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REVIVING JACOB AND YOUNGS, INC. v. KENT: MATERIAL BREACH DOCTRINE RECONSIDERED

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I. INTRODUCTION

WHEN parties enter into a contract, they come with hopes and fears. Their hopes are that the contract will go smoothly: that they will be able to perform exactly as they promised and that the other party will be able to perform as it promised. On the other hand, most people who enter into contracts are realistic enough also to have fears. They fear that they have failed to plan properly or that some event will occur that will prevent them from performing properly. They also fear that the other party will face some obstacle or for reasons of bad faith fail to perform as promised.1

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1. See Steven J. Burton & Eric G. Andersen, The World of a Contract, 75 IOWA L. REV. 861, 865 (1990) (discussing expectation interest). Professors Burton and Andersen describe contract formation stating: At the formation of an enforceable contract, the parties typically expect themselves and their contract partners to do what they promised to do. When that expectation is reasonable, because grounded in the world of the contract, it provides a good reason for a party to change position in advance of performance by action or inaction. The expectation, however, may be disappointed for a variety of familiar reasons, including mistakes, misunderstandings, changed circumstances, and misplaced trust. Id.; see also Arthur I. Rosett, Contract Performance: Promises, Conditions and the Obligation to Communicate, 22 UCLA L. REV. 1083, 1087 (1975) (discussing basic contract structure). The contract demands that each party do what he or she promised. Id. Breach results when one party fails to do what he or she promised thereby negating the expectations of the nonbreaching party. Id. The consequence is that the breaching party may be required to pay money damages to provide the nonbreaching party with the financial equivalent of performance. Id. Therefore, the expectation interest “defines the harm that is the distinctive . . . concern of contract.” Burton & Andersen, supra, at 865. Accordingly, the prime goal of judicial remedies for breach of contract is to compensate for harm to this expectation interest. Id.

See, e.g., L.L. Fuller & William R. Perdue, Jr., The Reliance Interest in Contract Damages: 1, 46 YALE L.J. 52, 57 (1936) (discussing legal protection of expectation interest). A breach by one party causes a sense of injury in the other party. Id. This feeling of injury is not limited, however, to cases where the promisee has relied on the promise. Id. “Whether or not he has actually changed his position because of the promise, the promisee has formed an attitude of expectancy such that...
In making the agreement that will govern their performance, parties may draft clauses to address these fears, such as escape clauses that will excuse the party from performing in the event of a particular contingency or clauses conditioning one party’s obligation on the other party’s performance. In many instances, however, the parties may not be so particular; some contracts, after all, are very informal, even unwritten. Even where the parties draft a formal contract, they may be unwilling or unable to plan for every fear, every obstacle. Whether the parties have planned for it specifically or not, when something goes wrong, the parties’ hopes are dashed and the agreement, no matter how carefully planned, is often an inadequate tool for handling the parties’ problems.

What is the proper role of the law in such instances? How should such disputes be resolved and how should the legal system accomplish that resolution? In particular, how should the law respond when one party fails to perform as it promised based on its a breach of the promise causes him to feel that he has been ‘deprived’ of something which was ‘his.’” Id. (emphasis added).

2. See Burton & Andersen, supra note 1, at 872 (discussing express conditions). Certain contract terms have the effect of making certain rights or remedies contingent on an event or condition. Id. For instance, parties to a contract can make the contract’s enforcement a contingent part of their bargain. Id. They may agree that certain acts or omissions by one party will enable the other party to cancel the agreement. Id. In addition, they may also agree that certain specified behavior will result in specific consequences. Id. These terms represent or create conditions. Id. at n.42; see also RESTATEMENT (SECOND) OF CONTRACTS § 224 (1979) (defining condition as “an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due”).

3. See Robert A. Hillman, An Analysis of the Cessation of Contractual Relations, 68 CORNELL L. REV. 617, 627 (1983) [hereinafter Hillman, Analysis of Cessation] (“Contracting parties may fail to consider and plan for contingencies that will arise because of the limitations of the human mind and imagination in anticipating the future . . . .”); see also Rosett, supra note 1, at 1084 (“[The] expectations [of the parties] are rarely thought through, and inherent limitations on the process of drafting agreements make it certain they will be incompletely and imperfectly expressed.”). In addition, changes in outside circumstances constantly affect contractual relations, “however firmly the parties may appear to be holding to their original course.” Ian R. Macneil, Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law, 72 NW. U. L. REV. 854, 874 (1978). Professors Goetz and Scott, borrowing from Professor Macneil, use the term “relational contracts” to describe agreements in which “the parties are incapable of reducing important terms of the arrangement to well-defined obligations.” Charles J. Goetz & Robert E. Scott, Principles of Relational Contracts, 67 VA. L. REV. 1089, 1090 n.4 (1981).

4. See, e.g., Hillman, Analysis of Cessation, supra note 3, at 628-29 (discussing judicial supplementation of freedom of contract). For example, the overall circumstances taken together with the contract terms may not make it clear whether an agreement is terminable at will or for cause or whether a particular breach entitles the nonbreacher to cease performance. Id. at 629. In situations such as these, courts heavily rely on fairness norms. Id.
belief that the other party has breached its obligation under the contract? In other words, should the law entitle one party to be excused from performing simply because the other party has failed to perform all or part of its obligations under the contract?

Under current common law principles, the answer to the question is "Yes, sometimes." If the breaching party has committed a "material breach," then the nonbreaching party is entitled to suspend its own performance, and assuming a showing of the breaching party's inability to cure in a timely way, the nonbreaching party can even terminate or cancel the entire contract. If, however, the breaching party has substantially performed and thus has not materially breached, then the nonbreaching party may not stop performing, but must continue to perform or else find itself exposed to possible liability for its breach of contract.

Determining whether a material breach has occurred under current law involves a weighing of several factors, a determination that often seems either completely without logic or precision, or self-evident and conclusory. Thus, parties are left not knowing what to do and what risks they may be assuming. The problem with the current application of material breach doctrine is in large part a result of an absence of focus. The courts apply the test without articulating any foundation or context on which it is based. As discussed below, the law in this area could be much improved if courts would return to Judge Cardozo's opinion in Jacob & Youngs, Inc. v. Kent. In Jacob & Youngs, Judge Cardozo defined the foundation

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5. See William J. Geller, Note, The Problem of Withholding in Response to Breach: A Proposal to Minimize Risk in Continuing Contracts, 62 Fordham L. Rev. 163, 166-67 (1993) (discussing constructive conditions and material breach). When a party fails to perform substantially the contract when such performance is due, that party has committed a material breach. Id. at 167. Because the constructive condition of performance has not occurred, the injured party has the right to cancel the contract and terminate any remaining obligations. Id. But see Restatement (Second) of Contracts § 237 reporter's note, § 242 cmt. a (stating that material breach merely allows injured party to suspend performance). The approach of the Second Restatement allows the breaching party to cure the breach until enough time has passed that cancellation is warranted. Id.; see also 2 E. Allan Farnsworth, Farnsworth on Contracts §§ 8.15, 8.18, at 435, 447 (2d ed. 1990) (discussing this approach).

6. See Geller, supra note 5, at 168 (discussing substantial performance). When substantial performance has been rendered and the constructive condition has been satisfied, the breach of contract is not material. Id. When this occurs, the nonbreaching party does not have the right to cancel the contract. Id. He or she may, however, sue for damages for the nonmaterial breach. Id.; see also Restatement (Second) of Contracts § 237 cmts. a, d (discussing effect of material and nonmaterial breach). For a discussion of material breach, see infra notes 35-84 and accompanying text.

7. 129 N.E. 889 (N.Y. 1921).
and the context which can provide courts with the appropriate focus to use in deciding cases of material breach.\(^8\)

This Article will thus critique and suggest a modification of material breach doctrine based largely on Judge Cardozo's reasoning in *Jacob & Youngs Inc. v. Kent*. Part II begins with a discussion of express conditions and then outlines the common law doctrine of constructive conditions and material breach and demonstrates how it is intended to apply.\(^9\) Part II also describes Judge Cardozo's opinion in *Jacob & Youngs* and how the drafters of the Second Restatement of Contracts attempted to incorporate that approach in their definition of material breach.\(^10\) Part III then illustrates how the courts have failed to use material breach doctrine to address successfully the problems it is intended to resolve.\(^11\) Part IV examines the writings of some of those who have also studied this area and critiques the models those scholars have proposed for improving the law that governs such disputes.\(^12\) Part IV also explores the structure of these disputes and the policy goals the law should be striving to accomplish once such disputes arise.\(^13\) Part V proposes a change in the law to accomplish those goals.\(^14\) Finally, Part VI concludes that a change in the law would promote good faith contract performance and independent resolution of contract disputes.\(^15\)

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8. For a discussion of Judge Cardozo's opinion in *Jacob & Youngs*, Inc. v. Kent, see *infra* notes 36-49.

9. For a further discussion of express conditions, see *infra* notes 16-27 and accompanying text. For a further discussion of the common law doctrines of constructive conditions and material breach, see *infra* notes 28-35 and accompanying text.

10. For a further discussion of Judge Cardozo's opinion in *Jacob & Youngs* and the Second Restatement's position on material breach, see *infra* notes 36-55 and accompanying text.

11. For a further discussion of misapplication of the material breach doctrine, see *infra* notes 56-84 and accompanying text.

12. For a further discussion of the critiques and models of constructive conditions and material breach by other commentators, see *infra* notes 85-124 and accompanying text.

13. For a further discussion of the policy goals behind the doctrines of constructive conditions and material breach, see *infra* notes 85-124 and accompanying text.

14. For a further discussion of this Article's proposal to accomplish the goals behind constructive conditions and material breach doctrines, see *infra* notes 126-49 and accompanying text.

15. For a further discussion of how to promote good faith contract performance and independent resolution of contract disputes, see *infra* notes 144-49 and accompanying text.
II. THE LAW OF CONDITIONS AND BREACH

A. Express Conditions

As stated above, parties entering into contracts hope that the intended exchange of performances will go as promised by both parties.\(^\text{16}\) Each party, however, also fears that something will go wrong. Whether expressed or not, the parties have concerns about the consequences of the other party’s failure to perform. When those concerns are expressed in the contract between the parties, the parties assume that the contract terms will govern any problems that arise. Thus, if the contract provides that an employee’s repeated absences will be grounds for termination, the employer assumes that he or she will have a right to terminate the employee if that employee is repeatedly absent. If a contract provides that a contractor’s delay in construction will result in a termination of the contract, the owner assumes that he or she will have a right to termination if the contractor fails to perform as promised.

The law generally provides that if express conditions are not satisfied as provided for in the contract, then the party whose performance is so conditioned will be excused from its obligations to perform.\(^\text{17}\) As defined in section 224 of the Restatement (Second) of Contracts: “[a] condition is an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due.”\(^\text{18}\) Williston defined the effect of a condition as follows: “A condition in a promise limits the undertaking of the promisor to perform, either by confining the undertaking to the case where the condition happens, or to the case where it does not happen.”\(^\text{19}\) As further provided in section 225 of

\(^{16}\) For a discussion of the parties’ “expectation interest,” see supra notes 1-4.

\(^{17}\) See Hillman, Analysis of Cessation, supra note 9, at 620 (discussing express conditions in context of cessation). When parties have clearly assigned the right of cessation, courts will generally enforce the agreement. Id. By doing so, courts are holding that “freedom of private parties to order their own affairs maximizes their welfare, and that of society.” Id. (footnote omitted); see also Union Tank Car Co. v. Lindsay Soft Water Corp., 257 F. Supp. 510 (D. Neb. 1966), aff’d sub nom. Heator Distrib. Co. v. Union Tank Car Co., 387 F.2d 477 (8th Cir. 1967) (termination based on franchisee’s failure to satisfy expressly stated minimum sales volume).

\(^{18}\) Restatement (Second) of Contracts § 224 (1979).

\(^{19}\) 5 Samuel Williston, A TREATISE ON THE LAW OF CONTRACTS § 663, at 125 (3d ed. 1961) (footnote omitted). For a discussion of conditions in contract law, see 3A Arthur L. Corbin, CORBIN ON CONTRACTS §§ 627-631, at 11-22 (1960); 2 Farnsworth, supra note 5, § 8.2, at 563 (2d ed. 1990). Corbin asserts that there is no single, correct definition for the term “condition.” 3A Corbin, supra, § 627, at 11. To avoid misunderstanding and inexact thinking in others, Corbin states that the word “condition,” as used in his work, is defined as “an operative fact, one on which the existence of some particular legal relation depends.” Id.
the Restatement (Second) of Contracts: "[p]erformance of a duty subject to a condition cannot become due unless the condition occurs or its non-occurrence is excused."20

Thus, if a contract makes an obligation expressly conditional upon the occurrence of an event, then that obligation will not become due if that event does not occur. For example, in Luttinger v. Rosen,21 the court excused a buyer from its obligation to buy real property as promised in a contract where the obligation was conditioned on the buyer's ability to obtain a bank mortgage for a defined term of years at a defined interest rate.22 The buyer was unable to obtain such bank financing, and even though the seller agreed to provide essentially equivalent financing, the court allowed the buyer to enforce the condition as expressly provided in its contract and to have its deposit refunded.23 As the court observed:

If the condition precedent is not fulfilled the contract is not enforceable. In this case the language of the contract is unambiguous and clearly indicates that the parties intended that the purchase of defendants' premises be conditioned on the obtaining by plaintiffs of a mortgage as specified in the contract.24

Thus, failure to satisfy an express condition will relieve the other party's obligation to perform.25

20. Restatement (Second) of Contracts § 225(1); see 3A Corbin, supra note 19, § 655, at 142 ("If a fact or event is a condition precedent to a promisor's duty to render the performance promised, its absence or non-occurrence is a 'defense' in an action brought against him for breach of his promise."); 2 Farnsworth, supra note 5, § 8.3, at 569-74 (discussing effects of nonoccurrence of condition).


