations in assessing the validity of the financial information which had been, and would be, provided to CBS by Ziff-Davis (§5.1 of the APA). Given the factual and fiscal complexity of this $362,500,000 acquisition, CBS chose to rely on its own investigation. What the CBS inspectors found in the Ziff-Davis books differed significantly from the financial picture the seller had painted. CBS notified Ziff-Davis of the discrepancies by letter on January 31, 1985, four days before the closing date. Despite its protest to the contrary, it had a contractual right under section 6.1 (a) of the APA to avert the closing if "all representations and warranties of Seller to Buyer" were not true on the closing date. Clearly then, CBS chose to rely on the results of its own investigation and made a business judgment to consummate the purchase rather than cancel the deal. It took the business risk of a big deal and tried by this subsequent litigation to mitigate whatever risk, if any, inured from that choice; in other words, CBS wanted to have its cake and eat it, too.

Supreme Court determined CBS did not rely on the Ziff-Davis warranties. The Appellate Division made the same determination and the nonreliance is acknowledged by the majority. . . . The reliance element is thus unnecessarily excised as a matter of law from the legal proposition governing and defining the cause of action. If I am "missing the point" . . . , I believe it is because that is where the appellant's argument and the state of the law have led me.

Part of CBS's argument is that it should prevail because the closing day letter purports to reserve its rights as to the Ziff-Davis warranties and section 8.1 of the APA purports to be a kind of nonmerger survival clause. On a *sui generis* contract basis therefore, without affecting the traditional reliance element of the cause of action, this argument is enticing. Nevertheless, I conclude — and the majority apparently agrees in this respect — that the argument is not dispositive. The warranties given to CBS created a right to rely on the financial data as part of the sales agreement, not a right not to rely on them, then consummate the deal and then sue on them besides. These aspects of the agreement, therefore, merely manifested the parties' intent not to allow the closing to operate as a waiver of CBS's right to rely — a right which was surrendered *before* the closing. If this issue were dispositive, it would render the case and the contract entirely *sui generis* and there would be no need to address or alter the long-standing test with its reliance element. However, the court confronts and decides the broader issue, and on that we see and understand the case all too well in a fundamentally different way.

"It is elementary that, in order to entitle the plaintiff to maintain an action for breach of an express warranty, it must be established that the warranty was relied on." (Crocker-Wheeler Elec. Co. v. Johns-Pratt Co., 29 App. Div. 300, 302 [51 N.Y.S. 793], *aff'd,* 164 N.Y. 593 [58 N.E. 1086].) This

plain language proposition has been recognized by this court and by the Appellate Division. . . . The majority declares the oft-quoted principle of *Crocker-Wheeler* "is not to be followed" . . . , based in part on a dormant tort/contract categorical bifurcation drawn largely from Ainger v. Michigan Gen. Corp., 476 F. Supp. 1209. Also, part of the justification for this departure from stare decisis in the field of common-law commercial transactions — where the burden for change is very high — is Professor Williston's "criticism" of *Crocker-Wheeler*. Examination of the complete section of the quoted text, however, discloses a significant qualification: "[I]t is generally and rightly held that inspection by the buyer does not excuse the seller from liability for . . . an express warranty, *if the difference between the goods and the description was not detected*" (8 Williston, Contracts §973, at 501 [3d ed.] (nn. omitted; emphasis added)). "The difference" was definitively detected here by CBS pursuant to its express contractual right to personally assess the financial data.

In exchange for the long-standing, well-regarded and well-founded rule, New York law is subordinated to a theory advanced in Ainger v. Michigan Gen. Corp., 476 F. Supp., supra, at 1226. Among the problems of this approach, however, is that in affirming *Ainger* the Court of Appeals for the Second Circuit emphasized the limited impact of the District Court's categorical discussion of the precise issue before us. After stating that the District Court Judge's "finding of reliance made a discussion of New York law unnecessary," the Second Circuit said "[b]ecause there was reliance in this case, we will not speculate how the New York courts would decide a case in which there was none." (Ainger v. Michigan Gen. Corp., 632 F.2d 1025, 1026, n.1.) The reliance on CPC Intl. v. McKesson Corp. (134 Misc. 2d 834 [513 N.Y.S.2d 319]) also seems misplaced. Again, the trial court in that case extensively discussed the reliance question. However, the appellate courts in an entirely different procedural review significantly minimized the discussion of the pertinent subject matter (see, CPC Intl. v. McKesson Corp., 70 N.Y.2d 268, 285 [519 N.Y.S.2d 804, 514 N.E.2d 116] ["plaintiff, in contracting to purchase (defendant's corporation), relied solely on the warranties"], 120 A.D.2d 221, 229, 507 N.Y.S.2d 984 ["plaintiff relied solely upon the express warranties"]). Lack of reliance, therefore, was not part of the holdings in *Ainger* or *CPC*, even at their trial level citations by the majority. Yet those cases are accorded significant deference on the critical issue and they override superior longer-standing sources.

Finally, while I agree that analogy to the Uniform Commercial Code is "instructive" . . . , I believe the directly on-point express warranty section, U.C.C. 2-313, emphasizes the need to stand by our precedents and thus affirm. Official comment 3 of that section indicates that were this a transaction governed by the Uniform Commercial Code, CBS's nonreliance would take the seller's warranties out of the agreement, especially after a buyer consummates the deal with full knowledge and with open disagreement concerning key financial data. . . .

Thus, we are presented with no binding or persuasive authorities sufficient to warrant overturning a venerable rule of the kind used especially in the commercial world to reliably order affairs in such a way as to reasonably avoid litigation (see, Cardozo, Selected Writings of Benjamin Nathan Cardozo, The Growth of the Law, at 236 ["In this department of activity

(commercial law), the current axiology still places stability and certainty in the forefront of the virtues."]). Allowing CBS to consummate the deal, and then sue on warranted financial data it personally investigated and verified as wrong beforehand, unsettles the finality, "stability and certainty" of commercial transactions and business relationships.

CBS chose — for business reasons it knows best — to complete its significant acquisition at the impressively high agreed price with its cyclopean eye wide open. That tips the scales in favor of retaining and applying the traditional rule requiring a reliance element to sue for breach of warranty.

I would affirm the order in its entirety and leave the law where it was and the parties where they put themselves. . . .

Order modified, etc.

REFERENCE: Murray, §101(B)

3. Express Disclaimers of Warranty

Although the law of contract supplies certain warranties when the parties are silent, the parties may still contract around these "default rules." In Chapter 2, we observed one such method. Recall the disclaimer of liability by Federal Express:

> In any event, we will not be liable for any damage, whether direct, incidental, special, or consequential, in excess of the declared value of a shipment, whether or not FedEx has knowledge that such damages might be incurred, including but not limited to loss of income and profits.

The next case illustrates another method for contracting around the implied warranties of merchantability and fitness for a particular use.

STUDY GUIDE: Note the formalities that existed in the next case. Are they necessary, and if so, why?

SCHNEIDER v. MILLER

Court of Appeals of Ohio, Hancock County,
73 Ohio App. 3d 335, 597 N.E.2d 175 (1991)

THOMAS F. BRYANT, Presiding Judge.*

This is an appeal from a judgment entered in the Findlay Municipal Court in favor of defendant-appellee, Harold Robert Miller, d.b.a. Miller

* *Thomas F. Bryant* (1932-†) was educated at Bowling Green State College (B.A.) and Ohio Northern University (J.D.) before serving as clerk to District Judge Girard E. Kalbfleisch, U.S. District Court for the Northern District of Ohio (1966-1968). After clerking, Bryant became an assistant professor of law at Ohio Northern University College of Law (1968-1970) and later an adjunct professor of law (1970-1975). Before joining the Court of Appeals of Ohio, Hancock County (1989-present), Judge Bryant served as Judge in the Findlay Municipal Court, Findlay, Ohio. Now retired from the bench, Judge Bryant is a veteran of the Korean War. — L.R.

Motors or Classic Motors, and against plaintiff-appellant, R. Larry Schneider, following a bench trial.

On August 20, 1988, appellant learned that appellee had a 1966 Chevrolet Impala SS at his used car lot in Findlay. Appellant was in the market for such a car and, along with his brother-in-law (who had told him about the car), went to appellee's place of business to look at the car. Appellant took a test drive in the car and decided to purchase it.

When appellant returned to the car lot, he asked appellee about a squeaking noise in the car and appellee told him it was the brakes and they needed to be replaced. Appellee also pointed out to appellant that the trunk was rusted and it would cost about $500 to repair, and that the engine might need to be rebuilt at some point. Negotiations for the purchase price then began and the parties settled on a price of $2,580. Appellant made a down payment of $100 toward the purchase price.

On August 21, 1988, appellant returned to the car lot with his wife and stepson (for whom he was purchasing the car). He paid the balance of the purchase price, signed a bill of sale acknowledging that the car was sold "as is," and signed a separate document indicating that the car was sold "as is" with no warranty. The car was then driven by appellant or his stepson to their home in Marysville with a detour to Lakeview to show the car to someone attending a classic car show.

Within a day or two after taking the car to Marysville, appellant drove it to a repair shop to have the brakes replaced and the trunk repaired. On September 8, 1988, appellant wrote a letter to appellee seeking to rescind the contract. He offered to return the car to appellee in exchange for a return of the purchase price. Appellant alleged that the entire underside of the car was hardly attached to the frame because the frame was rusted, that the car was not safe to drive, could not be repaired and was a "death trap." Appellee refused to agree to rescind the contract and appellant subsequently brought suit.

After a bench trial, the trial court entered judgment in favor of appellee. The court denied appellant's claim for breach of warranty because the car was sold "as is" without any warranty. As to appellant's claim for fraud and deceit, the court held that appellee had not engaged in conduct that could be construed as a false representation nor had he concealed any material fact concerning the vehicle. The court also denied appellant's claim for rescission of the contract, holding that appellee made no assurances or guarantees that the vehicle was in any certain condition. The court further denied appellant's claim that appellee had engaged in unfair and deceptive practices in violation of R.C. 1345.02.

Appellant's first assignment of error on appeal is as follows:

> I. The court errored (sic) in its decision both factually and under the law in finding that there was no ground for recision [sic] and revocation of acceptance under Ohio Revised Code Section 1302.66. . . .

Appellant argues that the defects in this vehicle substantially impair its value to him and that he could not have reasonably discovered the defects prior to the purchase. Appellant admitted at trial that he took a test drive in the vehicle and saw the areas of the trunk that were rusted out. At no time

did appellant testify that he could not have had this vehicle inspected by a mechanic or other knowledgeable person for defects. Furthermore, appellant admitted that appellee acknowledged the rust problem in the trunk of the car.

It is interesting to note that appellant owned another 1966 Chevrolet Impala SS at the time he purchased the vehicle which is the subject matter of this lawsuit. He testified at trial that he had experienced problems with rust on the underside of that car, but claimed that such knowledge did not put him on notice that more than just the trunk of this car could be rusted.

In support of his contention that he is entitled to rescission or revocation of acceptance, appellant cites McCullough v. Bill Swad Chrysler-Plymouth, Inc. (1983), 5 Ohio St. 3d 181, 5 O.B.R. 398, 449 N.E.2d 1289, and Goddard v. General Motors Corp. (1979), 60 Ohio St. 2d 41, 14 O.O.3d 203, 396 N.E.2d 761. Both cases deal with warranties on new cars limiting the buyer's remedy to repair and replacement of defective parts. Neither case addresses the sale of a twenty-two year old car sold "as is" with no warranty. Appellant's reliance on these cases is misplaced.

Appellant claims that "there has been a failure of 'essential purpose' to the contract when the alleged motor vehicle turns out to be nothing but 'junk.'" This is not a valid argument. Appellant apparently borrows the "failure of essential purpose" language from the law applicable to limited warranties. In particular, when a new car warranty is limited to repair and replacement of defective parts, a court will afford the purchaser additional relief if that limited warranty fails of its essential purpose. McCullough v. Bill Swad Chrysler-Plymouth, Inc., supra, and Goddard v. General Motors Corp., supra. The present case involves a car sold "as is" and does not involve a limited warranty.

Appellant has not shown that he accepted this vehicle on the reasonable assumption that its alleged nonconformity would be cured, nor has he shown that such nonconformity was induced by the difficulty of discovery before acceptance or by appellee's assurances. Accordingly, he is not entitled to revoke acceptance of the vehicle pursuant to that statute.

Appellant's next argument in support of his right to rescind or revoke acceptance is based on R.C. 1302.28, which relates to warranties of fitness for particular purpose. Appellant claims that appellee knew he was purchasing the car for his sixteen-year-old stepson to use as a motor vehicle, not for parts. He concludes that such knowledge on the part of appellee makes R.C. 1302.28 applicable.

Appellant completely ignores the portion of R.C. 1302.28 which provides that "there is *unless excluded or modified under section 1302.29* of the Revised Code an implied warranty that the goods shall be fit for such purpose." (Emphasis added.) R.C. 1302.29 relates to exclusion or modification of warranties and is particularly applicable to the facts of this case. That statute provides in part:

> (C) Notwithstanding division (B) of this section:
>
> (1) unless the circumstances indicate otherwise all implied warranties are excluded by expressions like "as is," "with all faults," or other language which in common understanding calls the buyer's attention to

> the exclusion of warranties and makes plain that there is no implied warranty; and
>
> (2) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him[.]

Official Comment No. 7 to U.C.C. 2-316 (R.C. 1302.29) provides that terms like "as is" "in ordinary commercial usage are understood to mean that the buyer takes the *entire risk* as to the quality of the goods involved." (Emphasis added.) . . .

The evidence in this case is undisputed that appellant test drove this car and apparently examined it as fully as he desired before the purchase. Furthermore, he initialed the bill of sale directly underneath the notation which indicated that the car was sold "as is" and had more than one hundred thousand miles on it. Appellant also signed the bill of sale directly under language which provides:

> Purchaser agrees that this Order includes all of the terms and conditions on both the face and reverse side hereof, that this Order cancels and supersedes any prior agreement and as of the date hereof comprises the complete and exclusive statement of the terms of the agreement relating to the subject matters covered hereby[.]

It has been held that an integration clause such as this which provides that the entire agreement between the parties is contained within the four corners of the contract is effective to waive any implied warranty. Nick Mikalacki Constr. Co. v. M.J.L. Truck Sales, Inc. (1986), 33 Ohio App. 3d 228, 515 N.E.2d 24.

In addition to signing the bill of sale in two places, appellant also signed a Buyers Guide which indicates the vehicle is sold "AS IS — NO WARRANTY." This document instructs the buyer to read the back of the form which provides that one of the major defects that may occur in a used motor vehicle is "cracks, corrective welds, or [a] rusted through" frame.

Appellant is a practicing attorney who claims that he should not be held to the provisions of the documents which he signed. Such a claim is untenable.

Appellant claims that the trial court abused its discretion in basing its decision on inaccurate facts because the decision states that appellant used the car several weeks before taking it to the repair shop when the evidence shows that he had the car only two or three days. The trial court's decision states that appellant took the car to the repair shop "[a]fter several weeks of usage," but this is merely an observation by the trial court and clearly not the basis for its decision.

Appellant's first assignment of error is overruled.

Appellant's second assignment of error is:

> II. The court errored (sic) in its decision both factually and under Ohio law in finding that there was no ground for violation of the Consumer Practices Act under Ohio Revised Code Section 1345.03.

R.C. 1345.03 provides that no supplier shall commit an unconscionable act or practice in connection with a consumer transaction. Pursuant to the definitions contained in R.C. 1345.01(A) and 1345.01(C), appellee is subject to the provisions contained in R.C. Chapter 1345. Appellant produced no evidence at trial that appellee had knowledge of the alleged defect in this car at the time of the sale, nor did he produce any evidence that appellee attempted to conceal such defect even if he did have knowledge of it.

Appellant having produced no evidence of any conduct on the part of appellee which would have been a violation of the Consumer Sales Practices Act, appellant's second assignment of error is overruled. . . .

Accordingly, the judgment of the Findlay Municipal Court is affirmed.

Judgment affirmed.

PELC v. SIMMONS, APPELLATE COURT OF ILLINOIS, FIFTH DISTRICT, 249 ILL. APP. 3D 852, 620 N.E.2D 12 (1993): Justice WELCH.* Words do have meaning. "Sold as is" when posted on a used car means just that; to rule otherwise would make it meaningless and create a new body of law as to what words need be published and what words need to be said or not said in order to sell something without a warranty.

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§2-316. EXCLUSION OR MODIFICATION OF WARRANTIES

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other

* *Thomas M. Welch* (1939-†) studied at the University of Illinois (B.S.) and the University of Missouri (J.D.). After being admitted to the bar of Illinois in 1965, he began a career in public service as a magistrate of the Illinois Circuit Court (1965-1971), Assistant State's Attorney for Madison County (1971-1972), and City Attorney of Collinsville (1975-1980). Welch was elected to the Appellate Court of Illinois in 1980 and was again retained in his current position by election in 2010. — K.T.

language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).

REFERENCE: Farnsworth, §§4.26, 4.28
Murray, §101(E)

STUDY GUIDE: *It is important to note that the Uniform Commercial Code applies to contracts with consumers, not just between merchants. Although the warranties provided by the U.C.C. are default rules, consumer protection statutes may supplement the U.C.C. by making some duties owed by merchants to consumers immutable.*

MORRIS v. MACK'S USED CARS

Supreme Court of Tennessee,
824 S.W.2d 538 (1992)

REID, C.J.* . . .

Disclaimers permitted by §47-2-316 of the Uniform Commercial Code (U.C.C.) may limit or modify liability otherwise imposed by the code, but such disclaimers do not defeat separate causes of action for unfair or deceptive acts or practices under the Consumer Protection Act, T.C.A. §§47-18-101 to -5002.

The U.C.C. contemplates the applicability of supplemental bodies of law to commercial transactions. Section 47-1-103, T.C.A., provides the following:

> Unless displaced by the particular provisions of chapters 1 through 9 of this title, the principles of law and equity, including the law merchant and the law

**Lyle Reid* (1930-†) was educated at the University of Tennessee (B.S., B.A., J.D.), worked in the state attorney general's office of Tennessee (1961-1963) and as county attorney for Haywood County (1964-1986), practiced privately for three years (1963-1966), and was a member of the General Assembly (1967-1968). In 1987, Reid took a seat on the Tennessee Court of Criminal Appeals, which he left to accept appointment as Chief Justice of the Supreme Court of Tennessee in 1990. From 1990 to 1994, he served as Chief Justice of the Tennessee Supreme Court, and he continued to serve on the Supreme Court as justice until 1998. Reid also served with the U.S. Air Force during the Korean War. He retired to private practice in 1994. In 1998, Judge Reid became vice president of litigation for Columbia/HCA Healthcare Corporation. He was associated with Wyatt, Tarrant & Combs from 2000 until he joined the Law Office of J. Houston Gordon in February 2002. — K.T.

> relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

Also, the supplementary nature of the Consumer Protection Act is made clear by T.C.A. §47-18-112, which states,

> The powers and remedies provided in this part shall be cumulative and supplementary to all other powers and remedies otherwise provided by law. The invocation of one power or remedy herein shall not be construed as excluding or prohibiting the use of any other available remedy.

A seller may disclaim all implied warranties pursuant to T.C.A. §47-2-316, which provides in pertinent part,

> *Exclusion or modification of warranties* . . . (3)(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty.

The Consumer Protection Act recognizes this right of exclusion or modification of warranties under the U.C.C. Section 47-18-113, T.C.A., provides,

> *Waiver of Rights.* (a) No provision of this part may be limited or waived by contract, agreement, or otherwise, notwithstanding any other provision of law to the contrary; provided, however, the provisions of this part shall not alter, amend, or repeal the provisions of the Uniform Commercial Code relative to express or implied warranties or the exclusion or modification of such warranties.

The above provision, however, also specifically precludes disclaimer of liability under the Consumer Protection Act. . . .

Claims under the U.C.C. and the Consumer Protection Act are distinct causes of action, with different components and defenses. The Consumer Protection Act is applicable to commercial transactions, also regulated by the U.C.C. . . .

The Tennessee Consumer Protection Act is to be liberally construed to protect consumers and others from those who engage in deceptive acts or practices. . . . In a case similar to the one before the Court, the seller's failure to disclose to the buyer that the vehicle had been in an accident and had been repaired constituted a violation of the Consumer Protection Act. See Paty v. Herb Adcox Chevrolet Co., 756 S.W.2d 697 (Tenn. Ct. App. 1988). To allow the seller here to avoid liability for unfair or deceptive acts or practices by disclaiming contractual warranties under the U.C.C. would contravene the broad remedial intent of the Consumer Protection Act.

13

CONDITIONS*

Sometimes a performance is due only if something happens or does not happen. This type of occurrence is called a "condition." Unless the condition is satisfied, nonperformance is not a breach. In his influential article on conditions, Arthur Corbin offered the following definition:

> The word "condition" is used in the law of property as well as in the law of contract and it is used with some variation in meaning. In the law of contract it is sometimes used in a very loose sense as synonymous with "term," "provision," or "clause." In such a sense it performs no useful service; instead, it affords one more opportunity for slovenly thinking. In its proper sense the word *"condition" means some operative fact subsequent to acceptance and prior to discharge*, a fact upon which the rights and duties of the parties depend. Such a fact may be an act of one of the two contracting parties, an act of a third party, or any other fact of our physical world. It may be a performance that has been promised or a fact as to which there is no promise. . . .
>
> *Express, implied and constructive conditions.* A certain fact may operate as a condition, because the parties intended that it should and said so in words. It is then an express condition. It may operate as a condition because the parties intended that it should, such intention being reasonably inferable from conduct other than words. It is then a condition implied in fact. Lastly, it may operate as a condition because the court believes that the parties would have intended it to operate as such if they had thought about it at all, or because the court believes that by reason of the *mores* of the time justice requires that it should so operate. It may then be described as a condition implied by law, or better as a *constructive condition.*[1]

A condition is not the same thing as a promise. To take a common example, imagine that you have bought a fire insurance policy. You pay the premiums. The insurance company is not required to perform, however, unless your house burns. The burning of the house is the *condition precedent* to the insurance company's duty to pay. The happening of the condition *precedes* the company's duty to pay, but you hardly promise the insurance company that your house is going to burn down. As should become apparent below, however, the distinction between conditions and promises often blurs.

*Note: The materials on conditions in this chapter (and portions of the next) were compiled by and edited with Professor David V. Snyder of the American University Washington College of Law.

1. Arthur L. Corbin, Conditions in the Law of Contract, 28 Yale L.J. 739, 743-744 (1919).

Your insurance policy might also provide that you cannot recover if you do not bring suit within a year after the fire. The failure to bring suit may be seen as a *condition subsequent.* As soon as the house burns, though, the company has a duty to pay. If you fail to bring suit within a year, the company's duty will be discharged. The condition subsequent — the failure to bring suit — occurs subsequent to the company's duty to pay and discharges that duty. (This "after the fact" effect is similar to the rule we studied in Chapter 4 whereby, while an acceptance of an offer by performance creates a contract, under certain circumstances the failure to timely notify the other party of this acceptance can cause, in the words of Restatement (Second) §54(3), "the contractual duty [to be] discharged").

This theoretically clear distinction between a condition precedent and a condition subsequent can be hard to put into practice, but much hinges on the distinction. Procedural law often gives the plaintiff the burden of pleading and proving conditions precedent but gives the defendant the burden for conditions subsequent. Several of the following cases therefore refer to this traditional distinction.

In this chapter, we seek to understand better the effects of a condition, the ways that courts interpret agreements to discern exactly what is a condition, and the tools courts use to avoid enforcing conditions in appropriate cases. In Chapter 14, we shall consider how courts use "constructive conditions" (and other doctrines) to decide whether nonperformance is justified in the absence of an express condition.

A. The Effect of a Condition

Study Guide: What effect does the failure of the condition have on the duty of the employer? Do you find the result of this case harsh? Should a court intervene if the contract made by the parties leads to a harsh result? Why would the company label the condition "precedent" rather than "subsequent"? Although in the court's discussion of anticipatory repudiation is preserved, we shall not discuss that doctrine until Chapter 14.

INMAN v. CLYDE HALL DRILLING CO.

Supreme Court of Alaska
369 P.2d 498 (1962)

Dimond, J.* This case involves a claim for damages arising out of an employment contract. The main issue is whether a provision in the contract,

* *John H. Dimond* (1918-†) was born in Valdez, Alaska, and completed his undergraduate education at Catholic University of America. Once in Valdez, in the 1930s, William Egan, later to become Alaska's first governor after statehood, was giving boxing lessons to Dimond and a group of other young men. When it came Dimond's turn to spar with Egan, his first punch knocked Egan through a window and onto the ground outside. After several minutes, Egan finally came through the door and said, "OK boys, the lesson is over for today." When serving as a platoon leader in the U.S. Army during World War II, Dimond saw action in three campaigns in the South Pacific, for which he received the Silver Star, the Bronze Star, the Purple Heart, the Asiatic Pacific Medal with two Bronze Stars, and the Philippine Liberation Service Medal with a Bronze Star. He ended his military service in 1945 as a Captain. Having

making written notice of a claim a condition precedent to recovery, is contrary to public policy.

Inman worked for the Clyde Hall Drilling Company as a derrickman under a written contract of employment signed by both parties on November 16, 1959. His employment terminated on March 24, 1960. On April 5, 1960, he commenced this action against the company claiming that the latter fired him without justification, that this amounted to a breach of contract, and that he was entitled to certain damages for the breach. In its answer the Company denied that it had breached the contract, and asserted that Inman had been paid in full the wages that were owing him and was entitled to no damages. Later the Company moved for summary judgment on the ground that Inman's failure to give written notice of his claim,[2] as required by the contract, was a bar to his action based on the contract.[3] The motion was granted, and judgment was entered in favor of the Company. This appeal followed.

A fulfillment of the thirty-day notice requirement is expressly made a "condition precedent to any recovery." Inman argues that this provision is void as against public policy. In considering this first question we start with the basic tenet that competent parties are free to make contracts and that they should be bound by their agreements. In the absence of a constitutional provision or statute which makes certain contracts illegal or unenforceable, we believe it is the function of the judiciary to allow men to manage their own affairs in their own way. As a matter of judicial policy the court should maintain and enforce contracts, rather than enable parties to escape from the obligations they have chosen to incur.

We recognize that "freedom of contract" is a qualified and not an absolute right, and cannot be applied on a strict, doctrinal basis. An established principle is that a court will not permit itself to be used as an instrument of inequity and injustice. As Justice Frankfurter stated in his dissenting opinion in United States v. Bethlehem Steel Corp., "The fundamental principle of law that the courts will not enforce a bargain where one party has unconscionably taken advantage of the necessities and distress of the other has found expression in an almost infinite variety of cases." In determining whether certain contractual provisions should be enforced,

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received his bachelor's degree from the Catholic University of America before the war, he returned to Catholic for his J.D. Upon graduating, he began practicing law in Juneau in 1948. In 1959, Governor Egan named him a justice on the first Alaska Supreme Court following statehood, where he sat until his retirement in 1971.

2. The fact that Inman did not give written notice was not disputed.

3. The portion of the contract with which we are concerned reads:

> You agree that you will, within thirty (30) days after any claim (other than a claim for compensation insurance) that arises out of or in connection with the employment provided for herein, give written notice to the Company for such claim, setting forth in detail the facts relating thereto and the basis for such claim; and that you will not institute any suit or action against the Company in any court or tribunal in any jurisdiction based on any such claim prior to six (6) months after the filing of the written notice of claim hereinabove provided for, or later than one (1) year after such filing. Any action or suit on any such claim shall not include any item or matter not specifically mentioned in the proof of claim above provided. It is agreed that in any such action or suit, proof by you of your compliance with the provisions of this paragraph shall be a condition precedent to any recovery.

the court must look realistically at the relative bargaining positions of the parties in the framework of contemporary business practices and commercial life. If we find those positions are such that one party has unscrupulously taken advantage of the economic necessities of the other, then in the interest of justice — as a matter of public policy — we would refuse to enforce the transaction. But the grounds for judicial interference must be clear. Whether the court should refuse to recognize and uphold that which the parties have agreed upon is a question of fact upon which evidence is required.

The facts in this case do not persuade us that the contractual provision in question is unfair or unreasonable. Its purpose is not disclosed. The requirement that written notice be given within thirty days after a claim arises may have been designed to preclude stale claims; and the further requirement that no action be commenced within six months thereafter may have been intended to afford the Company timely opportunity to rectify the basis for a just claim. But whatever the objective was, we cannot find in the contract anything to suggest it was designed from an unfair motive to bilk employees out of wages or other compensation justly due them.

There was nothing to suggest that Inman did not have the knowledge, capacity or opportunity to read the agreement and understand it; and the terms of the contract were imposed upon him without any real freedom of choice on his part; that there was any substantial inequality in bargaining positions between Inman and the Company. Not only did he attach a copy of the contract to his complaint, which negatives any thought that he really wasn't aware of its provisions, but he also admitted in a deposition that at the time he signed the contract he had read it, had discussed it with a Company representative, and was familiar with its terms. And he showed specific knowledge of the thirty-day notice requirement when, in response to a question as to whether written notice had been given prior to filing suit, he testified:

A. Well, now, I filed — I started my claim within 30 days, didn't I, from the time I hit here. I thought that would be a notice that I started suing them when I first came to town.
Q. You thought that the filing of the suit would be the notice?
A. That is right.

