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Performance Risks

PERFORMANCE HAZARDS

Black's Law Dictionary defines performance as "[t]he successful completion of a contractual duty, usu. resulting in the performer's release from any past or future liability"[1] and default as "the omission or failure to perform a legal or contractual duty."[2] The chances that an obligor will not so perform or will so default are performance risks. A performance hazard is a condition (or circumstance that exists at contract formation) or contingency (or event that occurs after contract formation) that indicates the obligor might not perform as expected.

Willingness, Ability, and Execution

An obligor's default will be attributable to one or more of the following causes:

- its lack of intent or desire or its unwillingness to perform when performance is due,
- its lack of financial, technical, and other resources to perform or its inability to perform when performance is due, and
- its lack of diligence or care when performing, or its incompetent or inept performance.

Performance hazards are conditions and contingencies that indicate the obligor lacks or will lack at the time performance is due a willingness or ability to perform or will lack sufficient diligence when performing. Such conditions and contingencies may occur earlier than breach, anticipatory breach, and repudiation.

Unwillingness and Inability to Perform. An unwillingness or inability may be the result of a condition that exists at contract formation or it may be the result of a contingency that occurs later. Such condition or contingency may cause an obligor to immediately lose its willingness or ability to perform or may portend a future loss of such willingness or ability. In the latter case, additional contingencies, acts, and events may have to occur before the obligor becomes unwilling or unable to perform. Until that time, one or more such conditions and contingencies evidence uncertainty about such willingness and ability.

The following cases illustrate such conditions and contingencies:

- *Channel Master Corp. v. Aluminum Ltd. Sales, Inc.*[3]: A seller agreed to sell a quantity of aluminum ingots each month for five years, knowing that it did not have sufficient supplies and intending to sell only supplies not sold to other buyers. The intent not to sell was a condition that existed at contract formation. The harm would come to the buyer on the first date delivery was due; before that time, the seller's lack of intent was a hazard to the buyer.[4] Unwillingness to perform was a condition at contract formation.
- *In re Newport Offshore, Ltd.*[5]: Newport, a ship repair firm, agreed to complete alterations and repairs to Long's vessel. It had competent welders on staff but assigned incompetent welders to the work because of commitments to other vessel owners, with the result that the repairs to Long's vessel were incompetently performed. A hazard occurred at contract formation when Newport committed to repair more vessels than it had competent staff to do the repairs. If, at that time, Newport expected to assign its incompetent welders to the vessel's repairs, it did not intend to perform as it had committed to do. If, at that time, Newport had not decided the repairs to which it would assign the incompetent welders, it was neither willing nor unwilling to perform. That would come later when it had to appoint the staff to repair Long's vessel.[6] The hazard existed at contract formation because the overcommitment created the chance Newport would not assign competent welders when it finally had to assign welders to the job, even if it hoped they would satisfactorily complete their tasks.
- *Resource Management Co.*[7]: This case is summarized in chapter 3.[8] A company that owned 8,000 acres of ranch land in Utah and its shareholders negotiated a two-page consulting agreement that generously compensated the consultant. The company and the brothers later decided not to use the consultant's services, claiming the contract was unconscionable because the consultant would receive far more than its services were worth.[9] The hazard, the decision not to use the consultant, occurred whenever they changed their minds; that resulted in harm on the first occasion they entered into a mineral lease without consulting the consultant. Their unwillingness to perform most likely occurred sometime after contract formation but before performance was due.
- *Trans World Airlines, Inc. v. Skyline Air Parts, Inc.*[10]: TWA solicited bids for certain boost pumps it once had as spare parts but had sold and shipped them two months earlier; it accepted the winning bid.[11] Its inability to perform was a condition at contract formation.