22. Id. at 758.

23. Id.

24. Id. (citations omitted).

25. See Otis Elevator Co. v. George Washington Hotel Corp., 27 F.3d 903, 909 (3d Cir. 1994) (holding party's failure to comply with notice provision to prevent automatic contract renewal in time required did not satisfy such condition and resulted in automatic renewal, even though late notice did not prejudice other party); Brown-Marx Assocs., Ltd. v. Emigrant Sav. Bank, 709 F.2d 1361, 1369 (11th Cir. 1983) (holding substantial performance of minimal annual rental income condition to bank financing obligation was insufficient to hold condition satisfied; strict compliance required of express, as opposed to constructive, conditions); MXL Indus. v. Mulder, 623 N.E.2d 369, 374-76 (Ill. App. Ct. 1993) (discussing strict compliance and substantial performance and holding express condition for early termination by lessee of lease required strict compliance; substantial performance doctrine held inapplicable); Della Ratta v. American Better Community Dev., Inc., 380 A.2d 627, 637-38 (Md. Ct. Spec. App. 1977) (holding express condition requiring building permits before contractor is obligated to commence work must be complied with strictly; substantial performance doctrine not applicable); see also
In many instances, however, courts will disregard the express language of the contract and hold that even though a condition has not been satisfied, its occurrence has been excused and thus, the other party is not discharged from performing. In finding that the occurrence of a condition has been excused, the courts rely on several different doctrines. For example, as discussed in comment b to section 225 of the Second Restatement:

The non-occurrence of a condition may be excused on a variety of grounds. It may be excused by a subsequent promise, even without consideration, to perform the duty in spite of the non-occurrence of the condition. . . . It may be excused by acceptance of performance in spite of the non-occurrence of the condition, or by rejection following its non-occurrence accompanied by an inadequate statement of reasons. It may be excused by repudiation of the conditional duty or by a manifestation of an inability to perform it. It may be excused by prevention or hindrance of its occurrence through a breach of the duty of good faith and fair dealing. And it may be excused by impracticability.26

Wakefield v. Northern Telecom, Inc., 769 F.2d 109, 113-14 (2d Cir. 1985) (holding district court erred in charging jury that substantial performance would satisfy express condition because there must be strict compliance with express condition), modified, 813 F.2d 535 (2d Cir. 1987); Renovest Co. v. Hodges Dev. Corp., 600 A.2d 448, 452-53 (N.H. 1991) (involving buyer who failed to comply with deadline for notifying seller of unsatisfactory inspection report; court applied rule of strict compliance of express condition and held buyer to obligations under contract, reasoning that "when . . . parties expressly condition . . . upon the occurrence or nonoccurrence of an event, rather than simply including the event as one of the general terms of the contract, the parties' bargained-for expectation of strict compliance should be given effect").

26. Restatement (Second) of Contracts § 225 cmt. b (1979); see Roberts Oil Co., Inc. v. Transamerica Ins. Co., 833 F.2d 222, 226-27 (N.M. 1992) (remanding case with instruction that insured's violation of express contractual condition prohibiting voluntary payments will be excused if insurer is not substantially prejudiced by violation); Red River Commodities v. Eidsness, 459 N.W.2d 805, 809-10 (N.D. 1990) (holding failure to comply strictly with express condition requiring written notice by certified mail of any "act of God" causing shortfall in crop production excused where party received oral notification of shortfall); cf. Hardin, Rodriguez & Boivin Anesthesiologists, Ltd. v. Paradigm Ins. Co., 962 F.2d 628, 633-34 (7th Cir. 1992) (holding plaintiff did not waive condition by conduct where it continued to inquire about defendant's ability to satisfy condition). See generally 3A CORBIN, supra note 19, §§ 752-771, at 478-560 (discussing elimination of conditions by waiver or prevention); 2 FARNSWORTH, supra note 5, §§ 8.5-8.6, at 586-95 (stating conditions may be excused by waiver or by other parties' breach that causes nonoccurrence of condition); 5 WILLISTON, supra note 19, §§ 676-811, at 219-903 (discussing excuses for nonperformance of condition); Burton & Andersen, supra note 1, at 872-75 (discussing and citing cases on enforcement of express conditions); see also Robert A. Hillman, Keeping the Deal Together After Material Breach—Common Law
Thus, even where the parties by their own agreement have made an obligation conditional upon the occurrence of some specified event, the courts may apply one of the "excuse" doctrines to override the express terms of the contract and enforce the obligation in spite of the nonoccurrence of the condition.27

Mitigation Rules, the UCC, and the Restatement (Second) of Contracts, 47 U. COLO. L. REV. 553, 563 (1976) [hereinafter Hillman, Keeping the Deal Together] (discussing harsh results of strict application of material breach doctrine).

In addition, the Restatement (Second) of Contracts § 229 provides that a condition may be excused in order to avoid a 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." RESTATEMENT (SECOND) OF CONTRACTS § 229; see 2 FARNsworth, supra note 5, § 8.7, at 384 (discussing impracticability as excuse and disproportionate forfeiture). As discussed in comment b to § 229, "'forfeiture' is used to refer to the denial of compensation that results when the obligee loses his right to the agreed exchange after he has relied substantially, as by preparation or performance on the expectation of the exchange." RESTATEMENT (SECOND) OF CONTRACTS, § 229 cmt. b. Thus, for example, if a builder has already purchased supplies and substantially completed construction, there might be a disproportionate forfeiture suffered by that builder if the owner could invoke the nonoccurrence of a condition, for example, the failure to comply with some minor aspect of the contract specifications, as a basis for avoiding its contractual obligation to pay the builder for the work already done. See American Ins. Co. v. C.S. McCrossan, Inc., 829 F.2d 702, 705 (8th Cir. 1987) (holding express condition regarding approval of premium computation by third party excused to prevent forfeiture); Sahadi v. Continental Ill. Nat'l Bank & Trust Co., 706 F.2d 193, 199 (7th Cir. 1983) (noting express condition regarding effect of late payment may be excused to prevent forfeiture); Aetna Cas. & Sur. Co. v. Murphy, 538 A.2d 219, 222-24 (Conn. 1988) (holding insurer's failure to comply with timely notice condition in insurance contract did not automatically discharge insurer, given contract of adhesion and forfeiture to insured, as long as insured can show no material prejudice to insurer); Miles v. CEC Homes, Inc., 753 P.2d 1021, 1026-27 (Wyo. 1988) (holding condition, requiring one contractor to inform other of specifications before incurring expenses, excused, in part to prevent forfeiture).

27. See Hillman, Analysis of Cessation, supra note 3, at 633-34 (observing that courts will disregard express conditions in situations that would otherwise violate certain "fairness" norms such as unconscionability and forfeiture); see also UHS-Qualicare, Inc. v. Gulf Coast Community Hosp., Inc., 525 So. 2d 746, 756 (Miss. 1987) (interpreting termination clause allowing termination for any failure to perform any material term of contract as allowing termination only for material breach of any material term because court considered any other reading to "produce harsh, unreasonable, expensive and unintended consequences").

Despite the traditional maxim of contract law that express conditions will be strictly enforced, courts use a variety of techniques for circumventing them. See Burton & Andersen, supra note 1, at 872 (arguing that express conditions often are not strictly enforced). Thus, courts have lessened the freedom to contract by subjecting express conditions and provisions to unconscionability tests and other related doctrines such as forfeiture, good faith and public policy. See Hillman, Analysis of Cessation, supra note 3, at 621 & n.25 (discussing unconscionability and related doctrines in context of express right of cessation provisions). Unconscionability generally encompasses unequal bargaining position or bargaining misconduct, including fraud, duress and the duty to disclose. Id. Although courts are generally reluctant to override express contract provisions, "they have intervened on unconscionability and related grounds to ensure some degree of balance in the
B. Constructive Conditions

Not all conditions, however, are created by the express agreement of the parties. Some conditions are supplied by the courts in circumstances where "the parties have omitted a term that is essential to a determination of their rights and duties."28 For example, an employment contract may not specify when the obligation to pay for services rendered will be excused; it may simply describe the obligations of the employee and the compensation to be paid. If the employee fails to perform as promised, the employer may assert that its obligation to pay was conditioned on the employee's performance of those contractual obligations, even though the contract does not so specify. Historically, the common law provided that in such an instance, the promises of the employer were independent of the obligations of the employee and that the employer had no right to terminate or to withhold pay.29 Then, in the historic case of Kingston v. Preston,30 Lord Mansfield laid the fruits of the exchange." Id. at 622. See generally, Robert Childs, Conditions in the Law of Contracts, 45 N.Y.U. L. REV. 33 (1970) (documenting failure of courts to enforce strictly express conditions with any consistency).

28. Restatement (Second) of Contracts § 226 cmt. c. The Second Restatement states that "[a]n event may be made a condition either by the agreement of the parties or by a term supplied by the court." Id. § 226 (emphasis added). Therefore, when parties have omitted a term that is essential to a determination of their rights and duties, a term, which is reasonable under the circumstances, may be supplied by the court. Id. This supplied term is a constructive condition. Id.

Corbin notes that courts may hold that a constructive condition is required, even if the parties had no intention that the fact or event should operate as such and did nothing from which such an inference can be drawn. 3A Corbin, supra note 19, § 632, at 22. "It is operative as a condition for the reason that courts have held or will hold it so on grounds of justice that are independent of expressed intention." Id.

29. See 3A Corbin, supra note 19, § 654, at 163 (discussing history of implied and constructive conditions); 2 Farnsworth, supra note 5, § 8.9, at 398 (surveying cases involving implied and constructive conditions); 6 Williston, supra note 19, § 816, at 28 (discussing original independence of mutual promises); Clinton W. Francis, The Structure of Judicial Administration and the Development of Contract Law in Seventeenth-Century England, 83 COLUM. L. REV. 35, 102-09 (1983) (discussing the notion of mutual promises).

Williston states that: "It was settled law for centuries that mutual promises unless containing express conditions were independent. This had certainly been established as to mutual covenants by the year 1500 and probably earlier, and remained unquestioned law both as to covenants and simple contracts until the eighteenth century." 6 Williston, supra note 19, § 816, at 28. Therefore, prior to the recognition of bilateral contracts, failure by a promisor to perform his or her promise did not affect the other party's duty. See 3A Corbin, supra note 19, § 654, at 136 (discussing history of implied and constructive conditions).

groundwork for the eventual development of the doctrines of substantial performance and material breach. 31 By reading into the contract a condition where the parties themselves had not expressed one, Lord Mansfield recognized that parties have a general expectation of the interdependence of their performance obligations. 32

Based on this expectation, the courts and later the drafters of the Restatements of Contracts developed the doctrine of constructive conditions and material breach as we know it today. Returning to our hypothetical employment agreement, if the contract itself did not specify that the employer’s obligation to pay was conditioned on the employee’s performance of its contractual obligations, the court will probably provide that missing term, i.e., it will construe the employee’s performance obligations as conditions to the employer’s obligation to pay, creating what the Second Restatement calls a “constructive condition.” 33

31. Williston notes that even after 200 years, the principles set forth in Kingston v. Preston still represent the law. 6 Williston, supra note 19, § 817, at 30.

32. In Kingston, a silk mercer and his apprentice made a contract which provided that after one year and a quarter, the mercer was to convey the business to the apprentice and a partner. Kingston, 99 Eng. Rep. at 437. In return, the apprentice was to pay for his share of the business in monthly installments and to assure these payments, give “good and sufficient security.” Id. The apprentice sued the mercer for failure to convey the business, and the mercer defended by alleging that the apprentice had not given the required security. Id. The apprentice argued that the mercer’s promise to convey was independent of his promise to give security. Id. Lord Mansfield rejected this argument and held for the defendant mercer. Id. at 438. Lord Mansfield stated that there were instances where one promise under a bilateral contract was dependent on a return promise and in such cases nonperformance of the return promise was an excuse for the nonperformance of the first promise. Id. Under Lord Mansfield’s approach, the court determines whether a promise by one of the parties is dependent upon the other’s return promise. Id. If it is, the court then supplies a term that makes the first party’s promise conditional on performance of the return promise. Id.

33. See Restatement (Second) of Contracts § 226 cmt. c. (”When the parties have omitted a term that is essential to a determination of their rights and duties, the court may supply a term which is reasonable under the circumstances. [Such terms are] often described as “constructive.”” (citation omitted)); see also 3A Corbin, supra note 19, § 653, at 132 (“A constructive condition has been defined as a fact or event that is operative as such on grounds of fairness and justice, even though the parties expressed no intention whatever.”); 2 Farnsworth, supra note 5, § 8.9, at 398 (“Constructive conditions of exchange play an essential role in assuring parties to a bilateral contract that they will actually receive the performance that they have been promised.”); 6 Williston, supra note 19, § 825, at 57-60 (criticizing fiction of “implied intent” to create dependent promises and uses term “constructive conditions imposed by law” as better reflecting the reality behind such dependency). See generally Edwin W. Patterson, Constructive Conditions in Contracts, 42 Colum. L. Rev. 903, 907-28 (1942) (discussing constructive conditions).
As the Second Restatement observes, however, courts may treat a constructive condition differently from a condition expressly provided for by the parties—

[T]o the extent that the parties have, by a term of their agreement, clearly made an event a condition, they can be confident that a court will ordinarily feel constrained strictly to apply that term, while the same court may regard itself as having considerable latitude in tailoring a similar term that it has itself supplied.34

This latitude is reflected in the doctrine of material breach.

C. Material Breach

The doctrine of material breach is based on the law's willingness to construe, as a term of all contracts, that "it is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time."35 In other words, if one party has committed a "material failure" to perform its already due contractual obligations, the other party can assert that its own contractual obligations have not become due; the breaching party's obligation to perform is thus construed by the courts as a condition to the other party's obligation to perform. In more concrete terms, the obligation of the employer to pay the employee in our hypothetical contract is constructively conditioned on the employee's performance of its obligations under the contract. The court's latitude in applying this constructive condition lies in its determination of whether or not the party's failure to perform is "material," that is, is it serious enough to excuse the other party from performing?


