Chapter 7: Defining the Terms of Performance

A. Introduction

1. Definitions:

a. A "condition" is an event the nonoccurrence of which excuses a performance. See RESTATEMENT OF CONTRACTS (2D) §224.

b. A "covenant" or "promise" is an obligation of one of the parties which if not satisfied will give rise to an action for breach of contract.

2. Implications:

a. Some conditions will be within the control of a party while others will not. For example, suppose you purchase fire insurance. The insurance company's obligation to pay you is conditional on there being a fire. This condition is not within the control of either party. The insurance company's obligation to pay you is also conditional on your filing a claim. This condition is within your control. Note that your filing a claim might be both a condition and a covenant.

b. When a condition is within the control of one of the parties, it might also be a covenant. In general, the performance of a party could be (1) only a condition of the other party's performance, (2) only a covenant, or (3) both a condition and a covenant. See RESTATEMENT OF CONTRACTS (2D) §225(3). When something is not within the control of the parties, it might be a condition, a warranty, or both.

c. Note that the nonoccurrence of a condition will work a forfeiture in the sense that one party is thereafter excused from performance. Were the condition a mere covenant, performance might still be owed with an allowance for damage. For this reason, courts lean toward interpreting a performance as a covenant alone. See also RESTATEMENT OF CONTRACTS (2d) §229.

3. All conditions are subsequent to contract formation and precedent to the conditional performance. Courts sometimes try to distinguish between conditions subsequent and precedent, usually to allocate the burden of proof. For example, compare (1) "We, the insurance company, will pay you, the boat owner, if the boat sinks, conditional on the sinking not being caused by neglect or act of war" with (2) "We, the insurance company, will pay you, the boat owner, if the boat sinks unless the boat sinks by reason of neglect or act of war." Suppose the boat sinks without evidence of the cause. Many courts would say the insurance company wins in case (1) but the boat owner wins in case (2), based on the burden of proof.

4. When performance is due simultaneously, we say the performances are mutual and dependent. When one performance is due prior to the other, we say the performances are independent (although that is a mis-statement in one direction). See RESTATEMENT OF CONTRACTS (2D) §234. If several performances are to be done simultaneously but they are complex in nature, it often makes sense to use an escrow arrangement. Note that independent performances necessarily imply that one party must face a credit risk.

B. Conditions

1. Implied Conditions

a. Allocating the Risks of Nonperformance

i. *Stees v. Leonard* (p. 74): A builder agreed to build a multistory structure on plaintiff's land. The builder made two attempts, but the structure collapsed each time after three stories. The builder refused to continue, saying that the land was too soft and wet to support the structure. The builder alleged that the plaintiff had selected the precise

location for the structure, that the builder's work had conformed to the plaintiff's specifications, and that after the first attempt, the plaintiff had agreed to keep the land dry yet failed to do so. The plaintiff seeks damages and refuses to pay the builder. To get damages, the plaintiff must prove that the builder did not do something he promised to do. To avoid paying, the plaintiff must show that some event has not occurred upon which his obligation to pay was conditional. What was that event?

ii. We have assumed that if one party breaches a contract, the other party is excused from further performance. That concept can be found in the RESTATEMENT OF CONTRACTS (2D) §237 in which it is provided that "it is a condition of each party's remaining duties . . . that there be no uncured material failure by the other party." Note that not *all* breaches by the other party will excuse return performance: the failure must be "material." We sometimes say that "substantial" performance is a condition of the return performance, where "substantial" performance means that any failure is not "material."

iii. *Paradine v. Jane* (Note 2 at 77): The defendant leased a house from plaintiff on a four-year term. During the term of the lease, the house was occupied by foreign invaders, expelling the defendant. At issue is whether the tenant must pay rent for the period when he was expelled from the house. *Held*, rent is still owed. If a loss is borne by the owner absent some agreement to shift it, who "owns" the house. Is it fair to describe a lease as the purchase of a portion of the house, not a geographical slice but a temporal slice?