- *Christy v. Pilkington*[12]: Buyers of an apartment building paid a down payment at contract formation and expected to borrow the balance of the purchase price; however, after contract formation, they became unable to do so.[13] Like many real property purchasers, residential and investment, the buyers were not expected to have all the cash needed to purchase the property when the contract was signed but to be able to raise the necessary funds when they needed to do so. Because the borrowers were presumably qualified at contract formation to obtain the loan, the change in their financial condition was the cause of their failure to perform. The buyers lost their ability (or qualifications) to acquire the capability (funds necessary to pay the purchase price) after contract formation.
- *Tri-State Transmission and Generation Association, Inc. v. Shoshone River Power, Inc.*[14]: A cooperative utility obligated to buy all its electric power requirements from a power-generating cooperative seller decided to go out of business and sell its assets. The generating cooperative seller obtained an injunction to restrain the sale without the court deciding if the buyer was obligated to continue its business. The utility lost its willingness to perform when it decided to sell its assets and would have lost its ability to perform had it sold them, in both cases after contract formation.

Inability and Infeasibility. Inability to perform differs from infeasibility of performance. The legal distinction between objective and subjective impossibility is useful here: impossibility is objective when a task cannot be completed by anyone and subjective when it can be completed but not by a specific obligor.[15] Like objective impossibility and impracticability, completion of a task is infeasible when no one (person or entity) can complete a task as contemplated by the parties (in the quantity and quality required, at the time and cost projected) and feasible when someone can. Unlike impossibility, infeasibility is a matter of degree: a task impossible to complete under certain conditions may be capable of completion under other, more relaxed conditions. Infeasibility may exist at contract formation or occur later.

The following cases illustrate the distinction between inability and infeasibility:

- *B's Co., Inc. v. B.P. Barber & Assoc., Inc.*[16]: A subcontractor hired to install two pipes under a river according to the plans and specifications provided by a county's engineers tried twice and failed, but another subcontractor who was brought in successfully laid the pipes using a different method. If the pipes could not have been and were not installed according to the plans and specifications provided the first subcontractor (and were modified for the second subcontractor), as the subcontractor claimed, the work asked of the first subcontractor would have been infeasible. If the pipes could have been so installed, as the contractor successfully claimed, the first subcontractor lacked the skills (or ability) to lay the pipes because it tried twice.[17]
- *U.S. v. Wegematic Corp*.[18]: A contractor agreed, but failed within the agreed time, to design, build, and deliver to a federal government agency a "truly revolutionary" computer system. The government sued for damages. In response, the contractor argued the project was impractical from the outset and another year and between one million and one and one-half million dollars would have been needed to complete the work, and even then the outcome would have been uncertain. The court held for the government. The case illustrates a task that as conceived was infeasible and perhaps impossible at contract formation.

Infeasibility, like impossibility and inability, is a risk to an obligee, that the performance it expected from the obligor will not be forthcoming. Like impossibility and inability risks, responsibility for infeasibility risk must be allocated to one or both parties. As illustrated in *U.S. v. Wegematic Corp*., an obligor may assume responsibility for the risk its performance is infeasible.

Inept Performance. An obligor may have both the will and ability to perform but nonetheless fail to do so. Such failure cannot be attributed to inability or unwillingness, interference by third parties, or other external causes. For example, in *TCBY Systems, Inc. v. RSP Co., Inc.*,[19] a frozen yogurt franchisor disapproved a location proposed for a franchise store in a suburb of the Twin Cities suggested by the franchisee and proposed two locations in Minnesota outside the Twin Cities, even though its only location outside the Twin Cities in that state was failing. Based on an investigation by an inexperienced division manager, it approved an alternative location in central Minnesota proposed by the franchisee, even though the location did not meet the minimum demographic criteria the franchisor required in its internal guidelines. The franchise business failed. A reasonable interpretation of the events is that the franchisor had the resources to help choose a good franchise location but failed to use them on this occasion.[20] Performance is inept when the only logical conclusion is that an obligor could have performed but simply did not do so. The explanation for the failure lies in the skills, experience, and knowledge of the individuals charged with performance

Information, Assumption, and Uncertainty Risks

Information and Assumption Risks. A party may believe a performance hazard does not exist when it does because it has incorrect information about an obligor's identity or intent or ability to perform, it may have correct information about such matters but process such data incorrectly, or it may have no or insufficient information about such matters and make an incorrect assumption about them. Such a mistaken party may be the obligor, in which case it has incorrect information, incorrectly processes correct information, or makes an incorrect assumption about its own ability to perform. Such a mistaken party may be the obligee, in which case it has incorrect information, incorrectly processes correct information, or makes an incorrect assumption about the other party's ability to perform. Such hazards are comparable to the information and assumption hazards described in chapter 4, concerning benefits and tasks.