35. Restatement (Second) of Contracts § 237.
1. Jacob & Youngs, Inc. v. Kent

In his well-known opinion in *Jacob & Youngs, Inc. v. Kent*, Judge Cardozo provided much of the analytic framework for determining when a failure to perform is serious enough to excuse the other party from performing. In *Jacob & Youngs*, the plaintiffs were builders hired by the defendant to build an expensive home. Defendent refused to pay the plaintiffs the final amount due on the contract, asserting that plaintiffs had installed a brand of pipe other than that specified in the contract. Plaintiffs sued for payment of the amount owed, claiming that the pipes installed were equivalent in quality to those called for in the contract. The trial court refused to admit evidence with respect to this equivalence and, on the basis of the plaintiffs’ failure to comply with the contractual specifications with respect to the pipes, directed a verdict in favor of the defendant. After the New York Supreme Court, Appellate Division reversed and granted a new trial, the defendant appealed to the New York Court of Appeals, which affirmed the Appellate Division and ordered judgment in favor of the plaintiffs.

Writing for the majority, Judge Cardozo explored the distinction between dependent and independent promises and observed that some promises, “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.” In other words, where a failure to perform a promise is substantial, that promise will be construed as a condition to the other party’s obligations. On the other hand, where the failure is insubstantial, the promise will be construed as independent and not a condition of the other party’s obligation to perform. The more difficult question for Judge Cardozo is how to determine when a particular failure to perform is significant enough to render that promise dependent:

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 multifari-

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36. 129 N.E. 889 (N.Y. 1921).
37. *Id.* at 890.
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
ous and the intricate. . . . 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.43

Thus, Judge Cardozo recognized that notions of equity and forfeiture must be considered in determining whether a failure to perform should excuse the other party. If the breaching party will suffer a forfeiture because its defective work cannot be returned, it would be less fair to excuse the nonbreaching party than where the nonbreaching party can return to the breaching party the defective goods. As Kent could not return the pipes already installed into his house to the builders, Judge Cardozo would weigh that factor against Kent in determining if the builders had materially breached.

Judge Cardozo also believed that the reasonable expectations of the nonbreaching party must be weighed in such determinations: "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."44 In other words, if a party intends to make a trivial defect by the other party enough to excuse itself from performing, it had better expressly state that in its contract. Otherwise, the law will assume that the intention was that only significant defects in the breaching party’s performance will excuse the nonbreaching party from performing. Judge Cardozo observed that "[w]here the line is to be drawn between the important and the trivial cannot be settled by a formula."45 He recognized that this question must be determined on a case-by-case basis, looking to promote justice based on the reasonable expectations of the parties.46

One situation, however, where Judge Cardozo concluded some limits could be stated was that involving an intentional breach: "The willful transgressor must accept the penalty of his transgression. For him there is no occasion to mitigate the rigor of implied

43. Id. at 890-91.
44. Id. at 891.
45. Id.
46. See id. (stating "[t]he question is one of degree . . . to be answered by the triers of the facts").
conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong.\textsuperscript{47} The moral tone of this language is unmistakable. Cardozo believed that in addition to concerns of fairness, the court should consider the conduct of the breaching party: was he or she operating in good faith? Although Cardozo does not explain what he means by a "willful transgressor," he made it clear that the intentions of that transgressor were an important factor to consider.\textsuperscript{48}

In sum, Judge Cardozo outlined three basic factors that should inform decisions about whether a breach is trivial or significant enough to excuse the nonbreaching party from performing. These factors are the degree of harm to the breaching party, in particular, the possibility that that party will suffer inequitable forfeiture if the contract is terminated; the degree of harm caused by the breach to the reasonable expectations of the nonbreaching party; and good faith.\textsuperscript{49}

2. \textit{The Restatement Definition of Material Breach}

The same factors discussed by Judge Cardozo in \textit{Jacob \& Youngs} were incorporated into the \textit{Restatement (Second) of Contracts} definition of a "material" failure to perform. The Second Restatement defined a "material failure" in section 241:

In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

(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 the part of that 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 to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;

\textsuperscript{47} \textit{Id.} (citations omitted).

\textsuperscript{48} See \textit{id.} (stating "[w]e must weigh \ldots the excuse for deviation from the letter").

\textsuperscript{49} See \textit{id.} (listing factors as purpose to be served, desire to be gratified, excuse for deviation and cruelty of enforced adherence).
(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.\textsuperscript{50}

As in \textit{Jacob \& Youngs}, the Second Restatement thus calls for consideration of the degree of harm caused by the breach to the reasonable expectations of the nonbreaching party (factors (a) and (b)); the degree of harm to the breaching party if the contract is terminated (factor (c)); and the good faith of the breaching party (factors (d) and (e)).\textsuperscript{51}

\textsuperscript{50} \textbf{Restatement (Second) of Contracts} § 241 (1979). A number of courts have applied § 241 of the Second Restatement. \textit{See} Sun Studs, Inc. v. ATA Equip. Leasing, Inc., 872 F.2d 978, 992 (Fed. Cir. 1989) (finding breach of confidentiality clause in patent agreement was material, discharging plaintiff from obligations under contract), overruled by A.C. Aukerman Co. v. R.L. Chaides Constr. Co., 960 F.2d 1020, 1038 (Fed. Cir. 1992) (denying motion for summary judgment on issue of material breach); O'Connell Management Co. v. Carlyle-XIII Managers, Inc., 765 F. Supp. 779, 783 (D. Mass. 1991) (holding genuine issue of material fact existed as to whether building manager materially breached by informing potential tenant of suitable space in other buildings and as to whether breach was curable and cured); Jafari v. Wally Findlay Galleries, 741 F. Supp. 64, 67 (S.D.N.Y. 1990) (finding purchaser's failure to tender payment for painting by deadline was material breach, discharging seller from any obligation under contract); Tyro Indus., Inc. v. Trevose Constr. Co., 737 F. Supp. 856, 865 (E.D. Pa. 1990) (holding failure to maintain liability insurance was material breach of contract, entitling contractor to terminate); Conam Alaska v. Bell Lavalin, Inc., 842 F.2d 148, 159 (Alaska 1992) (affirming jury verdict that breach was not material); Fitz v. Coutinho, 622 A.2d 1220, 1223 (N.H. 1993) (affirming trial court's determination that party's failure to tender payment was not material breach).

\textsuperscript{51} The doctrine of substantial performance views problems of failure to perform from a different angle, but with the same underlying concerns. According to this parallel doctrine, if a party substantially performs its contractual obligations, the other party is not excused from performing. For a discussion of substantial performance, see 3A \textbf{CORBIN}, supra note 19, §§ 700-712, at 308-51 (discussing substantial performance, its character and effect); 2 \textbf{FARNSWORTH}, supra note 5, § 8.12, at 414 (same); 6 \textbf{WILLISTON}, supra note 19, § 842, at 165-71 (same). It is sometimes said that substantial performance doctrine is the flip side of material breach doctrine: If a party substantially performs, that party has not committed a material breach; on the other hand, if a party has not substantially performed, then it has committed a material breach. \textit{See} 2 \textbf{FARNSWORTH}, supra note 5, § 8.16, at 442 ("The doctrine of material breach is simply the converse of the doctrine of substantial performance."); 6 \textbf{WILLISTON}, supra note 19, § 842, at 165-66 (arriving at same conclusion). Determinations of substantial performance consider many factors similar to those used in determinations of material breach: the extent of nonperformance, the extent to which the nonbreaching party has been denied the benefits of the contract, the willfulness of the breach and the extent to which the nonbreaching party can be compensated in damages. \textit{See} generally 3A \textbf{CORBIN}, supra note 19, §§ 704-707, at 318-51 (discussing factors considered when determining material breach); 2 \textbf{FARNSWORTH}, supra note 5, § 8.12, at 414-22 (same). Similar to determinations of material breach, determinations of substantial performance are fact-based and not easily predicted. As Corbin said:

It is not easy to lay down rules for determining what amounts to "substantial performance"... in any particular case. It is always a question of fact, a matter of degree, a question that must be determined relatively to all.
Assuming that the failure to perform is a material one, the Second Restatement provides that the nonbreaching party is entitled initially to suspend or withhold performance of its contractual obligations. If, however, that failure to perform remains uncured, the obligations of the nonbreaching party may be discharged completely.\textsuperscript{52} Section 242 of the \textit{Restatement (Second) of Contracts} provides:

In determining the time after which a party's uncured material failure to render or to offer performance discharges the other party's remaining duties to render performance under the rules stated in [sections] 237 and 238, the following circumstances are significant:

(a) those stated in [section] 241;

(b) the extent to which it reasonably appears to the injured party that delay may prevent or hinder him in making reasonable substitute arrangements;

the other complex factors that exist in every instance. The variation in these factors is such that generalization is difficult and the use of cases as precedents is dangerous.

\textsuperscript{3A} \textsc{Corbin}, supra note 19, § 704, at 318-19.

Given the essential identity of the two doctrines, the discussion herein of "material breach" doctrine and its flaws applies as well to "substantial performance" doctrine.

\textsuperscript{52} Corbin used different terminology; he distinguished between "total breach" and "partial breach":

A total breach . . . is a non-performance of duty that is so material and important as to justify the injured party in regarding the whole transaction as at an end . . . A total breach by A will usually terminate B's duty to perform any further on his part, but it does not always do so.

\textsuperscript{4} Corbin, supra note 19, § 946, at 809. In contrast, "[a] partial breach by one party . . . does not justify the other party's subsequent failure to perform; both parties may be guilty of breaches, each having a right to damages." \textit{Id.} at 811 (footnote omitted). Corbin recognized that the courts often use other terminology: "not infrequently the term material breach is used to mean one that the injured party can elect to treat as a total breach." \textit{Id.} at 813 (footnote omitted). Williston also distinguished between "partial" and "total" breach. \textsc{11} \textsc{Williston}, supra note 19, § 1292, at 8-11 (stating that slight breach may not excuse injured party from performance). Farnsworth uses the term "material breach" to refer to the circumstances which justify a party in suspending its own performance, as in § 241 of the Second Restatement. \textsc{2} \textsc{Farnsworth}, supra note 5, §§ 8.15-8.18, at 435-55. The Second Restatement uses the terms "total breach" and "partial breach" to distinguish between different ways of calculating contract damages. \textit{Restatement (Second) of Contracts} § 236. The Second Restatement uses the term "uncured material failure" to describe the circumstances which determine whether or not a nonbreaching party is excused from performance. \textit{See id.} § 237 ("[I]t is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time.").
(c) the extent to which the agreement provides for performance without delay, but a material failure to perform or to offer to perform on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.53

Thus, if the breaching party's failure is a material one, as defined in section 241, and that failure remains uncured for a period of time beyond that allowed by the intent of the contract or for a period of time which hinders the ability of the nonbreaching party to find a reasonable substitute, then not only can the nonbreaching party withhold performance of its contractual obligations temporarily, it can withhold performance permanently. In other words, it can "cancel" or "terminate" the entire contract.54 For example, if the employee's material failure to perform as promised remains uncured beyond a reasonable time as determined under section 242, the employer will be discharged from paying that employee under the terms of the contract.

53. Restatement (Second) of Contracts § 242. There are very few cases expressly relying on or interpreting § 242. Compare Commonwealth Petroleum Co. v. Billings, 759 F.2d 736, 738-39 (Colo. Ct. App. 1987) (determining, for purposes of right to terminate under § 242, whether time was of essence in contract for assignment of lease, required consideration of number of factors resulting in finding that time was not of essence), with Garcia v. Alfonso, 490 So. 2d 130, 131 (Fla. Dist. Ct. App. 1986) (holding time was of essence and contract properly terminated where buyers did not obtain financing until three weeks after 30-day period specified in contract had expired). For a critical discussion of § 242 and its incorporation of the opportunity to cure a material failure to perform, see William H. Lawrence, Cure After Breach of Contract Under the Restatement (Second) of Contracts: An Analytical Comparison with the Uniform Commercial Code, 70 Minn. L. Rev. 713, 723-24, 735-36 (1986).

54. Farnsworth uses the word "terminate" to describe the right of the nonbreaching party to "put an end to the contract" after an uncured material failure to perform. 2 FARNSWORTH, supra note 5, § 8.18, at 447. Others also use this terminology. See, e.g., Rosett, supra note 1, at 1086 (noting that after material breach, nonbreaching party may be justified in terminating his or her own performance). Some commentators instead describe this right as a right to "cancel" the contract. See, e.g., Eric G. Andersen, A New Look at Material Breach in the Law of Contracts, 21 U.C. Davis L. Rev. 1073, 1075 (1988) (noting that under UCC nonbreaching party "is entitled to 'cancel' the contract"). The drafters of the Second Restatement described the effect of an uncured material failure to perform as a "discharge" of the remaining duties of the nonbreaching parties. See, e.g., Restatement (Second) of Contracts § 242 (discussing determination of dischargeability of remaining duties). All these different terms reflect the same underlying concept: At some point a nonbreaching party has a right to claim that it no longer has any obligation to perform its duties under the contract.
The rights of the parties thus depend greatly on whether or
not a particular failure to perform is a material failure, or as usually
referred to by the courts, whether or not it is a material breach.
Unfortunately, as the cases reveal, instead of focusing on Judge Car-
dozo’s three principal concerns, the courts have often become en-
tangled in the various factors outlined in section 241 and have not
provided clear discussion of why a particular breach is or is not con-
sidered material. This unfocused case law has made it extremely
difficult to determine whether or not a particular failure is
material.55

55. Although beyond the scope of this Article, it is interesting to note that
similar problems exist with respect to the doctrine of anticipatory breach.
Whereas material breach doctrine deals with a failure to perform contractual obli-
gations that have become due, anticipatory breach doctrine deals with the
problems created where one party indicates, by words or conduct, that it will not or
cannot perform contractual obligations that are not yet due. The doctrinal re-
sponse to this problem is in some ways similar to the response to problems of
material breach. An anticipatory breach is held to discharge the nonbreaching
party’s obligations to perform any duties remaining under its contract. “Where
performances are to be exchanged under an exchange of promises, one party’s
repudiation of a duty to render performance discharges the other party’s remain-
ing duties to render performance.” Restatement (Second) of Contracts
§ 253(2). See generally 6 Corbin, supra note 19, §§ 1255, 1259-1260, at 21-22, 91-38;
2 Farnsworth, supra note 5, §§ 8.20-8.23, at 466-92; 11 Williston, supra note 19,§§ 1300-1312, at 76-110. That is, as with a material breach that remains uncured,
an anticipatory breach entitles the nonbreaching party to suspend and ultimately
terminate its obligation under the contract.