iv. *United States v. Spearin* (Note 3 at 78): The US government contracted with a private party for the construction of a dry dock in accordance with the detailed specifications provided by the government. The dry dock could not be constructed satisfactorily because there was a flaw in the specifications, and the contractor argued that its failure to complete the contract was justified because it fully performed in accordance with the terms of the contract. *Held*, for the contractor.

b. Implied or Constructive Conditions of Exchange

i. *Bell v. Elder* (p. 616): Plaintiff contracted to purchase land from Elder, and at issue is whether Elder was obligated to provide water to the plaintiff's land or only to be able to provide water if plaintiff obtained a building permit and begun construction. The language of the writing made the obligation unconditional but the trial court allowed parol evidence showing the condition, and the appellate court affirmed this factual finding. Is there a reason to conclude that the building should not have been a condition of the water delivery? Would not the land be more valuable with the water? Does the defendant really have any interest in the construction? If the contractor in *Stees* got paid less than he should have, does not the seller in this case get more? Is it fair to read the agreement as imposing an obligation on the buyer to build on the land. Recall (from page 616) that the contract included the following language: "If Buyer is unable to obtain [a] building permit by July, 1978, the seller agrees to endemnify [sic] and repay this contract with six month." Does this language seem to impose an obligation on the Buyer that can be enforced by the Seller or does it offer the Buyer an escape if the Buyer tries to build but is not allowed to do so? What does "unable" mean? I think it means "tries and fails."

ii. *Stewart v. Newbury* (Note 1, at 619): This statement of the traditional rule puts the credit risk entirely on the worker. Could the credit risk be shifted in the contract? Of course. Could it be substantially reduced? Sure, and that is what the court tried to do. Note that good rules *minimize* rather than *allocate* risks and losses. But how should the amounts due for each part performance be determined?

c. Divisibility

i. Hypos:

(a) You go to a florist on your way to work, seeking two dozen flowers. You tell the florist that you want one dozen red roses and one dozen yellow roses. The florist states that she has red in stock and that she expects to receive yellow later that day or possibly the next day. You agree to pay $35 per dozen, taking a dozen red roses with you. You return later in the day to find that the yellow in fact arrived but were sold to another customer. Can you resist paying for the red?

(b) Same facts except you are assured that the yellow will arrive later in the day, so you agree to return just before closing. The yellow have been sold to another customer. Must you take the red?

(c) You hire a company to lease six billboards advertising your pet store. Two of the six are, in violation of the contract, leased to someone else in an unrelated line of business. Must you pay for the four? Is it relevant how the signs are located?

(d) Seller agrees to ship to buyer's restaurant 10 crates of onions per week for 52 weeks. In one week, the shipment of onions contains only 7 crates. Must buyer accept that shipment? Can buyer cancel the remainder of the contract? See U.C.C. §2-612. What if the spot market for onions is substantially higher than the price available on a long-term contract? What if the seller says that he can get the remaining three crates there by the next day?

ii. *John v. United Advertising, Inc.* (p. 620): The plaintiff rented six signs to be used as advertising for his two motels. Four of the six signs were displayed properly, while one was not displayed at all and one was displayed improperly. Held, that the defendant was entitled to keep the contract price for the four signs that were displayed properly because the contract was divisible. Note in particular that a price for each contract was provided. Why is that important?

2. Express Conditions

a. Promises and Conditions

i. *Howard v. Federal Crop Insurance Corp.* (p. 625): The plaintiff's crop was destroyed by rain, and the defendant had written an insurance policy on those crops. Clause 5(f) of the insurance policy provided: "The tobacco stalks . . . with respect to which a loss is claimed shall not be destroyed until the [defendant] makes an inspection." In fact, the plaintiff plowed under the destroyed crops in order to plant a cover crop of rye.

(A) What was the plaintiff's argument based upon clause 5(b)? What drafting lesson do we learn from this case?

(B) What was the holding of the case? What will be litigated on remand?

