Chapter 9: Conduct Constituting Breach

A. Introduction: A "breach" of contract is the failure to render a performance when performance is due, unless the performance has been excused. An "anticipatory repudiation" is an announcement by a party to a contract that she will not perform an obligation when the time for performance arrives. Recall the distinction between a "material" breach and "substantial performance": a material breach excuses future obligations of the counterparty while substantial performance only permits an offset for damage actually incurred.

B. Anticipatory Breach

1. *Truman I. Flatt & Sons Co., Inc v. Sara Lee Schupf* (p. 781): The plaintiff agreed to purchase certain real estate from the defendant at a purchase price of $160,000. The buyer had the right to void the contract and get a return of its earnest money if the land could not be rezoned to accommodate an Asphalt plant. The plaintiff began the rezoning process but discovered substantial public opposition to the plan, and so the buyer discontinued its application. The buyer then sent a letter to the seller informing the seller of the failure and seeking a reduced price for the land without the rezoning. When the seller refused to accept a lower price, the buyer confirmed the terms of original contract. But the seller refused to perform, saying that the initial letter constituted an anticipatory repudiation.

a. What is an "anticipatory repudiation"? *See* Restatement of Contracts (Second) §253(a) (p. 35). If the buyer in fact refused to purchase the land, would that have been a breach? Can a threat to do what one is permitted to do under the contract constitute a "repudiation"?

b. Is there any reason to give legal effect to a repudiation by one who is holding a binding option contract?

2. A Theory of Anticipatory Repudiation

a. Is there a legitimate concern that the non-repudiating party will use the repudiation as an opportunity to hedge on the repudiating party's nickel? The "duty to mitigate" requires the nonbreaching (or nonrepudiating) party to take reasonable steps to reduce damage arising from the breach (or repudiation).

i. What gives an option value?

ii. Suppose the nonrepudiating party can cover immediately at the contract price. Is there a reason why he might not do so? See UCC §2-610 (p. 247). Note that this does not require the nonrepudiating party to have some unusual ability to anticipate the direction of the market price. For example, suppose there is a 50% chance that the price of the good will double by the time performance is due and a 50% chance that the price of the good will decline by 50%. What will a seller do if the buyer repudiates and the seller can cover whenever he prefers? What will a buyer do if the seller repudiates and the buyer can cover whenever he prefers?

b. Note that a party can repudiate by word or by deed. If a party puts performance beyond its ability, that is treated as a repudiation. See Restatement of Contracts (Second) §250(b) (p. 35). What if the nonrepudating party learns of that from a third-party, and the information is inaccurate? The classic example of an implicit repudiation by the seller of land is a sale to someone other than the buyer.

c. The UCC now recognizes that there should be a middle case between repudiation and nonrepudiation. See UCC §2-609. The drafters of the second restatement have followed this approach in §251 (p. 35). Should insolvency of the buyer be such an occasion?

See Restatement of Contracts (Second) §252 (p. 35). *See also* Note 6 (p. 793). Should a buyer who sells on credit really be expected to deliver when ability to pay is in serious jeopardy? See U.C.C. §2-702. On the other hand, who gets to determine when insolvency is present? Should a court seek some objective evidence? What might such evidence be?

c. How should a party respond to a contracting party who asserts he will not perform unless the contract is modified? Is it relevant whether the proposed modification is a material change (that is, if the performance as modified would constitute "substantial performance" of the unmodified contract)?

C. Measuring Damages for Anticipatory Repudiation

1. *Cosden Oil & Chemical Co. v. Karl O. Helm Aktienggesellschaft* (p. 798): This case deals with the difficult issue under the U.C.C. of determining the proper measure of damages when the seller repudiates prior to the time for delivery in a rising market. Under the common law, the buyer who elected not to cover was entitled to receive the excess of the spot price over the contract price as of the date performance was due. (Note that even this rule leaves an ambiguity if the seller has a period of time during which it is permitted to make delivery.) Damages after cover are defined in U.C.C. §2-712.

   a. First look at U.C.C. §2-713 providing that the buyer's measure of damages for repudiation is based on the market price "at the time when the buyer learned of the breach [repudiation]." Note that this section references U.C.C. §2-723 for the proof of market price, and this section also references the time that the buyer learns of the repudiation.

   b. Now look at U.C.C. §2-610 permitting a party who learns of a repudiation "for a commercially reasonable time await performance by the repudiating party." Note that this section does not say what happens if the nonrepudiating party waits for more than a commercially reasonable time.

   c. If a buyer covers by purchasing a new forward contract within a commercially reasonable time, it is clear that the usual cover damages are awarded.

   d. This court says that U.C.C. §§2-713 and 2-610 can be reconciled by interpreting the phrase "at the time when the buyer learned of the breach" to mean "a commercially reasonable time after the buyer learned of the breach."

   e. Can the two provisions be harmonized by saying that damages for cover will be based on the market price no later than a commercially reasonable time but that damages if there is no cover will be based on market price when the buyer learned of the breach? What incentive will this give to a buyer in a rising market? Should we care about a falling market?

2. If the buyer's damages are determined by the market price with any delay after learning of the repudiation, the buyer will be able to speculate without risk of loss. How so? If the price continues to rise during the delay, the buyer will be protected. If the price falls below the contract price, the buyer can cover.

3. A similar problem arises when an option writer repudiates the option when the option period has not yet expired. Should damages be computed at the time of the repudiation or at the end of the option period? Is potential speculation by

the option holder a concern here?