As with the doctrine of material breach, however, there is considerable diffi-
culty in knowing for certain whether a party has, in fact, committed an anticipatory
breach. First of all, “the threatened breach . . . must be serious enough that the
injured party could treat it as total if it occurred.” 2 Farnsworth, supra note 5,
§ 8.21, at 474-75 (footnote omitted). In addition, in order to find that the party
has anticipatorily breached the contract, one must consider the words and/or con-
duct used to create the impression of an intention not to perform as promised.
Thus, as Farnsworth describes it, “[t]he statement must be sufficiently positive to
be reasonably understood as meaning that the breach will actually occur. A party’s
expressions of doubt as to its willingness or ability to perform do not constitute a
repudiation.” Id. § 8.21, at 475 (footnote omitted); see Restatement (Second) of
Contracts § 250 cmt. b (“In order to constitute 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 his willingness or abili-
ty to perform is not enough to constitute a repudiation . . . .”). See generally 2
Farnsworth, supra note 5, § 8.21, at 474-75 (“For repudiation to have legal effect,
the threatened breach must be serious . . . . [E]xpressions of doubt . . . do not
constitute repudiation.”). A contract can be repudiated by conduct only if the
party has voluntarily acted in a way that makes its performance of its contractual
obligation impossible. Delay or unwillingness reflected in conduct is not enough.
See id. § 8.51, at 479; see also Restatement (Second) of Contracts § 250 cmt. c
(“In order to constitute a repudiation, a party’s act must be both voluntary and
affirmative, and must make it actually or apparently impossible for him to per-
form.”); 4 Corbin, supra note 19, § 954, at 829 (surveying breach by repudiation).
Obviously, such standards require the nonbreaching party to weigh and interpret
the statements and/or conduct before deciding to suspend its own performance.
III. MATERIAL BREACH CASE LAW: A MUDDLED APPROACH

Professor Eric G. Andersen provided a very thorough evaluation of the way courts have relied on section 241 to determine material breach.\(^{56}\) Professor Andersen asserted that the Second Restatement factors have failed to provide a coherent or meaningful approach to determining a material failure. According to Professor Andersen, "the Restatement factors fall seriously short of providing a workable definition of materiality."\(^{57}\) He asserted that the Second Restatement provides no "underlying, unifying principle more specific than 'fairness' or 'justice'" to use in determining how to weigh or balance the various factors.\(^{58}\) Professor Andersen

An incorrect assessment of the other party's intent or ability to perform can lead to liability if the nonbreaching party withholds its performance.

56. See Andersen, supra note 54, at 1089-92 (analyzing judicial application of § 241).
57. Id. at 1083 (noting that most obvious failing of Second Restatement factors is absence of any guidance on their relative priorities or how to combine them).
58. Id. Andersen reviewed the ways that the courts have treated the § 241 factors in many decided cases. He argued that the first factor, "the extent to which the injured party will be deprived of the benefit which he reasonably expected," which is apparently intended to consider the gravity of the nonperformance, is unhelpful because it provides no substantive content to determine that gravity. Id. at 1085.

He argued that the second factor, "the extent to which the injured party can be adequately compensated for the part of the benefit of which he will be deprived," is an inappropriate factor for determining material breach because its focus is on the need for certainty in recovering compensatory damages. Id. The courts and the Second Restatement comments appear to consider a breach more likely to be "material" and thus relieving the nonbreaching party of its contractual obligations when the nonbreaching party would have difficulty proving the actual damages caused by that breach with the degree of certainty which contract law requires. As Andersen points out, if the certainty requirement is itself justified as a matter of contract law, "it is not clear why cancellation should be available in place of damages when the requirement is not satisfied." Id. at 1085-86. In other words, the probability of actual damages caused by a breach should not be relevant to determining whether or not the breach itself is a material one.

The third factor, "the extent to which the party failing to perform or to offer to perform will suffer forfeiture," Andersen considered relevant, but not as a factor for determining the materiality of the breach itself. Andersen argued that the question of materiality should focus on the impact of the breach on the nonbreaching party, not the effect of cancellation on the breaching party. Id. at 1087. He would consider forfeiture as a relevant factor in determining the breaching party's right to restitution and the extent of the nonbreaching party's right to withhold its own performance, but not as a factor in determining materiality and thus the basic right of the nonbreaching party to suspend or withhold its performance. Id. at 1111-22.

With respect to the fourth § 241 factor, "the likelihood that the party failing to perform or to offer to perform will cure his failure," Andersen believed that this should be a factor considered in determining material breach, but claimed that without some explanatory framework to explain the doctrine of material breach, it is not possible for the courts to consider this factor appropriately. Id. at 1087.
then discussed the ways that the courts have dealt with this flawed set of factors, and he concluded that the courts either cite the factors and disregard them, or rely on one or more factors without a thorough or satisfying analysis of those factors. Thus, Professor Andersen concluded that the doctrine of material breach, as defined in section 241 and as applied by the courts, is so riddled with ambiguity and imprecision that it fails to provide parties to the contract with sufficient guidance for determining whether or not a particular failure to perform will be considered material.59

A look at some recent cases applying the doctrine of material breach illustrates some of these flaws in the material breach doctrine. For example, Stone Forest Industries, Inc. v. United States60 illustrates the arbitrariness and uncertainty of material breach doctrine. In this case, the United States Forest Service had entered into a contract with the plaintiff whereby the plaintiff was allowed to remove timber from land in a national forest in exchange for payment.61 The plaintiff had made certain advance deposits and then was denied access to some of the land covered by the contract. The plaintiff requested a return of a portion of its deposits, and the Forest Service refused to return the entire amount requested.62 After finding that the Forest Service had in fact denied the plaintiff access to 15.89% of the land covered by the contract, the court concluded that this amounted to a material breach of the contract, entitling the plaintiff to a return of the portion of that amount of its

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59. Id. at 1088-89; see also Lawrence, supra note 53, at 746 (criticizing “waver- ing material breach standard” of Second Restatement because it causes uncer- tainty); Rosett, supra note 1, at 1091-92 (difficulty in distinguishing between failure of condition which discharges performance obligations as opposed to one which merely suspends them leads to uncertainty for party deciding how to respond to such failure); Geller, supra note 5, at 181-92 (outlining various risks, situational and legal, that parties face when trying to determine how to respond to failure to perform by other party to contract).

60. 973 F.2d 1548 (Fed. Cir. 1992).

61. Id. at 1549. Stone Forest Industries (“SFI”) agreed to purchase, cut and remove 19,430 MBF (thousand board feet) of timber in the Klamath National For- est in California. Id. The contract termination date of March 31, 1980 was ex- tended several times, until the contract finally terminated on September 3, 1985. Id. On September 28, 1984, the California Wilderness Act was enacted. Id. This Act affected four of the 14 units of SFI’s contract. Id. As a result, access was de- nied to these four units. Id.

62. Id. at 1550.
deposit representing the portion of land to which it was denied access.\textsuperscript{63} The court distinguished the case from an earlier case, \textit{Everett Plywood Corp. v. United States},\textsuperscript{64} where the plaintiff was denied access to only 6.5\% of the lumber covered by a contract with the Forest Service and no material breach was found.\textsuperscript{65} Although the \textit{Stone Forest} court observed that "percentages alone are not always dispositive,"\textsuperscript{66} it did not explain why a denial of access to 15.89\% constituted a material breach, but a denial of access to 6.5\% did not. Thus, the Forest Service in future cases might be led to assume that a material breach of a timber removal contract may be committed if they deny access to somewhere between 6.5\% and 15.89\% of the land covered by the contract.

The uncertainty of material breach determinations and the risks created by that uncertainty is also illustrated by \textit{Health Related Services v. Golden Plains Convalescent Center},\textsuperscript{67} which involved plaintiff's ten-year contract to operate and manage defendant's nursing home. After the management company was acquired by a different corporation almost five years into the contract, the nursing home began to be dissatisfied with the manager's performance and at the end of the sixth year terminated its contract, alleging material failures to perform.\textsuperscript{68} The management company sued, seeking lost profits as damages, and the nursing home counterclaimed, alleging damages from the management company's unsatisfactory performance.\textsuperscript{69}

At trial, the nursing home submitted evidence that the management company had paid vendor invoices late, had failed to obtain Medicare reimbursements, had failed to supply payroll checks and had failed to staff the facility adequately.\textsuperscript{70} Although there was

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  \item \textsuperscript{63} \textit{Id.} at 1552. The court observed that the materiality of a breach is determined in light of the totality of events and circumstances. \textit{Id.} (citing Restatement (Second) of Contracts \S 241 cmt. a (1974)). It is incorrect, therefore, to "measure each contributing element separately and, finding it small, remove it from the equation." \textit{Id.}
  \item \textsuperscript{64} 512 F.2d 1082 (Ct. Cl. 1975).
  \item \textsuperscript{65} \textit{Stone Forest}, 973 F.2d at 1552. Significantly, the \textit{Everett} court stated that the denial of access to only a portion of the lumber "'neither defeated the whole purpose of the contract nor deprived plaintiff of substantially all it had bargained for:'" \textit{Id.} (quoting \textit{Everett}, 512 F.2d at 1093-94).
  \item \textsuperscript{66} \textit{Id.} In stating that the percentages alone are not dispositive, the \textit{Stone Forest} court cited, with approval, the Second Restatement view that "'it is impossible to lay down a rule that can be applied with mathematical exactness.'" \textit{Id.} (quoting Restatement of Contracts \S 275 cmt. a (1932)).
  \item \textsuperscript{67} 806 S.W.2d 102 (Mo. Ct. App. 1991).
  \item \textsuperscript{68} \textit{Id.} at 103-04.
  \item \textsuperscript{69} \textit{Id.} at 104.
  \item \textsuperscript{70} \textit{Id.} at 105.
\end{itemize}
evidence that the management company had been responsive and had corrected some of the problems, there was also evidence that some problems had never been fully resolved. Even in the face of this evidence, the jury found for the management company and awarded damages.71

The nursing home appealed, but the Missouri Court of Appeals upheld the jury's verdict, saying only that:

It is not every dissatisfaction with a contract performance, nor even every breach—but only a material breach—that excuses performance by the other party. The circumstances significant to that determination are given in Restatement (Second) of Contracts § 241 (1981). . . . It is sufficient to say that, under those principles, neither the evidence nor the arguments [defendant] brings to bear, shows any [plaintiff] neglect that constitutes a material failure to perform under the contract.72

The court never explained how section 241 should be applied to the evidence submitted or why the problems experienced by the nursing home were not sufficiently serious to justify termination of its contract with the management company.73

Given this ambiguity and uncertainty in material breach determinations, a nonbreaching party can expose itself to liability if it decides to suspend its own performance. For example, in the

71. Id. at 106.
72. Id. at 105 (citations omitted).
73. The uncertainty of predicting whether or not a breach is material is not uncommon. See Eastern Ill. Trust & Sav. Bank v. Sanders, 826 F.2d 615, 618-19 (7th Cir. 1987) (affirming district court's finding that bank's granting of additional side loans to borrower in breach of explicit term of guaranty agreement with Small Business Administration was not material breach); Sahadi v. Continental Ill. Nat'l Bank & Trust Co., 706 F.2d 193, 200 (7th Cir. 1983) (reversing district court summary judgment on issue of materiality of breach because issue of materiality is factually complex); Fitz v. Coutinho, 622 A.2d 1220, 1223 (N.H. 1993) (noting whether delay in payment is material breach is complex factual determination and holding timber buyers delay in payment was not material).

Another indication of the uncertainty involved in determining material breach is that some courts are reluctant to issue summary judgment where material breach has been alleged, treating the issue as a question of fact for the jury. See, e.g., Sahadi, 706 F.2d at 194 (reversing district court grant of summary judgment holding material breach had occurred where lender tendered interest payment one day later in breach of express term of contract because of factual complexity regarding materiality); O'Connell Management Co. v. Carlyle-XIII Managers, Inc., 765 F. Supp. 779, 784 (D. Mass. 1991) (holding summary judgment inappropriate to determine material breach). But see Milner Hotels, Inc. v. Norfolk & Western Ry., 822 F. Supp. 341, 347 (S.D.W. Va. 1993) (granting summary judgment because where facts not in dispute, material breach is question of law), aff'd, 19 F.3d 1429 (4th Cir. 1994).
Golden Plains case, the nursing home was held liable for terminating the management company after incorrectly concluding that its failings constituted a material breach.

This phenomenon is further illustrated in McClain v. Kimbrough Construction Co. McClain, a brick mason, entered into a subcontract with Kimbrough to do the brick work at a condominium project for which Kimbrough was the general contractor. McClain had worked for three weeks, laying over 20,000 bricks, when it was forced to stop work so that Kimbrough could complete grading work. By this time, however, Kimbrough had already discovered several problems with the brick work, and although McClain had attempted to make some corrections, Kimbrough decided never to call McClain back to the job after the grading was completed. Instead, Kimbrough contracted with a different brick mason to finish the job.

McClain sued Kimbrough for breach of contract, and Kimbrough counterclaimed for the increased costs it incurred as a result of having to replace portions of McClain’s work. The trial court ruled that Kimbrough had breached its contract with McClain and awarded damages accordingly; it also dismissed Kimbrough’s counterclaim.