(C) Why might a condition have been much more valuable to the defendant than a covenant?

ii. Conditions and Timing Clauses:

(A) Hypo: Builder agrees to erect a house on the land of Homeowner. Builder hires SubCo to pour the foundation. The contract between Builder and SubCo provides that Builder will pay SubCo when Builder gets paid from Homeowner. During construction and after the foundation has been poured, Homeowner files for bankruptcy and Builder never gets paid. Must Builder ever pay SubCo?

(B) I loan you $1,000 to be repaid when you cut the timber on your land. The trees accidentally burn prior to harvest. Must you repay the $1,000 loan?

(C) How should a court interpret a "pay when paid" clause? What are the two alternatives? See Note 3 (p. 630).

b. Conditions Precedent and Conditions Subsequent

i. *Gray v. Gardner* (p. 633): What is going on here? See Note 1 (p. 634).

ii. Why might the parties have chosen this method of adjusting the price rather than using a single contract with a conditional price?

iii. Attorney-Approval Clauses: When the quality of performance is hard to measure without special expertise, parties often provide that performance is not complete until some specified expert certifies completion. For example, a landowner and a builder might agree that an architect's certificate of completion is required before the builder gets paid. We will look at this issue more closely later, but in general the courts will enforce such an agreement according to its terms. In this case, until the certificate is issued, the builder is not finished. Compare *Gaglia v. Kirchner* (Note 2, at 635) in which the buyer's attorney's approval was required for a contract to be binding. The attorney insisted on additional terms, and ultimately one party disavowed the contract. *Held*, once the attorney refuses to accept the original contract, neither party was bound. Why is this different from the architect's approval?

c. Modification, Waiver, Election, and Estoppel of Conditions **[omitted]**

C. Performance Standards

1. Warranties: The three warranties under the U.C.C. that we will cover are (1) the implied warranty of merchantability in Section 2-314(1) (see especially 2-314(2)(c)); (2) express warranties in Section 2-313; and (3) the implied warranty of fitness for a particular purpose in Section 2-315.

a. Express Warranties

i. *Sessa v. Riegle* (p. 650): The buyer of a standardbred race horse sues the seller for breach of warranty because the horse arrived at the buyer's property unable to run well. The buyer alleges that the seller told the buyer that "the horse was sound." *Held*, no express warranty was created within the meaning of U.C.C. §2-313 because the alleged statement by the seller was opinion or commendation. *Held further*, that even if an express warranty was made, it was not a "part of the bargain" because the seller did not substantially rely on the statement. Buyer had sent his agent to inspect the horse prior to sale and buyer had indicated that he would follow this agent's judgment on the matter of the sale.

(a) While creation of an express warranty requires an affirmative statement or action by the seller, such warranty once made will be considered a part of the bargain unless there is "clear affirmative proof" that it has been removed. Comment (3).

(b) If the seller had said that the horse could cover one mile in 1.25 minutes, would that comment be more or less likely to be considered a warranty? See Note 2 (p. 668).

(c) Is there any way to distinguish *Wilkinson v. Stettler* and from *Flood v. Yeager* (both cited on p. 652)? Compare U.C.C. §2-315. How is *McNeir v. Greer-Hale Chinchilla* (Note 1, at 654) different from *Sessa v. Riegle*?

(d) Is it possible that a warranty was made but that no breach occurred? What if the horse was injured in transit?

ii. Can a seller avoid creating an express warranty by prefacing the comment by "in my opinion" or "in my mind"?

b. Implied Warranties

i. *Flippo v. Mode O'Day Frock Shops of Hollywood* (p. 657): Is there an implied warranty that clothes for sale in a retail store will be free from spiders? Note that there was nothing wrong with the article of clothing itself. The court holds that the implied

warranty of merchantability does extend to hold the seller liable for any injury that might be suffered by the plaintiff in the store. Of course, if the seller is negligent, the customer can recover. This court refuses the treat the warranty of merchantability as the equivalent of a strict liability standard.

ii. *Coffer v. Standard Brands, Inc.* (Note 2 at p. 659): Note how the court looked to state guidelines for determining whether the standard had been breached. Note also that at issue is the possible breach of an implied warranty. Why are the contours of an implied warranty necessarily less precise than those of an express warranty?

c. *Pelc v. Simmons* (p. 664): The seller of a used car tells the buyer that he personally rebuilt the engine and that it was "a good car." In fact, the engine fails almost immediately. A sign in the window of the car said that the car was offered for sale "as-is." Does the sign operate as an effective disclaimer despite the verbal assurances? *Held*, it operates as an effective disclaimer.