Under these circumstances we do not find that such a limitation on Inman's right of action is offensive to justice. We would not be justified in refusing to enforce the contract and thus permit one of the parties to escape his obligations. It is conceivable, of course, that a thirty-day notice of claim requirement could be used to the disadvantage of a workman by an unscrupulous employer. If this danger is great, the legislature may act to make such a provision unenforceable.[4] But we may not speculate on what in the future may be a matter of public policy in this state. It is our function to act only

4. In Oklahoma the constitution (art. XXIII, §9) provides: "Any provision of any contract or agreement, express or implied, stipulating for notice or demand other than such as may be provided by law, as a condition precedent to establish any claim, demand, or liability, shall be null and void." . . .

where an existent public policy is clearly revealed from the facts and we find that it has been violated. That is not the case here.

Inman's claim arose on March 24, 1960. His complaint was served on the Company on April 14. He argues that since the complaint set forth in detail the basis of his claim and was served within thirty days, he had substantially complied with the contractual requirement.

Service of the complaint probably gave the Company actual knowledge of the claim. But that does not serve as an excuse for not giving the kind of written notice called for by the contract. Inman agreed that no suit would be instituted "prior to six (6) months *after the filing of the written notice of claim.*" (emphasis ours) If this means what it says (and we have no reason to believe it does not), it is clear that the commencement of an action and service of the complaint was not an effective substitute for the kind of notice called for by the agreement. To hold otherwise would be to simply ignore an explicit provision of the contract and say that it had no meaning. We are not justified in doing that.

The contract provides that compliance with its requirement as to giving written notice of a claim prior to bringing suit "shall be a condition precedent to any recovery." Inman argues that this is not a true condition precedent — merely being labeled as such by the Company — and that noncompliance with the requirement was an affirmative defense which the Company was required to set forth in its answer under Civ.R. 8(c). He contends that because the answer was silent on this point, the defense was waived under Civ.R. 12(h).[5]

The failure to give advance notice of a claim where notice is required would ordinarily be a defense to set forth in the answer. But here the parties agreed that such notice should be a condition precedent to any recovery. This meant that the Company was not required to plead lack of notice as an affirmative defense, but instead, that Inman was required to plead performance of the condition or that performance had been waived or excused. The Company may not be charged under Civ.R. 12(h) with having waived a defense which it was not obliged to present in its answer.

Relying upon the doctrine of anticipatory breach of contract, Inman argues that when the Company discharged him it repudiated the employment agreement, and he was then excused from any further performance, including performance of the condition precedent of giving written notice of his claim.

What the Company allegedly did was not an anticipatory breach of contract in the strict sense of the term. Such a breach would have been committed only if the Company had repudiated its contractual duty before the time fixed for its performance had arrived. That was not the case here. Both parties had commenced performance on November 16, 1959, and they continued to perform until March 24, 1960. We believe Inman's real claim is that there was a breach of an existing duty accompanied by words or acts disclosing the Company's intention to refuse performance in the future,

5. This rule provides in part that "[a] party waives all defenses and objections which he does not present either by motion as hereinbefore provided or, if he has made no motion, in his answer or reply * * *."

and that this conferred upon him the privilege to deal with the contract as if broken altogether.

But even assuming that there had been a breach which excused Inman from further performance of his contractual obligation to work for the Company for the full term of the contract,[6] it does not follow that he was also excused from performing the condition precedent to commencement of this action for damages. He did not allege, nor does the record indicate, that his failure to give notice was caused by the Company's fault. There is no showing nor any inference that the Company, by words or conduct, induced Inman not to give the required notice, or led him to believe that giving notice would be a futile gesture. In fact, he admitted in his deposition that his reason for not complying with the condition was because he thought the filing of the suit would constitute the required notice.

Inman's last point is that the trial court erred in entering a final judgment. He argues that the failure to give written notice was merely a matter in abatement of his action until the condition could be performed, and that the most the court ought to have done was to dismiss the action without prejudice.

This argument is unsound. At the time judgment was entered Inman could no longer perform the condition precedent to recovery by giving written notice of his claim within thirty days after the claim arose, because this time limitation had expired. In these circumstances his right to seek redress from the court was barred and not merely abated. Final judgment in the Company's favor was proper.

The judgment is affirmed.

UNDERSTANDING THE EFFECTS OF CONDITIONS: A PROBLEM

Recall the facts of Carlill v. Carbolic Smoke Ball Co., which begins on page 317. The Smoke Ball Company offered a £100 reward for anyone who bought the smoke ball, used it according to the directions, and caught the flu. If you were the judge, when would you hold that a contract had been formed: when Mrs. Carlill bought the smoke ball, when she used it, or when she caught the flu? In your view, once the contract had been formed, did the Smoke Ball Company have a duty of immediate performance?

B. What Events Are Conditions?

An event that is uncertain to occur — that is, an event other than the passage of time — may be a condition, a promise, or a "promissory condition" (which is both a promise and a condition). The event may also be none of these things; it might merely indicate at what point in time the parties

6. The contract provided that "The term of your employment will be on a twelve (12) month's basis terminable at the end of twelve (12) months by either the Company or yourself, or by the Company at any time on five (5) days previous written notice to you." Inman had worked approximately four months when his employment was terminated.

have contemplated a performance. Courts have long struggled to distinguish these different contractual devices.

1. Is the Event a Condition, a Promise, or Both?

STUDY GUIDE: What tools do courts use to tell the difference between a promise and a condition? What are the different effects of a promise, a condition, and a promissory condition? Which interpretation do courts prefer? Why?

HOWARD v. FEDERAL CROP INSURANCE CORP.

United States Court of Appeals for the Fourth Circuit, 540 F.2d 695 (1976)

WIDENER, Circuit Judge.* Plaintiff-appellants sued to recover for losses to their 1973 tobacco crop due to alleged rain damage. The crops were insured by defendant-appellee, Federal Crop Insurance Corporation (FCIC). . . . The district court granted summary judgment for the defendant and dismissed all three actions. We remand for further proceedings. . . .

Federal Crop Insurance Corporation, an agency of the United States, in 1973, issued three policies to the Howards, insuring their tobacco crops, to be grown on six farms, against weather damage and other hazards.

The Howards (plaintiffs) established production of tobacco on their acreage, and have alleged that their 1973 crop was extensively damaged by heavy rains, resulting in a gross loss to the three plaintiffs in excess of $35,000. The plaintiffs harvested and sold the depleted crop and timely filed notice and proof of loss with FCIC, but, prior to inspection by the adjuster for FCIC, the Howards had either plowed or disked under the tobacco fields in question to prepare the same for sowing a cover crop of rye to preserve the soil. When the FCIC adjuster later inspected the fields, he found the stalks had been largely obscured or obliterated by plowing or disking and denied the claims, apparently on the ground that the plaintiffs had violated a portion of the policy which provides that the stalks on any acreage with respect to which a loss is claimed shall not be destroyed until the corporation makes an inspection.

* *H. Emory Widener, Jr.* (1923-2007), was educated at Virginia Polytechnic Institute and State University (1940-1941), the U.S. Naval Academy (B.S.), and Washington and Lee University (LL.B.). After serving in the U.S. Navy from 1944 to 1949, he was called to the Virginia bar in 1951 and began his legal practice in Bristol, Virginia. While in practice, he served as an instructor at the Southern Seminary & Junior College (1950-1951), as a Lieutenant in the naval reserves (1951-1952), and as the U.S. Commissioner for the Western District of Virginia (1963-1966). He left private practice to become Judge (1969-1972) and Chief Judge (1971-1972) of the U.S. District Court Western District of Pennsylvania. Judge Widener served as Judge for the United States Court of Appeals for the Fourth Circuit, a position to which he was appointed in 1972. Widener taught at the University of Texas (1974), Washington and Lee University (1998), and the College of William and Mary (1999-2000). — L.R.

The holding of the district court is best capsuled in its own words: "The inquiry here is whether compliance by the insureds with this provision of the policy was a condition precedent to the recovery. The court concludes that it was and that the failure of the insureds to comply worked a forfeiture of benefits for the alleged loss."

There is no question but that apparently after notice of loss was given to defendant, but before inspection by the adjuster, plaintiffs plowed under the tobacco stalks and sowed some of the land with a cover crop, rye. The question is whether, under paragraph 5(f) of the tobacco endorsement to the policy of insurance, the act of plowing under the tobacco stalks forfeits the coverage of the policy. Paragraph 5 of the tobacco endorsement is entitled *Claims.* Pertinent to this case are subparagraphs 5(b) and 5(f), which are as follows:

> 5(b) *It shall be a condition precedent* to the payment of any loss that the insured establish the production of the insured crop on a unit and that such loss has been directly caused by one or more of the hazards insured against during the insurance period for the crop year for which the loss is claimed, and furnish any other information regarding the manner and extent of loss as may be required by the Corporation. (Emphasis added)
>
> 5(f) The tobacco stalks on any acreage of tobacco of types 11a, 11b, 12, 13, or 14 with respect to which a loss is claimed *shall not be destroyed until the Corporation makes an inspection.* (Emphasis added)

The arguments of both parties are predicated upon the same two assumptions. First, if subparagraph 5(f) creates a condition precedent, its violation caused a forfeiture of plaintiffs' coverage. Second, if subparagraph 5(f) creates an obligation (variously called a promise or covenant) upon plaintiffs not to plow under the tobacco stalks, defendant may recover from plaintiffs (either in an original action, or, in this case, by a counterclaim, or as a matter of defense) for whatever damage it sustained because of the elimination of the stalks. However, a violation of subparagraph 5(f) would not, under the second premise, standing alone, cause a forfeiture of the policy.

Generally accepted law provides us with guidelines here. There is a general legal policy opposed to forfeitures. . . . Insurance policies are generally construed most strongly against the insurer. . . . When it is doubtful whether words create a promise or a condition precedent, they will be construed as creating a promise. . . . The provisions of a contract will not be construed as conditions precedent in the absence of language plainly requiring such construction. . . . Restatement of the Law, Contracts, §261.

Plaintiffs rely most strongly upon the fact that the term "condition precedent" is included in subparagraph 5(b) but not in subparagraph 5(f). It is true that whether a contract provision is construed as a condition or an obligation does not depend entirely upon whether the word "condition" is expressly used. . . . However, the persuasive force of plaintiffs' argument in this case is found in the use of the term "condition precedent" in subparagraph 5(b) but not in subparagraph 5(f). Thus, it is

argued that the ancient maxim to be applied is that the expression of one thing is the exclusion of another.

The defendant places principal reliance upon the decision of this court in Fidelity-Phenix Fire Insurance Company v. Pilot Freight Carriers, 193 F.2d 812, 31 A.L.R. 2d 839 (4th Cir. 1952). Suit there was predicated upon a loss resulting from theft out of a truck covered by defendant's policy protecting plaintiff from such a loss. The insurance company defended upon the grounds that the plaintiff had left the truck unattended without the alarm system being on. The policy contained six paragraphs limiting coverage. Two of those imposed what was called a "condition precedent." They largely related to the installation of specified safety equipment. Several others, including paragraph 5, pertinent in that case, started with the phrase, "It is further warranted." In paragraph 5, the insured warranted that the alarm system would be on whenever the vehicle was left unattended. Paragraph 6 starts with the language: "The assured agrees, by acceptance of this policy, that the foregoing conditions precedent relate to matters material to the acceptance of the risk by the insurer." Plaintiff recovered in the district court, but judgment on its behalf was reversed because of a breach of warranty of paragraph 5, the truck had been left unattended with the alarm off. In that case, plaintiff relied upon the fact that the words "condition precedent" were used in some of the paragraphs but the word "warranted" was used in the paragraph in issue. In rejecting that contention, this court said that "warranty" and "condition precedent" are often used interchangeably to create a condition of the insured's promise, and "[m]anifestly the terms 'condition precedent' and 'warranty' were intended to have the same meaning and effect." 193 F.2d at 816.

Fidelity-Phenix thus does not support defendant's contention here. Although there is some resemblance between the two cases, analysis shows that the issues are actually entirely different. Unlike the case at bar, each paragraph in *Fidelity-Phenix* contained either the term "condition precedent" or the term "warranted." We held that, in that situation, the two terms had the same effect in that they both involved forfeiture. That is well established law. . . . In the case at bar, the term "warranty" or "warranted" is in no way involved, either in terms or by way of like language, as it was in *Fidelity-Phenix*. The issue upon which this case turns, then, was not involved in *Fidelity-Phenix*.

The Restatement of the Law of Contracts states:

> §261. Interpretation of Doubtful Words as Promise or Condition.
>
> Where it is doubtful whether words create a promise or an express condition, they are interpreted as creating a promise; but the same words may sometimes mean that one party promises a performance and that the other party's promise is conditional on that performance.

Two illustrations (one involving a promise, the other a condition) are used in the Restatement:

> 2. *A*, an insurance company, issues to *B* a policy of insurance containing promises by *A* that are in terms conditional on the happening of certain events. The policy contains this clause: "provided, in case differences shall

arise touching any loss, *the matter shall be submitted to impartial arbitrators*, whose award shall be binding on the parties." This is a promise to arbitrate and does not make an award a condition precedent of the insurer's duty to pay.

3. *A*, an insurance company, issues to *B* an insurance policy in usual form containing this clause: "In the event of disagreement as to the amount of loss it shall be ascertained by two appraisers and an umpire. The loss shall *not be payable until 60 days after the award of the appraisers when such an appraisal is required.*" This provision is not merely a promise to arbitrate differences but makes an award a condition of the insurer's duty to pay in case of disagreement." (Emphasis added)

We believe that subparagraph 5(f) in the policy here under consideration fits illustration 2 rather than illustration 3. Illustration 2 specifies something to be done, whereas subparagraph 5(f) specifies something not to be done. Unlike illustration 3, subparagraph 5(f) does not state any conditions under which the insurance shall "not be payable," or use any words of like import. We hold that the district court erroneously held, on the motion for summary judgment, that subparagraph 5(f) established a condition precedent to plaintiffs' recovery which forfeited the coverage.[7] . . .

The explanation defendant makes for including subparagraph 5(f) in the tobacco endorsement is that it is necessary that the stalks remain standing in order for the Corporation to evaluate the extent of loss and to determine whether loss resulted from some cause not covered by the policy. However, was subparagraph 5(f) inserted because without it the Corporation's opportunities for proof would be more difficult, or because they would be impossible? Plaintiffs point out that the Tobacco Endorsement, with subparagraph 5(f), was adopted in 1970, and crop insurance goes back long before that date. Nothing is shown as to the Corporation's prior 1970 practice of evaluating losses. Such a showing might have a bearing upon establishing defendant's intention in including 5(f). Plaintiffs state, and defendant does not deny, that another division of the Department of Agriculture, or the North Carolina Department, urged that tobacco stalks be cut as soon as possible after harvesting as a means of pest control. Such an explanation might refute the idea that plaintiffs plowed under the stalks for any fraudulent purpose. Could these conflicting directives affect the reasonableness of plaintiffs' interpretation of defendant's prohibition upon plowing under the stalks prior to adjustment?

We express no opinion on these questions because they were not before the district court and are mentioned to us largely by way of argument rather than from the record. . . . Nothing we say here should preclude FCIC from asserting as a defense that the plowing or disking under of the stalks caused damage to FCIC if, for example, the amount of the loss was thereby made more difficult or impossible to ascertain whether the plowing or

7. The district court also referred to subparagraph 5(f) as a condition subsequent. The difference in terminology is of no consequence here.

disking under was done with bad purpose or innocently. To repeat, our narrow holding is that merely plowing or disking under the stalk does not of itself operate to forfeit coverage under the policy.

The case is remanded for further proceedings not inconsistent with this opinion. Vacated and Remanded.

RESTATEMENT (SECOND) OF CONTRACTS

§227. STANDARDS OF PREFERENCE WITH REGARD TO CONDITIONS

(1) In resolving doubts as to whether an event is made a condition of an obligor's duty, and as to the nature of such an event, an interpretation is preferred that will reduce the obligee's risk of forfeiture, unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk.

(2) Unless the contract is of a type under which only one party generally undertakes duties, when it is doubtful whether

(a) a duty is imposed on an obligee that an event occur, or

(b) the event is made a condition of the obligor's duty, or

(c) the event is made a condition of the obligor's duty and a duty is imposed on the obligee that the event occur,

the first interpretation is preferred if the event is within the obligee's control.

2. Is the Event a Condition, a Promise, or Neither?

CHIRICHELLA v. ERWIN

Court of Appeals of Maryland, 270 Md. 178, 310 A.2d 555 (1973)

LEVINE, J.* This appeal is from a decree for specific performance of a contract for the sale of real estate. Appellants (the Chirichellas) had contracted in June 1971 to sell their home in Silver Spring to appellees (the Erwins) for the sum of $39,000. Due to the refusal of the Chirichellas to settle, the Erwins finally sued them on August 31, 1972 for specific

* *Irving A. Levine* (1924-†) completed his legal education at George Washington University (LL.B.) after serving in the U.S. Army Corps (1943-1945). He was admitted to practice in the District of Columbia in 1950 and Maryland in 1955. Judge Levine's judicial career began as Judge for the Maryland Tax Court (1965-1967) and continued with his service as Judge in the Maryland Circuit Court Sixth Judicial Circuit (1967-1972). Governor Marvin Mandel appointed Levine to the Maryland Court of Appeals in 1972, where he sat until 1978. — L.R.

performance. At the conclusion of the trial, the circuit court for Montgomery County (Miller, J.) entered the decree from which this appeal is taken.

The contract entered into by the parties was the "standard" form used by the Montgomery County Board of Realtors. Paragraph Six of the form contract, entitled "Settlement," reads as follows:

> Within _____ days from date of acceptance hereof by the Seller, or as soon thereafter as a report of the title can be secured if promptly ordered, and/or survey, if required, and/or Government-insured loan, if used, can be processed, if promptly applied for, the Seller and Purchaser are required and agree to make full settlement in accordance with the terms hereof. . . .

Apparently when the real estate salesman initially submitted the contract to the Chirichellas, the words, "by Oct. 1, 1971 or sooner," had been inserted in the blank space. By mutual agreement, this language was amended to read, "Coincide with settlement of New Home in Kettering Approx. Oct. '71." No other reference to the "New Home in Kettering" appears in the contract.

The Chirichellas had contracted to purchase the "New Home" in April 1971. Their agreement provided that they were to settle "within fifteen (15) days from the date of completion." Although construction of the new house had not yet commenced when the Erwin contract was executed in April, the Chirichellas were confident that it would be completed by October unless unforeseen developments intervened. Their confidence proved to be unwarranted as the first settlement of the "New Home" was scheduled for June 15, 1972. The record does not indicate when construction actually commenced.

The June settlement on the "New Home" never materialized because the Chirichellas claimed it was not completed "in a workmanlike manner." . . . Settlement has never occurred on the "New Home" and it appears that it has been resold to another purchaser.

The first settlement of the contract on the house sold by the Chirichellas to the Erwins was also scheduled for June 15, 1972. Sometime prior to that date, but after October 1971, Mr. Erwin asked Mr. Chirichella to settle, but the latter refused because the "New Home" was not ready. The Chirichellas did not appear at the June 15 settlement, and it was rescheduled for August 9. When that proved to be futile, the Erwins filed their suit on August 31, 1972.

Although he was of the view that the Chirichellas' complaints concerning the "New Home" were justified, the chancellor concluded that the provision for settlement inserted in the Erwin contract was not a condition precedent to performance, but merely a requirement that settlement take place during the month of October 1971, or within a reasonable time thereafter. And, since more than a reasonable time had elapsed, the Erwins were entitled to a decree for specific performance. We agree, and therefore affirm.

Before this Court, the Chirichellas attack the chancellor's ruling on the same grounds raised below: That the contested provision was a condition

precedent to performance on their part, and since that condition failed, the contract failed with it. . . .

A condition precedent has been defined as "a fact, other than mere lapse of time, which, unless excused, must exist or occur before a duty of immediate performance of a promise arises," 17 Am. Jur. 2d, Contracts, §320. . . . The question whether a stipulation in a contract constitutes a condition precedent is one of construction dependent on the intent of the parties to be gathered from the words they have employed and, in case of ambiguity, after resort to the other permissible aids to interpretation. . . . Although no particular form of words is necessary in order to create an express condition, such words and phrases as "if" and "provided that," are commonly used to indicate that performance has expressly been made conditional . . . as have the words "when," "after," "as soon as," or "subject to" . . .

We turn then to the question of whether the language in controversy here meets the definition of a condition precedent, i.e., whether it may be read to mean that settlement of the "New Home in Kettering" must have occurred before the Chirichellas' duty to settle with the Erwins arose. We think the provision in issue no more accomplishes that purpose than the words which it replaced. As we read the clause, "Coincide with settlement of New Home in Kettering Approx. Oct. '71," it merely fixes a convenient and appropriate time for settlement.

Although the amendment attempted to link one settlement with the other, its only effect was to insure that the October 1971 time designation not be regarded as of the essence. . . .

Here, whatever might have been the consequence had the phrase, "Approx. Oct. '71," not been added to the insertion, its inclusion effectively defeats the Chirichellas' argument. The result, as the chancellor ruled, was not to allow them to "avoid the contract," but to "delay settlement for a reasonable period of time while the [new] house was completed."

In sum, the Chirichellas' duty to perform by settling under their contract with the Erwins was not subject to the condition precedent that they first settle on the new house. Hence, they were required to do so within a reasonable time after October 1971. As suggested by the chancellor, that time had long since expired by January 29, 1973, the day of trial.

Decree affirmed; appellants to pay costs.

Reference: Farnsworth, §§8.1-8.4
Calamari & Perillo, §§11.1-11.15
Murray, §§100, 102-104

C. Avoiding Conditions

As some of the previous cases show, the operation of a condition is sometimes harsh. Courts have developed various doctrines to avoid the effect of a condition. We shall consider three: waiver, estoppel, and excuse (although the term "excuse" is sometimes used more broadly to describe any doctrine that avoids the effect of a condition).

1. Waiver and Estoppel

STUDY GUIDE: What is the difference between waiver, modification, and estoppel? What policies underlie the doctrine of waiver? How does the estoppel discussed here differ from promissory estoppel?

CLARK v. WEST

Court of Appeals of New York,
193 N.Y. 349, 86 N.E. 1 (1908)

Appeal from Supreme Court, Appellate Division, Second Department.

Action by William L. Clark against John B. West. From a judgment of the Appellate Division of the Supreme Court reversing an interlocutory judgment overruling a demurrer to the complaint and sustaining the demurrer (125 App. Div. 64, 110 N.Y. Supp. 110), plaintiff, by permission, appeals, and the Appellate Division certifies questions. Reversed, and interlocutory judgment affirmed. . . .

WERNER, J.* . . . The contract before us, stripped of all superfluous verbiage, binds the plaintiff to total abstention from the use of intoxicating liquors during the continuance of the work which he was employed to do. The stipulations relating to the plaintiff's compensation provide that if he does not observe this condition he is to be paid at the rate of $2 per page, and if he does comply therewith he is to receive $6 per page. The plaintiff has written one book under the contract, known as "Clark & Marshall on Corporations," which has been accepted, published, and copies sold in large numbers by the defendant. The plaintiff admits that while he was at work on this book he did not entirely abstain from the use of intoxicating liquors. He has been paid only $2 per page for the work he has done. He claims that, despite his breach of this condition, he is entitled to the full compensation of $6 per page, because the defendant, with full knowledge of plaintiff's nonobservance of this stipulation as to total abstinence, has waived the breach thereof and cannot now insist upon strict performance in this regard. This plea of waiver presents the underlying question which determines the answers to the questions certified.

Briefly stated, the defendant's position is that the stipulation as to plaintiff's total abstinence is the consideration for the payment of the difference between $2 and $6 per page, and therefore could not be waived except by a new agreement to that effect based upon a good consideration; that the so-called waiver alleged by the plaintiff is not a waiver, but a modification of the contract in respect of its consideration. The plaintiff on the other hand, argues that the stipulation for his total abstinence was merely a condition precedent, intended to work a forfeiture of the additional

* *William E. Werner* (1855-1916) was born in Buffalo, New York. He read for the bar and was admitted in 1880, and he practiced in Rochester until becoming Clerk of the Municipal Court of Rochester in 1879. He was a special judge of Monroe County from 1884 to 1889 before being elected county judge in 1889. In 1894, he was elected a justice of the Supreme Court from the Seventh Judicial District, where he sat until his elevation by Governor Theodore Roosevelt to be an associate justice of the Court of Appeals, a position to which he was elected in 1904. In 1913, he was nominated for Chief Justice by the Republican Party but was defeated by Judge Willard Bartlett. He continued on the court until his death.

compensation in case of a breach, and that it could be waived without any formal agreement to that effect based upon a new consideration.

The subject-matter of the contract was the writing of books by the plaintiff for the defendant. The duration of the contract was the time necessary to complete them all. The work was to be done to the satisfaction of the defendant, and the plaintiff was not to write any other books except those covered by the contract, unless requested so to do by the defendant, in which latter event he was to be paid for that particular work by the year. The compensation for the work specified in the contract was to be $6 per page, unless the plaintiff failed to totally abstain from the use of intoxicating liquors during the continuance of the contract, in which event he was to receive only $2 per page. That is the obvious import of the contract construed in the light of the purpose for which it was made, and in accordance with the ordinary meaning of plain language. It is not a contract to write books in order that the plaintiff shall keep sober, but a contract containing a stipulation that he shall keep sober so that he may write satisfactory books. When we view the contract from this standpoint, it will readily be perceived that the particular stipulation is not the consideration for the contract, but simply one of its conditions which fits in with those relating to time and method of delivery of manuscript, revision of proof, citation of cases, assignment of copyrights, keeping track of new cases and citations for new editions, and other details which might be waived by the defendant, if he saw fit to do so. . . . If that conclusion is well founded, there can be no escape from the corollary that this condition could be waived; and, if it was waived, the defendant is clearly nor in a position to insist upon the forfeiture which his waiver was intended to annihilate. The forfeiture must stand or fall with the condition. If the latter was waived, the former is no longer a part of the contract. Defendant still has the right to counterclaim for any damages which he may have sustained in consequence of the plaintiff's breach, but he cannot insist upon strict performance. . . .

This whole discussion is predicated, of course, upon the theory of an express waiver. We assume that no waiver could be implied from the defendant's mere acceptance of the books and his payment of the sum of $2 per page without objection. It was the defendant's duty to pay that amount in any event after acceptance of the work. The plaintiff must stand upon his allegation of an express waiver, and if he fails to establish that he cannot maintain his action. . . .

The cases which present the most familiar phases of the doctrine of waiver are those which have arisen out of litigation over insurance policies where the defendants have claimed a forfeiture because of the breach of some condition in the contract . . . , but it is a doctrine of general application which is confined to no particular class of cases. A "waiver" has been defined to be the intentional relinquishment of a known right. It is voluntary and implies an election to dispense with something of value, or forego some advantage which the party waiving it might at its option have demanded or insisted upon . . . , and this definition is supported by many cases in this and other states. In the recent case of Draper v. Oswego Co. Fire R. Ass'n, 190 N. Y. 12, 16, 82 N. E. 755, Chief Judge Cullen, in speaking for the court upon this subject, said: "While that doctrine and the doctrine of equitable estoppel are often confused in insurance litigation,

there is a clear distinction between the two. A 'waiver' is the voluntary abandonment or relinquishment by a party of some right or advantage. As said by my Brother Vann in the Kiernan Case, 150 N. Y. 190, 44 N. E. 698: 'The law of waiver seems to be a technical doctrine, introduced and applied by the court for the purpose of defeating forfeitures. . . . While the principle may not be easily classified, it is well established that, if the words and acts of the insurer reasonably justify the conclusion that with full knowledge of all the facts it intended to abandon or not to insist upon the particular defense afterwards relied upon, a verdict or finding to that effect establishes a waiver, which, if it once exists, can never be revoked.' The doctrine of equitable estoppel, or estoppel in pais, is that a party may be precluded by his acts and conduct from asserting a right to the detriment of another party who, entitled to rely on such conduct, has acted upon it. . . . As already said, the doctrine of waiver is to relieve against forfeiture. It requires no consideration for a waiver, nor any prejudice or injury to the other party." . . .