On appeal, the Tennessee Court of Appeals affirmed, holding that McClain’s performance deficiencies did not constitute a material breach, and therefore, that Kimbrough’s failure to give McClain notice and a reasonable opportunity to correct its work constituted a material breach of the contract by Kimbrough.

The court observed:

A party who has materially breached a contract is not entitled to damages stemming from the other party’s later material breach of the same contract. Thus, in cases where both parties have not fully performed, it is necessary for the courts to determine which party is chargeable with the first uncured material breach.

The court then found that Kimbrough’s failure to provide a suitable place to work or a reasonable opportunity to perform and its

74. 806 S.W.2d 194 (Tenn. Ct. App. 1990).
75. Id. at 196.
76. Id.
77. Id. at 196-97.
78. Id. at 197.
79. Id.
80. Id. at 199 (citations omitted).
failure to give notice before terminating the contract preceded McClain's failure to complete the job in a workmanlike manner.\textsuperscript{81} Therefore, Kimbrough's breaches excused McClain's nonperformance, and McClain's nonperformance thus did not prevent it from recovering damages from Kimbrough.

To the extent material breach doctrine places such significance on who committed the first material breach, as illustrated by this case and the \textit{Golden Plains} case, it fails to treat contract disputes in a realistic or fair manner.\textsuperscript{82} As the cases indicate, all the parties to the contract may have contributed to the exacerbation of the dispute. Although one party may have made the first error in performance, at some point it is fair to say that both parties have not fulfilled the promises they made in their contract. For example, in the \textit{McClain} case, it appears to be hairsplitting to say that Kimbrough materially breached first by failing to allow McClain to correct the problems with its work. This analysis is particularly arbitrary, because it is so difficult to say with any certainty whether a particular breach is material. To determine a party's rights by focusing on the chronological occurrence of problems that really may be occurring more or less simultaneously seems quite absurd and even unfair.\textsuperscript{83}

\textsuperscript{81} Id.

\textsuperscript{82} See also Fitz v. Coutinho, 622 A.2d 1220 (N.H. 1993) (demonstrating risks involved where one party suspends or terminates performance in response to what it believes is other party's material breach). In \textit{Fitz}, the defendant had terminated its contract with plaintiff based on its belief that plaintiff had materially breached its contract by removing timber in an unworkman-like manner and tendering payments late. \textit{Id.} at 1222. The plaintiff sued for wrongful termination and prevailed, based on the court's conclusion that the plaintiff's breaches were not material. \textit{Id.} The defendant was held liable to the plaintiff for its lost profits. \textit{Id.} at 1223.

\textsuperscript{83} See Geller, supra note 5, at 190 n.175. In this student Note on the problem of determining a party's right to withhold performance in response to the other party's failure to perform as promised, the author analogizes this approach to the parent who punishes the child "who started it." \textit{Id.} According to the author, the court which tries to determine who committed the first material breach is like the parent who tries to determine which child escalated a dispute by going beyond the limits of trivial misbehavior and committing a punishable offense. \textit{Id.} What this analogy illustrates with respect to material breach doctrine is what most parents learn when they try to determine "who started it." See \textit{id.} In the end, that is not relevant, since at some point both children have contributed to and escalated the dispute. See \textit{id.} A similar point can be made with respect to determining material breach in a contractual dispute. It should not necessarily matter who committed the first material breach if both parties have contributed to and escalated the dispute.

See also 2401 Pennsylvania Ave. Corp. v. Federation of Jewish Agencies, 489 A.2d 733 (Pa. 1985). In 2401 Pennsylvania Ave., the plaintiff, who was the owner of certain real estate, entered into a two-year lease agreement with the defendant to begin May 1, 1974. \textit{Id.} at 734. The parties also agreed, however, that in the event that the current tenant did not vacate by May 1, 1974, the plaintiff would have until
This chronological analysis has important practical significance for parties involved in a potential contract dispute. If a nonbreaching party cannot be sure that the other party's failure to perform will be considered the first material breach, then that party will not know whether it is entitled to suspend or withhold its own performance. In fact, as in these cases, the nonbreaching party runs the risk of being held to have materially breached first if it suspends its performance or terminates the contract in response to what it thinks is the other's material breach.

August 31, 1974, to make the premises available to the defendant. Id. at 734-35. As predicted, the current tenant was unable to vacate by May 1, 1974, and the defendant seemed to acquiesce to the delay. Id. In June 1974, however, the defendant found a building in what it considered a better and less costly location and purchased it on July 1, 1974. Id. at 735. When the plaintiff's current tenant then requested an extension of its lease with the plaintiff beyond August 31, 1974, the plaintiff asked the defendant to approve its right to grant the further extension. Id. The defendant refused, claiming that the entire lease agreement was invalid due to the plaintiff's failure to deliver the premises by May 1, 1974, and that it therefore did not want to do anything to signify that it believed the lease was valid. Id. The plaintiff thereafter granted its current tenant the requested extension of its lease through October 31, 1974. Id. at 736. Nonetheless, the plaintiff sent the defendant a bill for October rent, which the defendant refused to pay. Id. The plaintiff then sued for anticipatory breach of contract. Id. The trial court awarded the plaintiff damages of $292,000, plus interest and the defendant appealed. Id. at 734.

Faced with this sad state of events, the Pennsylvania Supreme Court split 4-3. See id. at 738 (holding for defendant). The majority found that the defendant had not anticipatorily breached the lease. Id. at 737. Rather, the plaintiff's extension of its current tenant's lease beyond August 31, 1974, constituted a material breach of its lease with the defendant, excusing the defendant from any obligation to pay rent or other damages. Id. at 738. The majority focused on the fact that the defendant had not unequivocally indicated a refusal to honor its obligation to pay rent under the lease. Id. at 737.

Three judges dissented in two separate opinions, but all three would have held that the defendant did anticipatorily breach the lease by finding other premises and indicating that it had no intention to move into the plaintiff's building. Id. at 745 (Larsen, J., dissenting); id. at 747 (Hutchinson, J., dissenting). Judge Larsen further argued that even if the defendant had not committed an anticipatory breach by finding other premises, the plaintiff still had not materially breached by extending the lease of its current tenant because the defendant had no intention of occupying the premises anyway. Id. at 746 (Larsen, J., dissenting). Thus the dissenters would have affirmed the trial court's judgment and the award of damages to the plaintiff. Id. at 747 (Larsen, J., dissenting).

This series of events is symptomatic of the problems in many contract disputes. The parties began with good intentions, hoping to have the premises available by May 1, but both recognized the possibility of delay and accepted that possibility. See id. at 735 (noting that plaintiff expressed these concerns in November 1973 letter to defendant). Then, one party, finding a better deal, wanted to back out of the lease and purported that the delay was its reason. Id. The plaintiff, claiming that the defendant had anticipatorily breached the contract by finding other premises, extended its current tenancy, but still sued the defendant for rental payments. Id. at 736. It appears that to some extent both parties were at fault, and yet each charged the other with responsibility for the mess they had both created.
This material breach doctrine, as currently applied, leaves parties to contracts without predictable guidelines to follow in determining their conduct. By failing to discuss the actual basis for whether a breach is or is not material, the courts have not educated the parties as to what to expect from the law in such cases. By focusing on which side committed the first material breach, the courts have compounded the problem by protecting one party when that party may be just as responsible for the breakdown of the contract as the other party. Other scholars have proposed alternative models or approaches to the problems addressed by the material breach doctrine. Although each of these has its merits, for reasons discussed below, none goes far enough.

IV. THE GOALS OF MATERIAL BREACH DOCTRINE

Before proposing possible solutions to the problems created by current material breach doctrine, it is important to consider the goals the law is seeking to accomplish through contract law and particularly through material breach doctrine. Possible goals of contract law include: completion of contractual obligations; economic efficiency; protecting the expectation and reliance interests of the parties; and fairness and equity. All of these goals play some part in contract jurisprudence.

With respect to material breach doctrine in particular, it is helpful to return to Judge Cardozo's opinion in Jacob & Youngs, Inc. v. Kent. The goal here is not to ensure contract performance at all costs, nor is it primarily to promote economic efficiency. Rather, the purpose of determining if a breach is "material" is to decide whether it is reasonable for the nonbreaching party to be excused from its contractual obligations because of the other party's breach.

84. See Andersen, supra note 54, at 1075 (noting that many courts that purport to follow Restatement actually ignore it when time comes to decide materiality question and that other courts seem to pick and choose among stated factors without justifying their choices); Rosett, supra note 1, at 1081-82 (noting that despite several centuries of effort by legal scholars and jurists, traditional contract law provides no comprehensive set of principles to supply clear answers to central questions in most contract disputes regarding whether there has been performance, whether there has been breach and whether there has been discharge of obligation); Alex Y. Seita. Uncertainty and Contract Law, 46 U. Pitt. L. Rev. 75, 102-22 (1984) (discussing how uncertainty about litigation outcomes in contract disputes can lead to inefficient breaches and discourage efficient breaches); Geller, supra note 5, at 164-65 (stating that courts have applied several different standards to determine whether withholding performance is proper and because of this, parties to continuing contracts face substantial risk when they make decisions concerning withholding following breach of contract).

85. 129 N.E. 889 (N.Y. 1921). For a discussion of Judge Cardozo's opinion in Jacob & Youngs, Inc. v. Kent, see supra notes 36-49 and accompanying text.
In his article on material breach, Professor Andersen focused on one of Judge Cardozo’s three factors: the degree of harm caused by the breach to the reasonable expectations of the nonbreaching party. As conceptualized by Professor Andersen, the doctrine of material breach must be understood as related to the remedies it triggers, that is, suspension and cancellation of contract obligations by the nonbreaching party. Professor Andersen described two interests of the nonbreaching party that are at stake when the other party fails to perform as promised. One interest, as labeled by Professor Andersen, is the interest in present performance, that is, the interest of the nonbreaching party in the performance obligations of the other party that have already become due. The other interest of the nonbreaching party is the interest in future performance, that is, the nonbreaching party’s interest in the performance obligations of the other party that have yet to become due.

According to Professor Andersen, it is the interest of the nonbreaching party in future performance that the material breach doctrine is intended to protect and not the interest in present performance. Professor Andersen argues that traditional contract damage remedies are sufficient to protect the nonbreaching party’s interest in the obligations that have already become due and have not been fulfilled; the nonbreaching party does not need to suspend or cancel its performance obligations to protect that interest. On the other hand, where the nonbreaching party has serious concerns regarding the other party’s willingness or ability to perform in the future, then the nonbreaching party may need to protect itself by suspending or even terminating its own performance. According to Professor Andersen, courts should determine

86. Andersen, supra note 54, at 1092-1111.
87. Id. at 1092 (explaining also that primary policy of remedies is to protect victim’s expectation interest without imposing unnecessary costs on party in breach).
88. Id.
89. Id. at 1092, 1095-1101.
90. Id. at 1092, 1096-1101 (assuming contract is executory, or bilateral, and not unilateral where only one party has interest in future performance of other party).
91. Id. at 1104-05 (noting that breach by anticipatory repudiation is “pure” example of material breach).
92. Id. at 1095 (recognizing, however, that difficult issues may arise in connection with determining amount required to compensate for failure to perform properly or with decision to award specific relief rather than damages).
93. See id. at 1096, 1106 (noting that security of whether other party will perform as agreed is one of primary benefits of contractual relationships and proposing cancellation may be necessary to protect party’s concern about future performance).
whether a breach is material with this concern in mind.\textsuperscript{94} Only if the breach would raise concerns in the mind of the objectively reasonable nonbreaching party about the breaching party’s future performance so that the cancellation remedy is necessary to protect the nonbreaching party’s interest, should that breach be considered material.\textsuperscript{95}

Professor Andersen’s insights and analysis are very valuable. It is appropriate to link the doctrine of material breach with the remedy it triggers. Professor Andersen’s analysis focuses, however, too heavily on only one of the factors relevant to material breach determinations: the harm caused by the breach to the reasonable expectations of the nonbreaching party.\textsuperscript{96} According to Professor Andersen, if the nonbreaching party is reasonably concerned that those expectations will not be met, then the breach is material and the party may suspend performance.\textsuperscript{97} Professor Andersen’s analysis is flawed, however, to the extent that he fails to consider fully Judge Cardozo’s other concerns: harm to the breaching party if the contract is not terminated and that party’s good faith.\textsuperscript{98}

Professor Andersen did give some consideration to the effects of termination on the breaching party.\textsuperscript{99} He recognized that allowing the nonbreaching party to terminate the contract based on its reasonable expectations could produce harsh results for the breaching party.\textsuperscript{100} Thus, he recommended that the law protect at least the restitutionary interest of the breaching party, and in many instances the expectation interest as well, by requiring the nonbreaching party to compensate the breaching party for the work done before cancellation.\textsuperscript{101} In addition, Professor Andersen would limit the nonbreaching party’s right to withhold moneys due under the contract to a reasonable amount by considering the

\textsuperscript{94} Id. at 1106-09.

\textsuperscript{95} Id. at 1106. For additional discussion by Professor Burton on these ideas, see Burton & Anderson, supra note 1, at 870-72.

\textsuperscript{96} Andersen, supra note 54, at 1095-1101.

\textsuperscript{97} Id. at 1107.

\textsuperscript{98} For a discussion of Judge Cardozo’s concerns regarding material breach doctrine, see supra notes 36-49 and accompanying text.

\textsuperscript{99} Andersen, supra note 54, at 1111-23 (discussing protecting interests of breaching party and noting that although many jurisdictions grant restitution to defaulting plaintiff, measure of recovery may be unnecessarily miserly).

\textsuperscript{100} Id. at 1112 (stating that routine element of conventional material breach analysis balances harm that breach caused victim against harm that cancellation would impose on breaching party).