D. Insecurity and the Right to Demand Assurances

1. *National Farmers Organization v. Bartlett & Co. Grain* (p. 812): Buyer and seller of grain agreed to multiple forward contracts. The seller failed to make several deliveries, and the buyer informed the seller that monies due on some delivered products would be held back against losses sustained on the goods not delivered (note that this implies a rising market price). The seller responded by saying that it would not make future deliveries unless the buyer brought its account current. In a statement of account sent in late January, the buyer recognized amounts owed of $74,814.39 but also claimed setoffs of $45,840.81 on past due and repudiated contracts, and on this basis the seller included a check for the net balance of $28,973.58. The buyer generally accepted the computation of the seller but claimed that two setoffs were improper because it (the seller) had not repudiated the underlying contracts.

a. The court holds that the seller's letter stating that no future deliveries would be made until buyer brought its account current was an anticipatory repudiation of the contracts calling for future delivery.

b. In determining what constitutes a repudiation, the court looked to comment 2 to §2-610, concluding that "a statement of intention not to perform except on conditions which go beyond the contract" amounts to a repudiation.

c. The court further held that buyer's failure to pay what was then owed might have given the seller reasonable cause for insecurity, but the Code does not permit the seller to repudiate the contracts based upon that insecurity. Rather, U.C.C. §2-609 gives the insecure party specific and limited options.

d. Note that if all of the contracts had been treated as a single contract, a different result almost certainly would arise. The court adopts the "separate contract rule" of *Northwest Lumber Sales, Inc. v. Continental Forest Products, Inc.* (discussed on p. 817). If you represented a client who wanted to avoid this rule, what would you do? Can a contract provide that a default in some other contract is treated as a default in the current contract? (Note: issuers of consumer credit cards generally are forbidden from raising the interest rate on one card when there is a default on another card. Why?)

e. Does this case seem to strike the proper balance? Should a seller be forced to ship on credit when past bills have not been paid? Did the seller act unreasonably in this case? Did the buyer?

2. *Norcon Power Partners, L.P. v. Niagra Mohawk Power Corp.* (p. 818): The highest court of New York incorporates Restatement of Contracts (Second) §251 into its common law. That provision is based on U.C.C. §2-609. Note that the Restatement is less precise in what steps the insecure party must do to make a qualifying "demand."

E. Installment Contracts

1. Note that U.C.C. §2-609(1) provides in part: "When reasonable grounds for insecurity arise with respect to the performance of either party the other party 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." While this provision applies to all contracts covered by article 2 of the Uniform Commercial Code, its most common application is in installment contracts because such contracts are likely to be partially executory on both sides even after performance has begun.

2. *Pakas v. Hollingshead* (p. 829): The seller of 50,000 pairs of bicycle pedals to be delivered in installments failed to make a perfect tender as to the first two installments. The

buyer sued and collected a judgment for damages arising out of the breach of the first two installments. Subsequently, the seller failed to make additional deliveries, and the buyer again sues for damages arising out of these subsequent failures. The defendant pleads the prior action as a complete res judicata defense. *Held*, for the defendant, that because the contract was entire (i.e., indivisible), a party who sues for breach is necessarily treating the contract at an end and so must seek damages for the entire contract. Thus, if the nonbreaching party does not want to treat the breach of one installment as a breach of the entire contract, she must wait until the entire contract is completed (or breached) prior to suit (or risk subsequent nonperformance without a remedy). The Uniform Commercial Code expressly takes a different approach, allowing a party to sue for past damages only and thereby reinstate the contract, §2-612(3), or treat the contract as ended, §2-703(f).

3. *Cherwell-Ralli, Inc. v. Rytman Grain Co.* (p. 833): The buyer failed to make several payments as called for in the installment contract. A truck driver not employed by the seller told the buyer that the seller will not make any subsequent deliveries because of the nonpayment. The buyer then stopped payment on a check it had sent to the seller (for goods already delivered and accepted) and demanded assurance from the seller that there would be future deliveries. The seller refused to provide such assurance absent payment from the buyer, and the buyer neither made further payments nor made good on the stopped check. The seller made no further deliveries and ultimately went out of business. Each party sues the other for breach. *Held* for the seller, that the buyer did not have reasonable grounds for insecurity. The lower court also determined that even if the buyer had had reasonable grounds for insecurity, it had received adequate assurance for the seller. Finally, the court held that a seller need not go through the mechanism of U.C.C. §2-609 in response to egregious nonpayment by the buyer: "if the buyer's conduct is sufficiently egregious, such conduct will, in and of itself, constitute substantial impairment of the value of the contract as a whole contract and a present breach of the contract as a whole."

a. If you had been the seller's lawyer, what would you have advised once the buyer's check had been stopped? What risks will the seller face if it refuses to make subsequent deliveries?

b. Suppose the buyer had not stopped its check. Could the seller have suspended deliveries under §2-609 until the buyer could guarantee prompt payment? If the buyer misses one payment, can the seller treat the contract as ended?

c. Is there an argument that the buyer should have a more liberal right than the seller to treat breach of one installment as a breach of the whole contract? Note that the judicial remedy for breach of contract (i.e., an award of money damages) makes the seller whole but may not do so for the buyer, at least when the goods are unique or no reasonable substitute is available within the needed time. See Note 2 (pp. 762-63).