It remains to be determined whether the plaintiff has alleged facts which, if proven, will be sufficient to establish his claim of an express waiver by the defendant of the plaintiff's breach of the condition to observe total abstinence. In the 12th paragraph of the complaint, the plaintiff alleges facts and circumstances which we think, if established, would prove defendant's waiver of plaintiff's performance of that contract stipulation. These facts and circumstances are that, long before the plaintiff had completed the manuscript of the first book undertaken under the contract, the defendant had full knowledge of the plaintiff's nonobservance of that stipulation, and that with such knowledge he not only accepted the completed manuscript with out objection, but "repeatedly avowed and represented to the plaintiff that he was entitled to and would receive said royalty payments (i.e., the additional $4 per page), and plaintiff believed and relied upon such representations, . . . and at all times during the writing of said treatise on Corporations, and after as well as before publication thereof as aforesaid, it was mutually understood, agreed, and intended by the parties hereto, that, notwithstanding plaintiff's said use of intoxicating liquors, he was nevertheless entitled to receive and would receive said royalty as the same accrued under said contract." The demurrer not only admits the truth of these allegations, but also all that can by reasonable and fair intendment be implied therefrom. . . . Tested by these rules, we think it cannot be doubted that the allegations contained in the twelfth paragraph of the complaint, if proved upon the trial, would be sufficient to establish an express waiver by the defendant of the stipulation in regard to plaintiff's total abstinence. . . .

Order reversed, etc.

RESTATEMENT (SECOND) OF CONTRACTS

§84. PROMISE TO PERFORM A DUTY IN SPITE OF NON-OCCURRENCE OF A CONDITION

(1) Except as stated in Subsection (2), a promise to perform all or part of a conditional duty under an antecedent contract in spite of the

non-occurrence of the condition is binding, whether the promise is made before or after the time for the condition to occur, unless

(a) occurrence of the condition was a material part of the agreed exchange for the performance of the duty and the promisee was under no duty that it occur; or

(b) uncertainty of the occurrence of the condition was an element of the risk assumed by the promisor.

(2) If such a promise is made before the time for the occurrence of the condition has expired and the condition is within the control of the promisee or a beneficiary, the promisor can make his duty again subject to the condition by notifying the promisee or beneficiary of his intention to do so if

(a) the notification is received while there is still a reasonable time to cause the condition to occur under the antecedent terms or an extension given by the promisor; and

(b) reinstatement of the requirement of the condition is not unjust because of a material change of position by the promisee or beneficiary; and

(c) the promise is not binding apart from the rule stated in Subsection (1).

COMMENT

b. "Waiver and "Estoppel"; Mistake. "Waiver" is often inexactly defined as "the voluntary relinquishment of a known right." When the waiver is reinforced by reliance, enforcement is often said to rest on "estoppel." . . .

STUDY GUIDE: Does the U.C.C. recognize waiver? Estoppel? What is the difference between the two? How are they related?

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

Reread: U.C.C. §2-208 (p. 384).

§2-209. MODIFICATION, RESCISSION AND WAIVER

(1) An agreement modifying a contract within this Article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

2. Excuse to Prevent Forfeiture

STUDY GUIDE: Does the distinction drawn by the majority remind you of the difference between conditions precedent and conditions subsequent? Does the holding of the majority have substantial economic consequences for lessors in general? What is the value of the approach advanced by the dissent?

J.N.A. REALTY CORP. v. CROSS BAY CHELSEA, INC.

Court of Appeals of New York,
42 N.Y.2d 392, 366 N.E.2d 1313, 397 N.Y.S.2d 958 (1977)

WACHTLER, J.* J.N.A. Realty Corp., the owner of a building in Howard Beach, commenced this proceeding to recover possession of the premises claiming that the lease has expired. The lease grants the tenant, Cross Bay Chelsea, Inc., an option to renew and although the notice was sent, through negligence or inadvertence, it was not sent within the time prescribed in the lease. The landlord seeks to enforce the letter of the agreement. The tenant asks for equity to relieve it from a forfeiture.

The Civil Court, after a trial, held that the tenant was entitled to equitable relief. The Appellate Term affirmed, without opinion, but the Appellate Division, after granting leave, reversed and granted the petition. The tenant has appealed to this court.

Two primary questions are raised on the appeal. First, will the tenant suffer a forfeiture if the landlord is permitted to enforce the letter of the agreement. Secondly, if there will be a forfeiture, may a court of equity grant

* *Solomon Wachtler* (1930-†) was educated at Milford Academy and Washington and Lee University (B.A., LL.B.). After being admitted to practice in New York in 1956, he authored numerous articles while in private practice. In 1973, he was elected as Associate Judge of the New York Court of Appeals and was appointed Chief Judge by Governor Hugh Carey in 1986. Judge Wachtler was arrested in November 1992 following a bizarre 13-month harassment campaign against his former lover, the socialite and Republican Party fundraiser, Joy Silverman. He pleaded guilty in April 1993 to a single federal felony count of threatening to kidnap Ms. Silverman's 14-year-old daughter. His actions, he told the court, were meant to force Ms. Silverman to "seek my help and protection." After submitting his resignation from the bar in 1993 following his guilty plea, he was disbarred. In October 1994, Wachtler was released from prison after serving 12 months of his 15-month sentence and then performed 500 hours of court-ordered community service. In 1995, Wachtler formed an alternative dispute resolution company in Long Island. More than fifty retired judges, corporate executives, public officials, and labor lawyers have agreed to mediate or arbitrate cases for Wachtler's firm. In 1997, his book After the Madness: A Judge's Own Prison Memoir was published by Random House. His license to practice law in New York was reinstated October 1, 2007.

the tenant relief when the forfeiture would result from the tenant's own neglect or inadvertence. At the trial it was shown that J.N.A. Realty Corp. (hereafter JNA) originally leased the premises to Victor Palermo and Sylvester Vascellaro for a 10-year term commencing on January 1, 1964. Paragraph 58 of the lease, which was attached as part of a 12-page rider, granted the tenants an option to renew for a 10-year term provided "that Tenant shall notify the landlord in writing by registered or certified mail six (6) months prior to the last day of the term of the lease that tenant desires such renewal." The tenants opened a restaurant on the premises. In February, 1964 they formed the Foro Romano Corp. (Foro) and assigned the lease to the corporation. By December of 1967 the restaurant was operating at a loss and Foro decided to close it down and offer it for sale or lease. In March, 1968 Foro entered into a contract with Cross Bay Chelsea, Inc. (hereafter Chelsea), to sell the restaurant and assign the lease. As a condition of the sale Foro was required to obtain a modification of the option to renew so that Chelsea would have the right to renew the lease for an additional term of 24 years.

The closing took place in June of 1968. First JNA modified the option and consented to the assignment. The modification, which consists of a separate document to be attached to the lease, states: "the Tenant shall have a right to renew this lease for a further period of Twenty-Four (24) years, instead of Ten (10) years, from the expiration of the original term of said lease. . . . All other provisions of Paragraph #58 in said lease, . . . shall remain in full force and effect, except as hereinabove modified." Foro then assigned the lease and sold its interest in the restaurant to Chelsea for $155,000. The bill of sale states that "the value of the fixtures and chattels included in this sale is the sum of $40,000 and that the remainder of the purchase price is the value of the leasehold and possession of the restaurant premises." At that point five and one-half years remained on the original term of the lease.

In the summer of 1968 Chelsea reopened the restaurant. JNA's president, Nicholas Arena, admitted on the stand that throughout the tenancy it regularly informed Chelsea in writing of its obligations under the lease, such as the need to pay taxes and insurance by certain dates. For instance on June 13, 1973 JNA sent a letter to Chelsea informing them that certain taxes were due to be paid. When that letter was sent the option to renew was due to expire in approximately two weeks but JNA made no mention of this. A similar letter was sent to Chelsea in September, 1973. Arena also admitted that throughout the term of the tenancy he was "most assuredly" aware of the time limitation on the option. In fact there is some indication in the record that JNA had previously used this device in an attempt to evict another tenant. Nevertheless it was not until November 12, 1973 that JNA took any action to inform the tenant that the option had lapsed. Then it sent a letter noting that the date had passed and, the letter states, "not having heard from you as prescribed by paragraph #58 in our lease we must assume you will vacate the premises" at the expiration of the original term, January 1, 1974. By letter dated November 16, 1973 Chelsea, through its attorney, sent written notice of intention to renew the option which, of course, JNA refused to honor.

At the trial Chelsea's principals claimed that they were not aware of the time limitation because they had never received a copy of paragraph 58 of the rider. They had received a copy of the modification but they had assumed that it gave them an absolute right to retain the tenancy for 24 years after the expiration of the original term. However, at the trial and later at the Appellate Division, it was found that Chelsea had knowledge of, or at least was "chargeable with notice" of, the time limitation in the rider and thus was negligent in failing to renew within the time prescribed.

Chelsea's principals also testified that they had spent an additional $15,000 on improvements, at least part of which had been expended after the option had expired. Toward the end of the trial JNA's attorney asked the court whether it would "take evidence from" Arena that he had negotiated with another tenant after the option to renew had lapsed. However, the court held that this testimony would be immaterial.

It is a settled principle of law that a notice exercising an option is ineffective if it is not given within the time specified. . . . "At law, of course, time is always of the essence of the contract". . . . Thus the tenant had no legal right to exercise the option when it did, but to say that is simply to pose the issue; it does not resolve it. Of course the tenant would not be asking for equitable relief if it could establish its rights at law.

The major obstacle to obtaining equitable relief in these cases is that default on an option usually does not result in a forfeiture. The reason is that the option itself does not create any interest in the property, and no rights accrue until the condition precedent has been met by giving notice within the time specified. . . .

But when a tenant in possession under an existing lease has neglected to exercise an option to renew, he might suffer a forfeiture if he has made valuable improvements on the property. This of course generally distinguishes the lease option, to renew or purchase, from the stock option or the option to buy goods. This was a distinction which some of the older cases failed to recognize. . . .

Here, as noted, the tenant has made a considerable investment in improvements on the premises — $40,000 at the time of purchase, and an additional $15,000 during the tenancy. In addition, if the location is lost, the restaurant would undoubtedly lose a considerable amount of its customer good will. The tenant was at fault, but not in a culpable sense. It was, as Cardozo says, "mere venial inattention." There would be a forfeiture and the gravity of the loss is certainly out of all proportion to the gravity of the fault. Thus, under the circumstances of this case, the tenant would be entitled to equitable relief if there is no prejudice to the landlord.

However, it is not clear from the record whether JNA would be prejudiced if the tenant is relieved of its default. Because of the trial court's ruling, JNA was unable to submit proof that it might be prejudiced if the terms of the agreement were not enforced literally. Its proof of other negotiations was considered immaterial. It may be that after the tenant's default the landlord, relying on the agreement, in good faith, made other commitments for the premises. But if JNA did not rely on the letter of the agreement then, it should not be permitted to rely on it now to exact a substantial

forfeiture for the tenant's unwitting default. This, however, must be resolved at a new trial.

Finally we would note, as the dissenters do, that it is possible to imagine a situation in which a tenant holding an option to renew might intentionally delay beyond the time prescribed in order to exploit a fluctuating market. However, as the dissenters also note, there is no evidence to suggest that that is what occurred here. On the contrary there has been an affirmed finding of fact that the tenant's late notice was due to negligence. Of course a tenant who has intentionally delayed should not be relieved of a forfeiture simply because this tenant, who was merely inadvertent, may be granted equitable relief. But, on the other hand, we do not believe that this tenant, or any tenant, guilty only of negligence should be denied equitable relief because some other tenant, in some other case, may be found to have acted in bad faith. By its nature equitable relief must always depend on the facts of the particular case and not on hypotheticals.

Accordingly, the order of the Appellate Division should be reversed and a new trial granted.

BRETTEL, C.J. (dissenting). . . . Had an honest mistake or similar "excusable fault," as opposed to what is undoubtedly mere carelessness, occasioned the tenant's tardiness, absent prejudice to the landlord, equitable relief would be available. . . . At issue, instead, is the availability of equitable relief where the only excuse for the commercial tenant's dilatory failure to exercise its option to renew is sheer carelessness.

Enough has been said to uncover a common situation. Experienced and even hardened businessmen at cross-purposes over the renewal of a valuable lease term seek on the one hand to stand by the written agreement, and on the other, to loosen the applicable rules to receive *ad hoc* adjustment of equities and relief from economic detriment. The landlord wants a higher return. The tenant wants to keep the old bargain. Which of the profit-seeking parties in this particular case should prevail as a matter of morals is not within the province of the courts. The well-settled doctrine is that with respect to options, whether they be lease renewal options, options to purchase real or personal property, or stock options, time is of the essence. The exceptions, namely, estoppel, fraud, mistake, accident, or overreaching, are few. Commercial stability and certainty are paramount, and always the dangers of unsolvable issues of fact and speculative manipulation (as with stock options) are to be avoided.

The landlord should be awarded possession of the premises in accordance with the undisputed language and manifested intention of the written lease, its 12-page rider, and modification. It does not suffice that the tenant may suffer an economic detriment in losing the renewal period. Nor does it suffice that the delay in giving notice may have caused the landlord no "prejudice," other than loss of the opportunity to relet the property or renegotiate the terms of a lease on a fresh basis. Once an option to renew a lease has been conditioned upon the tenant's giving timely notice, the commercial lessee should not be heard to complain that through carelessness a valued asset has been lost, anymore than one would allow the

landlord to complain of the economic detriment to him in agreeing to an improvident option to renew.

The court unanimously accepts the general rule at law: an option to renew a commercial lease must be exercised within the appointed time period. . . . Underlying the bar to equitable relief is the theory that until the condition precedent is fulfilled, that is, until the required timely notice is given, there is no "forfeiture" for which equity will extend protection. . . . While the rule has been bolstered by traditional concepts of estates in land, its basis has current commercial and economic validity.

In this State, as in others, relief has been afforded tenants threatened with loss of an expected renewal period. . . . But in New York, as elsewhere, the circumstances conditioning such relief have been carefully limited. It is only where the tenant can show, not mere negligence, but an excuse such as fraud, mistake, or accident, that is, one or more of the categories common and integral to invocation of equity, that courts have, despite the literal agreement and intention of the parties, stepped in to prevent a loss. . . .

Even in the case of excusable default by the tenant the court looks to the investment the tenant has made to bolster his right to equitable relief. But the fact of tenant investment alone is not enough to justify intervention. . . . In no case of accepted or acceptable authority . . . were improvements alone enough to help the negligent tenant. . . .

[U]nder the guise of sheer inadvertence, a tenant could gamble with a fluctuating market, at the expense of his landlord, by delaying his decision beyond the time fixed in the agreement. The market having resolved in favor of exercising the option, the landlord, even though the day appointed in the agreement has passed, could be held to the return set out in the option, although if the market had resolved otherwise, the tenant could not be held to the renewal period.

Considering investments in the premises or the renewal term a "forfeiture" as alone warranting equitable relief would undermine if not dissolve the general rule upon which there is agreement. For, it is difficult to imagine a dilatory commercial tenant, particularly one in litigation over a renewal, who would not or could not point, scrupulously or unscrupulously, to some threatened investment in the premises, be it a physical improvement or the fact of good will. As a practical matter, it is not unreasonable to expect the commercial tenant, as compared with his residential counterpart, to protect his business interests with meticulousness, a meticulousness to which he would hold his landlord. All he, or his lawyer, need do is red-flag the date on which he has to act.

Having established no excuse, other than its own carelessness, Chelsea's claim is unfounded. Even if Chelsea honestly thought it enjoyed a 30-year lease, it does not change the result. Nor is it helpful to argue that Chelsea, always represented by a lawyer, was unable to procure a copy of the entire lease agreement. Indeed, it borders on the utterly incredible that experienced, sophisticated businessmen and their lawyers would not have assembled and scrutinized every relevant document affecting a long-term lease covering, with a renewal, a 30-year period.

That adherence to well-settled principles, like a Statute of Limitations or a Statute of Frauds, works a hardship on some does not, alone, permit a

court to depart from sound doctrine and principles. Even if precedent did not control the same doctrines and principles discussed should be applied.

Accordingly, I dissent and vote that the order of the Appellate Division should be affirmed, and the landlord awarded possession of the premises.

Order reversed, with costs, and a new trial granted.

RESTATEMENT (SECOND) OF CONTRACTS

§229. EXCUSE OF A CONDITION TO AVOID FORFEITURE

To the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange.

REFERENCE: Farnsworth, §§8.5-8.7
Calamari & Perillo, §§11.27-11.37
Murray, §§111, 112

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BREACH

In Chapter 13, we saw that the duty of performance can be conditioned on the occurrence or nonoccurrence of an event. One of the events on which a duty of performance may be expressly conditioned is the promised performance of the other party. In the absence of an express condition, are there any circumstances that justify one party unilaterally putting an end to the contract? Courts have developed a number of doctrines to answer this question. We shall consider three: "constructive conditions" (that is, conditions that are implied), anticipatory repudiation, and material breach. We then conclude this chapter by examining two different ways to measure damages when the party in breach has substantially performed.

A. CONSTRUCTIVE CONDITIONS*

In the previous chapter, we examined how courts interpret express clauses in agreements to determine whether or not they are conditions. In other cases, courts "fill gaps" in agreements that lack an express condition by supplying what is called a "constructive condition." By definition, then, a constructive condition is one that is not expressed, but it nonetheless has the same effect: The breach of a constructive condition by one party can relieve the other party of its duty of performance. In Section B, we shall consider the doctrine of material breach. Because a material breach by one party can also relieve the other party of its duty of performance, these doctrines are very closely related. At the risk of oversimplification, we can distinguish them as follows: Finding a constructive condition depends on a backward-looking inquiry into the presumed intentions of the parties at the time of formation, whereas finding a material breach depends on a forward-looking inquiry into the likelihood of performance occurring in the future. (But this distinction, like most, gets muddy pretty quickly in the context of particular cases.) We shall see how the former inquiry sometimes resembles the duty of good-faith performance (which we studied in Chapter 12), while the latter resembles the doctrine of anticipatory repudiation, so we will postpone our study of material breach until after we read about anticipatory repudiation.

*Once again, I thank David V. Snyder of the American University Washington College of Law, for compiling and coediting the materials in this section.

STUDY GUIDE: Given that performances in the next case were not expressly conditioned on each other, why did the court "construe" the agreement to include a condition? The rules in the following cases are still with us, for example in Restatement (Second) §237 and §§2-507 and 2-511 of the U.C.C.

KINGSTON v. PRESTON

Court of King's Bench,
Lofft 194, 198, 98 Eng. Rep. 606, 608 (1773)

It was an action of debt, for nonperformance of convenants contained in certain articles of agreement between the plaintiff and the defendant. The declaration stated; — That, by articles made the 24th of March 1770, the plaintiff, for the considerations therein-after mentioned, covenanted, with the defendant, to serve him for one year and a quarter next ensuing, as a covenant-servant, in his trade of a silk-mercer at £200 a year, and in consideration of the premises, the defendant covenanted, that at the end of the year and a quarter, he would give up his business of a mercer to the plaintiff, and a nephew of the defendant, or some other person to be nominated by the defendant, and give up to them his stock in trade, at a fair valuation; and that, between the young traders, deeds of partnership should be executed for 14 years, and, from and immediately after the execution of the said deeds, the defendant would permit the said young traders to carry on the said business in the defendant's house. — Then the declaration stated a covenant by the plaintiff, that he would accept the business and stock in trade, at a fair valuation, with the defendant's nephew, or such other person, c. and execute such deeds of partnership, and, further, that the plaintiff should, and would, at, and before the sealing and delivery of the deeds, cause and procure good and sufficient security to be given to the defendant, to be approved of by the defendant, for the payment of £250 monthly, to the defendant, in lieu of a moiety of the monthly produce of the stock in trade, until the value of the stock should be reduced to £4000. — Then the plaintiff averred, that he had performed, and been ready to perform, his covenants, and assigned for breach, on the part of the defendant, that he had refused to surrender and give up his business, at the end of the said year and a quarter. — The defendant pleaded, 1. That the plaintiff did not offer sufficient security and, 2. That he did not give sufficient security for the payment of the £250 c. — And the plaintiff demurred generally to both pleas. — On the part of the plaintiff, the case was argued by Mr. Buller, who contended, that the covenants were mutual and independent, and, therefore, a plea of the breach of one of the covenants to be performed by the plaintiff was no bar to an action for a breach by the defendant of one of which he had bound himself to perform, but that the defendant might have his remedy for the breach by the plaintiff, in a separate action. On the other side, Mr. Grose insisted, that the covenants were dependent in their nature, and, therefore, performance must be alleged: the security to be given for the money, was manifestly the chief object of the transaction, and it would be highly unreasonable to construe the agreement, so as to oblige the defendant to give up a beneficial business, and valuable stock in trade,

and trust to the plaintiff's personal security, (who might, and indeed was admitted to be worth nothing,) for the performance of his part. — In delivering the judgment of the court, LORD MANSFIELD* expressed himself to the following effect: — There are three kinds of covenants: 1. Such as are called mutual and independent, where either party may recover damages from the other, for the injury he may have received by a breach of the covenants in his favour, and where it is no excuse for the defendant, to allege a breach of the covenants on the part of the plaintiff. 2. There are covenants which are conditions and dependent, in which the performance of one depends on the prior performance of another, and, therefore, till this prior condition is performed, the other party is not liable to an action on his covenant. 3. There is also a third sort of covenants, which are mutual conditions to be performed at the same time and, in these, if one party was ready, and offered, to perform his part, and the other neglected, or refused to perform his, he who was ready, and offered, has fulfilled his engagement, and may maintain an action for the default of the other; though it is not certain that either is obliged to do the first act. — His Lordship then proceeded to say, that the dependence or independence, of covenants was to be collected from the evident sense and meaning of the parties, and, that, however transposed they might be in the deed, their precedency must depend on the order of time in which the intent of the transaction requires their performance. That, in the case before the court, it would be the greatest injustice if the plaintiff should prevail: The essence of the agreement was, that the defendant should not trust to the personal security of the plaintiff, but, before he delivered up his stock and business, should have good security for the payment of the money. The giving such security, therefore, must necessarily be a condition precedent. — Judgment was accordingly given for the defendant, because the part to be performed by the plaintiff was clearly a condition precedent.[1]

* *William Murray,* Earl of Mansfield (1704-1793) was born in Scone (near Perth), Scotland. In 1727, he received his B.A. from Oxford, his M.A. in 1730, and was then called to the bar at Lincoln's Inn. In 1742, after a career as a barrister in the Court of Chancery, Murray was made solicitor general and entered parliament. He continued as solicitor general until his promotion to the position of attorney-general. Murray received his appointment as Lord Chief Justice of the King's Bench, and his creation as Lord Mansfield in the county of Nottingham on November 8, 1756. Known as "the founder of the commercial law of the country," during the 32 years of his tenure, there were only two cases in which the whole bench was not unanimous, and only two of his judgments were reversed on appeal. He officially retired in 1788. — L.R.

1. This account of Kingston v. Preston is taken from the argument of one of the advocates in Jones v. Barkley, 2 Dougl. 685, 689, 99 Eng. Rep. 434, 437 (K.B. 1781). Blindly trusting an advocate's characterization of a case can be dangerous, so the reporter's version of the lead opinion is reproduced in this note. The reporter's version (Lofft 194, 198, 98 Eng. Rep. 606, 608) is less straightforward but is perhaps more reliable — and more vivid.

> The rule of law, to be sure is, that covenants independent cannot be set off one against the other. There is another sort of covenants, which are, in their nature, conditions; and he who is to perform the first condition, cannot have his action till he has performed.
>
> There are also covenants reciprocal: such are all purchases; in which, if the seller is ready, tendering the conveyance, and the buyer is not ready to pay the money, then the seller shall not pass his estate without.

MORTON v. LAMB

Court of King's Bench,
7 T.R. 125, 101 Eng. Rep. 890 (1797)

LORD KENYON, C.J.* If this question depended on the technical niceties of pleading, I should not feel so much confidence as I do: but it depends altogether on the true construction of this agreement. The defendant agreed with the plaintiff for a certain quantity of corn, to be delivered at Shardlow within a certain time, and there can be no doubt but that the parties intended that the payment should be made at the time of the delivery. It is not imputed to the defendant that he did not carry the corn to Shardlow, but that he did not deliver it to the plaintiff: to this declaration the defendant objects, and says "I did not deliver the corn to you (the plaintiff), because you do not say that you were ready to pay for it; and if you were not ready, I am not bound to deliver the corn;" and the question is, whether that should or should not have been alleged. The case decided by Lord Holt in Salk. 112, if indeed so plain a case wanted that authority to support it, shews that where two concurrent acts are to be done, the party who sues the other for non-performance must aver that he had performed, or was ready to perform, his part of the contract. Then the plaintiff in this case cannot impute to the defendant the non-delivery of the corn, without alleging that he was ready to pay the price of it. A plaintiff, who comes into a Court of Justice, must shew that he is in a condition to maintain his action. But it has been argued that the delivery of the corn was a condition precedent, and some cases have been cited to prove it: but they do not appear to me to be applicable. In the one in *Saunders*, the party was to pull down a wall, and was then to be paid for it; there is no doubt but that the pulling down of the wall was a condition precedent to the payment; the act was to be done, and then the price was to be paid for it. So in the case in Salk. 171, where work was to be done, and then the workman was to be paid. And in ordinary cases of this kind the work is to be done before the wages are earned: but those cases do not apply to the present, where both the acts

It would be the most monstrous case in the world, if the argument on the side of Mr. Buller's client was to prevail. It's of the very essence of the agreement, that the defendant will not trust the personal security of the plaintiff. A Court of Justice is to say, that by operation of law he shall, against his teeth. He is to let him into his house to squander every thing there, without any thing to rely on but what he has absolutely refused to trust. This payment, therefore, was a precedent condition before the covenant of putting into possession was to be performed on the part of the defendant.

**Lloyd Kenyon* (Lord Kenyon) (1732-1802) was entered at the Middle Temple and called to the bar on February 7, 1756. Kenyon became known for attending courts in the Welsh and Oxford circuits and interposing, sometimes as *amicus curiae*, with some abtruse law or forgotten clause in an old act of parliament. His eccentric manner attracted the attention of Lord Thurlow, who, upon becoming Lord Chancellor, conferred upon Kenyon the chief justiceship of Chester. He was advanced to the attorney-generalship in 1782 and served until 1783, when both he and Lord Thurlow were turned out by the Coalition. Although he was subsequently reappointed under Mr. Pitt, Kenyon chose to receive the office of Master of the Rolls, and the honor of a baronetcy in 1784. After presiding at the Rolls for four years, he was raised, on the resignation of Lord Mansfield, to the head of the Court of the King's Bench on June 9, 1788, and was created a peer by the title of Lord Kenyon of Gredington on the same day. His presidency lasted 14 years until his death, which occurred in 1802. — L.R.

are to be done at the same time. Speaking of conditions precedent and subsequent in other cases only lead to confusion. In the case of Campbell v. Jones, I thought, and still continue of that opinion, that whether covenants be or be not independent of each other, must depend on the good sense of the case, and on the order in which the several tbings are to be done: but here both things, the delivery of the corn by one, and the payment by the other, were to be done at the same time; and as the plaintiff has not averred that he was ready to pay for the corn, he cannot maintain this action against the defendant for not delivering it.

GROSE, J.* It is difficult to reconcile all the cases in the books on the subject of conditions precedent; but the good sense to be extracted from them all is, that if one party convenant to do one thing in consideration of the other party's doing another, each must be ready to perform his part of the contract at the time he charges the other with non-performance. Here the question is, what was the intention of the parties; they clearly intended that something should be done by each at the same time. The corn was to be delivered at Shardlow to the plaintiff for a certain price to be tberefore paid by him, that is, at the time of the delivery; then the readiness to pay should have been averred by the plaintiff. . . .

STUDY GUIDE: The next case raises two distinct issues. First, was the promise to pay the balance due on the house "conditioned" on the perfect completion of all work or was it "independent"? Second, if independent, what is the appropriate way to measure the expectation interest given the nature of the breach: "cost of replacement" or "diminution in market value"? We shall take up the first of these questions here and postpone the second until the end of this chapter in Section C. For now, consider why, given the various stipulations in the contract, Cardozo decided that the promise to pay the balance due was not conditioned on perfectly complete performance. Is Jacob & Youngs *consistent with Morton v. Lamb and Kingston v. Preston? Can its holding be seen as a response to those cases that was intended "to mitigate the[ir] rigor"?*

JACOB & YOUNGS v. KENT

Court of Appeals of New York,
230 N.Y. 239, 129 N.E. 889 (1921)

CARDOZO, J. The plaintiff built a country residence for the defendant at a cost of upwards of $77,000, and now sues to recover a balance of $3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of

* *Nash Grose* (approx. 1740-1814) was called to the bar at Lincoln's Inn in November 1766. After a short career as a barrister, he took the degree of serjeant in 1774 and soon commanded the leading business in the Common Pleas until he was raised to the bench to succeed Justice Edward Wiles in 1787 and received the usual honor of knighthood. After occupying the same seat for 26 years, his failing health forced him to resign in 1813. He died the following year, and his remains were interred in the Isle of Wight. His name should look familiar from Kingston v. Preston. — L.R.

defective performance until March, 1915. One of the specifications for the plumbing work provides that

> all wrought iron pipe must be well galvanized, lap welded pipe of the grade known as "standard pipe" of Reading manufacture.