The following are cases that illustrate a combination of such information and assumption and performance hazards:

- *Sassower v. Blumenfeld* [21] illustrates an obligor who had incorrect information about its own ability to perform. A property buyer believed he had sufficient funds in his investment account with Bernie Madoff's firm to pay the $1,800,000 purchase price of a home, based on statements provided by Madoff's firm. Because Madoff's scheme was fraudulent, the buyer had no funds in the account he could use to pay such price.[22] The case is summarized further in chapter 10.[23]
- *Trans World Airlines, Inc. v. Skyline Air Parts, Inc.*[24] also illustrates an obligor who had believed it had the ability to perform when it did not. The airline wrongly believed it had the spare parts to sell, an error attributable to its failure to check its own records.

- *Bliven v. The New England Screw Co.*[25] illustrates an obligee who wrongly assumed its obligor had the intent and ability to perform. A manufacturer received six orders from a buyer for screws that stated the dates by which the buyer expected delivery. As was its custom and practice, the seller accepted the orders, even though it knew it could and would not fill, and had no intention of filling, them until it had filled all prior orders, also overdue. The buyer sued for breach of contract. The court held that because the seller's custom and practice was widely known, the buyer was charged with knowing such practice. The obligee did not know of such practice and incorrectly assumed the obligor was willing and able to perform the order as stated.

Uncertainty Risks. Incidents that occur prior to default by the obligor that adversely affect willingness and ability to perform may be evidence that the obligor will not or is unlikely to perform when performance is due. The existence of a condition at contract formation or the occurrence of an incident later may correlate to an obligor or obligors in general losing or suffering an impairment of their willingness or ability to perform. The fact that an obligor has previously performed ineptly when completing similar tasks for an obligee or third parties may be evidence that it will repeat such performance, even though it has on other occasions performed satisfactorily. That correlation may also be weak or strong, depending upon the extent to which willingness and ability are impaired and the proximity to the time when performance is due. The stronger the correlation between previous and future inept performances, the stronger is the evidence that performance will likely be inept. Incidents that precede and correlate with unwillingness, inability, and inept performance are hazards to performance. The more irreversible the impairment of willingness or ability, the stronger is the evidence that performance is unlikely. In all but the clearest of cases, whether a hazard has occurred and whether there is strong evidence that a commitment will not be fulfilled will be uncertain. Such uncertainty hazard is comparable to the uncertainty hazards described in chapter 5, concerning conditions and contingencies.

Following are cases that illustrate a combination of uncertainty and performance hazards:

- *McCloskey & Co. v. Minweld Steel Co., Inc.*[26]: A subcontractor who had agreed to furnish and erect all of the structural steel required on two buildings to be built on the grounds of a state hospital and to furnish all of the long span steel joists required in the construction of one of the two buildings became concerned about the tightening of the steel market after trying unsuccessfully to purchase steel from Bethlehem Steel, U.S. Steel, and Carnegie-Illinois and asked the general contractor for help to procure the steel, hoping for assistance from a state authority. The subcontractor's difficulty acquiring the required quantity of steel in the market may have been due to a condition that existed at contract formation or a contingency that occurred later, when the market tightened. In either case, the subcontractor's difficulty may have been evidence that the subcontractor would fail to procure the steel, though this was not a foregone result. The hazard was not irreversible. The risk to the general contractor was that the longer it waited for the subcontractor to fail, the more difficult and less likely it would be able to avoid all or to reduce its losses.[27] Conversely, the risk to the subcontractor was that the earlier the general contractor terminated, the earlier the general contractor foreclosed whatever chance the subcontractor had to succeed, even if against the odds.[28] Until the situation was clear one way or the other, that the subcontractor could or could not perform, uncertainty about its ability to perform continued.
- *KMC Co., Inc. v. Irving Trust Co.*[29]: Irving made loans to KMC, a wholesale grocery business, based on a percentage of the value of KMC's inventory and receivables; the maximum outstanding amount was not to exceed $3.5 million. The loans were secured by KMC's inventory and accounts. KMC asked Irving to increase the maximum to $4 million to enable it to pay its suppliers but was refused. It then requested a loan of $800,000 to cover outstanding checks and was refused, even though the aggregate outstanding loans would be below the $3.5 million limit. No prior notice had been given that loans below the maximum would be refused. The bank officer was concerned that not all checks would be cleared, KMC's financial condition was precarious, and the bank would not be repaid. Unable to pay its obligations, KMC became bankrupt and was liquidated.[30] If the bank officer had been correct that KMC could not pay all its bills with its available cash and the maximum amount of borrowings under the line of credit, a hazard had occurred—KMC was insolvent or potentially so—and refusing the loans would have mitigated its potential losses that would have resulted when KMC filed for bankruptcy. But, as KMC successfully claimed, the bank officer was incorrect and KMC could have paid all its bills, no such hazard existed, only a potential hazard at worst; the bank had overreacted.[31] Uncertainty about KMC's ability to repay the loans existed for a short while, during which time the bank's officer acted precipitously.