2. Measuring Compliance

a. Substantial Performance

i. *Jacob & Youngs v. Kent* (p. 66): After completion of a building, the owner discovered that the builder failed to use pipe made by the Reading company, although that brand of pipe was explicitly called for in the construction contract. Owner sued for the value of replacing the pipe, much of which was behind finished walls. Because the builder used pipe of equal capabilities, failure to use the Reading pipe did not result in any loss of market value. *Held*, the owner may not recover more than the diminution in value (here, none) because performance was substantial and cost of repair would far exceed the harm.

(a) Note that the owner specified the brand he desired, presumably a very unusual step, and he provided that any failure must be "removed and remade." (See Note 5 at p. 73). What more could the owner have done? Note that the "removal" clause does not refer specifically to the brand of pipe but rather applies generally to all the provisions in the contract.

(b) Might the case have come out differently if the owner had a good reason for wanting Reading pipe? What if the owner was the president of the Reading company? In such circumstances, would we then need to know whether the builder knew of the special purpose? Or is the dissent by Justice McLaughlin correct that the outcome should not turn on our judgment of the owner's motives?

ii. *O.W. Grun Roofing & Const. Co. v. Cope* (p. 670): What constitutes "substantial" performance? Any defect must not "frustrate the purpose of the contract in any real or substantial sense." (p. 671) See also Restate (Second) of Contracts §241. Note that this court determines that matters of taste and fancy may be critical in the context of homes and their decorations. What if the builder used the wrong brand of furnace? The wrong wallpaper? The wrong countertop material?

iii. *Haymore v. Levinson* (p. 673): What is the issue here? Whether "satisfactory completion" of the house should be judged objectively or subjectively. Why does the court prefer an objective interpretation?

iv. A Note on Satisfaction as a Condition: Contracting parties may agree that work to be performed must be performed to the satisfaction of some judge. Such situations can be divided into three categories.

(a) Third-Party Judge: The parties may agree that the quality of work will be judged by an independent third-party. For example, a builder and landowner may agree that the builder's work will be judged by the architect. In such circumstances, as long as the designated third-party exercises her independent judgment, that judgment stands.

For example, if the architect says that the builder should have used a different grade of material in the project, the builder cannot complain that the architect is being unreasonable or simply is wrong: having agreed to be bound to the architect's judgment, the builder and landowner will be held to that bargain. However, if the third-party judge cannot perform the judging function (e.g., is dead or incapacitated) or refuses to exercise her independent judgment (e.g., refuses to issue the certificate of completion until builder does some additional work on unrelated structure also owned by homeowner), the condition of satisfaction may be deemed waived.

(b) Contracting-Party Judge: The parties may agree that the work must be performed to the satisfaction of the buyer. For example, a builder might agree to erect a home to the satisfaction of the landowner. In such circumstances, we consider the following two possibilities.

(1) Matters of Taste or Fancy: To the extent the work to be judged is a matter of taste or fancy (e.g., the type of wallpaper to be put in the house, or the color of the paint), the landowner must express her true opinion as to satisfaction, but no standard of reasonableness will be imposed.

(2) Other Matters: If the work to be judged includes elements whose function is not subject to one's taste or fancy (e.g., the brand of furnace, when the brand is not specified in the contract), the judging party will be held to a standard of reasonableness; i.e., would an objective third-party in the position of the landowner be satisfied with the installed furnace?