The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract — that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture. The distinction is akin to that between dependent and independent promises, or between promises and conditions. Anson on Contracts (Corbin's Ed.) §367; 2 Williston on Contracts, §842. Some promises are so plainly independent that they can never by fair construction be conditions of one another. . . . Others are so plainly dependent that they must always be conditions. Others, though dependent and thus conditions when there is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant. . . . Considerations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another. The simple and the uniform will call for different remedies from the multifarious and the intricate. The margin of departure within the range of normal expectation upon a sale of common chattels will vary from the margin to be expected upon a contract for the construction of a mansion or a "skyscraper." There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason

in the implication of a like condition when the subject-matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.

Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier. The decisions in this state commit us to the liberal view, which is making its way, nowadays, in jurisdictions slow to welcome it. . . . Where the line is to be drawn between the important and the trivial cannot be settled by a formula. "In the nature of the case precise boundaries are impossible" (2 Williston on Contracts, §841). The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract. . . . There is no general license to install whatever, in the builder's judgment, may be regarded as "just as good." . . . The question is one of degree, to be answered, if there is doubt, by the triers of the facts . . . , and, if the inferences are certain, by the judges of the law. . . . We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfillment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression. . . . For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong. . . .

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no

occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure. . . . The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. "There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable" (Handy v. Bliss, 204 Mass. 513, 519 . . .). The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

McLaughlin, J.* I dissent. The plaintiff did not perform its contract. Its failure to do so was either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing, nor did it make any proof of the cost of compliance, where compliance was possible.

Under its contract it obligated itself to use in the plumbing only pipe (between 2,000 and 2,500 feet) made by the Reading Manufacturing Company. The first pipe delivered was about 1,000 feet and the plaintiff's superintendent then called the attention of the foreman of the subcontractor, who was doing the plumbing, to the fact that the specifications annexed to the contract required all pipe used in the plumbing to be of the Reading Manufacturing Company. They then examined it for the purpose of ascertaining whether this delivery was of that manufacture and found it was. Thereafter, as pipe was required in the progress of the work, the foreman of the subcontractor would leave word at its shop that he wanted a specified number of feet of pipe, without in any way indicating of what manufacture. Pipe would thereafter be delivered and installed in the building, without any examination whatever. Indeed, no examination, so far as appears, was made by the plaintiff, the subcontractor, defendant's architect, or any one else, of any of the pipe except the first delivery, until after the building had

* *Chester Bentine McLaughlin* (1856-1929) graduated University of Vermont (A.B.) and studied law privately (1879-1881). He practiced law at Port Henry (1881-1896), serving as county judge and surrogate of Essex County, New York (1891-1895), and delegate to the New York Constitutional Convention (1894). He served two terms as justice on the Supreme Court of New York before being designated justice of the Appellate Division in 1898. He resigned from the Supreme bench in 1917 to accept appointment to the Court of Appeals of New York, to which he was elected in 1918. He retired from the bench in 1927, and became official referee for the State of New York. — K.T.

been completed. Plaintiff's [sic] architect then refused to give the certificate of completion, upon which the final payment depended, because all of the pipe used in the plumbing was not of the kind called for by the contract. After such refusal, the subcontractor removed the covering or insulation from about 900 feet of pipe which was exposed in the basement, cellar and attic, and all but 70 feet was found to have been manufactured, not by the Reading Company, but by other manufacturers, some by the Cohoes Rolling Mill Company, some by the National Steel Works, some by the South Chester Tubing Company, and some which bore no manufacturer's mark at all. The balance of the pipe had been so installed in the building that an inspection of it could not be had without demolishing, in part at least, the building itself.

I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions. . . . But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor was any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either "nominal or nothing." Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been "just as good, better, or done just as well." He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed. . . . The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application. . . .

What was said by this court in Smith v. Brady (supra) is quite applicable here:

> I suppose it will be conceded that everyone has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. The specifications of the contract become the law between the parties until voluntarily changed.

> If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian. If the owner, having regard to strength and durability, has contracted for walls of specified materials to be laid in a particular manner, or for a given number of joists and beams, the builder has no right to substitute his own judgment or that of others. Having departed from the agreement, if performance has not been waived by the other party, the law will not allow him to allege that he has made as good a building as the one he engaged to erect. He can demand payment only upon and according to the terms of his contract, and if the conditions on which payment is due have not been performed, then the right to demand it does not exist. To hold a different doctrine would be simply to make another contract, and would be giving to parties an encouragement to violate their engagements, which the just policy of the law does not permit. (p. 186.)

I am of the opinion the trial court did not err in ruling on the admission of evidence or in directing a verdict for the defendant.

For the foregoing reasons I think the judgment of the Appellate Division should be reversed and the judgment of the Trial Term affirmed.

HISCOCK, C.J., and HOGAN and CRANE, JJ., concur with CARDOZO, J. POUND and ANDREWS, JJ. concur with MCLAUGHLIN, J. Order affirmed, etc.

STUDY GUIDE: To understand the following per curiam opinion on the motion for reargument, you must know that the actual contract between Kent and Jacob & Youngs also contained the following provision: "Any work furnished by the Contractor, the material or workmanship of which is defective or which is not fully in accordance with the drawings and specifications, in every respect, will be rejected and is to be immediately torn down, removed, and remade or replaced in accordance with the drawings and specifications, whenever discovered." In light of this clause, was the stipulation in the contract that Reading pipe be used a condition, a promise, or a promissory condition? How did Cardozo distinguish them?

JACOB & YOUNGS v. KENT

Court of Appeals of New York,
230 N.Y. 656, 130 N.E. 933 (1921)

ON MOTION FOR REARGUMENT:

PER CURIAM. The court did not overlook the specification which provides that defective work shall be replaced. The promise to replace, like the promise to install, is to be viewed, not as a condition, but as independent and collateral, when the defect is trivial and innocent. The law does not nullify the covenant, but restricts the remedy to damages.

The motion for a reargument should be denied.

HISCOCK, C.J., and CARDOZO, POUND, MCLAUGHUN, CRANE, and ANDREWS, JJ., concur.

Motion denied.

Relational Background: Why All the Fuss About Reading Pipe?

STUDY GUIDE: How does the following discussion from Danzig cast light on the issue of subjectivity of value? In light of specification 22 of the contract quoted in this passage, could you argue that there was complete rather than substantial performance of the clause specifying the pipe? Finally, does this excerpt suggest that the concept of good faith may be helpful in determining whether the failure to install Reading pipe was an "independent promise" (or a material breach)?

RICHARD DANZIG, THE CAPABILITY PROBLEM IN CONTRACT LAW 120-125 (1978): . . . George Edward Kent, the defendant in this case, was a successful New York lawyer who maintained two offices and two apartments in Manhattan as well as the mansion in Jericho (Long Island) whose construction provoked this litigation. In addition, George Kent acquired substantial wealth and political connections by his marriage (at age 38) to a daughter of W. R. Grace, then the owner of a large shipping line, and later Mayor of New York.

In 1913 when the Kents decided to build on land Mrs. Kent had acquired in Jericho during an earlier period, they hired an architect, William Wells Bosworth of New York City, who drew plans and specifications for a mansion on the property. In response to these plans Jacob and Youngs, a substantial, though not eminent, New York construction firm, tendered a "proposal" (an estimate of cost) for construction which was accepted. The contract and specifications for construction . . . were drawn and dated May 5 and May 7, 1913.

Why was pipe manufactured by the Philadelphia and Reading Iron and Coal Company specified? If Mr. Kent had a professional or financial connection with the Reading Company it remains buried. His surviving daughters, one born in 1898, another in 1911, are unaware of any such connection, as is his personal secretary of 20 years. While the latter entered Kent's employ in 1927, he saw most of Kent's papers and was consequently aware of his stockholdings and major clients for some years before that. In addition veteran employees at the remnants of what were the Reading Companies have never heard of a Kent or Grace connection and no member of either family shows up in the companies' annual reports as a director or officer from 1915-1945.

The contract specified a standard of pipe which cost 30% more than steel pipe — then the most widely used (and now the almost universally used) pipe. The makers of wrought iron pipe, however, claimed that the savings due to durability and low maintenance more than made up for the added expense.[2] The years from 1905-1920 saw a peak in the popularity of wrought iron pipe. For example Byers Co. reported a rise in the use of wrought iron pipe from 40-50% of the total market in New York City in the "few years" previous to 1916. This rise occurred, according to Byers, not in "cheap buildings sold to the public at large," but rather "in skyscraper construction as well as in other large buildings planned and constructed

2. A. M. Beyers Co., The Selection of Pipe for Modern Buildings 7 (1916).

with expertness and care." As an example of such a building a Byers publication printed a picture of a house built in Southampton, Long Island, another area like Jericho into which wealthy New Yorkers were moving after 1910. The house is very like that constructed for the Kents.

The Reading Company was by its account the largest manufacturer of wrought iron pipe in the country, having provided it for such famous New York buildings as the Metropolitan Life Insurance Building and the Chrysler Building. Indeed, its 1911 brochure asserted that "the majority of the modern and most prominent buildings in New York City are equipped with READING wrought iron pipe" and that "many leading architects and engineers have drawn their specifications in favor of wrought iron pipe, in instances prohibiting steel pipe entirely."

Interestingly, as this last comment suggests, these trade publications made their comparative claims not so much with reference to their competitors who made wrought iron pipe, as to those who made steel pipe. According to a pipe wholesaler interviewed in New York City in 1975, genuine wrought iron pipe was manufactured in the pre-war period by four largely non-competing companies: Reading, Cohoes, Byers and Southchester. According to this informant, all of these brands "were of the same quality and price. The manufacturer's name would make absolutely no difference in pipe or in price."

The testimony prepared for the Kent trial was to the same effect. If one reads between and around objections and exclusions of evidence it is apparent that Jacob and Youngs were prepared to show equality of price, weight, size, appearance, composition, and durability for all four major brands of wrought iron pipe. Indeed, in addition to other witnesses, an employee of the Reading Company was prepared to testify to this effect. Probably because of this evidence, Kent's briefs on appeal conceded that "experts could have testified that the substitute pipe was the same in quality in all respects. . . ." It appears that this concession crystallized into a "stipulation" before argument in the Court of Appeals, and that Cardozo's reference was to this when he directed a judgment for Jacob and Youngs.

Why then was Reading Pipe specified? Apparently because it was the normal trade practice to assure wrought iron pipe quality by naming a manufacturer. In contemporary trade bulletins put out by Byers and Reading, prospective buyers were cautioned that some steel pipe manufacturers used iron pipe and often sold under misleading names like "wrought pipe." To avoid such inferior products, Byers warned: "When wrought iron pipe is desired, the specifications often read 'genuine wrought iron pipe' but as this does not always exclude wrought iron containing steel scrap, it is safer to mention the name of a manufacturer known not to use scrap." Reading's brochure said: "If you want the best pipe, specify 'Genuine wrought iron pipe made from Puddled Pig Iron' and have the Pipe-Fitter furnish you with the name of the manufacturer."

The contract makes it especially clear that the use of Reading was primarily as a standard. Specification twenty-two says: "Where any particular brand of manufactured article is specified, it is to be considered as a standard. Contractors desiring to use another shall first make application in writing to the Architect stating the difference in cost and obtain their written approval of change." (Jacob and Youngs stressed the implications of this first sentence in their court of appeals brief.)

Why, given a realistic indifference to the maker of the pipe, did Kent refuse to pay for anything but Reading Pipe through three levels of litigation? Mr. Kent, according to some who knew him, carried cost consciousness "to an extreme point." As one put it: "The old man would go all over town to save a buck." Perhaps having paid the extra cost of wrought iron pipe, he felt cheated when not indisputably assured of the highest quality and purity with which Reading's name was associated. However, a Reading representative's willingness to testify for the plaintiff, and the apparent ability of Jacob and Youngs to show the equality of Byers, Cohoes, Southchester and Reading pipes (an equality probably realized by Kent's architect) suggest that Kent may have seized upon the pipe substitution as an expression of other dissatisfactions in his relationship with Jacob and Youngs. A summary of the construction process as revealed during the suit suggests anything but a harmonious relationship between builder and owner. . . .

While work was originally to be completed on the fifteenth of December, 1913, a modification was written and signed on the twenty-third of that month, extending the contract for an unspecified time and adding $580.00 to Kent's bill. (Complaint, paragraphs 6, 12, 13.) The reason given for the delay is that "the defendant failed to perform what he was to do under the said contract in time so the plaintiff's work could be completed by the said time," and because of "the defaults and delays of defendant." This language parallels one excuse for delay allowed in Art. III of the contract. The only duty which Kent seems to have owed Jacob and Youngs was to make payment, although the missing specifications may have detailed some preparatory work which Kent or his agents were to have done. Thus the delay and need for modification may have hinged on other troubles causing Kent to withhold payment at certain points. Paragraph 8 of the complaint notes "certain alterations and omissions entitled the defendant to a deduction of $4,031.41." Here again, there is evidence of unhappiness on Kent's part with work done by Jacob and Youngs. The whole price paid under the subcontract for the plumbing was only $6,000, so the earlier disputes were over equally large aspects of the contract.

The Kents moved into the house in June 1914, after twice as much time had passed for completion as the contract specified. Yet even Jacob and Youngs averred no more in their complaint than that "substantial completion" occurred by November 13, 1914. At that time a new modification entitled Jacob and Youngs to $240, and specified several "minor details of work" yet to be completed. The $3,483.46 outstanding on the contract would not be paid until these defaults were cured. (Complaint, paragraphs 14, 15.)

Moreover, though Kent occupied the house in June 1914 and work stopped except for "minor details" by November, Jacob and Youngs had not received the final payment or certificate by March 1915, 2 years after the contract was signed, and 1 1/2 years after it was to have been completed. (World War I began in Europe in the summer of 1914, probably complicating supply conditions.) Yet until then, Reading pipe was never mentioned as a subject of dispute. . . .

REFERENCE: Farnsworth, §§8.1, 8.10, 8.19
Calamari & Perillo, §§11.8, 11.12-11.26
Murray, §§102(C), 105, 112

B. Prospective Nonperformance

1. Anticipatory Repudiation

One reason why a party will be able to cancel a contract is if, before the time for performance arrives, the other party indicates that she does not intend to perform and thereby "repudiates" the contract. Because this repudiation happens before performance is due, it is called "anticipatory repudiation." (You will recall that the court in Inman v. Clyde Hall Drilling Co. discussed this doctrine.)

Study Guide: When reading the cases in this section, note the connection between anticipatory repudiation and the doctrine of avoidability of damages that we studied in Chapter 2.

ALBERT HOCHSTER v. EDGAR DE LA TOUR
In the Queen's Bench,
2 E. & B. 678, 118 Eng. Rep. 922 [1853]

On the trial, before Erle, J., at the London sittings in last Easter Term, it appeared that plaintiff was a courier, who, in April, 1852, was engaged by defendant to accompany him on a tour, to commence on 1st June 1852, on the terms mentioned in the declaration. On the 11th May 1852, defendant wrote to plaintiff that he had changed his mind, and declined his services. He refused to make him any compensation. The action was commenced on 22d May. The plaintiff, between the commencement of the action and the 1st June, obtained an engagement with Lord Ashburton, on equally good terms, but not commencing till 4th July. The defendant's counsel objected that there could be no breach of the contract before the 1st of June. The learned Judge was of a contrary opinion, but reserved leave to enter a nonsuit on this objection. The other questions were left to the jury, who found for plaintiff.

Hugh Hill, in the same Term, obtained a rule Nisi to enter a nonsuit, or arrest the judgment. . . .

Lord Campbell, C.J.,* now delivered the judgment of the Court.

On this motion in arrest of judgment, the question arises, Whether, if there be an agreement between *A.* and *B.*, whereby *B.* engages to employ *A.* on and from a future day for a given period of time, to travel with him into

*Professors Farnsworth and Young report that *John Campbell* (1779-1861) was "a Scotsman of ancient lineage, matriculated at St. Andrews University at the age of eleven. Upon entering the English bar he predicted that he would become Lord Chancellor. His name is associated with a number of law reform statutes which he pressed as a member of Parliament, as Attorney General, and in the House of Lords. As a reward for his services to the government, he was made the first Baron Campbell. He won literary fame with his 'Lives of the Lord Chancellors,' followed by the 'Lives of the Chief Justices.' These works are full of good stories, inaccuracies, and harsh judgments; it was said that they had added a new sting to death. He held judicial office briefly as Lord Chancellor of Ireland, where he was not popular, and as Chief Justice of England from 1850 to 1859. Then he became Lord Chancellor of England, at the age of eighty." E. Allan Farnsworth & William F. Young, Cases and Materials on Contracts 737 (4th ed. 1988).

a foreign country as a courier, and to start with him in that capacity on that day, *A.* being to receive a monthly salary during the continuance of such service, *B.* may, before the day, refuse to perform the agreement and break and renounce it, so as to entitle *A.* before the day to commence an action against *B.* to recover damages for breach of the agreement; *A.* having been ready and willing to perform it, till it was broken and renounced by *B.* The defendant's counsel very powerfully contended that, if the plaintiff was not contented to dissolve the contract, and to abandon all remedy upon it, he was bound to remain ready and willing to perform it till the day when the actual employment as courier in the service of the defendant was to begin; and that there could be no breach of the agreement, before that day, to give a right of action. But it cannot be laid down as a universal rule that, where by agreement an act is to be done on a future day, no action can be brought for a breach of the agreement till the day for doing the act has arrived. If a man promises to marry a woman on a future day, and before that day marries another woman, he is instantly liable to an action for breach of promise of marriage; Short v. Stone, (8 Q.B. 358). If a man contracts to execute a lease on and from a future day for a certain term, and, before that day, executes a lease to another for the same term, he may be immediately sued for breaking the contract; Ford v. Tiley, (6 B. C. 325). So, if a man contracts to sell and deliver specific goods on a future day, and before the day he sells and delivers them to another, he is immediately liable to an action at the suit of the person with whom he first contracted to sell and deliver them Bowdell v. Parsons, (10 East, 359). One reason alleged in support of such an action is, that the defendant has, before the day, rendered it impossible for him to perform the contract at the day; but this does not necessarily follow; for, prior to the day fixed for doing the act, the first wife may have died, a surrender of the lease executed might be obtained, and the defendant might have repurchased the goods so as to be in a situation to sell and deliver them to the plaintiff. Another reason may be, that, where there is a contract to do an act on a future day, there is a relation constituted between the parties in the meantime by the contract, and that they impliedly promise that in the meantime neither will do anything to the prejudice of the other inconsistent with that relation. As an example, a man and woman engaged to marry are affianced to one another during the period between the time of the engagement and the celebration of the marriage. In this very case, of traveller and courier, from the day of the hiring till the day when the employment was to begin, they were engaged to each other; and it seems to be a breach of an implied contract if either of them renounces the engagement. This reasoning seems in accordance with the unanimous decision of the Exchequer Chamber in Edlerton v. Emmens, [6 Com. B. 160], which we have followed in subsequent cases in this Court. The declaration in the present case, in alleging a breach, states a great deal more than a passing intention on the part of the defendant which he may repent of, and could only be proved by evidence that he had utterly renounced the contract, or done some act which rendered it impossible for him to perform it. If the plaintiff has no remedy for breach of the contract unless he treats the contract as in force, and acts upon it down to the 1st June 1852, it follows that, till then, he must enter into no employment which will interfere with his promise "to start with the defendant on such travels on the day and year," and that he

must then be properly equipped in all aspects as a courier for a three months' tour on the continent of Europe. But it is surely much more rational, and more for the benefit of both parties, that, after the renunciation of the agreement by the defendant, the plaintiff should be at liberty to consider himself absolved from any future performance of it, retaining his right to sue for any damage he has suffered from the breach of it. Thus, instead of remaining idle and laying out money in preparations which must be useless, he is at liberty to seek service under another employer, which would go in mitigation of the damages to which he would otherwise be for a breach of the contract. It seems strange that the defendant, after renouncing the contract, and absolutely declaring that he will never act under it, should be permitted to object that faith is given to his assertion, and that an opportunity is not left to him of changing his mind. If the plaintiff is barred of any remedy by entering into an engagement inconsistent with starting as a courier with the defendant on the 1st June, he is prejudiced by putting faith in the defendant's assertion: and it would be more consonant with principle, if the defendant were precluded from saying that he had not broken the contract when he declared that he entirely renounced it. Suppose that the defendant, at the time of his renunciation, had embarked on a voyage for Australia, so as to render it physically impossible for him to employ the plaintiff as a courier on the continent of Europe in the months of June, July, and August 1852: according to decided cases, the action might have been brought before the 1st June; but the renunciation may have been founded on other facts, to be given in evidence, which would equally have rendered the defendant's performance of the contract impossible. The man who wrongfully renounces a contract into which he has deliberately entered cannot justly complain if he is immediately sued for a compensation in damages by the man whom he has injured: and it seems reasonable to allow an option to the injured party, either to sue immediately, or to wait till the time when the act was to be done, still holding it as prospectively binding for the exercise of this option, which may be advantageous to the innocent party, and cannot be prejudicial to the wrongdoer. An argument against the action before the 1st of June, is urged from the difficulty of calculating the damages: but this argument is equally strong against an action before the 1st of September, when the three months would expire. In either case, the jury in assessing the damages would be justified in looking to all that had happened, or was likely to happen, to increase or mitigate the loss of the plaintiff down to the day of trial. We do not find any decision contrary to the view we are taking of this case. . . .

If it should be held that, upon a contract to do an act on a future day, a renunciation of the contract by one party dispenses with a condition to be performed in the meantime by the other, there seems no reason for requiring that other to wait till the day arrives before seeking his remedy by action: and the only ground on which the condition can be dispensed with seems to be, that the renunciation may be treated as a breach of the contract.

Upon the whole, we think that the declaration in this case is sufficient. It gives us great satisfaction to reflect that, the question being on the record, our opinion may be reviewed in a Court of Error. In the meantime we must give judgment for the plaintiff.

Judgment for Plaintiff.

STUDY GUIDE: The doctrine of anticipatory repudiation gives rise to two dangers. One concerns the vulnerability of the party who accuses the other of repudiation; the other concerns the potential misuse of the doctrine by a party seeking to justify its breach. Can you identify these pitfalls in the next case? How do you think the case would have been decided had the market price fallen instead of having risen?

HARRELL v. SEA COLONY, INC.

Court of Special Appeals of Maryland, 35 Md. App. 300, 370 A.2d 119 (1977)

MELVIN, J.*

By written contract, dated 14 November 1972, the appellant (plaintiff below), Sam L. Harrell, agreed to buy, and the appellee (one of the defendants below), Sea Colony, Inc., a Delaware corporation, agreed to sell for $74,900.00 a condominium unit to be constructed by Sea Colony, Inc. in Bethany Beach, Delaware. The contract called for a deposit of $11,235.00 and the balance of the purchase price to be paid "at settlement." The $11,235.00 deposit consisted of $5,000.00 cash paid by Harrell and the execution by him, pursuant to the contract, of a promissory note for $6,235.00, payable "at settlement." Other pertinent parts of the contract were the following provisions:

> . . . In the event of a default by the Purchaser hereunder, Seller shall have the right to retain the cash deposit and enforce the Note. . . .
>
> Settlement shall take place within thirty (30) days of the posting of written notice to the Purchaser of substantial completion of the above unit, and at the offices of an attorney selected by the Seller. . . .
>
> In the event the above unit is not delivered to the Purchaser on or before January 1, 1974, the Purchaser shall have the right to terminate the Agreement and secure refund of deposit.

On 12 January 1974, the parties agreed in writing to extend the limiting date for delivery to 31 December 1974.

On 12 November 1974, Harrell filed a declaration in the Circuit Court for Montgomery County against Sea Colony, Inc. (Sea Colony) and its agent, Carl M. Freeman Associates, Inc. (Freeman), seeking damages for an alleged anticipatory breach of the contract. Harrell claimed that the defendants had "repudiated" the contract and sold the condominium unit to another buyer

* *Ridgely P. Melvin, Jr.* (1917-1999) was educated at Princeton University (A.B.) and the University of Maryland (LL.B.). Admitted to practice in Maryland in 1947, he was a member of the Maryland House of Delegates from 1954 to 1962 and a circuit judge from 1966 until his appointment to the Maryland Court of Special Appeals in 1974. He was elected to that post in 1976 and retired from the bench in 1981. Known affectionately as "Ridge," his obituary described him as "Maryland special appeals judge and ocean mariner extraordinaire." During World War II, Judge Melvin served as an officer aboard the battleship *Washington* in the Pacific naval campaign. As a devoted yachtsman from childhood, he won the Triton Class National Championship in the early 1970s. In 1985, he and his wife Lucy sailed their sloop *Song* across the Atlantic. For the next eight years, they lived aboard while sailing through European and Mediterranean waters. — K.T. & J.B.

for more than the contract price. He claimed as damages the $5,000.00 cash deposit as well as the difference between the contract price and the amount for which the unit was sold to the other buyer. Harrell also claimed, in his second amended declaration, punitive damages. After considerable pre-trial maneuverings, the case finally came on for trial before the court sitting without a jury on 6 May 1976.

The evidence before the trial judge consisted of various documentary exhibits and the live testimony of the appellant Harrell and that of Mr. Norman Dreyfuss who was an employee of Freeman. The judge concluded that the appellant had without justification unilaterally cancelled the contract and judgment was entered in favor of both appellees, Sea Colony and Freeman. Because we find the evidence legally insufficient to support the trial court's conclusion that Harrell unilaterally cancelled the contract, we shall vacate the judgment as to Sea Colony. As to Freeman, however, we shall affirm the judgment in its favor.

Regarding Freeman, the most the record shows is that after the contract of sale was executed by Harrell and Sea Colony, Freeman acted only as agent for Sea Colony, its disclosed principal. Freeman was not a party to the contract and its name nowhere appears therein. The general rule regarding an agent's contractual liability to a third party is set forth in A. S. Abell Co. v. Skeen, 265 Md. 53, 288 A.2d 596 (1972):

> . . . If an agent, acting for his principal, enters into an agreement with a third party, he is personally responsible under that contract *if the identity of his principal is not fully disclosed and is in fact unknown to the third party.* This concept encompasses two basic factual situations: where the third party knows there is an agency relationship but is unaware of the principal's identity; and where the third party is not even cognizant that an agency relationship exists. (Citations omitted.) *Generally, if an agent fully discloses the identity of his principal to the third party, then, absent an agreement to the contrary, he is insulated from liability.* (Citations omitted.) However, this is subject to exception when the purported principal that is disclosed is nonexistent or fictitious; or when the principal is legally incompetent. (Citations omitted.) Id. at 56 [288 A.2d at 597].

(Emphasis added.) Here, there is no indication that in his dealings with Freeman, Harrell was not fully aware that Freeman was no more than an agent for Sea Colony. Nor is there any evidence or claim that Sea Colony, as a corporate entity, is "nonexistent or fictitious" or "legally incompetent." Under these circumstances, we hold that the judgment in favor of Freeman was properly entered, albeit not for the reason given by the trial court.

We turn now to the principal issue raised in this appeal, and that is the correctness of the trial court's ruling that Harrell had breached the contract. There is no evidence that Sea Colony or its agent Freeman ever gave notice, written or otherwise, to Harrell "of substantial completion" of the condominium unit he had agreed to purchase. On 28 May 1974, Harrell requested of Dreyfuss that he be allowed to assign the contract. He was told that he could not do so.[3] Harrell testified that he then told Dreyfuss

3. The contract provided that it "shall not be assigned or transferred without written consent of the Seller."

> that I would be interested in getting out of the contract, that the units were selling for substantially more than my contract price, we all knew this, and I asked them if they would be interested in taking my contract back and reselling the unit, they could make any additional profit on it, if they could, and he said that he would look into the matter and he would be in touch with me.

Mr. Dreyfuss, testifying for the defendants, corroborated much of Harrell's testimony concerning this conversation and did not contradict any of it. He said:

> Mr. Harrell stated he wanted to cancel the contract, did not want to proceed with settlement, and indicated that he wanted another disposition of his deposit. He did discuss the matter of the assignability, and I informed him again it was not assignable, and that was pretty much the gist of the conversation.
>
> He told me that the reason was his personal financial situation, which was such that he felt he could not proceed with the purchase of this unit.

It was this 28 May conversation that the trial court seems principally to have relied upon to conclude that Harrell had anticipatorily breached the contract. We think the conclusion was clearly erroneous, particularly in view of subsequent events.

Following the 28 May conversation between Harrell and Dreyfuss, Dreyfuss sent Harrell a letter in mid-July enclosing a "cancellation *request* which must be signed by you in order for us to process *your release.*" (Emphasis added.) The letter continued:

> Please detail the reasons *for your request*, and the factors effecting your decision not to proceed with the settlement of Unit 901-S, Phase II.
>
> Once we receive this information we will be able to proceed with the determination on the disposition of your deposit. (Emphasis added.)

Harrell responded with a letter dated 17 July 1974 as follows:

> Dear Mr. Dreyfuss:
>
> Enclosed herewith is the Release relative to the above. You will note that I have predicated this upon the refund of my deposit and execution of the Release by Sea Colony by July 25th. This is necessary due to the proximity of the completion of the building so that unless Sea Colony is going to release me from the Contract and refund my deposit I will need as much time as possible to take the necessary action to protect my interest in this matter.
>
> Thank you for your consideration in this matter.