Changes in Party. Chapter 7 describes how changes of or in a party that has discretion can be a hazard to the other party. A change *of* party occurs when a contract is transferred to a third party, by assignment, distribution, merger, or otherwise. A change *in* a party occurs when the ownership or control of that party is transferred, the management of that party or the personnel in that party responsible for implementation of a contract is changed. Any such change of or in a party does not automatically alter its willingness or ability to perform or result in inept performance. The changed party may find the benefits of the contract as attractive as and the burdens no more burdensome than its predecessor. Until the details of a change are known, the obligee cannot assess the potential effect of a change on the obligor's potential performance. A contract that allows a change of or in a party creates uncertainty for the other party about whether such a change will occur. It also becomes a more significant hazard to the other party when a change occurs and adversely affects the obligor's willingness or ability to perform or the standard of its performance. Responsibility for the losses that result from such a change, however, may or may not remain with the changed party.

The following illustrate how such changes become hazards and how responsibility for such hazards are allocated:

- *Travellers International AG v. Trans World Airways, Inc.*[32]: Travellers, which began in 1972, developed certain package tours, agreed with TWA that it would continue to develop such tours, sell them to TWA, and produce brochures for marketing them. TWA agreed to provide the air transportation for and to market such tours. TWA also agreed to decide the number of tour passengers each year, not less than 100,000. In practice, the parties met annually and planned the number and content of the tours and brochure content. In 1985, Carl Icahn acquired control and in 1986 became chairman of the board of TWA. The owner of Travellers decided to sell the company and offered it to TWA. Icahn declined the offer, uncertain about expanding TWA's business in that direction. A year later, Icahn offered to buy Travellers from its new owner at the price he paid for it, but the new owner declined to sell. Icahn investigated how profitable Travellers' business was and how TWA could develop the land tour package business inside the airline. He decided to develop that business but recognized that the arrangements with Travellers would first have to be "cleared up." TWA terminated the contract, citing two grounds: the departure of a number of management employees at Travellers and the operation of a cruise program with SAS.[33] The case illustrates how a change of control of a party can prompt regret over the benefits ceded to the other party,[34] in this instance the profit realized by Travellers from flights arranged with TWA. The potential for an investor, such as Icahn, to acquire control of TWA was a hazard to Travellers from contract formation and became more significant when Icahn acquired control, threatening TWA's willingness to continue to perform the contract with Travellers. Because it was not at liberty to repudiate its commitments to Travellers following a change of control, TWA remained responsible for any losses that resulted from TWA's repudiation or breach (the outcome of any change in intent about performing).