\textsuperscript{101} Id. at 1116-20 (concluding that this compensation implements policy that victim’s expectation interest to be protected is at least cost to breaching party).
value of work already done by the breaching party. In other words, while upholding the right of the nonbreaching party to cancel the contract in response to a material breach, Professor Andersen would require the nonbreaching party to compensate the breaching party in order to prevent a result that is too harsh.

Other scholars have also recognized the need to provide some compensation to the breaching party. This view has often been rationalized on the basis of contract law’s nonpunitive view of contract breachers. Professor Robert A. Hillman stressed the economic and other benefits of encouraging parties to “hold the

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102. Id. at 1120-22 (noting, however, that limit will be “practicable only when the victim’s performance consists of the payment of money or perhaps the transfer of some other divisible, fungible units of goods or services” and explaining that breaching party’s interest will be subject to good faith of victim in determining reasonable estimate of damages).

103. Id. at 1116-22.

104. The nonpunitive view of contract breach is best reflected in the concept of efficient breach, i.e., the view that as long as the nonbreaching party is fully compensated and the breaching party is better off, a breach of contract should be encouraged, not discouraged, in order to promote the most efficient use of assets. See, e.g., Robert L. Birmingham, Breach of Contract, Damage Measures, and Economic Efficiency, 24 Rutgers L. Rev. 273, 284-86 (1970) (discussing efficient breach theory). Professor Birmingham argued that:

Repudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered. . . . To penalize such adjustments through overcompensation of the innocent party is to discourage efficient reallocation of community resources. . . . Rigidity resulting from thus binding a party to his undertaking limits the factor and product mobility essential to proper functioning of the market mechanism.

Id. at 284-85. See generally Richard A. Posner, Economic Analysis of Law § 4.8, at 117-26 (4th ed. 1992) (discussing fundamental principles of contract damages and explaining that it makes difference in deciding which remedy to grant whether breach is efficient).

This theory has been scrutinized by many scholars and has been convincingly criticized for its failure to account for the transaction costs involved in any contract dispute. See, e.g., Daniel A. Farber, Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract, 66 Va. L. Rev. 1443 (1980) (arguing that efficient breach model based on compensatory damages is flawed because it fails to consider adequately transaction costs incurred in breach of contract, including renegotiation and litigation as well as cost of undetected inefficient breaches, which add to costs without increasing quality of efficiency); Daniel Friedmann, The Efficient Breach Fallacy, 18 J. Legal Stud. 1 (1989) (asserting that efficient breach theory fails to consider transaction costs and other uncertainties which result from breach of contract and advantages in some situations of encouraging transactions between nonbreaching party and third party who has provided impetus for breach); Ian R. Macneil, Efficient Breach of Contract: Circles in the Sky, 68 Va. L. Rev. 947, 957 (1982) (“Whether an expectation damages rule or a specific performance rule is more efficient depends entirely upon the relative transaction costs of operating under the rules. . . . None of the transaction costs can be deduced by use of the microeconomic model, but can only be determined inductively from empirical evidence.”).
deal together."¹⁰⁵ He discussed the law's attempt to balance the rights of the nonbreaching party with the goals of economic efficiency and avoidance of waste.¹⁰⁶ As described by Professor Hillman, contract law seeks to avoid waste by enforcing rules of mitigation, that is, that the nonbreaching party cannot act in ways that will needlessly increase the damages caused by the breach of

Others have gone beyond the flaws in the theory with respect to economics to criticize its failure to account for the moral value of keeping promises as well as the general societal benefits that flow from the ability to rely on others to live up to their promises. See, e.g., Peter Linzer, On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement, 81 COLUM. L. REV. 111 (1981) (arguing that theories of efficient breach fail to consider noncommercial and idiosyncratic values that people place on contract performance and ignore moral basis underlying contracts and asserting that courts should instead rely on remedy of specific performance to promote fair and efficient results); Patricia H. Marshall, Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract, 24 ARIZ. L. REV. 733 (1982) (arguing that efficient breach theory is faulty and courts should not allow willful breacher to profit from his or her breach). Professor Marshall explained that: "Even if the theory of efficient breach were realistic, the values that support it are of less importance to society than the principle of good faith and fair dealing in the performance and enforcement of contracts." Id. at 734. Thus, Professor Marshall asserted that: "Courts ought to be putting more emphasis on the notion of sanctity of contract and the resulting moral obligation to honor one's promises." Id. at 740; see also Russell J. Weintraub, A Survey of Contract Practice and Policy, 1992 Wis. L. Rev. 1, 30-35 (finding in survey of corporate practice that there is substantial sentiment among corporate counsel that even in the absence of actual reliance, contractual commitment should be enforced).

Professor Friedmann also questions the notion underlying the efficient breach theory that one has a right to breach a contract. Friedmann, supra, at 13-18. He asserts that throughout property and tort law, the law rejects this notion by protecting a party's entitlement to his or her property and the interests in it created by contracts. Id.; see also Macneill, supra, at 961-69 (arguing that efficient breach theory ignores fact that party's entitlement to rewards of contract is not determined separately from remedy granted for breach of contract). Professor Macneill states that "there is no a priori basis for selecting any particular time or event for determining that the transaction is closed," and only then does the party have a new property right which may be protected by more than ordinary contract remedies. Id. at 964.

Furthermore, others have pointed to and supported the increased willingness of courts to grant punitive damages for breach of contract. See, e.g., Marshall, supra, at 758-60 (determining that punitive damages should be used to deter willful breaches of contract); Timothy J. Sullivan, Punitive Damages in the Law of Contract: The Reality and Illusion of Legal Change, 61 MINN. L. REV. 207 (1977) (discussing judicial decisions that blurred distinction between tort and contract law in regard to punitive damages); Randy L. Sassaman, Note, Punitive Damages in Contract Actions—Are the Exceptions Swallowing the Rule?, 20 WASHBURN L.J. 86, 104-05 (1980) (concluding that "better rule would allow punitive damages based on the quality of defendants' conduct, without regard to the rigid tort-contract dichotomy").

¹⁰⁵ Hillman, Keeping the Deal Together, supra note 26, at 556-58 (noting that it has been suggested that contract breach penalties would deter contract formation and therefore would run counter to purposes of contract remedies).

¹⁰⁶ Id. at 558-61 (discussing avoidable consequences doctrine). For a further discussion of the avoidable consequences doctrine, see infra notes 107-11 and accompanying text.
contract. The nonbreaching party is required to take steps to make substitute arrangements with third parties, when reasonable, that will reduce the damages caused by the breach; for example, a wrongfully discharged employee cannot sit idle and seek recovery of all lost wages if reasonably comparable work is available. According to Professor Hillman, such rules are desirable because they avoid economic waste.

Professor Hillman would extend this notion of avoiding waste even further by requiring the nonbreaching party to accept a post-breach modification offer from the breaching party in situations that will avoid harm to the breaching party without increasing the costs to the nonbreaching party. Thus, where there are no other reasonable substitutes for the nonbreaching party and the breaching party’s offer is reasonable and does not waive the nonbreaching party’s rights to sue for the breach of the original contract, the nonbreaching party must accept the breaching party’s offer under the rules of mitigation. Professor Hillman argues that to allow the nonbreaching party to reject such offers and to cancel the contract is inconsistent with the economic, nonpunitive view of contract law. He thus recognized that material breach doctrine, as cur-

108. Id.
109. Id.at 559-61 (noting that mitigation rules should not conflict with expectancy theory). Professor Hillman states that “the main purpose of the doctrine [of avoidable consequences] is to avoid economic waste which would result from the injured party suffering damages from the breach which could have been avoided by reasonable efforts.” Id.
110. Id. Hillman states:
Under the rule of avoidable consequences, the injured party must, when reasonable, make substitute agreements with third parties to avoid loss from the breach. The extent to which the injured party must deal with the breaching party to avoid loss is less clear. . . . In many instances it may be economically reasonable for the injured party to avoid waste by accepting a new offer made by the breaching party.
111. Id. For a further discussion of the rule of avoidable consequences, see supra notes 106-10 and accompanying text.
112. Hillman, Keeping the Deal Together, supra note 26, at 598-615. Professor Hillman also discussed the law’s interest in balancing the harm to the breaching party in the event of termination with the harm to the nonbreaching party. Hillman, Analysis of Cessation, supra note 3, at 634-37, 656-57. Other scholars have also focused on the need to provide the breaching party with an opportunity to cure the breach and on the need to protect the breaching party from unduly harsh consequences, such as forfeiture. See Lawrence, supra note 55, at 724-25 (stressing that providing breaching party with opportunity to cure its breach is best justified by “general contract remedial principles of protecting expectations and avoiding waste of resources, while also protecting the breaching party against forfeiture of its contract rights” (footnote omitted)). Professor Lawrence asserts that encour-

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rently applied, interferes with the goal of "holding the deal together" by allowing the nonbreaching party simply to terminate the contract in response to a material breach.\textsuperscript{113} His view would con-

and accept that cure will most effectively promote society's interests in economic efficiency. See id. at 724-35 (encouraging avoidance of waste). He further observes, however, that although the Second Restatement incorporated the concept of cure by making only an unsecured material failure a condition to the other party's duty to perform, the awkward drafting of § 237 makes it likely that courts will continue to neglect this notion of cure. \textit{Id.} at 735-44; see \textit{Restatement (Second) of Contracts} § 237 (1979) (discussing effect of other party's duties of cure to render performance).

This view is also reflected in the approach of Article 2 of the Uniform Commercial Code (UCC) to the problem of the seller's tender of nonconforming goods. For example, although a buyer is entitled to reject nonconforming goods, Article 2 requires the buyer to give notice to the seller of such rejection and requires that the buyer reject within a reasonable time after tender or delivery of such nonconforming goods. U.C.C. §§ 2-601(a), 2-602(1). In addition, and most significantly, Article 2 provides the seller with an opportunity to cure, i.e., to tender conforming goods. \textit{Id.} § 2-508. Although there are limitations on this opportunity to cure, the UCC's drafters clearly intended to increase the likelihood that parties could resolve their own disputes without resorting to litigation by requiring the buyer to provide the seller with notice of rejection and by allowing the seller some opportunity to cure the defect in its original tender. Thus, the drafters of the UCC wanted to encourage communications between the parties in order to facilitate independent resolution of such disputes. For a more complete discussion of the UCC's treatment of problems of contract performance and breach, see Hillman, \textit{Keeping the Deal Together}, supra note 26, at 579-94; Lawrence, supra note 53, at 718-20; John A. Sebert, Jr., Rejection, Revocation and Cure Under Article 2 of the Uniform Commercial Code: Some Modest Proposals, 84 Nw. U. L. Rev. 375, 376 (1990) (rewriting revisions for Article 2). For a comparison of the UCC's perfect tender rule and the common law standard of substantial performance, see \textit{Ramirez v. Autosport}, 440 A.2d 1345, 1348-52 (N.J. 1982).

As defined by Professor Richard Craswell, the most efficient termination rule is one that prevents a promisee from terminating the contract "whenever that promisee will be fully compensated if the promisor's attempt to perform should fail." Richard Craswell, \textit{Insecurity, Repudiation, and Cure}, 19 J. LEGAL STUD. 399, 430 (1990). Where such compensation is not certain, e.g., where the promisor is not solvent or where damages are too uncertain, then the promisee should be allowed to terminate the contract in response to a repudiation or breach by the promisor unless "(1) the promisee's uncertainty about the promisor's performance is no greater than it was when the original contract was signed," —that is, where the promisee had information about the risks at the time it entered the contract—or "(2) even successful performance has become undesirable for the promisee," —that is, where the promisee's reasons for terminating are based on the fact that the contract, even if fully performed by the promisor, is no longer as valuable or desirable as originally assumed by the promisee. \textit{Id.} In sum, Craswell recognizes that termination may sometimes be the most efficient alternative, but concludes that current rules based on material breach do not reflect the most appropriate rule for determining when termination will be efficient. \textit{Id.}

\textsuperscript{113} Hillman, \textit{Keeping the Deal Together}, supra note 26, at 562-64. Hillman states: "The material breach doctrine would lead to harsh results if an insignificant breach were interpreted to deprive the injured party of 'substantially what he bargained for.'" \textit{Id.} at 562. Hillman added that factors that should be considered in distinguishing a material breach from an immaterial breach normally help protect against harsh results where justice and common sense require. \textit{Id.} at 563. "Nevertheless, the material breach doctrine often leads to unjust results." \textit{Id.}
Consider the harm to the breaching party by limiting the nonbreaching party's right of termination in cases where the harm to the breaching party if the contract is terminated outweighs the harm to the nonbreaching party that is caused by the breach.\footnote{114} Professor Arthur I. Rosett viewed this problem from a different perspective.\footnote{115} He argued that the underlying problem with contract law's treatment of the issues that arise in contract disputes is that the law has been shaped to guide courts rendering decisions in cases that have gone to litigation.\footnote{116} Instead, according to Professor Rosett, contract law should attempt to guide the private parties to resolve those contract disputes by themselves.\footnote{117} He asserts that "since the parties are in a better position than courts to determine what to do, they would be best served by rules which encourage them to solve the problem themselves."\footnote{118} For Professor Rosett, this would mean imposing a duty on the nonbreaching party to offer the breaching party an opportunity to cure before a court would allow the discharge of the nonbreaching party's contractual obligations.\footnote{119} Such a duty, according to Professor Rosett, would increase the likelihood that the parties would resolve the matter themselves.\footnote{120}

What underlies Professors Hillman's and Rosett's views is a fundamental belief that society and the parties to contracts would benefit from independent resolutions of contract disputes that do not involve the courts.\footnote{121} Moreover, there is an implicit, if not explicit,
assumption that disappointing the reasonable expectations of the nonbreaching party does not itself justify terminating the contract. The impact on the breaching party is also significant and must be considered, whether for reasons of economic efficiency, as articulated by Professor Hillman, or for reasons of fairness and autonomy, as articulated by Professor Rosett.122 Thus, as had been identified by Judge Cardozo, the second factor that must be considered when determining material breach is the harshness of the effect that termination will have on the breaching party.123 A nonbreaching party’s right to terminate in response to the breaching party’s failure to perform is not simply a function of the nonbreaching party’s own disappointed expectations, but also is affected by the degree of harm that termination will inflict on the breaching party.