The "Release" enclosed with Harrell's letter was the "Cancellation Request" form sent to him in mid-July. He stated therein that he "*wishe[d] to rescind* his Agreement for the following reasons: Personal financial considerations and the refusal of Sea Colony to allow the assignment of this contract. *This Release is contingent upon refund of deposit by July 25, 1974.*" (Emphasis added.)

On 18 August 1974, Sea Colony entered into a contract with a third party to sell the condominium unit for $82,000.00, i.e., $7,100.00 more than

the original contract price that Harrell had agreed to pay. In the meantime, so far as the record discloses, there had been no communication between Harrell and Sea Colony or its agent. Thereafter, Harrell received the following letter from Freeman, dated 23 August 1974 — five days after Sea Colony had resold the unit to a third party:

> Dear Mr. Harrell:
>
> *We are accepting your request to cancel* your unit number 901-South of Sea Colony Phase II. However, due to your being unwilling to comply with the terms of the contract, we are keeping your deposit as liquidated damages. (Emphasis added.)

This letter was followed by another from Freeman, dated 28 August, 1974:

> Dear Mr. Harrell:
>
> Enclosed is an executed release which relieves you of any further obligation towards the purchase of a home in Sea Colony. Enclosed you will find your cancelled Promissory Note in the amount of $6,235.00.
>
> We are sorry that you are unable to proceed with the purchase of one of our homes. If in the future we can be of service, we would be pleased to have the opportunity to serve you.

The "executed release" enclosed with this letter consisted of the same "Cancellation Request" form that Harrell had forwarded to Freeman with his letter of 17 July 1974. The form contained a space for "Agency Approval" and was executed by an "authorized officer of seller." The executing officer, however, had crossed out Harrell's statement on the form that "This Release is contingent upon refund of deposit by July 25, 1974."

In our view, Sea Colony unilaterally attempted to convert Harrell's *request* for a mutual rescission of the contract to an anticipatory breach or repudiation on his part.

In 6 Corbin, Contracts, §973, the standard for determining an anticipatory breach of contract is set forth:

> In order to constitute an anticipatory breach of contract, *there must be a definite and unequivocal manifestation of intention on the part of the repudiator that he will not render the promised performance when the time fixed for it in the contract arrives.* Doubtful and indefinite statements that the performance may or may not take place and statements that, under certain circumstances that in fact do not yet exist, the performance will not take place, will not be held to create an immediate right of action. *A mere request for a change in the terms or a request for cancellation of the contract is not in itself enough to constitute a repudiation.* (Emphasis added.)

Measured against that standard, we think the evidence in this case falls short of warranting a finding that Harrell breached his contract. Sea Colony argues that Harrell's statements to Dreyfuss in their 28 May conversation

that he (Harrell) "wanted to cancel the contract" and "did not want to proceed with settlement" because his "personal financial situation . . . was such that he felt he could not proceed with the purchase of this unit" amounted to an impermissible unilateral cancellation of the contract and that Sea Colony was therefore justified in retaining Harrell's $5,000 cash deposit and in re-selling the property to a third party. Sea Colony concedes that Harrell's "Cancellation Request" in July "was simply an offer of the appellant to rescind." It contends, however, that the "contract at that time was already breached" by Harrell and therefore Sea Colony "was under no obligation to even consider" the rescission offer.

As evidence of Harrell's alleged anticipatory breach of contract, in addition to Harrell's 28 May conversation with Dreyfuss, Sea Colony points to the fact that Harrell failed to answer requests from Sea Colony to choose which of two attorneys' offices he preferred as the location for settlement. As we have already noted, the contract provided that "Settlement shall take place within thirty (30) days of the posting of written notice to the Purchaser of substantial completion of the . . . unit, and *at the offices of an attorney selected by the Seller.*" (Emphasis added.) In early April 1974, Harrell received a letter from Freeman indicating that the "Seller" had "selected" two alternative law firms at which settlement would take place — one located in Delaware and one located in Bethesda, Maryland. The letter asked Harrell to "indicate which location would be more desirable for you." The letter concluded with this statement: "Once we have received your preferences, the attorney's office will be contacting you with regard to more specific information." Harrell did not reply to this letter, nor to an identical one he received in early May. His failure to reply cannot be regarded as even a partial breach of contract, for there is nothing in the contract imposing upon him a duty to do so — and, as we have already indicated, there is no evidence that at the time he received these letters the triggering event for scheduling a settlement (that event being written notice of substantial completion of the condominium unit) had occurred, or that he ever refused to attend a settlement, or otherwise refused or failed to fulfill any obligation imposed upon him by the contract.

In summary, we hold that the evidence as a whole is legally insufficient to permit a finding that there was "a definite and unequivocal manifestation of intention" on Harrell's part that "he . . . [would] not render the promised performance when the time fixed for it in the contract arrive[d]." 6 Corbin, Contracts, supra. See also, Friedman v. Katzner, 139 Md. 195, 114 A. 884 (1921), where the Court of Appeals, in discussing the doctrine of anticipatory breach, made it clear that the alleged repudiator's "refusal to perform must be positive and unconditional" in order that it may be treated as an anticipatory breach.

Because the trial court found that Harrell had breached the contract, it did not reach the precise issue of whether or not Sea Colony was guilty of an anticipatory breach as alleged by Harrell when it (Sea Colony) resold the property to a third party. Although it may be said that the trial court did, at least by implication, determine that issue, it did not do so in the context of a non-breach by Harrell. We think the issue should now be decided in that context by the court below upon remand rather than by us in the first

instance. Md. Rule 1085. We think the issue can be determined by the trial court on the present record and see no necessity for further evidence to be taken. We point out, however, that on the evidence before it a finding by the trial court that Sea Colony breached the contract of sale may not be required. On the evidence, another possible finding would be that there was a mutual rescission of the contract effected by the words and conduct of the parties. Under the particular circumstances of this case, these two possible alternative findings (a breach by Sea Colony or mutual rescission) are mutually exclusive. If the latter finding be made, it would seem that Harrell is entitled to the return of his $5,000.00 deposit. If the former finding be made, he may, in addition to the deposit, be entitled to further damages for Sea Colony's breach.

Judgment for appellee Carl M. Freeman Associates, Inc. affirmed. Judgment for appellee Sea Colony, Inc. vacated. Case remanded for further proceedings not inconsistent with this opinion. Costs to be paid by Appellee Sea Colony, Inc.

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§2-610. ANTICIPATORY REPUDIATION

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or

(b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

(c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704).

§2-611. RETRACTION OF ANTICIPATORY REPUDIATION

(1) Until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this Article (Section 2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

2. Adequate Assurances of Performance

The converse of the situation involving anticipatory repudiation arises when one party wishes to withhold performance because he suspects, for some reason, that the other party may not perform. May he suspend his performance pending the receipt from the other party of adequate assurances of due performance?

STUDY GUIDE: When reading the next case notice how the issue of adequate assurances of performance mirrors the issue of anticipatory repudiation. Once again, notice the danger for the party seeking assurances: That party is accused by the other party of repudiating — and thereby breaching — the contract.

SCOTT v. CROWN

Court of Appeals of Colorado, 765 P.2d 1043 (1988)

PLANK, J.*

In this breach of contract action, defendant, Dennis Crown d/b/a Crown Company (Buyer), appeals from a judgment entered in favor of plaintiffs, Larry and Vera Scott, and from the dismissal of Buyer's counterclaim against them. We reverse.

During February 1983, Larry Scott (Seller) and Buyer entered into contract No. 76 for the sale of 16,000 bushels of U.S. No. 1 wheat. Pursuant to the contract, Buyer paid Seller $2,000 as an advanced payment. With respect to payment of the contract balance, the agreement reads in part:

> Payment by Buyer is conditioned upon Sellers [sic] completion of Delivery of total quantity as set forth in this contract. Any payment made prior to completion of delivery is merely an accommodation. In making such accommodation, Buyer does not waive any condition of this contract to be performed by Seller.

Elsewhere, the contract provided that the full balance would be paid 30 days after shipment of the total contract quantity of grain.

By March 13, 1983, Seller had delivered all the wheat called for in the contract. Payment of the full contract balance of approximately $49,000 was due on April 13, 1983.

On March 1, 1983 Seller and Buyer executed contract 78-2 for the sale of 13,500 bushels of U.S. No. 1 wheat and contract No. 81-3 for the sale of approximately 30 truck loads of U.S. No. 1 wheat. These contracts are the

* *Leonard P. Plank* (1932-†) was educated at Regis College (B.S.) and the University of Denver (LL.B.) and was admitted to practice in Colorado in 1961. That year, he began legal practice in Denver; he served as judge on the Denver County Court (1970-1974) and the Colorado District Court (1974-1988). He was appointed to the Colorado Court of Appeals in 1988, where he currently serves. — K.T.

subject of this action. With the exception of quantity, the contracts had identical terms and conditions as those in contract No. 76, including the above-quoted provision and the provision for full payment by Buyer 30 days after complete performance by Seller.

In early March 1983, Seller commenced performance of contract No. 78-2. By March 15, 1983, he had delivered to Buyer approximately 9,086 bushels of wheat. However, he ceased performance because of his belief that Buyer could not pay for the wheat.

Seller was contracting with other grain dealers while working with Buyer. Seller suffered a loss on an unrelated contract. When reviewing this loss with his banker, Seller was told that Buyer was not the "best grain trader" and was advised to contact an agent from the Department of Agriculture for additional information about Buyer. The agent, Mr. Witt, indicated there was an active complaint against Buyer concerning payments to other farmers.

The next day, one of Buyer's trucks appeared at Seller's farm to take another load of grain. Seller refused to deliver the grain. Instead, he testified that he told the driver:

> that we had the grain, but were trying to get in touch with Mr. Crown, and my attorney advised me not to load until we had made contact with Mr. Crown to settle some questions that we had.

Seller and Witt testified that during the period of March 21 through April 6, 1983, they and Seller's attorney had attempted to contact Buyer several times by telephone, but were not successful.

By a letter dated March 23, 1983, Buyer responded to Seller's refusal to load the wheat. Buyer stated that he had not breached the contracts; however, Seller had breached the agreements. Buyer pointed out the payment terms requiring shipment of the full quantity before payment was due and requested that Seller resume performance. Otherwise, Buyer would be forced to "resort to cover."

Buyer followed up the letter with an April 4, 1983, correspondence in which he notified Seller that he was cancelling the contracts. However, he assured Seller that, if the contracts were performed, his company would pay according to the contract terms.

Through counsel, Seller replied by an April 6, 1983, letter. Counsel informed Buyer that his client had not been paid on the contracts and that Seller had received information that Buyer had been paid by his buyers. Counsel demanded assurances of performance that Buyer would pay for the grain shipped on the fully performed contract 76 and the partially performed contract 78-2. However, under the contract terms, payment was not due on contract 76 until April 13, 1983, and was not due on contract 78-2 until 30 days after full performance.

Buyer cancelled contracts 78-2 and 81-3 on April 7, 1983. He had previously contacted grain sellers in Denver and Salt Lake City to effect cover, but by this date tbe grain was no longer available.

Seller instituted suit on April 25, 1983, alleging breach of contract by Buyer in not paying in full for the grain prior to delivery pursuant to his demand for adequate assurance of performance.

The circumstances at issue bring this action within the scope of §4-2-609(1), C.R.S., of the Uniform Commercial Code. That section provides: "A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party, the other may in writing demand adequate assurance of due performance and, until he receives such assurance, may if commercially reasonable suspend any performance for which he has not already received the agreed return."

By the express language of this provision, reasonable grounds for insecurity about the performance of either party must exist in order for the other party to exercise further rights.

Buyer alleges that Seller did not have reasonable grounds for insecurity and, further, that the demand for assurance of due performance was defective. We disagree that there were no reasonable grounds for insecurity, but agree that the demand for assurance of due performance was defective.

Whether Seller had reasonable grounds for insecurity is a question of fact. See AMF, Inc. v. McDonald's Corp., 536 F.2d 1167 (7th Cir. 1976). Since trial was to the court, we will not disturb the court's findings that Seller had reasonable grounds for insecurity unless it was clearly erroneous and not supported by the record. . . .

The trial court found that reasonable grounds for insecurity existed because: 1) Seller recently had had an unfortunate experience similar to the incident at issue with another grain dealer (i.e., a pattern of unreturned phone calls culminating in nonpayment for a grain delivery); 2) Investigator Witt had informed Seller that his office had active complaints by other farmers against Buyer; and 3) Buyer failed to make personal contact after Seller refused to load the wheat. This evidence supports the trial court's conclusion of reasonable grounds for insecurity.

There are, however, serious problems with the timing, form, and content of Seller's demand for assurances of performance. The court found that Seller had made an oral demand for assurances by his refusal [to] load the grain and his conversation with the driver on March 22, 1983. However, Seller did not make the written demand until his counsel's letter of April 6, 1983, some two weeks after he had suspended performance.

Generally, the express language of the statute is followed such that a demand for assurances of performance must be in writing in order to be effective. . . . However, in some cases an oral demand for assurances has sufficed. . . . In such cases, there appears a pattern of interaction which demonstrated a clear understanding between the parties that suspension of the demanding party's performance was the alternative, if its concerns were not adequately addressed by the other party.

In AMF, Inc. v. McDonald's Corp., supra, for example, McDonald's had ordered 23 computerized cash registers from AMF. However, a prototype machine installed at a McDonald's franchise performed poorly. McDonald's personnel then met with AMF and demanded that the order for their 23 units be held up pending resolution of the problems experienced in the prototype. AMF failed to resolve the problem, and McDonald's cancelled the order. The court expressly rejected AMF's argument that McDonald's

had not made a written demand, and held that McDonald's had properly invoked the pertinent Uniform Commercial Code provision.

Here, Seller made only the oral statement to Buyer's driver before he suspended performance. In our view, that was insufficient to make that suspension justified under §4-2-609.

Also, there was not a subsequent pattern of interaction between the parties that would clearly demonstrate that Buyer understood that Seller had requested assurances of performance. Indeed, Buyer's letter of March 23, and April 4, 1983, demonstrated that he thought that Seller had inexcusably refused to perform the contracts. Hence, we conclude that the conditions necessary to validate an oral demand were not met here.

Moreover, even if we were to conclude that an oral demand would have been permissible here, the content of the alleged demand is deficient. In contrast to AMF, Seller did not communicate clearly to Buyer that he was demanding assurances of performance. He simply told Buyer's driver that he wanted to "settle" some questions with Buyer. A mere demand for meeting to discuss the contracts, even if it had been in writing, would not be sufficient to constitute a proper demand for assurances. . . .

Finally, a demand for performance assurances cannot be used as a means of forcing a modification of the contract. . . . When Seller's counsel made the demand for assurances of performance, he demanded performance beyond that required by the contracts. In the April 6, 1983, letter, counsel requested payment in full of contract 76 and payment for the grain delivered on contract 78-2. At that time, Buyer was not obligated under the terms of the contracts to make such payments.

Under these facts, we conclude that Seller did not have the right to suspend performance because he failed to act in a manner that would bring him within the scope of §4-2-609. Instead, Seller's action constituted an anticipatory repudiation which gave Buyer the right to cancel the contracts and resort to the buyer's remedies as provided in §4-2-713, C.R.S.

This matter is remanded to the trial court to determine the following factual issues relating to Buyer's damages: (1) whether the grain being delivered was U.S. No. 1 wheat or a lesser quality; (2) the date Buyer first learned of the breach; and (3) the fair market value of the wheat on the date Buyer learned of the breach. Seller is entitled to all credit for grain sold and delivered and for which payment was not received.

Accordingly, the judgment is reversed and the cause is remanded with directions that the court enter judgment for Buyer after making findings on these issues.

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§2-609. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

REFERENCE: Barnett, §5.2
Farnsworth, §§8.20-8.23
Calamari & Perillo, §§12.1-12.10
Murray, §110

3. Material Breach

In deciding whether the promisee can unilaterally put an end to the contract, instead of seeking to find a "constructive condition," courts sometimes try to determine whether a particular breach by the promisor was "material." One way to understand this is to say that parties are free to expressly empower the victim of *any* breach — however small — to cancel the contract. But, in the absence of such an express condition, courts will not *construe* or imply a condition empowering the victim of a breach to cancel the contract when there has been *substantial* performance. And a party has substantially performed unless his nonperformance constitutes a material breach. In other words, in the absence of an expressed or constructive condition to the contrary, *only if a breach is material does it relieve the nonbreaching party of its duty of performance under the contract.* Another way to understand this shift in terminology is to consider that, in determining whether a breach is material, a court is no longer interested solely in the parties' presumed intentions at the time of formation. It is now also concerned with whether the nature of the breach jeopardized the promisee's confidence in receiving additional performances in the future.

An analogy by which we may better understand the concept of material breach has been offered by Eric Andersen:

> In countries such as the United Kingdom that have parliamentary systems of government, the current administration (or "government") remains in office until the next election or until it falls under a vote of no-confidence. Contract formation may be likened to the installation of a new government. One who enters a contract presumably has sufficient confidence in its future performance to make the promises or to give the other consideration required to bind the contracting partner to the deal, just as a majority in

parliament has sufficient confidence in party leaders to entrust it with political power. This is not to say that the person has full or even great confidence about the outcome, but only sufficient confidence to enter a relationship in which new legal obligations are created. With the creation of those obligations arises the interest in future performance. . . . [T]hat interest exists in the frame of reference created by the contract. Thus, even one who lacks great confidence that the agreement will be properly performed is legally entitled to look to the other party for full, proper performance, just as members of parliament are entitled to hold the government accountable to provide effective leadership even if its ability to govern well is in doubt.

A change of government under a regularly scheduled election may be compared to the full performance of a contract. A majority may be content to have the government retain power, despite flaws in its performance. Similarly, although one party may breach a contract, the other party, as a reasonable person, may be willing to seek only compensatory damages rather than end the contract.

A change of government under a vote of no-confidence is comparable to cancellation following material breach. Just as a majority in parliament may develop sufficient doubts about the government's ability to govern that they are prepared to undergo the uncertainties, confusion, and inefficiencies that accompany an unplanned election, a party to a contract may reasonably conclude that a breach has so impaired the interest in future performance that terminating the contract relationship is prudent, despite the disruptions and difficulties it may entail. When that point is reached, the materiality threshold has been crossed.[4]

According to this analogy, the doctrine of material breach has evolved to handle much the same problem as that of anticipatory repudiation: the promisee (like the Parliament) is no longer confident that she will receive the "future performance" she is due under the contract. For this reason the promisee wishes to cancel the contract and pursue other measures to secure performance (just as a Parliament may vote to hold an election for a new government). In the case of anticipatory repudiation, the promisee's lack of confidence in future performance stems from the promisor's having communicated a lack of willingness to perform. With material breach, the lack of confidence stems from the nature of a breach that has occurred. By this way of thinking, when a material breach has occurred, the injury to a promisee's "interest in future performance" is different from and in addition to any injury sustained as result of having received less than what was bargained for.

After reading two cases that address this issue, we turn our attention to the law governing the sale of goods. There, a more exacting standard known as the perfect tender doctrine had been adopted in the common law. We shall see how it has been modified by the Uniform Commercial Code. In Section C, we conclude our study of breach by examining two ways to measure expectation damages after there has been a *non*material breach — that is, after there has been substantial performance.

4. Eric G. Andersen, A New Look at Material Breach in the Law of Contracts, 21 U.C. Davis L. Rev. 1073, 1108-1109 (1988). Although the theory that material breach can best be understood as a way of protecting a party's interest in future performance is Professor Andersen's, he credits the analogy to a parliamentary vote of no-confidence to Richard A. Matasar.

STUDY GUIDE: Does Andersen's theory that the concept of material breach is used to protect a party's "interest in future performance" help explain the decisions in the next two cases?

B & B EQUIPMENT CO. v. BOWEN

Missouri Court of Appeals, Western District,
581 S. W.2d 80 (1979)

WASSERSTROM, J.* B & B Equipment Company, Inc. filed this suit to obtain a judgment declaring its right to terminate a contract under which defendant John A. Bowen was entitled to purchase 100 shares of the corporate stock. Bowen counterclaimed for a declaration that the contract is valid and subsisting and that he has a continuing right to purchase the 100 shares. The trial court rendered declaratory judgment as prayed by B & B, and Bowen appeals.

B & B is the successor to Braymen Tractor Company which was originally owned by Mr. and Mrs. L. D. Braymen. The Braymens took Robert J. Jaecques and William L. Hughes into the business in 1964, first as employees and then later as partners and finally as equal stockholders in a corporate form of doing business.

In 1968, L. D. Braymen wanted to retire and Jaecques and Hughes desired to find someone to take Braymen's place. At that particular time, Bowen who had had prior experience in the same line of business, was unemployed and available. Accordingly, on December 28, 1968, the parties entered into an oral agreement with Bowen under which Bowen would become an equal participant in the business in place of Braymen. Bowen, however, did not have sufficient funds to pay the value of Braymens' 100 shares of stock, which was agreed to be $15,000. The corporation therefore agreed to buy the stock from the Braymens for $15,000 and in turn to sell that stock to Bowen for the same sum. Bowen was to and did pay $2,500 direct to the Braymens. B & B gave the Braymens its note for $12,500, payable with interest of 6% per annum. Bowen was to be entitled to all dividends on the 100 shares, and he agreed to pay back the dividends to B & B for application on the purchase price of the stock. When those payments for the stock totaled $12,500, plus whatever interest B & B had by then incurred to the Braymens, B & B was to deliver the 100 shares to Bowen. Under the agreement, Bowen was to assume as his primary responsibility all the corporate record keeping and bookkeeping, and he was in addition to devote his full time and attention to the corporate business in whatever capacity became necessary, including selling. The salaries of all three men were to be equal.

Promptly after the making of that agreement, Bowen did assume his new duties and at the beginning performed in a manner satisfactory to Jaecques and Hughes. Dividends were declared from 1969 to 1976 of which Bowen's

* *Solbert M. Wasserstrom* (1913-1995) received his education at the University of Missouri (B.A., J.D.) before being admitted to practice in Missouri in 1935. He practiced in Kansas City until being appointed to the Missouri Court of Appeals Kansas City District by Governor Warren E. Hearnes in 1972. Judge Wasserstrom was re-elected in 1974 and completed his term in 1986.

share came to $7,156 and which were paid to him. He, in turn, repaid an equivalent amount on each occasion to be applied toward the stock purchase. However, starting in about 1972, Bowen began engaging in outside business activities and spent less time on his duties for B & B, with the result that Jaecques and Hughes became more and more dissatisfied with Bowen's performance. This dissatisfaction developed to the point that on April 27, 1976, a meeting was held between the three men in which Jaecques and Hughes informed Bowen that he was discharged. Approximately two or three weeks before that, B & B had paid a dividend for the year 1975, of which Bowen's share was $800, and at the time of the April 27 meeting Bowen had not yet repaid that sum to be credited on the stock purchase.

Following his discharge, Bowen retained counsel and on May 4 his lawyer wrote to the B & B attorney stating that Bowen would release any and all interest in the corporation for the sum of $82,350. On May 24, 1976, the corporation's attorney responded that B & B had elected to rescind the 1968 agreement and tendered to Bowen the sum of $9,656, representing the $2,500 paid by Bowen to the Braymens, together with the $7,156 dividends which Bowen had received from B & B and contributed toward payment of the stock. On June 2, 1976, Bowen's lawyer wrote rejecting the Corporation's tender and countered with a tender by Bowen of $5,344, plus whatever the amount of interest was that B & B had paid the Braymens, in exchange for which Bowen demanded the issuance to him of 100 shares of B & B stock.

The impasse thus created led to the present lawsuit. After hearing evidence without a jury, the trial court made findings of fact which included the following:

> 6. That on or about April 27, 1976 Jaecques and Hughes fired defendant as an employee and officer in the business. This action resulted from dissatisfaction with defendant in not devoting his full time and best efforts to the interest of the business. That defendant over a period of time did not properly keep the books of the plaintiff's business and did not devote his full time to his responsibility in the business. That defendant, as of April 27, 1976, had not paid to plaintiff the $800.00 dividend to be applied on defendant's obligation to purchase stock. That such actions and omissions and failure to act and perform on part of the defendant constituted a breach of the terms and conditions of the contract between plaintiff and defendant.
>
> 9. The court finds defendant did breach the conditions of the contract of December 28, 1968 as set out in paragraph 6 herein and that plaintiff was entitled to rescind the contract upon payment to defendant of the sum of $9,656.00 representing the total of the benefits received by plaintiff from defendant under said contract. . . .

Bowen's [argument] on appeal is that his "breach did not go to the very substance of the contract and further, any breach was waived and the trial court should have estopped assertions otherwise." The legal doctrine upon which Bowen rests this argument is that a rescission of a contract for breach by the other party must relate to a vital provision going to the very substance or root of the agreement, and cannot relate simply to a subordinate or incidental matter. . . . Bowen attempts to bring himself within that principle by arguing: "The contract respondent corporation and appellant entered into on December 28, 1968, was for the purchase of L. D. Braymen's One

Hundred (100) shares of stock. . . . The further agreement of employment with the respondent corporation was incidental to the major purpose of the contract, that of purchasing the stock of L. D. Braymen."

The argument just quoted turns the real situation up side down. Rather than the principal purpose of the agreement being the sale and purchase of stock, clearly the major purpose of the transaction between B & B and Bowen was the performance of services by Bowen. The stock itself was to go to Bowen on terms which can be explained only on the basis that Jaecques and Hughes were willing to let him become a one-third owner in expectation of valuable services to be contributed by Bowen. Indeed by far the major part of the purchase price was to come from the corporation itself in the nature of a bonus which could only be for services rendered.

B & B did not make this deal with Bowen in order to obtain needed capital. Instead the real purpose which stands out on this record as a whole is that Jaecques and Hughes wanted a "third partner" to take the place of the retiring partner Braymen. What they wanted were Bowen's services, not his money and in fact the only money which Bowen was ever to put up out of his own pocket was the initial $2,500. The only realistic appraisal of this situation is that the services to be performed by Bowen were the "very suhstance and root of the contract" so that his failure to adequately perform those duties did constitute a material breach warranting recission.

Bowen suggests that the definition of materiality should be amplified by utilization of the guidelines set forth in Restatement of Contracts, Section 275. Comment a to that section states that in determining whether a breach of contract is a material one, it is impossible to lay down a rule that can be applied with mathematical exactness and that such a determination depends upon considerations of inherent justice. Nevertheless, this section of the Restatement suggests certain guidelines, each of which will now be considered in connection with the facts of the present case:

A. *The extent to which the injured party will obtain the substantial benefit which he could have reasonably anticipated.* Here, B & B (the injured party) received some performance from Bowen for a period slightly in excess of five years, but those services were defective. . . . Jaecques and Hughes had agreed that Bowen could acquire a one-third ownership in their corporation on extremely favorable terms, in the expectation that they were obtaining an experienced partner who would devote his full time and attention to the company business. That expectation failed of fulfillment. It cannot reasonably be said that Jaecques and Hughes received the substantial benefit which they had a right to expect.

B. *The extent to which the injured party may be adequately compensated in damages for lack of complete performance.* Bowen suggests no way in which his breaches of contract may be measured in monetary terms. This situation does not lend itself to compensation in damages.

C. *The extent to which the party failing to perform has already partly performed or made preparations for performance.* Bowen here had partly performed, but defectively. Despite protests, he failed and neglected to make good the deficiencies. This guideline operates somewhat in Bowen's favor, but not decisively so.

D. *The greater or less hardship on the party failing to perform in terminating the contract.* The value of the 100 shares of B & B stock

appreciated between December 1968 and April 1976. Bowen will receive the benefit of at least a substantial part of that increase by reason of the payment to him of the $7,156 in dividends declared by B & B during that period. To the extent that Bowen does not receive the full benefit of the increase in value of the 100 shares, his wound is self-inflicted by his defaults in performance. In addition, whatever loss is suffered by Bowen is more than counterbalanced by the hardship and unfairness which would be caused to Jaecques and Hughes by an opposite ruling.

E. *The willful, negligent or innocent behavior of the party failing to perform.* . . . Jaecques made protest and gave fair warning to Bowen concerning the unacceptability of Bowen's performance. Bowen's continuance in his unacceptable performance was at the very least negligent.

F. *The greater or less uncertainty that the party failing to perform will perform the remainder of the contract.* This particular criterion is of doubtful application in this present situation. If it be applicable, Bowen has had over five years in which to demonstrate his good faith and willingness to carry his share of the burden. Jaecques and Hughes cannot with fairness be required to experiment even longer in some vague hope of improvement.

Bowen also argues that B & B should not be permitted to rescind because that would be a violation of good faith and fair dealing on its part, because it had waived any claim of defect in Bowen's performance, and because it should be estopped to assert any such defect. All this multifaceted argument rests on the assertion that B & B never protested to Bowen concerning the unacceptability of his performance of duty and that the corporation therefore caused him to rely upon a belief that his performance was satisfactory. That argument in all of its aspects fails because of the false factual premise. . . . Jaecques did protest to Bowen and gave him warnings. It cannot be fairly said that B & B failed in any duty of fair dealing or that it was waived or is estopped to assert its right of rescission. . . .