- *Comdisco Disaster Recovery Services, Inc. v. Money Management Systems, Inc.*[35]: Comdisco agreed to provide disaster recovery services for Money Management. Comdisco was obligated to maintain fully operational computer centers as a backup for customers, such as Money Management, whose businesses were dependent on computers. Money Management paid a monthly subscription fee for the service. Money Management was acquired by and became a subsidiary of SunGuard Data Systems, Inc., which had another subsidiary that was a chief competitor of Comdisco. Money Management stopped paying monthly fees to Comdisco and signed a new agreement for such services with the SunGuard affiliate.[36] Money Management claimed that Comdisco would have unfair access to SunGuard's proprietary information if it continued to provide disaster services to Money Management. The hazard to Comdisco was the potential change in control of its client, Money Management, who, as a result of such change, would be unwilling to continue performing. The case is similar to *Travellers International AG*. Assuming Comdisco might have had access to SunGuard's proprietary information as a result of the acquisition of Money Management, the potential hazard to SunGuard was acquiring a contract or business with a contract with a competitor that might result in that competitor receiving an advantage. Both hazards occurred. Money Management assumed responsibility for both risks, not having a right to terminate upon the occurrence of a change in its control.
- *Alternative Thinking Systems, Inc. v. Simon & Schuster*[37]: A publisher contracted with a company, the president of which authored a work the publisher was to publish. The author died shortly after the manuscript was accepted. The publisher decided against publishing the book because the author would not help in marketing. The case illustrates how the loss of a key person in one party can potentially so change the benefits for the other party that it wishes to reassess the value the transaction has for it. The hazard to the publisher was the loss of the author's participation in the marketing of the book. It assumed responsibility for that risk in the absence of a right to terminate upon the death of the author.[38]
- *Mindel v. Image Point Productions, Inc.*[39]: A production company recruited and hired a director to direct television commercials for one year. Shortly after his hiring, the production company fired the executive who had recruited and supervised the director. When the director learned of the firing and replacement of the representative, he indicated he would try working with the new representative; however, after asking for that individual to be replaced with someone he preferred and being refused, he complained he could not work with the designated replacement and quit the production company. His refusal to work with the replacement representative was held to repudiate the contract. The potential for a change in his supervisor was a hazard to the director because the new supervisor might be more difficult to work for than the executive who hired him. That harm occurred when a new supervisor was appointed with whom the director had difficulty working. The director assumed responsibility for the risk that such hazard could occur unless he could approve the replacement supervisor or otherwise terminate the contract upon the appointment of a new supervisor. He had neither of such rights.

PERFORMANCE RISK MANAGEMENT

The primary purposes of managing performance risks are

- to allocate responsibility for the uncertainty that occurs when conditions and contingencies indicate that an obligor may be sliding toward an unwillingness or inability to perform or will incompetently perform,
- to reduce the chance of an obligor's failing to perform, and
- once such failure occurs, to reduce the losses the obligee ultimately suffers therefrom.

Performance Risk Allocation

Information and Assumption Risk Allocation. The chance that a party may be mistaken about its or the other party's willingness or ability to perform is managed like other information and assumption risks. By committing to perform, an obligor assumes responsibility for the risk that it is not then willing or may later become unwilling to perform. It also assumes responsibility for the risk it may be laboring under incorrect information, have incorrectly processed good information, or made an incorrect assumption about its ability to perform or its capability of later acquiring such ability. *Sassower*[40] and *Trans World Airlines*[41] illustrate the allocation of responsibility for such risks to the obligor. Responsibility for that risk allocation is modified when the unilateral or mutual mistake doctrine applies, and the obligor is permitted to terminate the contract. The textbook case *Couturier v. Hastie*[42] illustrates such an allocation of responsibility: A factor sold a cargo of corn shipped for delivery in London and described as "of average quality," when at the time the cargo no longer existed because it had been removed while the vessel was in Tunis, having deteriorated while en route; the seller was held not liable for breach because at the time of sale it could not and did not know that the cargo no longer existed. *Bliven*[43] illustrates an allocation of responsibility for an incorrect assumption about the obligor's willingness and ability to the obligee.

The risk allocations previously described can be modified still further by a warranty that the obligor will perform or has certain or all of the resources it needs to perform or a disclaimer that it does not. The warrantor assumes responsibility for the risk it does or will not have the ability, and the obligee, by accepting the disclaimer, assumes responsibility for the risk the obligor does not have whatever is disclaimed.