(3) Note the question asked in Note 1 (p. 675): "Is there anything that a drafting attorney who represented the Levinsons coould do to guarantee their idiosyncratic preferences could be protected? How can the party with special needs communicate them to her counterparty?

v. In *Jacobs & Young v. Kent*, the owner had agreed to make partial payments as the building was erected, subject to retaining a portion not to be paid until the architect certified that the building was satisfactory and completed. Because that certificate was never issued, the builder should not be able to collect the retained funds. However, the architect seemingly withheld the certificate at the request of the owner and not because the architect actually believed the building was unsatisfactory. Thus, the condition that the certificate be issued was waived, and the builder is entitled to be paid. However, that all conditions were met or waived does not mean that the owner cannot sue for breach of covenants. Here, when the builder sued for the retained funds, the owner responded by saying that there had been a breach, the damages from which more than offset the retained funds.

vi. Note 2 (p. 676): Raises the very important question of how damages should be measured when performance is substantial but not complete. This Note should be reexamined when we cover *Peevyhouyse v. Garland Coal & Mining Co.* (p. 846).

b. Perfect Tender and Cure

i. The Statutory Scheme:

(a) The perfect tender rule is codified in U.C.C. §2-601 ("fail in any respect").

(b) If the buyer wants to reject the goods, she must do so within a reasonable time. U.C.C. §2-602(1).

(c) The buyer will lose her ability to reject if she accepts the goods, where acceptance is defined in U.C.C. §2-606(1). Note that the buyer has a reasonable opportunity to inspect the goods.

(d) A buyer who accepts a nonconforming tender can revoke

the acceptance and then reject the goods if the acceptance was based on one of the circumstances described in U.C.C. §2-608(1)(a)-(b), but only if the defect "impairs its value" to the buyer. Thus, *there is no perfect tender rule relevant to revoking an acceptance*.

ii. Hypos under U.C.C. Provisions §2-508:

(a) Computer arrives early missing its keyboard. Can you reject absolutely? No: the seller always can cure within the time for performance. U.C.C. §2-508(1).

(b) Same facts, but arrives on due date. Can you reject absolutely. Maybe not. Did the seller have reason to believe that you would accept the goods with or without a money allowance? Here, probably not. If the keyboard was "new and improved" (but not what was ordered), the seller probably would fall under 2-508(2).

iii. *Bartus v. Riccardi* (1967): The plaintiff sold one model of hearing aid but delivered a different, new and improved model. The defendant/buyer was told by the plaintiff that the new model would work, and relying on that advice took it home but he ultimately was unhappy with the new model. Plaintiff offered a replacement of the new model or an older model as ordered, whichever the defendant desired. The defendant accepted neither offer, returned the model he was given, and refuses to pay.

(a) The buyer can reject a tender that fails "in any respect." U.C.C. §2-601.

(b) Once acceptance is made, rejection is impossible (U.C.C. §2-607(2)) but revocation is possible. Did the buyer "accept" the newer model? Probably. See U.C.C. §§2-602 and 2-606(1)(a)-(b).

(c) Can the buyer revoke his acceptance? Yes. See U.C.C. §2-608 (acceptance is described in paragraphs 1(a) or (b)) *and* the "non-conformity substantially impairs its value to him."

(d) But U.C.C. §2-508 gives the seller two possibilities to cure: (1) an absolute right to cure if the time for performance has not expired and (2) a right to cure within a reasonable time if the original delivery was non-conforming because the seller "had reasonable grounds to believe [it] would be acceptable with or without a money allowance." *Note this right to cure does not under any circumstance give the seller a right to insist that the buyer accept a nonconforming tender.*

iv. *Ramirez v. Autosport* (p. 679): If a buyer rejects a nonconforming tender and cure is not forthcoming, is the buyer entitled to rescind the contract? This court says yes (there really is no other possible answer). Here, the seller could not return the down payment in-kind but only refund its cash value. The court holds that the value of the trade-in is a factual question for the jury and need not be the value specified in the contract.

v. Note 4 (p. 685): A seller's right to cure in effect requires the buyer to continue to deal with a seller in whom the buyer lacks confidence. But if the buyer accepts a nonconforming tender and then seeks breach of contract damages, the buyer has no duty to continue to deal with the seller. We will return to this point when we discuss mitigation.