The judgment is affirmed except as to the amount which is to be paid by B & B to Bowen. This case is remanded to the trial court for the purpose of determining the amount of income tax paid by Bowen attributable to the corporate earnings by B & B which were not distributed. That amount is to be added to the $9,656 paid by Bowen toward the 100 shares of capital stock, and the aggregate total of those two sums is to be paid to Bowen by B & B.

All concur.

LANE ENTERPRISES, INC. v. L. B. FOSTER CO.

Superior Court of Pennsylvania, 700 A.2d 465 (1997),
rev'd on other grounds, *710 A.2d 54 (1998)*

CIRILLO, President Judge Emeritus.* L. B. Foster Company (Foster) appeals from the order entered in the Court of Common Pleas of Bedford County. We reverse.

* *Vincent A. Cirillo* (1927-2000), a Korean War veteran, received his degrees from Villanova University (A.B.) and Temple University (LL.B.) before being admitted to the Pennsylvania bar and clerking for President Judge Harold G. Knight in Montgomery County (1955-1958). After serving as Assistant District Attorney (1958-1962), Assistant

This appeal arises out of litigation concerning an agreement between Foster, a manufacturer of steel bridge components and Lane Enterprises, Inc. (Lane), a company specializing in the coating of steel materials. In the spring of 1992, Foster agreed to sell Hammond Construction, Inc. (Hammond) various bridge components for use in the construction of a bridge in Summit County, Ohio. This agreement (the Hammond Agreement) specified that Foster was to supply the bridge components in two separate stages. The Hammond Agreement also stated that the bridge components were to be coated in accordance with the Ohio Department of Transportation (ODOT) specifications.[5] Because Foster was not equipped to coat the bridge components that it manufactured, it sought an outside contractor, Lane, to perform the coating process. On September 23, 1992, Foster and Lane orally agreed that Lane would clean and coat the bridge components. The agreement was confirmed by Foster's purchase order which specified that all cleaning and coating performed by Lane was to be in compliance with ODOT standard specifications for construction and materials and that Lane was not to ship any coated components without prior approval from an ODOT inspector (The Lane Agreement). In addition, reflecting Foster's delivery obligations pursuant to the Hammond Agreement, the Lane Agreement provided that Lane clean and coat the bridge components in two separate stages, the first stage to be delivered in October of 1992 (Stage I) and the second stage in June of 1993 (Stage II). Pursuant to the Lane Agreement, Foster shipped Stage I of the uncoated bridge components to Lane's facility in Carlisle, Pennsylvania for processing. Lane then commenced the cleaning and coating process for the Stage I components. During cleaning, however, some steel residue (shot) as well as other surface contaminants remained on the steel and became trapped under the coating.[6] ODOT Inspectors visited Lane and examined the coated components. Although the ODOT inspectors were not fully satisfied with the amount of contamination trapped under the epoxy coating, they permitted shipment pending removal and re-application of the coating.

On January 5, 1993, Lane's quality assurance manager, Gary Hinkelman, wrote a letter to Foster detailing the problems that Lane faced while coating the Stage I components. Hinkelman explained Lane's inability to remove all of the contaminants and inquired as to whether Foster desired Lane to coat the Stage II components or retain Midwest Coating to complete Stage II. On January 27, 1993, a meeting was held at the bridge construction site. ODOT engineer David Nist conducted an inspection of the delivered stage I components. Nist performed a contamination test by chipping a piece of the epoxy coating which revealed backside contamination. Additionally, Nist's inspection revealed that the epoxy coating on the trim-bars, components attached to the sides of the bridge floor, was readily

County Solicitor (1964-1971), and Commissioner of Lower Merion Township (1971). Judge Cirillo began his judicial career in 1982 as Judge for the Pennsylvania Court of Common Pleas Thirty-eighth Judicial District. In 1982, he was elected to the Superior Court of Pennsylvania.

5. Coating the metallic bridge components is necessary to prevent corrosion.

6. Impurities trapped between the epoxy coating and the steel surface in construction parlance is called "backside contamination."

removable. Nist then informed Lane that the coating procedure did not adhere to the Steel Structure Painting Council's surface preparation standard ten (SSPC SP-10) which was required for ODOT's approval. Nist, therefore, rejected the coated components.

A second on-site meeting was convened on February 5, 1993 to discuss how to rectify the situation. Representatives from Lane, Foster, and Hammond were all present. Lane representatives noted that pursuant to SSPC SP-10, ten to twenty percent backside contamination of an epoxy chip was acceptable. Via tele-conference, ODOT vehemently disagreed, stressing that SSPC SP-10 allowed zero percent backside contamination. Lane representatives then informed those present that if SSPC-10 required zero percent contamination, Lane would be unable to meet those requirements.

On February 8, 1993, ODOT sent a letter to Hammond formally rejecting the Stage I coated bridge components in their present condition. ODOT proposed, however, that if the unacceptable portions of the components underwent certain field repairs, ODOT would accept the components. Foster sent a letter to Lane advising that Foster would withhold payment until corrections were made. At this time, Foster still owed Lane $18,018.06 for Stage I. Lane agreed to assume the cost of the field repairs, which would be deducted from the $18,018.06 still owed to Lane. Hammond then subcontracted with Thomarios Painting to complete the field repairs at a cost of $10,935.84. After the repairs were completed, Lane requested the amount still owing on Stage I, $7,082.22.

ODOT eventually permitted Hammond to proceed with erection of the bridge, thus, presumably approving the repaired bridge components. On June 15, 1993, Foster sent Lane a letter inquiring as to whether Lane intended to perform Stage II of the Lane Agreement. The letter also stated that outstanding monies due Lane for Stage I, $7,082.22, would not be released until Lane gave assurances concerning its commitment to Stage II of the Lane Agreement. Lane responded that it would not discuss Stage II until Foster remitted the monies owed under Stage I. Foster sent a second letter on July 2, 1993, repeating its request for assurance of performance by Lane. Lane again responded that it would not proceed in any way until Foster satisfied the full payment for Stage I of the Lane Agreement. On August 17, 1993, Foster, faced with the prospect of delay damages under the Hammond Agreement, hired Encor Coating Incorporated (Encor) to complete Stage II at a cost of $99,329.15, $42,055.00 more than it would have paid Lane to complete Stage II under the agreement.

Foster then initiated suit against Lane by filing a writ of summons in Bedford County. Lane also initiated suit, filing a complaint in Cumberland County. The cases were subsequently consolidated in Bedford County and a bench trial ensued.

. . . The trial court found that Foster's failure to remit the final $7,082.22 on Stage I to Lane amounted to a breach of the Lane Agreement, thereby permitting Lane to suspend performance under the Lane Agreement. The trial court reasoned, therefore, that because Lane was legally entitled to suspend performance, Lane was not liable for any damages Foster incurred as a result of said suspension. Additionally, the trial court found that Lane was entitled to the $7,082.22 due and owing under the Lane Agreement.

Foster vehemently disagrees with the trial court's findings and conclusions. Foster argues that the withholding of Lane's $7,082.22 was not a material breach under established Pennsylvania contract law and thus Lane was not entitled to suspend its performance under the Lane Agreement. Additionally, Foster contends that it had the right to request adequate assurances of performance due to Lane's January 5, 1993 letter to Foster and that Lane's failure to provide such assurance amounted to a repudiation of the Lane Agreement. Foster concludes, therefore, that it is entitled to the amount over and above the full price of the Lane Agreement that it had to pay another contractor to coat the Stage II components less the $7,082.22 owed to Lane prior to Lane's breach.

Our initial inquiry must be whether the trial court erred in finding that Foster's withholding of $7,082.22 under the Lane Agreement constituted a material breach of that agreement. If the trial court did not err in so finding, then our inquiry ends because a material breach entitles the non-breaching party to suspend performance under the contract.

"When performance of a duty under a contract is due, any nonperformance is a breach." Restatement (Second) of Contracts §235(2) (1981). . . . If a breach constitutes a material failure of performance, then the non-breaching party is discharged from all liability under the contract. If, however, the breach is an immaterial failure of performance, and the contract was substantially performed, the contract remains effective. . . . John D. Calamari & Joseph M. Perillo, The Law of Contracts §11-22 (2d ed. 1977). In other words, the non-breaching party does not have a right to suspend performance.

Because Foster was in breach when it refused to remit the $7,082.22 still owing under Stage I of the Lane Agreement, it is necessary to ascertain whether such breach was material. . . . In determining materiality for purposes of breaching a contract, we consider the following factors:

a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
b) the extent to which the injured party can be adequately compensated for that part of the benefit of which he will be deprived;
c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
d) the likelihood that the party failing to perform or offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
e) the extent to which the behavior of the party failing to perform or offer to perform comports with standards of good faith and fair dealing.

Restatement (Second) of Contracts §241 (1981). . . .

In the present case, the trial court ruled that Foster's actions constituted a breach of its agreement with Lane. The trial court explained that because Foster gave Lane the opportunity to cure defects present in the coating and because Lane did in fact cure the defects, as evidenced by ODOT's permission to Hammond to commence construction with the coated components, Foster had no right to retain the $7,082.22 that it owed Lane for Stage I. The trial court, therefore, deduced that because Foster had no legitimate reason for failing to perform, Foster breached the Lane agreement.

The crux of Foster's contention is that although it may have breached the Lane agreement by withholding a small percentage of the sums due, this act was not a material breach. It is axiomatic, Foster asserts, that Lane was required to perform on Stage II of the Agreement. We agree. There has been no explicit finding that Foster's actions constituted a *material breach* of the agreement. . . . Moreover, applying the materiality test as set forth in the Restatement §241 . . . , we note that Foster failed to pay only $7,082.22 out of a $133,922.40 purchase order. . . . This amounts to a withholding of approximately 5% of the total contract price. *See* Calamari & Perillo, supra ("It is apparent that the ratio of the part performed to the part to be performed is an important question in determining . . . material breach.") Additionally, it is uncontradicted that Foster planned to remit the monies due once it received assurance from Lane that Lane could perform Stage II of the agreement. See 3A Corbin on Contracts §719 (time is generally not of the essence unless the parties have expressly manifested such an intent). Under these circumstances we conclude that the trial court erred in finding that Foster materially breached the Lane Agreement. Lane, therefore, was not entitled to suspend its responsibilities under the Lane Agreement. . . .

In light of our conclusion that Foster's breach did not materially impair the Lane Agreement, we must now determine whether Lane's failure to give Foster assurance of performance of Stage II of the Agreement amounted to an anticipatory breach. "Anticipatory breach of a contract occurs whenever there has been a definite and unconditional repudiation of a contract by one party communicated to another. A statement by a party that he will not or cannot perform in accordance with the agreement creates such a breach." Oak Ridge Const. Co., 351 Pa. Super. at 38, 504 A.2d at 1346. (1985). . . . Comment b to section 250 of the Restatement (Second) explains the nature of a repudiatory declaration:

> In order to reconstitute a repudiation, a party's language must be sufficiently positive to be reasonably interpreted to mean that the party will not or cannot perform. Mere expression of doubt as to willingness or ability to perform is not enough to constitute a repudiation. . . . However, language that under a fair reading amounts to a statement of intention not to perform except on conditions which go beyond the contract constitutes a repudiation.

Restatement (Second) of Contracts §250, cmt. b (1981). Accord Shafer v. A.I.T.S., Inc., 285 Pa. Super. 490, 428 A.2d 152 (1981) ("to be effective, a renunciation must be absolute and unequivocal.").

Although a statement by a party concerning its ability to perform may not be sufficiently absolute to constitute a repudiation of the contract, such a statement may warrant the other party to demand adequate assurance of performance, the failure of which may be treated as repudiation. . . . The Restatement explains:

> (1) where reasonable grounds arise to believe that the obligor will commit a breach by non-performance that would of itself give the obligee a claim for damages for total breach, the obligee may demand adequate assurance of due performance and may, if reasonable, suspend any performance for which he has not already received the agreed exchange until he receives such assurance

> (2) The obligee may treat as a repudiation the obligor's failure to provide within a reasonable time such assurances of due performance as is adequate in the circumstances of the particular case.

Restatement (Second) of Contracts §251 (1981). If a party is warranted in demanding adequate assurances of performance, therefore, and none is forthcoming, the requesting party may treat the failure to respond as a repudiation of the contract. Id. . . .

The rationale for demanding adequate assurance of performance is explained as follows: Although a party does not ordinarily have the right to demand reassurance that the other contracting party will perform, a reasonable belief that the other contracting party will not or cannot perform permits the contracting party to demand adequate assurance. Restatement (Second) of Contracts §251 cmt. a (1981). The rule is closely related to the duty of good faith and fair dealing present in every contract. Id. Whether a party has a reasonable belief that the other party cannot perform is determined by the totality of the circumstances surrounding the agreement. Restatement (Second) of Contracts §251 cmt. c (1981). It should be noted, however, that "minor breaches may give reasonable grounds for a belief that there will be more serious breaches, and the mere failure of the obligee to press a claim for damages for those minor breaches will not preclude him from basing a demand for assurances on them." Id. Moreover, "conduct by a party that indicates doubt as to his willingness to perform but that is not sufficiently positive to amount to a repudiation may give reasonable grounds for such a belief." Id.

In the present case, we must first illustrate the circumstances out of which the Lane Agreement was created. The ultimate goal was to construct a bridge in Ohio. To that end, Hammond contracted with Foster for the manufacture of components and Foster contracted with Lane to clean and coat the components. In order to shield itself from liability under the Hammond Agreement, therefore, Foster required that the coating be approved by an ODOT engineer as a condition of the Lane Agreement. The contract did not, however, specify the level of contamination permitted between the coating and the steel components.

The evidence at trial showed that Lane had experienced difficulties in the cleaning and coating of the Stage I bridge components. In fact, after the coated components were shipped to the bridge construction site, ODOT engineers refused to approve the components until certain modifications were made. Due to the problems that Lane experienced, Lane's quality assurance manager wrote a letter to Foster explaining that it could not meet ODOT's claimed requirement of zero percent contamination because that level was unattainable. After receiving this letter Foster did not request assurance of performance nor did Foster claim that Lane had breached the contract. Rather, Foster made an agreement with Lane that the Stage I components would be modified by another firm and it would deduct the cost from the amount it owed Lane. The modifications were made by another company. Subsequent to the modifications, ODOT permitted Hammond to commence construction, thus presumably approving the coated components for use. Only after the repairs were made on the Stage I components did Foster demand assurance of performance by Lane on Stage II of the agreement.

Without citing any authority, the trial court found that because Foster had agreed that Lane would be responsible for the cost of the repairs, Foster lost its opportunity to demand assurance of performance on Stage II. We fail to see how Foster's agreement to permit Lane to pay to cure the defects resulted in a loss of Foster's right to demand assurance of performance with regard to Stage II. As comment c to the Restatement (Second) §251 explains: mere failure of the obligee to press a claim for damages for minor breaches will not preclude him from basing a demand for assurances. A material condition of the Lane Agreement was ODOT's approval of the coated components. Due to the difficulties that Lane experienced performing Stage I of the Agreement, coupled with Lane's lukewarm expression of its ability to perform, we find that Foster had reasonable grounds to demand assurance of performance.[8] Jonnet, supra. Foster requested that Lane provide some assurance that it would complete Stage II. Lane refused to give such assurances and thus we find that Lane, not Foster, materially breached the agreement.

Having concluded that Lane materially breached the Lane Agreement, our final task is to instruct the trial court on the proper allocation of damages. Here, as a direct result of Lane's breach, Foster was required to pay another contractor $42,055.00 more than it would have paid Lane to complete Stage II of the Lane Agreement. Because this amount flowed directly from the breach, Lane is required to pay Foster this amount in damages. *See* . . . Keystone Floor Products Co. v. Beattie Mfg. Co., 432 F. Supp. 869 (E.D. Pa. 1977) (breaching party must pay for any damages that naturally and ordinarily result from the breach as well as any other reasonably foreseeable damages so long as they were within the contemplation of the parties at the time of the contract). Foster, however, failed to remit $7,082.22 owed to Lane from Stage I of the Lane Agreement, which also was a breach. Accordingly, Foster is entitled to recover from Lane the cost of finding another contractor to complete stage II ($42,055.00) which is to be offset by the amount that Foster withheld from Lane for completing Stage I ($7,082.22). Foster is entitled, therefore, to a net award of $34,972.78. On remand, the trial court shall enter an order consistent with this opinion.

Order reversed. Case remanded. Jurisdiction relinquished.

DID SHAWN KEMP MATERIALLY BREACH? A PROBLEM

Shawn Kemp was an NBA basketball player for the Portland Trailblazers who was nearing the end of a professional career that began in 1989. In 1992, he signed an agreement with Reebok to endorse a line of basketball shoes that included the following provisions:

> "5.1 *Exclusivity:* Player warrants and represents that he has not authorized and, during the Term of Agreement, will not authorize or permit the use of his

8. The trial court also indicated that ODOT's failure to provide approval to the coated components for Stage I was a reasonable ground upon which to demand assurance of performance. Specifically, the trial court found persuasive the testimony of defense expert Paul Krauss that ODOT's understanding of the contamination was faulty. Even assuming that ODOT's engineers were mistaken regarding the proper contamination specifications, only a Monday Morning Quarterback could conclude that Foster's concerns were unreasonable.

performance, the Player Endorsement, or any part thereof, nor will he render services in connection with any radio or television commercial or participate in any other activity for the purpose of advertising or promoting any service or product which, in the Company's reasonable opinion, is competitive with or antithetical to Company's products and/or the Endorsed Goods, including, but not limited to footwear or athletic apparel and accessories of any nature or kind.

5.2 *Use:* . . . It is agreed and understood that Player shall use exclusively the type of Company basketball shoes and other Endorsed Goods as Company shall request while participating in any and all games, practices, workouts and other athletic activities as a professional basketball player. Player further agrees not to appear in public in any product that is competitive with Company's products and/or Endorsed Goods and to wear Endorsed Goods where appropriate.

5.3 *No Disparagement:* Player agrees that at no time during and after the Term of the Agreement will he disparage his association with the Company, the products of Company, its advertising agencies or others connected with Company. . . ."

The contract commenced in October 1992 and was extended in 1997 to run until the end of September 2002. Under the extension, he was to receive approximately $11.2 million over the last five years of the agreement.

In April 2000, when Kemp was playing for the Cleveland Cavaliers, the *Akron Beacon Journal* published an article entitled "Footnoting Prose of Pros' Footwear: Kemp and His Teammates Stroll Down Memory Lane, Recalling Their Favorite Kinds of Shoes Growing Up." Near the beginning of the story is the following: " 'My all time favorite pair I would probably have to say was Air Force II by Nike,' said Kemp, not caring the least that he has an endorsement deal with Reebok. 'They were worn by Durell Griffith and Moses Malone. Oh, yeah, you had to have them. When I got a pair of Air Force IIs, I was the coolest kid in school. I'd wear them around just to let everybody know I'm a basketball player.' " The story then includes quotes from other players and concludes with this: "Kemp says today's shoes aren't as good as the old ones, because they're made to be lighter. Kemp calls them 'throw-aways,' because they rip so easily. 'I might go back next year to (Reebok) Kamakazes,' Kemp said. 'They've got a real crazy design. That's the shoe I started out wearing my third year and wore when I made my first All-Star Game (in his fourth season of 1992-93).' Kemp has plenty of Kamakazes in his basement. Alas, he has no Air Force IIs."

Later that same month Reebok terminated his endorsement agreement, claiming that by making these statements Kemp has breached the contract provisions quoted above. In its termination letter, Reebok's attorney states, "Given that you have been contractually obligated since 1992 to wear Reebok footwear exclusively during all athletic workouts, practices, tournaments, games, exhibitions and to otherwise fulfill your obligations under the Agreement, it is patently clear your comments could only have been directed at Reebok footwear." Under the terms of the agreement, this meant Reebok refused to pay approximately $4.1 million still due for the final 2½ years of the contract.

Did Kemp materially breach his agreement with Reebok? Was Reebok justified in terminating its agreement with Kemp, or by attempting to do so has Reebok breached the agreement itself? Does Eric Andersen's approach help you answer this? Does Restatement §241 (quoted in *Lane Enterprises*)? Would it affect your answer — and if so, why — to know that Kemp's career was in significant decline by 2000? Would it affect your answer — and if so, why — to know that Reebok was doing very poorly in the sales of basketball shoes and cut its endorsement contracts from around fifty to just a few (including Allen Iverson and Steve Francis)? Would proof of these facts be admissible in a suit by Kemp against Reebok for breach of contract?

REFERENCE: Barnett, §5.2
Farnsworth, §§8.15-8.16
Calamari & Perillo, §11.18
Murray, §§108-109

4. The Perfect Tender Rule: Cure and Rescission

When determining a buyer's right to reject nonconforming goods, the common law applied what came to be known as "the perfect tender doctrine." If taken literally, this would appear to be a more exacting standard than that of material breach. In this section, we consider how the Uniform Commercial Code treats this issue.

STUDY GUIDE: *In what respect has the U.C.C. adopted the so-called perfect tender rule? How does the U.C.C. treatment differ, if at all, from the common law concept of material breach?*

RAMIREZ v. AUTOSPORT

Supreme Court of New Jersey,
88 N.J. 277, 440 A.2d 1345 (1982)

The opinion of the Court was delivered by POLLOCK, J.*

This case raises several issues under the Uniform Commercial Code ("the Code" and "U.C.C.") concerning whether a buyer may reject a tender of goods with minor defects and whether a seller may cure the defects. We consider also the remedies available to the buyer, including cancellation of the contract. The main issue is whether plaintiffs, Mr. and Mrs. Ramirez, could reject the tender by defendant, Autosport, of a camper van with minor defects and cancel the contract for the purchase of the van.

* *Stewart Glasson Pollock* (1932-†) studied at Hamilton College (B.A.) and New York University (LL.B.). After he was admitted to the New Jersey bar in 1958, he worked in the U.S. attorney's office in Newark (1958-1960) and practiced privately in Morristown (1960-1974, 1976-1978). He served as counsel to the governor of New Jersey (1978-1979) and was appointed to the bench of the Supreme Court of New Jersey in 1979. He retired in 1999. — K.T.

The trial court ruled that Mr. and Mrs. Ramirez rightfully rejected the van and awarded them the fair market value of their trade-in van. The Appellate Division affirmed in a brief per curiam decision which, like the trial court opinion, was unreported. We affirm the judgment of the Appellate Division.

Trial ct = held for Π
Appeal ct = affirmed
Supreme = affirmed

I

Following a mobile home show at the Meadowlands Sports Complex, Mr. and Mrs. Ramirez visited Autosport's showroom in Somerville. On July 20, 1978 the Ramirezes and Donald Graff, a salesman for Autosport, agreed on the sale of a new camper and the trade-in of the van owned by Mr. and Mrs. Ramirez. Autosport and the Ramirezes signed a simple contract reflecting a $14,100 purchase price for the new van with a $4,700 trade-in allowance for the Ramirez van, which Mr. and Mrs. Ramirez left with Autosport. After further allowance for taxes, title and documentary fees, the net price was $9,902. Because Autosport needed two weeks to prepare the new van, the contract provided for delivery on or about August 3, 1978.

Πs bought camper + trade in 14,000 for new 4,700 for trade in

On that date, Mr. and Mrs. Ramirez returned with their checks to Autosport to pick up the new van. Graff was not there so Mr. White, another salesman, met them. Inspection disclosed several defects in the van. The paint was scratched, both the electric and sewer hookups were missing, and the hubcaps were not installed. White advised the Ramirezes not to accept the camper because it was not ready.

Π went to pick up camper

Mr. and Mrs. Ramirez wanted the van for a summer vacation and called Graff several times. Each time Graff told them it was not ready for delivery. Finally, Graff called to notify them that the camper was ready. On August 14 Mr. and Mrs. Ramirez went to Autosport to accept delivery, but workers were still touching up the outside paint. Also, the camper windows were open, and the dining area cushions were soaking wet. Mr. and Mrs. Ramirez could not use the camper in that condition, but Mr. Leis, Autosport's manager, suggested that they take the van and that Autosport would replace the cushions later. Mrs. Ramirez counteroffered to accept the van if they could withhold $2,000, but Leis agreed to no more than $250, which she refused. Leis then agreed to replace the cushions and to call them when the van was ready.

Πs w/ camper vacation told ready but was not + additional issues

On August 15, 1978 Autosport transferred title to the van to Mr. and Mrs. Ramirez, a fact unknown to them until the summer of 1979. Between August 15 and September 1, 1978 Mrs. Ramirez called Graff several times urging him to complete the preparation of the van, but Graff constantly advised her that the van was not ready. He finally informed her that they could pick it up on September 1.

Δ transferred title to Πs w/o their knowledge

When Mr. and Mrs. Ramirez went to the showroom on September 1, Graff asked them to wait. And wait they did — for one and a half hours. No one from Autosport came forward to talk with them, and the Ramirezes left in disgust.

Πs went to pick up - none came forward & they left

On October 5, 1978 Mr. and Mrs. Ramirez went to Autosport with an attorney friend. Although the parties disagreed on what occurred, the general topic was whether they should proceed with the deal or Autosport

should return to the Ramirezes their trade-in van. Mrs. Ramirez claimed they rejected the new van and requested the return of their trade-in. Mr. Lustig, the owner of Autosport, thought, however, that the deal could be salvaged if the parties could agree on the dollar amount of a credit for the Ramirezes. Mr. and Mrs. Ramirez never took possession of the new van and repeated their request for the return of their trade-in. Later in October, however, Autosport sold the trade-in to an innocent third party for $4,995. Autosport claimed that the Ramirez' van had a book value of $3,200 and claimed further that it spent $1,159.62 to repair their van. By subtracting the total of those two figures, $4,359.62, from the $4,995.00 sale price, Autosport claimed a $600-700 profit on the sale.

On November 20, 1978 the Ramirezes sued Autosport seeking, among other things, rescission of the contract. Autosport counterclaimed for breach of contract.

II

Our initial inquiry is whether a consumer may reject defective goods that do not conform to the contract of sale. The basic issue is whether under the U.C.C., adopted in New Jersey as N.J.S.A. 12A:1-101 et seq., a seller has the duty to deliver goods that conform precisely to the contract. We conclude that the seller is under such a duty to make a "perfect tender" and that a buyer has the right to reject goods that do not conform to the contract. That conclusion, however, does not resolve the entire dispute between buyer and seller. A more complete answer requires a brief statement of the history of the mutual obligations of buyers and sellers of commercial goods.

In the nineteenth century, sellers were required to deliver goods that complied exactly with the sales agreement. See Filley v. Pope, 115 U.S. 213, 220, 6 S. Ct. 19, 21, 29 L. Ed. 372, 373 (1885) (buyer not obliged to accept otherwise conforming scrap iron shipped to New Orleans from Leith, rather than Glasgow, Scotland, as required by contract); Columbian Iron Works & Dry-Dock Co. v. Douglas, 84 Md. 44, 47, 34 A. 1118, 1120-1121 (1896) (buyer who agreed to purchase steel scrap from United States cruisers not obliged to take any other kind of scrap). That rule, known as the "perfect tender" rule, remained part of the law of sales well into the twentieth century. By the 1920s the doctrine was so entrenched in the law that Judge Learned Hand declared "[t]here is no room in commercial contracts for the doctrine of substantial performance." Mitsubishi Goshi Kaisha v. J. Aron & Co., Inc., 16 E2d 185, 186 (2 Cir. 1926).

The harshness of the rule led courts to seek to ameliorate its effect and to bring the law of sales in closer harmony with the law of contracts, which allows rescission only for material breaches. . . . Nevertheless, a variation of the perfect tender rule appeared in the Uniform Sales Act. N.J.S.A. 46:30-75 (purchasers permitted to reject goods or rescind contracts for any breach of warranty); N.J.S.A. 46:30-18 to -21 (warranties extended to include all the seller's obligations to the goods). . . . The chief objection to the continuation of the perfect tender rule was that buyers in a declining market would reject goods for minor nonconformities and force the loss on surprised sellers. See Hawkland, Sales and Bulk Sales Under the Uniform Commercial

Code, 120-122 (1958), cited in N.J.S.A. 12A:2-508, New Jersey Study Comment 3.

To the extent that a buyer can reject goods for any nonconformity, the U.C.C. retains the perfect tender rule. Section 2-106 states that goods conform to a contract "when they are in accordance with the obligations under the contract." N.J.S.A. 12A:2-106. Section 2-601 authorizes a buyer to reject goods if they "or the tender of delivery fail in any respect to conform to the contract." N.J.S.A. 12A:2-601. The Code, however, mitigates the harshness of the perfect tender rule and balances the interests of buyer and seller. See Restatement (Second), Contracts, §241 comment (b) (1981). The Code achieves that result through its provisions for revocation of acceptance and cure. N.J.S.A. 12A:2-608, 2-508.