A focus just on Judge Cardozo’s first two factors could lead, however, to nothing more than a formulaic balancing test: Does the harm caused by the breach to the nonbreaching party’s reasonable expectations outweigh the harm that will be suffered by the breaching party if the contract is terminated? In order to avoid such a mechanical approach, it is necessary to incorporate Judge Cardozo’s third factor into the analysis: good faith.124 It is that factor which seems critical and yet, is the one that courts have paid the least attention.

V. THE SOLUTION: ACKNOWLEDGING THE CRITICAL ROLE OF GOOD FAITH

When considering a possible improvement in the law of material breach, it is first necessary to state certain assumptions about the way parties behave. We can assume that some disputes are

curs respondents were more likely to experience accommodation and compromise than to become involved in litigation.11 Id. at 51-52 (citations omitted); see also Geller, supra note 5, at 198 (arguing that improved standard to determine propriety of one party’s withholding of payment upon another party’s contractual breach should encourage parties to resolve their differences through communication, negotiation and settlement rather than through costly, risky process of litigation).

122. For a discussion of Hillman’s and Rosett’s opinions, see supra notes 110-20 and accompanying text.

123. See Jacob & Youngs, Inc. v. Kent, 129 N.E. 889, 891 (N.Y. 1921) (“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.” (emphasis added)).

124. See id. (explaining that “willful transgressor must accept the penalty of his transgression” while transgressor “whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong.” (citations omitted)).
"good faith" disputes and that some are "bad faith" disputes. Professors Burton and Andersen assert that when parties enter a contract, their intentions and reasonable expectations define the parameters for their conduct in performing and enforcing the contract. These intentions and expectations are considered by Burton and Andersen to create "the world of the contract." Determinations of breach then must be made based on the "world of the contract." A failure to perform as promised must be evaluated based on whether it can be justified on the basis of this "world of the contract"; that is, on the basis of the intentions and reasonable expectations of the parties as to what would justify a failure to perform.

In the terminology used here, a "bad faith" dispute is one that is not based on the "world of the contract" because it conflicts with those actual intentions and expectations; a "good faith" dispute reflects the party’s actual intentions and reasonable expectations. Where the parties both honestly believe that they are right, for ex-

125. U.C.C. § 1-201(19). The UCC defines "good faith" as "honesty in fact in the conduct or transaction concerned." Id. When concerning merchants, the UCC provides a definition of "good faith" to mean "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." Id. § 2-103(1)(b).

126. Burton & Andersen, supra note 1, at 862-69.

127. Id.

128. Id. at 867-69.

129. Id. at 862-69.

130. See Steven J. Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith, 94 Harv. L. Rev. 369, 385-87 (defining "good faith" as based on reasonable expectations of parties with respect to how each party would behave). Professor Burton also stated that:

The good faith performance doctrine may be said to permit the exercise of discretion for any purpose—including ordinary business purposes—reasonably within the contemplation of the parties. A contract would thus be breached by a failure to perform in good faith if a party uses its discretion for a reason outside the reasonable contemplated range—a reason beyond the risks assumed by the party claiming a breach.

Id. (footnotes omitted).

Burton further elaborated on this view in a subsequent article, asserting that: "The good faith performance doctrine is used to effectuate the intentions of the parties, or to protect their reasonable expectations, through interpretation and implication." Steven J. Burton, More on Good Faith Performance of a Contract: A Reply to Professor Summers, 69 Iowa L. Rev. 497, 499 (1984).

Although it is beyond the scope of this Article to explore fully the best approach for defining good faith, scholars have often discussed the concept of "good faith" and have developed differing views on how to define "good faith." For example, Professor Robert Summers argued that it is best to define "good faith" by considering what conduct would not be good faith conduct. Robert S. Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195, 201 (1968). That is, he thought good faith should be defined by what it excludes:
ample, where Owner honestly believes he or she is entitled to the correct brand of pipe and really cares that this brand be used and Contractor honestly believes that the pipe used is correct and that any change would unfairly increase the cost of the contract, we have a "good faith" dispute. On the other hand, if either party is acting in bad faith, for example, if Owner is using the pipe problem as a pretext for harassing Contractor to extract some financial concession or to escape its contractual obligations, or if Contractor has

It is a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith. In a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out.

Id. (footnote omitted). In a later article discussing § 205 of the Second Restatement and its recognition that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement," Professor Summers again asserted the benefits of the "excluder" approach to defining "good faith." Robert S. Summers, The General Duty of Good Faith—Its Recognition and Conceptualization, 67 CORNELL L. REV. 810, 824 (1982) (citing RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979)). He argued:

My view is that all . . . efforts [by other scholars] to define good faith, for purposes of a section like 205, are misguided. Such formulations provide very little, if any, definitional guidance. . . . Finally, the very idea of good faith, if I am right, is simply not the kind of idea that is susceptible of such a definitional approach.

Id. at 829-30.

It would seem that the mere the courts are forced to consider the concept of good faith, in the context of material breach decisions as well as in other aspects of contract formation and performance, the better will be our understanding of that concept and the best way to define it.


132. See, e.g., T. Ferguson Constr. v. Sealaska Corp., 820 P.2d 1058 (Alaska 1991) (illustrating issue of pretextual assertion of other party's material breach as justification for one's own nonperformance). In that case, the plaintiff had entered into a road construction contract with the defendant, but immediately fell behind schedule due to its inadequate equipment and financial resources. Id. at 1058-59. Five months after entering the initial contract, the parties modified the construction contract to resolve certain disputes concerning the interpretation of the payment clause and to reflect that, to date, the defendant had paid the plaintiff more than it was owed. Id. at 1059. The modification also specified dates for payment of certain cash advances to plaintiff for work still to be done. Id. One month later, disputes arose again. Id. at 1059-60. The plaintiff called to ask if the defendant had mailed the cash advance due that day, and although the defendant said that it had been mailed, the advance had not gone out due to a holiday. Id. at 1059. There was also a disagreement regarding how much was owed. Id. at 1059-60. On the following day, the defendant inspected the work sites, and finding that the plaintiff was not performing any work, decided to withhold payment. Id. at 1060. The plaintiff then stopped work and sued the defendant for alleged breach based on the defendant's failure to make the payment that was allegedly due. Id.

The trial court found that the defendant was not in breach and was excused from making further payment because it acted on the correct belief that the plaintiff was unable to perform. Id. at 1061-62. Rather, the trial court held that the plaintiff was in breach by its failure to perform after having not received payment
used the wrong pipe to save money, knowing that it was not what was the contract required, we have a "bad faith" dispute.

As the law currently stands, little, if any, express attention is paid to the good or bad faith nature of the breach. Although there is some scholarly support for the notion of deterring willful breaches and some weight placed on willfulness in some determinations from the defendant. Id. at 1062. The trial court awarded damages to the defendant in an amount that reflected payments made to the plaintiff in excess of work done, plus extra costs incurred by the defendant to complete the job. Id. at 1060 n.6.

The Alaska Supreme Court affirmed, agreeing with the factual findings of the trial court and its conclusion that defendant was justified to withhold the payment. Id. at 1061-62. Two judges dissented, asserting that the defendant had not withheld the payment because of the inability or failure of the plaintiff to complete the job. Id. at 1063-64 (Matthews, J., dissenting). The dissent found evidence that the defendant had withheld payment for other reasons. Id. at 1064 (Matthews, J., dissenting). The dissent concluded: "Withholding of progress payments is justified only if the withholding party actually relies on the circumstances which clearly warrant that action." Id. (Matthews, J., dissenting). In other words, the dissent believed that the defendant was not motivated by plaintiff's failure to perform, but had other reasons for withholding, including the lapse of plaintiff's performance bonds and the fact that plaintiff would have owed defendant money if the progress payment had been made. Id. at 1064, n.1 (Matthews, J., dissenting); see also Commonwealth Petroleum Co. v. Billings, 759 P.2d 736, 740 (Colo. Ct. App. 1987) (finding party's objection to form of assignment of lease to be "mere 'after-thought' used improperly" to claim material breach and holding use of wrong form was not material breach). But see Refinment Int'l Co. v. Eastbourne N.V., 815 F. Supp. 738, 742 (S.D.N.Y. 1993) ("Since [defendant] had the legal right to terminate its obligation under the contract, it is legally irrelevant whether [defendant] was also motivated by reasons which would not themselves constitute valid grounds for termination of the contract."). aff'd, 25 F.3d 105 (2d. Cir. 1994).

133. See, e.g., UHS-Qualicare, Inc. v. Gulf Coast Community Hosp., 525 So. 2d 746, 747 (Miss. 1987) (illustrating bad faith dispute). In UHS-Qualicare, the plaintiff was both a 50% owner and the management company of the defendant hospital. Id. When the plaintiff, in its capacity of manager, raised the daily rate for the hospital without approval of the hospital board, the hospital terminated plaintiff's management contract, claiming material breach. Id. at 748-49. This termination occurred after the other 50% owner had gained control of the board. Id. at 749. The court refused to uphold the finding of material breach and thus the defendant's right to termination, concluding that the defendant always reserved the power to override the rate increase. Id. at 757. The court, concluding that the defendant could not assert the rate increases as a material breach when it had the power to reverse those increases, said: "Today's horse ... was completely subject to the reins and whip of its master who was obligated to at least try to exercise its authority before declaring termination." Id. The court found it particularly telling that defendant had still not rolled back the hospital's rates after terminating plaintiff as evidence of the insincerity of defendant's claim of material breach. Id.; see also Kershenisev v. Mascotte Prods., Inc., 781 F. Supp. 399, 352 (E.D. Pa. 1991) (holding that booking agent's contract with ballet troupe was materially breached by: agent's failure to keep adequate records, lying, refusal to render accounting, failure to procure bookings, loss of funds and improper incorporation), rev'd, 981 F.2d 1247 (3d Cir. 1992).

134. See, e.g., Marschall, supra note 104, at 784 (arguing that any party who commits "willful breach" of contract should be subject to punitive damages). Pro-
nations of material breach, the law generally treats contract breach as an amoral matter with economic consequences for which there should be compensation, but not punishment. If, instead, the courts focused on the character of the breach and determined rights and remedies accordingly, the law might be able to encourage good faith conduct and independent resolution of contract disputes.

F. Marschall would define a "willful breach" as "a knowing breach by a party not legally excused from performing, which is made for any primary purpose other than to confer a benefit on the aggrieved party." Id. at 733; see also Frank J. Cavico, Jr., Punitive Damages for Breach of Contract—A Principled Approach, 22 ST. MARY'S L.J. 357, 375 (1990) ("The orthodox rule [of compensatory damages for breach of contract], which continually downplays or disregards the wrongfulness of the breaching party's conduct regardless of how outrageously immoral, offends one's sense of fairness and justice and engenders disrespect for the law.").

135. See Restatement (Second) of Contracts § 241(e) (defining one factor to be used to determine whether material failure has occurred is "the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing"). This factor has led courts to place some weight on the character of the breaching party's conduct in determining material breach and substantial performance. See Malone v. United States, 849 F.2d 1441, 1445-46 (Fed. Cir. 1988) (considering government's bad faith factor in finding that it had materially breached contract with painter where government had failed to notify painter that work was unsatisfactory until 70% of work was completed and had otherwise misled painter into believing work was approved); Eastbourne, 815 F. Supp. at 743 (upholding defendant's termination of contract with plaintiff where plaintiff unable to assert substantial performance, in part due to finding that its breach "was neither unintentional nor trivial, but clearly a willful breach of a material term of the contract"); Vincenzi v. Cerro, 442 A.2d 1352, 1354 (Conn. 1982) (reasoning that willfulness not solely determinative, but just one factor to be weighed in determining whether contractor had substantially performed and was therefore entitled to recover under contract); R.J. Berke & Co. v. J.P. Griffin, Inc., 367 A.2d 583, 586 (N.H. 1976) (holding that although willful breacher ordinarily denied even quantum meruit recovery, award to subcontractor upheld based on finding of no bad faith on its part); Kiriakides v. United Artists Communications, Inc., 440 S.E.2d 364, 367 (S.C. 1994) (considering tenant's good faith in immediately tendering amount due upon receiving actual notice of rent increase as factor in finding no material breach of lease); see also Andersen, supra note 54, at 1124-25 (discussing willful breach as relevant factor to issue of materiality and interest in future performance); Marschall, supra note 104, at 736 (noting that willfulness factor pervades Second Restatement, despite some American Law Institute support for efficient breach).

Similarly, in the parallel doctrine of substantial performance, weight is sometimes placed on the willfulness of the breach in determining if the breaching party has failed to perform substantially. See 3A CORBIN, supra note 19, § 707, at 329 (noting that when cases deny recovery to plaintiff on ground that breach was willful, it is "probable that his breach was actually such as to prevent his performance from being 'substantial'"); 2 FARNSWORTH, supra note 5, § 8.12, at 418 (explaining that concept of substantial forfeiture "evolved in response to the risk of forfeiture"); Farber, supra note 104, at 1470-73 (discussing willfulness element of substantial performance). For a discussion of the doctrine of substantial performance, see supra note 51 and accompanying text.

136. For a discussion of the compensatory nature of contract law, see supra note 104 and accompanying text.
Thus, if we assume that a dispute arises like that in *Jacob & Youngs, Inc. v. Kent*,\(^\text{137}\) when determining material breach by the Contractor, the court should first weigh the harm to the two parties: Is the harm to Owner's reasonable expectations greater than the harm to Contractor if Owner terminates the contract? If one assumes that Contractor had used an equivalent pipe, then it would seem that the harm to Owner should be weighed less heavily than the harm to Contractor, assuming Contractor has not been paid. On the other hand, if the pipe used was not equivalent, then the balance of harms might tip the other way. In many cases, the harm to the parties may be fairly closely balanced.