Initially, the rights of the parties vary depending on whether the rejection occurs before or after acceptance of the goods. Before acceptance, the buyer may reject goods for any nonconformity. N.J.S.A. 12A:2-601. Because of the seller's right to cure, however, the buyer's rejection does not necessarily discharge the contract. N.J.S.A. 12A:2-508. Within the time set for performance in the contract, the seller's right to cure is unconditional. Id., subsec. (1); see id., Official Comment 1. Some authorities recommend granting a breaching party a right to cure in all contracts, not merely those for the sale of goods. Restatement (Second), Contracts, ch. 10, especially §§237 and 241. Underlying the right to cure in both kinds of contracts is the recognition that parties should be encouraged to communicate with each other and to resolve their own problems. Id., Introduction p. 193.

The rights of the parties also vary if rejection occurs after the time set for performance. After expiration of that time, the seller has a further reasonable time to cure if he believed reasonably that the goods would be acceptable with or without a money allowance. N.J.S.A. 12A:2-508(2). The determination of what constitutes a further reasonable time depends on the surrounding circumstances, which include the change of position by and the amount of inconvenience to the buyer. N.J.S.A. 12A:2-508, Official Comment 3. Those circumstances also include the length of time needed by the seller to correct the nonconformity and his ability to salvage the goods by resale to others. See Restatement (Second), Contracts, §241 comment (d). Thus, the Code balances the buyer's right to reject nonconforming goods with a "second chance" for the seller to conform the goods to the contract under certain limited circumstances. N.J.S.A. 12A:2-508, New Jersey Study Comment 1.

After acceptance, the Code strikes a different balance: the buyer may revoke acceptance only if the nonconformity substantially impairs the value of the goods to him. N.J.S.A. 12A:2-608. . . . See generally, Priest, Breach and Remedy for the Tender of Non-Conforming Goods under the Uniform Commercial Code: An Economic Approach, 91 Harv. L. Rev. 960, 971-973 (1978). This provision protects the seller from revocation for trivial defects. . . . It also prevents the buyer from taking undue advantage of the seller by allowing goods to depreciate and then returning them because of asserted minor defects. . . . Because this case involves rejection of goods, we need not decide whether a seller has a right to cure substantial defects that justify revocation of acceptance. See Pavesi v. Ford Motor Co., 155 N.J. Super. 373, 378, [382 A.2d 954] (App. Div. 1978) (right to cure after acceptance limited to trivial defects). . . .

Other courts agree that the buyer has a right of rejection for any nonconformity, but that the seller has a countervailing right to cure within a reasonable time. . . .

One New Jersey case, Gindy Mfg. Corp. v. Cardinale Trucking Corp., suggests that, because some defects can be cured, they do not justify rejection. 111 N.J. Super. 383, 387 n.1, 268 A.2d 345 (Law Div. 1970). . . . Nonetheless, we conclude that the perfect tender rule is preserved to the extent of permitting a buyer to reject goods for any defects. Because of the seller's right to cure, rejection does not terminate the contract. Accordingly, we disapprove the suggestion in *Gindy* that curable defects do not justify rejection.

A further problem, however, is identifying the remedy available to a buyer who rejects goods with insubstantial defects that the seller fails to cure within a reasonable time. The Code provides expressly that when "the buyer rightfully rejects, then with respect to the goods involved, the buyer may cancel." N.J.S.A. 12A:2-711. "Cancellation" occurs when either party puts an end to the contract for breach by the other. N.J.S.A. 12A:2-106(4). Nonetheless, some confusion exists whether the equitable remedy of rescission survives under the Code. . . .

The Code eschews the word "rescission" and substitutes the terms "cancellation," "revocation of acceptance," and "rightful rejection." N.J.S.A. 12A:2-106(4); 2-608; and 2-711 and Official Comment 1. Although neither "rejection" nor "revocation of acceptance" is defined in the Code, rejection includes both the buyer's refusal to accept or keep delivered goods and his notification to the seller that he will not keep them. . . . Revocation of acceptance is like rejection, but occurs after the buyer has accepted the goods. Nonetheless, revocation of acceptance is intended to provide the same relief as rescission of a contract of sale of goods. N.J.S.A. 12A:2-608 Official Comment 1; N.J. Study Comment 2. In brief, revocation is tantamount to rescission. . . . Similarly, subject to the seller's right to cure, a buyer who rightfully rejects goods, like one who revokes his acceptance, may cancel the contract. N.J.S.A. 12A:2-711 and Official Comment 1. We need not resolve the extent to which rescission for reasons other than rejection or revocation of acceptance, e.g., fraud and mistake, survives as a remedy outside the Code. . . .

Although the complaint requested rescission of the contract, plaintiffs actually sought not only the end of their contractual obligations, but also restoration to their pre-contractual position. That request incorporated the equitable doctrine of restitution, the purpose of which is to restore plaintiff to as good a position as he occupied before the contract. . . . In U.C.C. parlance, plaintiffs' request was for the cancellation of the contract and recovery of the price paid. N.J.S.A. 12A:2-106(4), 2-711.

General contract law permits rescission only for material breaches, and the Code restates "materiality" in terms of "substantial impairment." . . . The Code permits a buyer who rightfully rejects goods to cancel a contract of sale. N.J.S.A. 12A:2-711. Because a buyer may reject goods with insubstantial defects, he also may cancel the contract if those defects remain uncured. Otherwise, a seller's failure to cure minor defects would compel a buyer to accept imperfect goods and collect for any loss caused by the nonconformity. N.J.S.A. 12A:2-714.

Although the Code permits cancellation by rejection for minor defects, it permits revocation of acceptance only for substantial impairments. That distinction is consistent with other Code provisions that depend on

whether the buyer has accepted the goods. Acceptance creates liability in the buyer for the price, N.J.S.A. 12A:2-709(1), and precludes rejection. N.J.S.A. 12A:2-607(2); N.J.S.A. 12A:2-606, New Jersey Study Comment 1. Also, once a buyer accepts goods, he has the burden to prove any defect. N.J.S.A. 12A:2-607(4). . . . By contrast, where goods are rejected for not conforming to the contract, the burden is on the seller to prove that the nonconformity was corrected. . . .

Underlying the Code provisions is the recognition of the revolutionary change in business practices in this century. The purchase of goods is no longer a simple transaction in which a buyer purchases individually-made goods from a seller in a face-to-face transaction. Our economy depends on a complex system for the manufacture, distribution, and sale of goods, a system in which manufacturers and consumers rarely meet. Faceless manufacturers mass-produce goods for unknown consumers who purchase those goods from merchants exercising little or no control over the quality of their production. In an age of assembly lines, we are accustomed to cars with scratches, television sets without knobs and other products with all kinds of defects. Buyers no longer expect a "perfect tender." If a merchant sells defective goods, the reasonable expectation of the parties is that the buyer will return those goods and that the seller will repair or replace them.

Recognizing this commercial reality, the Code permits a seller to cure imperfect tenders. Should the seller fail to cure the defects, whether substantial or not, the balance shifts again in favor of the buyer, who has the right to cancel or seek damages. N.J.S.A. 12A:2-711. In general, economic considerations would induce sellers to cure minor defects. See generally Priest, supra, 91 Harv. L. Rev. 973-974. Assuming the seller does not cure, however, the buyer should be permitted to exercise his remedies under N.J.S.A. 12A:2-711. The Code remedies for consumers are to be liberally construed, and the buyer should have the option of cancelling if the seller does not provide conforming goods. See N.J.S.A. 12A:1-106.

To summarize, the U.C.C. preserves the perfect tender rule to the extent of permitting a buyer to reject goods for any nonconformity. Nonetheless, that rejection does not automatically terminate the contract. A seller may still effect a cure and preclude unfair rejection and cancellation by the buyer. N.J.S.A. 12A:2-508, Official Comment 2; N.J.S.A. 12A:2-711, Official Comment 1.

III

The trial court found that Mr. and Mrs. Ramirez had rejected the van within a reasonable time under N.J.S.A. 12A:2-602. The court found that on August 3, 1978 Autosport's salesman advised the Ramirezes not to accept the van and that on August 14, they rejected delivery and Autosport agreed to replace the cushions. Those findings are supported by substantial credible evidence, and we sustain them. . . . Although the trial court did not find whether Autosport cured the defects within a reasonable time, we find that Autosport did not effect a cure. Clearly the van was not ready for delivery during August, 1978 when Mr. and Mrs. Ramirez rejected it, and Autosport had the burden of proving that

it had corrected the defects. Although the Ramirezes gave Autosport ample time to correct the defects, Autosport did not demonstrate that the van conformed to the contract on September 1. In fact, on that date, when Mr. and Mrs. Ramirez returned at Autosport's invitation, all they received was discourtesy.

On the assumption that substantial impairment is necessary only when a purchaser seeks to revoke acceptance under N.J.S.A. 12A:2-608, the trial court correctly refrained from deciding whether the defects substantially impaired the van. The court properly concluded that plaintiffs were entitled to "rescind" — i.e., to "cancel" — the contract. . . .

For the preceding reasons, we affirm the judgment of the Appellate Division.

SALES CONTRACTS: THE UNIFORM COMMERCIAL CODE

§2-106. DEFINITIONS: "CONTRACT"; "AGREEMENT"; "CONTRACT FOR SALE"; "SALE"; "PRESENT SALE"; "CONFORMING" TO CONTRACT; "TERMINATION"; "CANCELLATION"

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

§2-508. CURE BY SELLER OF IMPROPER TENDER OR DELIVERY; REPLACEMENT

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of bis intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller bad reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

§2-601. BUYER'S RIGHTS ON IMPROPER DELIVERY

Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest.

§2-602. MANNER AND EFFECT OF RIGHTFUL REJECTION

(1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (Sections 2-603 and 2-604),

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this Article (subsection (3) of Section 2-711), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this Article on Seller's remedies in general (Section 2-703).

§2-606. WHAT CONSTITUTES ACCEPTANCE OF GOODS

(1) Acceptance of goods occurs when the buyer

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

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

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

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

§2-607. EFFECT OF ACCEPTANCE; NOTICE OF BREACH; BURDEN OF ESTABLISHING BREACH AFTER ACCEPTANCE; NOTICE OF CLAIM OR LITIGATION TO PERSON ANSWERABLE OVER

(1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a non-conformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the non-conformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this Article for non-conformity.

(3) Where a tender has been accepted

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over

(a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of Section 2-312).

§2-608. REVOCATION OF ACCEPTANCE IN WHOLE OR IN PART

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods as if he had rejected them.

§2-709. ACTION FOR THE PRICE

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (Section 2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for non-acceptance under the preceding section.

§2-711. BUYER'S REMEDIES IN GENERAL; BUYER'S SECURITY INTEREST IN REJECTED GOODS

(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for non-delivery as provided in this Article (Section 2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

(a) if the goods have been identified recover them as provided in this Article (Section 2-502); or

(b) in a proper case obtain specific performance or replevy the goods as provided in this Article (Section 2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

REFERENCE: Farnsworth, §8.12
Calamari & Perillo, §11.20
Murray, §109D

C. COST OF COMPLETION V. DIMINUTION IN VALUE: THE EXPECTATION INTEREST REVISITED

In Jacob & Youngs v. Kent, Judge Cardozo found that, while the builder may have breached the contract, because it had nonetheless *substantially performed*, the owner must pay the balance due on the house, less any damages he might have sustained as a result of the breach. Judge Cardozo then considered the issue of the appropriate measure of damages when there has been substantial, but not complete, performance. The owner asked for "cost of replacement, which would be great" (p. 976), whereas Cardozo found he was only entitled to the "difference in value, which would be either nominal or nothing" (id.). He then offered the following rule:

> It is true that in most cases the cost of replacement is the measure. . . . The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. [p. 977]

The next two cases examine these two different ways to measure expectation damages and the merits of using one calculation or the other. Since this concerns the proper measure of damages, we might well have studied it when we initially considered the expectation interest and its limits in Chapter 2. Nevertheless, it is useful to evaluate this rule after learning about the doctrines of good faith and material breach because that is the context in which it arises in contracts disputes.

STUDY GUIDE: In the following case, both the majority and the dissent cite Judge Cardozo's opinion in Jacob & Youngs *in support of their position. Which one is correct? Is the court's use of the concept of "willful" breach helpful here? When is a breach of contract not willful?*

GROVES v. JOHN WUNDER CO.

Supreme Court of Minnesota,
205 Minn. 163, 286 N.W. 235 (1939)

STONE, J.*

Action for breach of contract. Plaintiff got judgment for a little over $15,000. Sorely disappointed by that sum, he appeals.

* *Royal A. Stone* (1875-1942) graduated from Washington University College of Law at St. Louis and was admitted to legal practice in 1897. He served as Assistant Attorney General (1905-1907) and with the infantry in the Spanish-American War and World War I. Stone was appointed Associate Justice of the Supreme Court in 1923 and elected to the same the following year. Stone was re-elected to consecutive terms, serving until his death. — K.T.

In August, 1927, S. J. Groves & Sons Company, a corporation (hereinafter mentioned simply as Groves), owned a tract of 24 acres of Minneapolis suburban real estate. It was served or easily could be reached by railroad trackage. It is zoned as heavy industrial property. But for lack of development of the neighborhood its principal value thus far may have been in the deposit of sand and gravel which it carried. The Groves company had a plant on the premises for excavating and screening the gravel. Nearby defendant owned and was operating a similar plant.

In August, 1927, Groves and defendant made the involved contract. For the most part it was a lease from Groves, as lessor, to defendant, as lessee; its term seven years. Defendant agreed to remove the sand and gravel and to leave the property "at a uniform grade, substantially the same as the grade now existing at the roadway . . . on said premises, and that in stripping the overburden . . . it will use said overburden for the purpose of maintaining and establishing said grade."

Under the contract defendant got the Groves screening plant. The transfer thereof and the right to remove the sand and gravel made the consideration moving from Groves to defendant, except that defendant incidentally got rid of Groves as a competitor. On defendant's part it paid Groves $105,000. So that from the outset, on Groves' part the contract was executed except for defendant's right to continue using the property for the stated term. (Defendant had a right to renewal which it did not exercise.)

Defendant breached the contract deliberately. It removed from the premises only "the richest and best of the gravel" and wholly failed, according to the findings, "to perform and comply with the terms, conditions, and provisions of said lease . . . with respect to the condition in which the surface of the demised premises was required to be left." Defendant surrendered the premises, not substantially at the grade required by the contract "nor at any uniform grade." Instead, the ground was "broken, rugged, and uneven." Plaintiff sues as assignee and successor in right of Groves.

As the contract was construed below, the finding is that to complete its performance 288,495 cubic yards of overburden would need to be excavated, taken from the premises, and deposited elsewhere. The reasonable cost of doing that was found to be upwards of $60,000. But, if defendant had left the premises at the uniform grade required by the lease, the reasonable value of the property on the determinative date would have been only $12,160. The judgment was for that sum, including interest, thereby nullifying plaintiff's claim that cost of completing the contract rather than difference in value of the land was the measure of damages. The gauge of damage adopted by the decision was the difference between the market value of plaintiff's land in the condition it was when the contract was made and what it would have been if defendant had performed. The one question for us arises upon plaintiff's assertion that he was entitled, not to that difference in value, but to the reasonable cost to him of doing the work called for by the contract which defendant left undone.

1. Defendant's breach of contract was wilful. There was nothing of good faith about it. Hence, that the decision below handsomely rewards bad faith and deliberate breach of contract is obvious. That is not allowable. Here the rule is well settled, and has been since Elliott v. Caldwell, 43 Minn. 357, 45 N.W. 845, 9 L.R.A. 52, that, where the contractor wilfully and

fraudulently varies from the terms of a construction contract, he cannot sue thereon and have the benefit of the equitable doctrine of substantial performance. That is the rule generally. . . .

Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 243, 244, 129 N.E. 889, 891, 23 A.L.R. 1429, is typical. It was a case of substantial performance of a building contract. (This case is distinctly the opposite.) Mr. Justice Cardozo, in the course of his opinion, stressed the distinguishing features. "Nowhere," he said, "will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract." Again, "the willful transgressor must accept the penalty of his transgression."

2. In reckoning damages for breach of a building or construction contract, the law aims to give the disappointed promisee, so far as money will do it, what he was promised. . . .

Never before, so far as our decisions show, has it even been suggested that lack of value in the land furnished to the contractor who had bound himself to improve it any escape from the ordinary consequences of a breach of the contract. . . .

Even in case of substantial performance in good faith, the resulting defects being remediable, it is error to instruct that the measure of damage is "the difference in value between the house as it was and as it would have been if constructed according to contract." The "correct doctrine" is that the cost of remedying the defect is the "proper" measure of damages. Snider v. Peters Home Building Co., 139 Minn. 413, 414, 416, 167 N.W. 108.

Value of the land (as distinguished from the value of the intended product of the contract, which ordinarily will be equivalent to its reasonable cost) is no proper part of any measure of damages for wilful breach of a building contract. The reason is plain.

The summit from which to reckon damages from trespass to real estate is its actual value at the moment. The owner's only right is to be compensated for the deterioration in value caused by the tort. That is all he has lost.[9] But not so if a contract to improve the same land has been breached by the contractor who refuses to do the work, especially where, as here, he has been paid in advance. The summit from which to reckon damages for that wrong is the hypothetical peak of accomplishment (not value) which would have been reached had the work been done as demanded by the contract.

The owner's right to improve his property is not trammeled by its small value. It is his right to erect thereon structures which will reduce its value. If that be the result, it can be of no aid to any contractor who declines performance. As said long ago in Chamberlain v. Parker, 45 N.Y. 569, 572: "A man may do what he will with his own, . . . and if he chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it, it does not lie with a defendant who has been so employed and paid for building it, to say that his own performance would not be beneficial to the plaintiff." . . .

Suppose a contractor were suing the owner for breach of a grading contract such as this. Would any element of value, or lack of it, in the land have any relevance in reckoning damages? Of course not. The contractor

9. So also in condemnation cases, where the owner loses nothing of promised contractual performance.

would be compensated for what he had lost, i.e., his profit. Conversely, in such a case as this, the owner is entitled to compensation for what he has lost, that is, the work or structure which he has been promised, for which he has paid, and of which he has been deprived by the contractor's breach.

To diminish damages recoverable against him in proportion as there is presently small value in the land would favor the faithless contractor. It would also ignore and so defeat plaintiff's right to contract and build for the future. To justify such a course would require more of the prophetic vision than judges possess. This factor is important when the subject matter is trackage property in the margin of such an area of population and industry as that of the Twin Cities. . . .

It is suggested that because of little or no value in his land the owner may be unconscionably enriched by such a reckoning. The answer is that there can be no unconscionable enrichment, no advantage upon which the law will frown, when the result is but to give one party to a contract only what the other has promised; particularly where, as here, the delinquent has had full payment for the promised performance.

3. It is said by the Restatement, Contracts, §346, Comment b: "Sometimes defects in a completed structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste. If no such waste is involved, the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance."

The "economic waste" declaimed against by the decisions applying that rule has nothing to do with the value in money of the real estate, or even with the product of the contract. The waste avoided is only that which would come from wrecking a physical structure, completed, or nearly so, under the contract. The cases applying that rule go no further. . . . Absent such waste, as it is in this case, the rule of the Restatement, Contracts, §346, is that "the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance." That means that defendants here are liable to plaintiff for the reasonable cost of doing what defendants promised to do and have wilfully declined to do.

It follows that there must be a new trial. . . .

The judgment must be reversed with a new trial to follow.

So ordered.

JULIUS J. OLSON, J.* (dissenting). . . .

Since there is no issue of fact we should limit our inquiry to the single legal problem presented: What amount in money will adequately compensate plaintiff for his loss caused by defendant's failure to render performance? . . .

**Julius Johann Olson* (1875-1955) received legal training at the University of Minnesota (LL.B.). Born in Norway, he was brought to America in 1883. He was admitted to the Minnesota bar in 1900 and practiced at Warren until 1930, when he was appointed district judge. In 1932, he was elected for a term of six years, leaving that court in 1934 to accept appointment to the Supreme Court of Minnesota. Elected to that post in 1934, he served on that bench until his retirement in 1948. — K.T.

As the rule of damages to be applied in any given case has for its purpose compensation, not punishment, we must be ever mindful that, "If the application of a particular rule for measuring damages to given facts results in more than compensation, it is at once apparent that the wrong rule has been adopted." Crowley v. Burns Boiler & Mfg. Co., 100 Minn. 178, 187, 110 N.W. 969, 973.

We have here then a situation where, concededly, if the contract had been performed, plaintiff would have had property worth, in round numbers, no more than $12,000. If he is to be awarded damages in an amount exceeding $60,000 he will be receiving at least 500 per cent more than his property, properly leveled to grade by actual performance, was intrinsically worth when the breach occurred. To so conclude is to give him something far beyond what the parties had in mind or contracted for. There is no showing made, nor any finding suggested, that this property was unique, specially desirable for a particular or personal use, or of special value as to location or future use different from that of other property surrounding it. Under the circumstances here appearing, it seems clear that what the parties contracted for was to put the property in shape for general sale. And the lease contemplates just that, for by the terms thereof defendant agreed "from time to time, as the sand and gravel are removed from the various lots . . . leased, it will surrender said lots to the lessor" if of no further use to defendant "in connection with the purposes for which this lease is made."

The theory upon which plaintiff relies for application of the cost of performance rule must have for its basis cases where the property or the improvement to be made is unique or personal instead of being of the kind ordinarily governed by market values. His action is one at law for damages, not for specific performance. As there was no affirmative showing of any peculiar fitness of this property to a unique or personal use, the rule to be applied is, I think, the one applied by the court. The cases bearing directly upon this phase so hold. Briefly, the rule here applicable is this: Damages recoverable for breach of a contract to construct is the difference between the market value of the property in the condition it was when delivered to and received by plaintiff and what its market value would have been if defendant had fully complied with its terms. . . .

The principle for which I contend is not novel in construction contract cases. It is well stated in McCormick, Damages, §168, pp. 648, 649, as follows:

> In whatever way the issue arises, the generally approved standards for measuring the owner's loss from defects in the work are two: First, in cases where the defect is one that can be repaired or cured without undue expense, so as to make the building conform to the agreed plan, then the owner recovers such amount as he has reasonably expended, or will reasonably have to spend, to remedy the defect. Second, if, on the other hand, the defect in material or construction is one that cannot be remedied without an expenditure for reconstruction disproportionate to the end to be attained, or without endangering unduly other parts of the building, then the damages will be measured not by the cost of remedying the defect, but by the difference between the value of the building as it is and what it would have been worth if it had been built in conformity with the contract.

And the same thought was expressed by Mr. Justice Cardozo in Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 244, 129 N.E. 889, 891, 23 A.L.R. 1429,

1433, thus: "The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value." . . .

No one doubts that a party may contract for the doing of anything he may choose to have done (assuming what is to be done is not unlawful) "although the thing to be produced had no marketable value." (45 N.Y. page 572.) . . .

But that is not what plaintiff's predecessor in interest contracted for. Such a provision might well have been made, but the parties did not. They could undoubtedly have provided for liquidated damages for nonperformance . . . or they might have determined in money what the value of performance was considered to be and thereby have contractually provided a measure for failure of performance.

. . . In what manner has plaintiff been hurt beyond the damages awarded? As to him "economic waste" is not apparent. Assume that defendant abandoned the entire project without taking a single yard of gravel therefrom but left the premises as they were when the lease was made, could plaintiff recover damages upon the basis here established? The trouble with the prevailing opinion is that here plaintiff's loss is not made the basis for the amount of his recovery but rather what it would cost the defendant. No case has been decided upon that basis until now. . . .

. . . I think the judgment should be affirmed.

STUDY GUIDE: Is there any relevant difference between Groves v. John Wunder and the next case? Does this factor support or undercut the outcome reached by the court? Are your sympathies for the party in breach different here than in Jacob & Youngs*? If so, why? Consider what this says both for and against the role of sympathies in deciding cases.*

reduced award to $300!

PEEVYHOUSE v. GARLAND COAL MINING CO.

Supreme Court of Oklahoma, 382 P.2d 109 (1962), cert. denied, 375 U.S. 906 (1963)

ISSUE - Δ rest. Prairie value cost of repair

JACKSON, J.*

In the trial court, plaintiffs Willie and Lucille Peevyhouse sued the defendant, Garland Coal and Mining Company, for damages for breach of contract. Judgment was for plaintiffs in an amount considerably less than was sued for. Plaintiffs appeal and defendant cross-appeals.

In the briefs on appeal, the parties present their argument and contentions under several propositions; however, they all stem from the basic question of whether the trial court properly instructed the jury on the measure of damages.

* *Floyd Louis Jackson* (1902-†) was educated at the University of Oklahoma (LL.B.) and was admitted to the Oklahoma bar in 1927 and the Texas bar in 1928. He began his legal career at Burkburnett, Texas, in 1928, and removed to Walters, Oklahoma, where he served as County Attorney for Cotton County (1931-1936) and practiced privately (1936-1942). He joined the bench as judge of the Fifth Judicial District Court in 1946, moving to the Supreme Court in 1955. He retired from the court in 1973. — K.T.

Briefly stated, the facts are as follows: plaintiffs owned a farm containing coal deposits, and in November, 1954, leased the premises to defendant for a period of five years for coal mining purposes. A "stripmining" operation was contemplated in which the coal would be taken from pits on the surface of the ground, instead of from underground mine shafts. In addition to the usual covenants found in a coal mining lease, defendant specifically agreed to perform certain restorative and remedial work at the end of the lease period. It is unnecessary to set out the details of the work to be done, other than to say that it would involve the moving of many thousands of cubic yards of dirt, at a cost estimated by expert witnesses at about $29,000.00. However, plaintiffs sued for only $25,000.00.

During the trial, it was stipulated that all covenants and agreements in the lease contract had been fully carried out by both parties, except the remedial work mentioned above; defendant conceded that this work had not been done.

Plaintiffs introduced expert testimony as to the amount and nature of the work to be done, and its estimated cost. Over plaintiffs' objections, defendant thereafter introduced expert testimony as to the "diminution in value" of plaintiffs' farm resulting from the failure of defendant to render performance as agreed in the contract — that is, the difference between the present value of the farm, and what its value would have been if defendant had done what it agreed to do.

At the conclusion of the trial, the court instructed the jury that it must return a verdict for plaintiffs, and left the amount of damages for jury determination. On the measure of damages, the court instructed the jury that it might consider the cost of performance of the work defendant agreed to do, "together with all of the evidence offered on behalf of either party."

It thus appears that the jury was at liberty to consider the "diminution in value" of plaintiffs' farm as well as the cost of "repair work" in determining the amount of damages.

It returned a verdict for plaintiffs for $5000.00 — only a fraction of the "cost of performance," *but more than the total value of the farm even after the remedial work is done.*

On appeal, the issue is sharply drawn. Plaintiffs contend that the true measure of damages in this case is what it will cost plaintiffs to obtain performance of the work that was not done because of defendant's default. Defendant argues that the measure of damages is the cost of performance "limited, however, to the total difference in the market value before and after the work was performed."

It appears that this precise question has not heretofore been presented to this court. In Ardizonne v. Archer, 72 Okl. 70, 178 P. 263, this court held that the measure of damages for breach of a contract to drill an oil well was the reasonable cost of drilling the well, but here a slightly different factual situation exists. The drilling of an oil well will yield valuable geological information, even if no oil or gas is found, and of course if the well is a producer, the value of the premises increases. In the case before us, it is argued by defendant with some force that the performance of the remedial work defendant agreed to do will add at the most only a few hundred dollars to the value of plaintiffs' farm, and that the damages should be limited to that amount because that is all plaintiffs have lost.

Plaintiffs rely on Groves v. John Wunder Co., 205 Minn. 163, 286 N.W. 235, 123 A.L.R. 502. In that case, the Minnesota court, in a substantially similar situation, adopted the "cost of performance" rule as opposed to the "value" rule. The result was to authorize a jury to give plaintiff damages in the amount of $60,000, where the real estate concerned would have been worth only $12,160, even if the work contracted for had been done.

It may be observed that Groves v. John Wunder Co., supra, is the only case which has come to our attention in which the cost of performance rule has been followed under circumstances where the cost of performance greatly exceeded the diminution in value resulting from the breach of contract. Incidentally, it appears that this case was decided by a plurality rather than a majority of the members of the court.

Defendant relies principally upon Sandy Valley E. R. Co. v. Hughes, 175 Ky. 320, 194 S.W. 344; Bigham v. Wabash-Pittsburg Terminal Ry. Co., 223 Pa. 106, 72 A. 318; and Sweeney v. Lewis Const. Co., 66 Wash. 490, 119 P. 1108. These were all cases in which, under similar circumstances, the appellate courts followed the "value" rule instead of the "cost of performance" rule. Plaintiff points out that in the earliest of these cases (*Bigham*) the court cites as authority on the measure of damages an earlier Pennsylvania *tort* case, and that the other two cases follow the first, with no explanation as to why a measure of damages ordinarily followed in cases sounding in tort should be used in contract cases. Nevertheless, it is of some significance that three out of four appellate courts have followed the diminution in value rule under circumstances where, as here, the cost of performance greatly exceeds the diminution in value.

The explanation may be found in the fact that the situations presented are artificial ones. It is highly unlikely that the ordinary property owner would agree to pay $29,000 (or its equivalent) for the construction of "improvements" upon his property that would increase its value only about ($300) three hundred dollars. The result is that we are called upon to apply principles of law theoretically based upon reason and reality to a situation which is basically unreasonable and unrealistic.

In Groves v. John Wunder Co., supra, in arriving at its conclusions, the Minnesota court apparently considered the contract involved to be analogous to a building and construction contract, and cited authority for the proposition that the cost of performance or completion of the building as contracted is ordinarily the measure of damages in actions for damages for the breach of such a contract.

In an annotation following the Minnesota case beginning at 123 A.L.R. 515, the annotator places the three cases relied on by defendant (*Sandy Valley*, *Bigham* and *Sweeney*) under the classification of cases involving "grading and excavation contracts."

We do not think either analogy is strictly applicable to the case now before us. The primary purpose of the lease contract between plaintiffs and defendant was neither "building and construction" nor "grading and excavation." It was merely to accomplish the economical recovery and marketing of coal from the premises, to the profit of all parties. The special provisions of the lease contract pertaining to remedial work were incidental to the main object involved.

Even in the case of contracts that are unquestionably building and construction contracts, the authorities are not in agreement as to the factors

to be considered in determining whether the cost of performance rule or the value rule should be applied. The American Law Institute's Restatement of the Law, Contracts, Volume 1, Sections 346(1)(a)(i) and (ii) submits the proposition that the cost of performance is the proper measure of damages "if this is possible and does not involve *unreasonable economic waste*"; and that the diminution in value caused by the breach is the proper measure "if construction and completion in accordance with the contract would involve *unreasonable economic waste.*" (Emphasis supplied.) In an explanatory comment immediately following the text, the Restatement makes it clear that the "economic waste" referred to consists of the destruction of a substantially completed building or other structure. Of course no such destruction is involved in the case now before us.

On the other hand, in McCormick, Damages, Section 168, it is said with regard to building and construction contracts that ". . . in cases where the defect is one that can be repaired or cured without *undue expense*" the cost of performance is the proper measure of damages, but where ". . . the defect in material or construction is one that cannot be remedied without *an expenditure for reconstruction disproportionate to the end to be attained*" (emphasis supplied) the value rule should be followed. The same idea was expressed in Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 129 N.E. 889, 23 A.L.R. 1429, as follows:

> The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value.

It thus appears that the prime consideration in the Restatement was "economic waste"; and that the prime consideration in McCormick, Damages, and in Jacob & Youngs, Inc. v. Kent, supra, was the relationship between the expense involved and the "end to be attained" — in other words, the "relative economic benefit."

In view of the unrealistic fact situation in the instant case, and certain Oklahoma statutes to be hereinafter noted, we are of the opinion that the "relative economic benefit" is a proper consideration here. This is in accord with the recent case of Mann v. Clowser, 190 Va. 887, 59 S.E.2d 78, where, in applying the cost rule, the Virginia court specifically noted that ". . . the defects are remediable from a practical standpoint and the costs *are not grossly disproportionate to the results to be obtained*" (emphasis supplied). . . .

We therefore hold that where, in a coal mining lease, lessee agrees to perform certain remedial work on the premises concerned at the end of the lease period, and thereafter the contract is fully performed by both parties except that the remedial work is not done, the measure of damages in an action by lessor against lessee for damages for breach of contract is ordinarily the reasonable cost of performance of the work; however, where the contract provision breached was merely incidental to the main purpose in view, and where the economic benefit which would result to lessor by full performance of the work is grossly disproportionate to the cost of performance, the damages which lessor may recover are limited to the diminution in value resulting to the premises because of the non-performance.

We believe the above holding is in conformity with the intention of the Legislature as expressed in the statutes mentioned, and in harmony with the better-reasoned cases from the other jurisdictions where analogous fact situations have been considered. It should be noted that the rule as stated does not interfere with the property owner's right to "do what he will with his own" (Chamberlain v. Parker, 45 N.Y. 569), or his right, if he chooses, to contract for "improvements" which will actually have the effect of reducing his property's value. Where such result is in fact contemplated by the parties, and is a main or principal purpose of those contracting, it would seem that the measure of damages for breach would ordinarily be the cost of performance. . . .

Under the most liberal view of the evidence herein, the diminution in value resulting to the premises because of non-performance of the remedial work was $300.00. After a careful search of the record, we have found no evidence of a higher figure, and plaintiffs do not argue in their briefs that a greater diminution in value was sustained. It thus appears that the judgment was clearly excessive, and that the amount for which judgment should have been rendered is definitely and satisfactorily shown by the record. . . .

We are of the opinion that the judgment of the trial court for plaintiffs should be, and it is hereby, modified and reduced to the sum of $300.00, and as so modified it is affirmed.

WELCH, DAVISON, HALLEY, and JOHNSON, JJ., concur.

WILLIAMS, C.J., BLACKBIRD, V.C.J., and IRWIN and BERRY, JJ., dissent.

IRWIN, J.* (dissenting).

By the specific provisions in the coal mining lease under consideration, the defendant agreed as follows:

> . . . 7b Lessee agrees to make fills in the pits dug on said premises on the property line in such manner that fences can be placed thereon and access had to opposite sides of the pits.
>
> [7]c Lessee agrees to smooth off the top of the spoil banks on the above premises.
>
> 7d Lessee agrees to leave the creek crossing the above premises in such a condition that it will not interfere with the crossings to be made in pits as set out in 7b. . . .
>
> 7f Lessee further agrees to leave no shale or dirt on the high wall of said pits. . . .

Following the expiration of the lease, plaintiffs made demand upon defendant that it carry out the provisions of the contract and to perform those covenants contained therein.

Defendant admits that it failed to perform its obligations that it agreed and contracted to perform under the lease contract and there is nothing in the record which indicates that defendant could not perform its obligations.

* *Pat Irwin* (1921-1999) studied at Southwestern State College and the University of Oklahoma (LL.B.). After serving as County Attorney for Dewey County (1949-1950) and secretary to the Oklahoma School Land Commission (1955-1958), he accepted appointment to the Supreme Court of Oklahoma in 1959, serving until 1983. He spent two terms as that court's Chief Justice (1969-1970, 1981-1982) and became U.S. Magistrate for the Western District of Oklahoma in 1983. — K.T.

Therefore, in my opinion defendant's breach of the contract was wilful and not in good faith.

Although the contract speaks for itself, there were several negotiations between the plaintiffs and defendant before the contract was executed. Defendant admitted in the trial of the action, that plaintiffs insisted that the above provisions be included in the contract and that they would not agree to the coal mining lease unless the above provisions were included.

In consideration for the lease contract, plaintiffs were to receive a certain amount as royalty for the coal produced and marketed and in addition thereto their land was to be restored as provided in the contract.

Defendant received as consideration for the contract, its proportionate share of the coal produced and marketed and in addition thereto, the *right to use* plaintiffs' land in the furtherance of its mining operations.

The cost for performing the contract in question could have been reasonably approximated when the contract was negotiated and executed and there are no conditions now existing which could not have been reasonably anticipated by the parties. Therefore, defendant had knowledge, when it prevailed upon the plaintiffs to execute the lease, that the cost of performance might be disproportionate to the value or benefits received by plaintiff for the performance.

Defendant has received its benefits under the contract and now urges, in substance, that plaintiffs' measure of damages for its failure to perform should be the economic value of performance to the plaintiffs and not the cost of performance.

If a peculiar set of facts should exist where the above rule should be applied as the proper measure of damages, (and in my judgment those facts do not exist in the instant case) before such rule should be applied, consideration should be given to the benefits received or contracted for by the party who asserts the application of the rule.

Defendant did not have the right to mine plaintiffs' coal or to use plaintiffs' property for its mining operations without the consent of plaintiffs. Defendant had knowledge of the benefits that it would receive under the contract and the approximate cost of performing the contract. With this knowledge, it must be presumed that defendant thought that it would be to its economic advantage to enter into the contract with plaintiffs and that it would reap benefits from the contract, or it would have not entered into the contract.

Therefore, if the value of the performance of a contract should be considered in determining the measure of damages for breach of a contract, the value of the benefits received under the contract by a party who breaches a contract should also be considered. However, in my judgment, to give consideration to either in the instant action, completely rescinds and holds for naught the solemnity of the contract before us and makes an entirely new contract for the parties. . . .

In my judgment, we should follow the case of Groves v. John Wunder Company, 205 Minn. 163, 286 N.W 235, 123 A.L.R. 502, which defendant agrees "that the fact situation is apparently similar to the one in the case at bar," and where the Supreme Court of Minnesota held:

> The owner's or employer's damages for such a breach (i.e. breach hypothesized in 2d syllabus) are to be measured, not in respect to the value of the land

to be improved, but by the reasonable cost of doing that which the contractor promised to do and which he left undone.

The hypothesized breach referred to states that where the contractor's breach of a contract is wilful, that is, in bad faith, he is not entitled to any benefit of the equitable doctrine of substantial performance.

In the instant action defendant has made no attempt to even substantially perform. The contract in question is not immoral, is not tainted with fraud, and was not entered into through mistake or accident and is not contrary to public policy. It is clear and unambiguous and the parties understood the terms thereof, and the approximate cost of fulfilling the obligations could have been approximately ascertained. There are no conditions existing now which could not have been reasonably anticipated when the contract was negotiated and executed. The defendant could have performed the contract if it desired. It has accepted and reaped the benefits of its contract and now urges that plaintiffs' benefits under the contract be denied. If plaintiffs' benefits are denied, such benefits would inure to the direct benefit of the defendant.

Therefore, in my opinion, the plaintiffs were entitled to specific performance of the contract and since defendant has failed to perform, the proper measure of damages should be the cost of performance. Any other measure of damage would be holding for naught the express provisions of the contract; would be taking from the plaintiffs the benefits of the contract and placing those benefits in defendant which has failed to perform its obligations; would be granting benefits to defendant without a resulting obligation; and would be completely rescinding the solemn obligation of the contract for the benefit of the defendant to the detriment of the plaintiffs by making an entirely new contract for the parties.

I therefore respectfully dissent to the opinion promulgated by a majority of my associates.

RESTATEMENT (SECOND) OF CONTRACTS

STUDY GUIDE: Does the following Restatement section adopt or modify the substantial performance doctrine as articulated by Judge Cardozo? Does it reconcile the three previous cases?

§348. ALTERNATIVES TO LOSS IN VALUE OF PERFORMANCE . . .

(2) If a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on

(a) the diminution in the market price of the property caused by the breach, or

(b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss of value to him. . . .

REFERENCE: Barnett, §2.3.7
Farnsworth, §12.13
Calamari & Perillo, §§14.28-14.29
Murray, §119

Relational and Legal Background: Is Peevyhouse *a Lesson in Lawyering or Corruption?*

STUDY GUIDE: In her massive study of the Peevyhouse *case, Professor Judith Maute reveals previously unknown facts about the dispute. Her research teaches valuable lessons to future lawyers about the all-too-common tendency of lawyers to avoid adequate preparation in favor of "shooting-from-the-hip." It also examines the charge that the decision was a product of corruption among members of the Oklahoma Supreme Court. (In order to present here as much of her findings as possible, most footnotes, reflecting Professor Maute's copious research, have been omitted.)*

JUDITH L. MAUTE, PEEVYHOUSE v. GARLAND COAL CO. REVISITED: THE BALLAD OF WILLIE AND LUCILLE, 89 NW. U. L. REV. 1341, 1350, 1358-1363, 1366-1369, 1372-1373, 1399-1401, 1403, 1405-1406, 1446-1447, 1451-1452, 1454-1455, 1465-1470 (1995):

> We picked a fine time to strip mine, Lucille.
> It sure looks to me like we got a raw deal.
> We picked a fine time to strip mine, Lucille.
> It sure looks to me like we got a raw deal.
> That smooth city-slicker said we'd all get rich quicker.
> I should have known it warn't real.
> We picked a fine time to strip mine, Lucille. . . .
>
> We picked a fine time to strip mine, Lucille.
> Make no mistake, hon, we got a raw deal.
> I never went to law school,
> I didn't know the value rule,
> I thought sure we'd win our appeal,
> The Supreme Court done gyped us, Lucille.[10] . . .

I. Contracts in Context: The Unearthed Facts of Peevyhouse v. Garland Coal Co. . . .

> That smooth talkin' stranger, I knew he was danger,
> The minute he walked in our yard.
> But his smooth city ways put us in a daze,
> And that's when we let down our guard.

10. Copyright Todd Lowrey, class of 1991, and William Blodgett, class of 1988, University of Minnesota, J.D. Sung to the tune of "It's a fine time to leave me, Lucille." (Originally written by Roger Bowling and Hal Bynum.) . . .

He said that his goal was to mine all the coal,
Lying beneath our farm.
But, he said not to worry, because in a hurry,
They'd put back our dirt with no harm. . . .

The Peevyhouse land, while quite small in relation to the total acreage and quantity of coal Garland expected to be mined, was key to a profitable mining operation. The targeted vein cut through the Peevyhouses' back twenty-acre parcel and a small portion of their forty-acre parcel. By leasing the Peevyhouses' sixty acres, Garland could move its mining operation efficiently from northwest to southeast.

It appears Garland was strongly motivated to obtain the Peevyhouse lease in order to divert Cedar Creek from the mining site onto their land. Cedar Creek naturally ran north of the property, passing through the heavily mined land owned by neighbors Nolen and Fowler, and eventually flowed onto the northeast corner of Peevyhouses' forty-acre parcel. Its diversion from the mining site was essential to avoid interference with ongoing mining operations.[11] Even before execution of the Peevyhouse lease, Garland began pumping water from the creek onto the Peevyhouses' land. Garland began blasting for the diversion immediately after the lease was signed.

The Peevyhouses were opposed to permitting any mining on their land. An earlier mining operation stopped at their property line, leaving behind the disturbed land, including a dangerous pit, highwall and unsighdy overburden. Their reluctance, combined with Garland's need to divert the creek, undoubtedly enhanced their bargaining power. Nevertheless, there is no indication they used this power to exact unreasonably favorable contract terms. The Peevyhouses waived the right to payment of $3,000 for surface damages in exchange for the promised remedial work. From Garland's perspective, the exchange appeared economically rational. It saved $3,000 immediate cash outlay, enabled prompt creek diversion and obtained rights to mine the Peevyhouse land. Alternatively, Garland might have purchased the land outright. It bought a 1.6 acre triangle of land from Thomas Laird, who owned the twenty-acre strip immediately south of the Peevyhouse twenty-acre parcel and refused to lease the property to Garland. Had the Peevyhouses refused to lease, Garland's mining operation could have skipped over their property and moved to the next leased property along the coal bed. It had done so previously when it could not reach agreement with another local property owner.

Lease negotiations between Cumpton and the Peevyhouses extended over several sessions. The two men dealt directly with each other while Lucille participated behind the scenes, assisting Willie in identifying issues and desired terms. The Peevyhouses were an astute and careful negotiating team. While they lacked advanced education and sophisticated business experience, the final agreement reflects sound judgment and survival skills acquired from living off the land.

11. Letter from R. W. Funston, P. E. to Charles Dietrich (March 22, 1990). . . . He explains:

> A creek is diverted by constructing a new channel around the mining operations and typically back into the original creek downstream so as to not affect downstream water rights. The original creek is then blocked off to divert water into the new channel.

The written contract clearly anticipated leaving an open pit on the Peevyhouses' land. This shows that Garland planned to make the last cut on their land, leaving behind a water-filled pit and the diverted creek. To minimize the long-term consequences of the mining, Peevyhouses negotiated remedial provisions that would provide access to a small amount of land north of the pit, assure its future utility as pasture land, and enhance the safety of persons and livestock when near the pit.

The Peevyhouses rejected many of the standardized lease terms. The Peevyhouses insisted on striking several provisions they thought gave the lessee inordinate powers. Most important, they gave up the customary advance payment for surface damages. Because they wanted the land restored to usable condition after the mining, they agreed to forego payment of $3,000 ($50 per acre for 60 acres) in exchange for Garland's promise to do remedial work. Willie explained his view that it was not right to take money for land and allow work to be done on it that would make the land worthless in the future. . . .

In comparison to other land owners who leased their land without protective restrictions, Garland left the Peevyhouse personal acreage in relatively good condition. Because the Peevyhouses refused to lease the land on which they lived, gardened, or used for pasture, the stripmining activity was somewhat removed from their daily life.

This mining operation took place along a V-shaped stretch extending approximately fifteen miles. . . .

Although Garland continued mining in Haskell County until January 1958, it mined this particular segment during 1956 and 1957. It removed substantial quantities of coal from the other leased properties, but comparatively little coal from the Peevyhouse land. The Peevyhouses received merely $500 beyond the $2,000 advance royalty. Garland's profits earned from sale of coal removed from the Peevyhouse land ranged from $25,000 to $34,500. This figure does not include other economic benefits Garland derived from the lease, such as creek diversion.[12] . . .

When Garland prepared to stop mining, Burl Compton explained to Willie Peevyhouse that the coal depth fell from forty-five to seventy feet below the surface shortly after the mining operation moved onto their land. Compton claimed that despite a ready market for coal, the price was not high enough to justify the increased costs of extraction of the coal located at the lower depth.

To evaluate Garland's asserted reason for leaving, I examined its operations map, which depicts course of activity, coal depths, and test borings for the mined segment. Contrary to Garland's assertion, there was little if any difference in the coal depth on Peevyhouse land as compared to adjacent areas that Garland fully mined. The operations map indicates coal depths ranging from thirty to sixty feet from the surface, whereas the coal bed on Peevyhouse land was about twenty-five to forty-eight feet deep. . . .

12. Garland extracted about 12,500 tons of coal from the Peevyhouse land at a cost of 20¢ a ton. Stigler coal sold for $6.70 a ton in the spring of 1957. Estimated production costs range from $3.94 to $4.70 a ton, giving the operator a net profit of somewhere between $2.00 and $2.76 per ton. . . .

If Garland stopped working this segment because the coal depth increased extraction costs, then this decision was based on generally applicable conditions and nothing unique about the Peevyhouse property. . . . Garland offered no excuse as to why it did not perform the promised remedial work. . . .

On February 29, 1960, [the Peevyhouses' attorney Woodrow] McConnell filed an action for money damages in Oklahoma County District Court, Oklahoma City. . . .

Quite possibly McConnell gave little thought to specific relief. Assuming he considered it, given equity's historical reluctance to become involved with construction disputes, McConnell could have reasonably predicted such relief was unlikely. His professional orientation also may have influenced the decision. As one who primarily practiced tort law, he was accustomed to seeking money damages. Moreover, because the case had been taken on a contingency basis, he had an interest in creating a fund from which he could recover a fee.

Regardless of the reason for not seeking specific performance, Garland's counsel perceived this election as evidence of opportunistic, strategic behavior. . . .

Word of the *Peevyhouse* decision spread quickly through the Oklahoma legal community. Many prominent lawyers thought it was wrongly decided and found ways to communicate their disagreement with members of the court. Distinguished University of Oklahoma law professor Eugene Kuntz debated the case over coffee with Justice Jackson. Oklahoma City University Professor (and now Oklahoma Supreme Court Justice) Marian Opala invited Justice Jackson to defend the decision before his contracts class. Seven weeks after the initial decision, ten highly regarded local attorneys and academics filed an amicus brief urging the court to reconsider and award plaintiffs the cost measure. They claimed to represent clients who enter contracts with comparable risks "projected into the future," and their concern with proper legal development. In three short pages, amicus forcefully argued for the sanctity of contracts.

> [A]t the very least, the express and unambiguous terms of contracts entered into by private individuals . . . cannot constitutionally be abrogated by it. Moreover, short of the wall of impossibility of performance, when contractual promises are broken, this Court should lend its aid to promisees relying on the promises of competent promisors and lend its most vigorous sanction, to insure to future promisees that the aid of this Court is certain and unwavering, particularly being mindful of the interests sought to be safeguarded by the promisee in stipulating for terms, and not alone the objective of the promisor.

Days later plaintiffs petitioned for rehearing and oral argument. McConnell's brief was verbose, burying otherwise viable arguments in excess prose or in abrasive attacks on the court. . . .

Justice Williams was known on the court for perpetual indecision. . . . Originally Justice Williams voted with Justice Jackson's five-to-three majority opinion. Conference minutes indicate that when the court discussed the request for rehearing on February 25, Justice Williams switched his vote to the dissent. The amicus brief may have persuaded him the case

was wrongly decided. Justice Jackson may also have had second thoughts, for he passed on voting that day. Justice Welch, who did not vote on December 11, now voted to rule in favor of Garland. Because of the four-to-four stalemate, *Peevyhouse* was backlisted, to be reconsidered at a future conference.

When the court discussed *Peevyhouse* on March 15, Justice Jackson recommended and voted to deny rehearing. Neither Justice Williams nor Justice Welch voted. Once more, the case was backlisted. Finally, on March 25, with all nine justices voting, the court denied rehearing on a five-to-four vote. Justice Welch, who had not previously participated in a dispositive vote in this case, cast his vote for Garland Coal. Justice Williams remained with the dissent. . . .

Confidential court records demonstrate that this case, involving relatively low stakes, commanded unusual attention. *Peevyhouse* was discussed in conference eight times in as many months. This sharply contrasts with the typical case presented and finally decided in one court conference. Whatever the cause, it was a troublesome case for the court. . . .

Willie and Lucille Peevyhouse still live on the land located outside Stigler. The land they leased to Garland has changed little from when the mining stopped more than thirty-five years ago. The rough, rocky surface on the highwall and spoil banks is sparsely vegetated. About half of the leased acreage remains unusable.

The diversion of Cedar Creek caused long-term harm. It eroded the makeshift fills and now flows into the abandoned mining pit instead of the diversionary channel. It carved a new path flowing out of the southeast portion of the pit. The renegade creek washed out a bridge on the property southwest of Peevyhouses owned by Lucille's parents. The dry diversionary channel is overgrown with weeds. Because the unmined area south of the pit often floods after heavy rains, it lies fallow and overgrown with scrub. Their adult son has begun clearing the area so the fertile land can again be used. . . .

IV. Strains on the Quality of Justice. . . . The unearthed facts in *Peevyhouse* raise disturbing questions about the quality of justice. The Peevyhouses bargained effectively to obtain contractual protection of their legitimate interests. When Garland breached, they sought legal redress but ultimately were denied meaningful contract enforcement. Meanwhile, the adversary system maintained the illusion that diminution damages protected their expectations of contract performance.

What went wrong? . . .

From the outset, it appeared that McConnell lacked sufficient grasp of the relevant facts and law, both essential to theory development. The problem is circular: lacking adequate knowledge of the underlying applicable law, the advocate is unaware of factual matters germane to theory development and rebuttal to the opposition.

In *Peevyhouse*, for example, . . . the complaint would have differentiated between the leased and unleased parcels, and specifically alleged the separate consideration the Peevyhouses gave to obtain the remedial promises. This trade-off in lieu of payment for surface damages strongly related to contract interpretation and substantial performance doctrine.

The competent advocate would have anticipated parol evidence objections and acquired mastery over the legal issues key to admission: non-integration of the writing, the failure of consideration challenged the existence of a legally enforceable contract, and the general admissibility of evidence on surrounding circumstances to aid interpretation.

By contrast, [Garland's attorney Clyde] Watts understood Garland's viewpoint enough to suggest the impracticability excuse and property line dispute, both of which triggered waste considerations and risk allocation. McConnell never stood "toe to toe" with Watts on these issues, and failed to pierce the defense with demands for proof. If the plaintiffs' side adequately understood the law of impracticability and mistake, it could have before trial gathered information to defeat those claims. Instead, it fearfully avoided confronting those issues. As a consequence, the defense obscured the litigation with meager suggestions of excuse.

As superior litigators know well, fact-gathering and legal research in advance of litigation are crucial to theory development and trial preparation. These time-consuming tasks may seem endless, with much time spent pursuing avenues that ultimately bear no fruit. Despite the frustrations, this time is not wasted. It enables the skilled advocate to discard weaker claims while developing a theory and presentation effectively supported by the evidence, law and policy. Such efforts also prepare to rebut assertions taken by the opposition. . . .

There were significant disparities between the advocacy skills of the parties' respective counsel. Watts was well-prepared, having adeptly planned a trial strategy with supporting witnesses and documentation, knew the weaknesses in his case, and formulated a plan to limit unfavorable evidence. Watts litigated the case aggressively, demonstrating the killer instinct possessed by many successful litigators. He took control from the outset, battering McConnell's initial efforts with constant interruptions. In short time, Watts obtained dismissal of the tort claim and stipulations that limited evidence to proving damages to the leased acreage caused by the breach. He objected frequently, disrupting the flow of plaintiffs' case, avoiding attention to contract interpretation, and diverting attention from adverse testimony. He cross-examined effectively, anticipating points he wanted made, and stopping when that was done. When presenting the defense, Watts asked his witnesses crisp, direct questions that usually elicited articulate and concise responses. They clearly understood their roles and performed well, likely the product of adept witness preparation. Sometimes he warned defense witnesses about dangerous territory with speaking objections. . . .

V. The Supreme Court Bribery Scandal: Tantalizing Speculation Questioning the Quality of Justice. . . . Some suspect *Peevyhouse* is a tainted decision.[13] In 1964, word broke of a bribery scandal involving several members of the Oklahoma Supreme Court, including two justices who voted with the *Peevyhouse* majority. Justice Corn, who was on senior

13. See, e.g., . . . John H. Jackson; Lee C. Bollinger, Contract Law in Modern Society, Cases and Materials 44 (2d ed. 1980) and Ian R. Macneil, Contracts: Exchange Transactions and Relations, Cases and Materials 132 (2d ed. 1978).

status and did not participate in the case, pled guilty to tax evasion and gave a statement implicating three others: Johnson, Welch and Bayless. Justice Johnson was impeached and convicted and Justice Welch resigned during impeachment proceedings. . . .

Was *Peevyhouse* tainted by the Supreme Court bribe scandal? Definitive proof is impossible. Suspicions persist based on the voting records of Justices Welch and Johnson, both listed in the *Pacific Reporter* as voting consistently with the majority. Supreme Court conference minutes show Welch did not participate in a dispositive vote on the case until March 1963, when the court denied plaintiffs' second rehearing petition. In September 1963, a court order retroactively added Welch to the original decision, which became necessary to preserve the original majority opinion after Williams switched to the dissent. . . .

There is no evidence that a bribe was paid in *Peevyhouse* or that Ned Looney sought favorable treatment from the court. However, overwhelming evidence shows that Justice Welch voted in favor of interests represented by the Looney, Watts law firm, especially in close cases where his vote could make a difference. *Peevyhouse* is such a case. Improper judicial bias may well have determined its outcome. Thus, if one defines taint as limited to bribery, then *Peevyhouse* is probably unblemished. If the definition includes all cases with outcomes affected by improper judicial bias, then *Peevyhouse* appears tainted.

The court's conference minutes catalogue Justice Welch's participation in the case. When considered against the backdrop of his vote in other close cases, his votes in *Peevyhouse* indicate that he voted when needed to secure a favorable outcome for the firm's client. . . .

Cases that reflect Judge Welch's vote demonstrate his tendency to favor the interests represented by the Looney, Watts firm. . . .

Overall, Welch voted with the majority or authored the majority opinions in 49% of the cases; he dissented in 7% of the cases. In examining Welch's overall voting pattern, there is a moderate statistically significant correlation reflecting a pro-Looney, Watts bias. In those cases where the interest represented by the Looney, Watts firm prevailed, Welch voted with the majority or authored majority opinions 67% of the time. He dissented, openly voicing opposition to the prevailing Looney, Watts interest only twice.[14] By contrast, he dissented in 13.8% of the cases where the firm lost.

Welch's bias is most striking in the seventeen close cases where his vote could affect the outcome. A close case is defined as one where the court was split on the final vote, with five or six justices in the majority. He voted in every close case. In all but one case Welch supported the interest represented by the Looney, Watts firm. In each case where the Looney, Watts interest lost, Welch dissented. In seven of the eight cases where the Looney interest prevailed, Welch voted with or authored the majority opinion. Only once did Welch dissent against the winning Looney interest. . . . Because of the small sample, normal statistical tests are considered less reliable.

Welch's likely favoritism is further evidenced by comparing how the other judges voted in the seventeen close cases. Welch voted for the interest represented by the Looney, Watts firm 94% of the time. No other judge

14. That is, Welch dissented in 1.8% of the cases when the firm prevailed.

came close. Johnson, who participated in fourteen of the cases, voted for the Looney, Watts interest nine times (64%). Corn supported the firm's interest in six of the eleven cases in which he participated (55%). The "loyalty rating" of other judges participating in most of the close cases ranged from a high of 47% to a low of 15%.

Welch appeared loyal to the Looney firm interest when it mattered. He never voted dispositively to defeat a Looney case, and cast the deciding vote in three cases, including *Peevyhouse.* Welch's conference votes in *Peevyhouse* suggest that he stayed his hand and did not participate in any dispositive vote until necessary for Garland to prevail.