Having identified the relative balance of harms, the court should then consider the factor of good faith and add that to the scale before deciding if the Contractor has committed a material breach. Although the good faith of a breaching party may not be enough to counterbalance any substantial harm to the nonbreaching party, it will play a critical role in those cases where the harm to the parties is more or less balanced. Thus, in those cases where each party will suffer similarly significant harm, if the other party does not complete its performance of the contract, the relative good faith of those parties will be the deciding factor for the courts to rely on in determining material breach and the appropriate outcome and remedies.

When both parties are operating in good faith, the law should act to encourage these parties to work out the matter among themselves by finding no material breach and thus refusing to sanction the termination of the contract by the nonbreaching party. The court should recognize the concerns each party may have as it negotiates with each other and not simply deny protection to the first breacher.

For example, if Contractor honestly believed that he was allowed to use the pipe installed and Owner honestly believed otherwise and she is honestly concerned about Contractor's future performance, there is a reasonable likelihood that these two parties can work out their differences independently. Both parties still can see some benefit from working together and both are operating

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137. 129 N.E. 889 (N.Y. 1921) (known as the "Reading Pipe Case"). In *Jacob & Youngs*, the plaintiff built a country residence for defendant. *Id.* at 890. The contract called for the use of "standard pipe" of "Reading manufacture." *Id.* The plaintiff used pipe that was not manufactured by Reading. *Id.* The court ruled that the omission was not willful and that replacement of the pipe would be extremely expensive. *Id.* The court thus found that the use of non-Reading pipe was insignificant. *Id.*
honestly and in good faith. Each, however, may have legitimate worries. Contractor may have two concerns: one, whether he will be paid for the work already done if he breaks off the relationship; and two, whether he will be paid for any future work if he continues working. Owner similarly will have two types of concerns: one, whether Contractor will perform the rest of the work to Owner’s satisfaction; and two, whether there will be some correction of or compensation for the error already committed.138

As described by Professor Andersen, each party will be concerned about both the risks of future performance and the desire for compensation for past performance.139 Professor Andersen argued that a party’s right to suspend performance should be determined on the basis of the party’s concerns for future performance.140 Although it is easier to sympathize with a party’s desire to suspend performance when that party has serious concerns about the other’s future performance, in good faith disputes, both parties may have legitimate concerns about the other’s future performance. It seems arbitrary and wasteful to focus only on who breached first and to allow for termination by the nonbreaching party as the parties may still be able to work together.

138. Many have commented on the role that nonlegal factors play in deterring breach and facilitating resolution of disputes. There is much sociological and economic literature on the subject of nonlegal factors that encourage parties to honor commitments. See, e.g., David Charny, Nonlegal Sanctions in Commercial Relationships, 104 Harv. L. Rev. 373, nn.59-82 (1990) (discussing the reasons for and consequences of commercial parties often relying on such nonlegal sanctions instead of legally enforceable agreements). Professor Charny describes three general categories of nonlegal sanctions that discourage breach of commitment: the loss of relationship-specific prospective advantages, such as future dealings with the other party or collateral posted as security; the injury to reputation among other market participants; and the damage to psychic and social goods, such as self-esteem and social acceptance. Id. at 392-97. Professor Farnsworth theorized that nonlegal sanctions are more effective in relationships that are reversible, i.e., relationships where the parties realize that each could be in the other’s position, e.g., in market transactions between equals. E. Allan Farnsworth, The Past of Promise: An Historical Introduction to Contract, 69 Colum. L. Rev. 576, 604-05 (1969). He further pointed out that such nonlegal sanctions are more effective in continuing relationships, as opposed to one-shot deals. Id.; see also Addison Mueller, Contract Remedies: Business Fact and Legal Fantasy, 1967 Wis. L. Rev. 833, 836 (noting that “it is nonlegal sanctions, not ‘the law,’ that keep contracts from being breached in most standard dealings between parties “); Weintraub, supra note 104, at 20 (finding in survey researching actual contract practice, that “[w]hen a dispute arises, parties with a history of mutually beneficial dealings are less likely to resort to litigation than are strangers”) (footnote omitted)).

139. See Andersen, supra note 54, at 1092 (discussing expectation interests of contracting parties).

140. Id. at 1092, 1096-1101. For a further discussion of Professor Andersen’s views, see supra notes 56-59 and accompanying text.
In this circumstance, the court should find no material breach. The law should seek to encourage these parties to negotiate rather than to allow one party to suspend performance simply because the other party breached first. Some have argued that the best way for the law to facilitate such negotiations is to deny monetary relief to either party if the dispute ends in litigation. Instead, these scholars argue, the courts should order specific performance. By doing so, the court will require the parties to reconsider their positions and either perform as originally agreed or modify the agreement to fit their changed perceptions and circumstances.

This solution may work satisfactorily with respect to two good faith parties. The knowledge that if the matter goes to litigation they will simply be ordered to perform may keep these parties at the negotiating table. Thus, if the balance of harms is relatively close and the parties are operating in good faith, neither party should be entitled to suspend or terminate the contract. In other words, no material breach should be found in these cases.

Such an approach, however, may be less effective if one party is not acting in good faith. When there is a bad faith breach on the part of one party, there may be little the law can do to encourage a fair independent settlement. By definition, that party is seeking to avoid its contractual obligations. Rather than treating such a breach as "acceptable" and awarding only compensatory damages to the nonbreaching party, the law's goal should be to deter parties from bad faith breaches by penalizing the breaching party. Thus, if a party is found to have breached in bad faith and the harm to the nonbreaching party outweighs the harm to the breaching party if the contract is terminated, that breach should be considered material. The court should then deny the breaching party any remedy, including restitution for work done, and should moreover hold that party liable to the other party for its expectation damages.

141. See, e.g., Robert L. Birmingham, Damage Measures and Economic Rationality: The Geometry of Contract Law, 1969 Duke L.J. 49, 70 ("The availability of the remedy of specific performance might permit achievement of the desired result without the expense of court action by encouraging one contemplating breach to bargain instead to adjust his duties."); Linzer, supra note 104, at 138 ("By holding the parties to their bargain, but permitting them to negotiate out, specific performance lets no outsiders substitute their values for those of the parties. Except in the most fungible of commercial transactions, courts should encourage this self-regulating and thus more efficient method of valuation and dispute resolution."); Macneil, supra note 104, at 959 (asserting that specific performance is more likely to encourage "consultation and mutually beneficial agreement," leading to more efficient result overall).
For example, if Contractor is found to be operating in bad faith by deliberately using the wrong pipe to save expenses, and the harm to the Owner outweighs or equals the harm to Contractor from termination of the contract, then Contractor has committed a material breach. Owner should then be able to recover her damages and to suspend performance, based on her good faith concerns about Contractor’s future performance. These damages should include the increased cost of completing the job and any additional expenses incurred. To the extent that Owner benefits from the work Contractor had already done, that benefit will be recognized by awarding only the increase in the cost of completion to the Owner as damages. Contractor, however, will have no separate claim for restitution. Thus, by penalizing the bad faith party and rewarding the good faith party in such disputes, the law can discourage bad faith breaches and perhaps reduce the likelihood of such disputes.

Similarly, the nonbreaching party may be seeking a discharge from its obligations by relying in bad faith on the other party’s defective performance. Thus, if, for example, Contractor breaches in good faith by mistakenly using the wrong pipe, and Owner is found to be using the pipe problem in bad faith to extract concessions from Contractor or to avoid the contract completely, a court should not consider the Contractor’s breach material. Here, Contractor has not acted in bad faith and the harm to Owner was not significant and did not actually raise legitimate concerns about future performance. Thus, Owner had no right to terminate, and by failing to perform in bad faith, should be liable to Contractor for damages. Owner should be liable to Contractor for any lost profit that Contractor had expected to make on the contract, less any costs Contractor has avoided by the termination of the contract. The court should also include any additional costs Contractor has incurred as a result of the dispute in the damages Contractor may recover from Owner. It should not matter that Contractor failed to perform first, if his nonperformance was in good faith.

142. See Jacob & Youngs, 129 N.E. at 891 (discussing breach).
143. In Bernstein v. Nemeyer, 570 A.2d 164 (Conn. 1990), the Connecticut Supreme Court took an approach which reflects these concerns. Plaintiffs had entered into a limited partnership agreement with defendants which all parties knew involved substantial financial risk. Id. at 165. As part of the agreement, defendants promised to loan money to the partnership to cover any negative cash flow. Id. at 165-66. The properties in which the partnership had invested failed to appreciate and eventually the mortgagees foreclosed on the properties. Id. at 166. All the parties lost their investment. Id. Defendants had failed to perform the negative cash flow guarantee completely and plaintiffs sued, alleging material
If both parties are failing to perform for bad faith reasons, the courts should treat the parties as equally responsible for the dispute. The appropriate remedy is then to place both parties in a position where both lose the benefits of the contract. If, for example, in our pipe hypothetical, Contractor used the wrong pipe in bad faith to save money and Owner asserted the use of the wrong pipe pretextually to stop payments to Contractor when, in fact, the brand of pipe did not matter to her, then both parties were acting in bad faith. Neither party should be “entitled” to suspend or terminate the contract because both are responsible for the breakdown in contractual relations. Thus, no material breach should be found.

Instead, if some of the work had been done by Contractor, and some of the price had been paid by Owner, then Owner should fully pay for the work done but only at the actual cost to Contractor. Contractor should not be able to recover any lost profits or other reliance damages. Owner should not be entitled to recover for completion costs or its reliance damages. By limiting the available remedies, the court may be placing the parties where they would have been if they could have successfully settled the matter themselves. If contracting parties are aware of these limited remedies, this may deter bad faith breaches or, at least, increase the incentives for the parties to work the matter out by themselves.

breach and seeking rescission and restitution of the money invested in the partnership. Id. The Connecticut Supreme Court held that although the breach was material because of the importance of the guaranty, the defendants had not acted in bad faith and had not been unjustly enriched by that breach. Id. at 170. Given the character of the breach as distinguished from its materiality, the court concluded that the defendants were not liable to the plaintiffs for restitution and that the material breach had merely discharged the plaintiff’s contractual obligation. Id. at 168-69. Thus, the court recognized that remedies should be adjusted to reflect the character of a breach, not simply its materiality. Id. at 168-70; see also Milner Hotels, Inc. v. Norfolk & Western Ry., 822 F. Supp. 341, 347 (S.D.W. Va. 1993) (determining that party who commits material breach is not entitled to recover rent payment where other party vacated premises as result of such breach), aff’d, 19 F.3d 1429 (4th Cir. 1994); Argentinis v. Gould, 592 A.2d 378, 381-82 (Conn. 1991) (holding that where contractor did not substantially perform contract to build house, owner is entitled to recover compensatory damages to cover costs of completion and repairs less any unpaid portion of contract price; however, contractor cannot sue for unpaid contract price if it has not substantially performed); R.J. Berke & Co. v. J.P. Griffin, Inc., 367 A.2d 583, 586-87 (N.H. 1976) (upholding quantum meruit recovery to subcontractor who had not substantially performed where both parties to construction contract had materially breached); Kriakides v. United Artists Communications, Inc., 440 S.E.2d 364, 367 (S.C. 1994) (holding that breach not material where lessee failed to pay increase in rent due to honest misunderstanding and immediately attempted to cure when notified, in part due to good faith of lessee).
It is, of course, impossible to predict whether a change in the application of legal doctrine will effect a change in human behavior. Even if this modification does not alter such behavior, it will at least clarify the law and provide courts and parties with a better understanding of how to make determinations of material breach.

VI. Conclusion

Under current law, the doctrine of material breach is applied by the courts in a muddled, unfocused way. The courts do not generally explain the basis of their decisions, nor do they provide any clear application of the Second Restatement factors for determining material breach. As a result, the decisions often seem unreasonable, and the focus on who breached first leaves parties exposed to uncertainty and the risk of liability, if they suspend or terminate performance in response to what they guess is a material breach by the other party.\textsuperscript{144}

There is little question that the public interest would be greatly served if the law clarified the doctrine of material breach. Thus, when focusing on the "materiality" of a particular failure to perform, courts should eschew the confused multifactor balancing test of the Second Restatement and instead focus, as Judge Cardozo did, on the degree of harm caused by the breach to the reasonable expectations of the nonbreaching party and on the degree of harm that the breaching party would experience if the court excused the other party from performing.\textsuperscript{145} This balance of harms should then be evaluated most carefully in light of the question of good faith. The courts should focus on the character of the conduct, that is, the motivation and state of mind of the parties.\textsuperscript{146}

In contract disputes where the balance of harms is close and the parties are all operating in good faith, courts should encourage the parties to resolve their dispute by finding no material breach and ordering specific performance of the contract.\textsuperscript{147} On the other hand, where the harm to the nonbreaching party significantly outweighs the risk of harm to the-breaching party, or where the breaching party is acting in bad faith, that breach should be consid-

\textsuperscript{144} For a discussion of the facts of the hypothetical, see supra note 132 and accompanying text.

\textsuperscript{145} See generally Jacob \& Youngs, 129 N.E. at 889 (highlighting Judge Cardozo's views).

\textsuperscript{146} See Rosett, supra note 1, at 1086 (discussing that traditional legal theories focus on who breached first).

\textsuperscript{147} See Hillman, Keeping the Deal Together, supra note 26, at 560 (discussing that expectations of parties is best way to resolve problems of breach).
ered material and the nonbreaching party should be fully compensated based on its expectation interest. If both parties are acting in bad faith, then no material breach should be found, and both parties should be denied the benefits of the contract.

By providing a more focused framework for determining material breach and by structuring contract law remedies to deter bad faith breaches, the law may more successfully promote good faith contract performance and independent resolution of contract disputes. At the very least, it will promote a better understanding of the law by parties and more honest and lucid decision-making by the courts.

148. For a discussion of specific performance and its role in material breach, see supra note 134 and accompanying text.

149. For a discussion of the notion of deterring willful breaches, see supra note 134 and accompanying text.