Gulf Oil Corporation v. Federal Power Commission[44] illustrates how a warranty that an obligor can or will perform trumps its claim it labored under a mistake of fact concerning its ability to perform. A gas supplier dedicated a gas field to a contract to sell gas and warranted to its buyer "to have available for delivery . . . on any day or days" a minimum quantity of gas. Both it and the buyer wrongly assumed the reserves in the field from which it expected to supply gas would be sufficient. The seller lacked the ability to produce sufficient gas from the field as it had assumed. Upon discovering the error, the supplier claimed it was entitled to relief on the basis of mutual mistake of fact. The court dismissed the supplier's argument: "We believe that the existence of a warranty as to the availability of gas completely forecloses equitable relief based on a mistake as to the availability of gas."[45] The court did not discuss if the mutual mistake doctrine would have otherwise excused the supplier's supply shortage. The supplier also claimed the impracticability of performance doctrine applied. Again, the court held the warranty precluded the excuse.[46] If either doctrine had applied, the warranty overrode the excuse and preserved the allocation of responsibility to the gas supplier.

Uncertainty Risk Mitigation. Terms and principles comparable to those that manage the uncertainty risks described in chapter 5 manage the risks that a condition or contingency has on or may adversely affect an obligor's willingness or ability to perform. Such principles include those that enable an obligee to decide when an obligor has partially and materially breached, anticipatorily breached, and repudiated a contract and allow it to respond to such incidents and other incidents that fall short of breach, anticipatory breach, and repudiation. Contractual terms that state when incidents are breaches and how an obligee may respond to them supplement such principles.

An obligee has two broad strategies for managing uncertainty performance risks: first, the contract can reserve to the obligee as much discretion as the obligor will allow for the obligee to decide from time to time that an action must be taken and what actions shall be taken to prevent or respond to incidents that portend a breach. As discussed in chapter 5, this is the preferred method of managing uncertainty risks, though it allocates responsibility for risk to the party not making the decisions the risk that the obligee will decide adversely in ways unexpected. Second, the contract can state what actions and incidents will constitute breaches and the remedies to which the obligee may resort to prevent and respond to the same. The strategies may be combined.

The following are two cases that illustrate such strategies, stating when incidents are breaches and granting the obligee discretion to determine when a breach has occurred.

- *R.W. Power Partners, L.P. v. Virginia Electric and Power Co*.[47]: A contract obligated a power generator, which sold electricity to a utility to maintain a standby letter of credit in the agreed amount at all times as security for its obligations to the utility. The first letter of credit was issued by a bank for the first year and renewed by that bank for the second. That bank decided not to renew the credit for the third year, and it expired without a replacement. Five days later, the utility terminated the contract, citing a clause that allowed it to do so if the generator failed to "perform any of its obligations." The following day the new issuer delivered the letter of credit to the utility.[48] That letter of credit did not allow the beneficiary to draw on a bank in Virginia, as required; the credit was amended the next day. The generator's efforts to replace the letter of credit, its performance, had been incompetently executed, but delays notwithstanding, no harm had come to the utility or was imminent when it terminated the contract. Had the contract been read literally to allow the utility to terminate for such a breach, as the utility claimed, the utility would have achieved a high level of certainty about when it had a right to terminate. The generator would have assumed responsibility for the risk any minor breach, even one that did not indicate a loss was likely, could result in its loss of its investment in the transaction. In fact, the contract was no longer financially desirable to the utility, which wanted to terminate it. By reading the contract to allow the utility to terminate only when it suffered actual harm from a breach, as the generator successfully claimed, uncertainty about when a partial breach might indicate a potential material breach and stipulated as a ground for terminating the contract crept back into the contract. The utility would have to wait until a breach could or was likely to result in the loss of the anticipated benefits, and this it could not do because a new letter of credit was about to be issued.[49]
- *Indiana v. International Business Machine Corp*.[50]: A state agency contracted with IBM to

  > establish centralized service and call centers for the processing of welfare applications, enable remote electronic access to the system, provide the [s]tate a paperless document system, create systems to combat fraud and improve Indiana's poor welfare-to-work record and lower administrative costs.[51]

  Twenty-seven months after signing the contract, the state requested IBM to adopt a "corrective action plan" to resolve 36 "issues" with its performance:

  > excessive wait times at local offices and for appointments, incorrectly categorized imaged documents, high staff turnover, inaccurate and incomplete data gathering, scheduling problems, clients not receiving mailed correspondence, poor communication to all staff, unresolved help-ticket requests and untimely application and redetermination processing times.[52]

  Four months later, the agency and IBM agreed on such a plan. Two months later, the agency concluded that while IBM had improved its technology and added more staff, it had not improved the timeliness of processing applications for food stamps, Medicaid, and other benefits. A month later, the agency terminated the contract for cause. The contract, referring to the state's anticipated benefits as "policy objectives," elaborated upon their meaning and stated eight "standards" by which performance would be measured. One such standard was the "[d]etermination by the State of [IBM]'s satisfactory performance of the Services and the Delegated Activities." The agency could terminate the contract for convenience or cause, in the latter case for material breach. In particular, a material breach included:

  > a series of breaches of [IBM]'s obligations, none of which individually, constitutes a breach of this Agreement which is material considering this Agreement as a whole, but which, in view of [IBM]'s history of breaches, whether or not cured, collectively constitute a breach of this Agreement which is material when considering this Agreement as a whole.[53]

  Whereas the parties may have been uncertain about the extent to which partial breaches could justify termination by the state, the clause empowered the state to decide when termination was justified. The clause also allowed the state to focus on partial breaches to the exclusion of the benefits the agency received from IBM's otherwise satisfactory performance. IBM was clearly doing something right, though not everything. As the state claimed, it could ignore those benefits and focus on IBM's shortcomings, the cumulative effect of which could be interpreted as an indication that ineptness on IBM's part might well continue. By accepting the provision, IBM assumed responsibility for the risk that its minor breaches could, when accumulated and determined by the state in the exercise of its discretion, entitle the state to terminate even though the state was realizing the material benefits of its contract.[54]

Mitigation of Risk of Breach

The risk that an obligor will fail to perform a task can be reduced or eliminated by the following:

- completion of that task before contract formation,
- substituting a third party for the obligor to complete that task,
- having a third party commit to perform that task when the obligor fails, and
- regulating the obligor's actions to preserve its willingness and ability to perform that task.

Advance Performance. Performance risks can be mitigated or eliminated by having an obligor complete some or all of its performance before or when the contract is executed. Full performance before or concurrently with contract formation assures the obligee at the time that nothing further remains to be done by its counterparty.

The following are examples of such advance performance:

- payment in full of the premium on an insurance policy for the term of coverage before the policy is issued,[55]
- payment in full of the price of goods to be delivered or land to be conveyed before the goods or land are delivered,[56] and
- payment of the freight for shipping goods before the goods are accepted by the carrier.[57]

When an obligor cannot rescind the contract and recover such a payment, breach and repudiation are impossible. Obligor performance risks—intent not to pay and inability to pay—have been eliminated.

Partial completion before or at contract formation can also mitigate counterparty performance risk: the risks are eliminated to the extent of such performance at such time and continue to the extent such performance remains uncompleted. Down payments on the price of goods or land or rent for space are common examples. The higher the down payment proportion of the total price, the greater is the reduction of the counterparty performance risks.

Before or at contract formation, payment in full into a trust or escrow from which funds are to be released upon satisfaction of agreed conditions also mitigates performance risks. A three-party agreement identifies the obligor who has deposited funds into the escrow; it identifies a stakeholder, a trustee or escrow agent, which holds the escrowed fund, and obligates it to disburse such funds according to the terms of that agreement to the obligor, obligee, or both; and it entitles the obligee to receive such funds when the escrow agent must disburse them. Because the obligor must deposit funds into the escrow before or at contract formation, the risk that it will fail to make such payment is eliminated. Risks still exist, however: an obligor who breaches might dispute the obligee's right to keep any deposit or down payment as unenforceable liquidated damages, and an obligor or a third party might dispute an obligee's right to receive payment from the escrow fund, blocking such payment until the dispute is resolved. The escrow agent may fail to perform the escrow agreement.

Substitute for Obligor Performance. Performance risks can be mitigated by removing the obligor as the party expected to perform one more tasks and having either the obligee or a third party—one who would perform the task anyway or who is considered at least as reliable as the obligor—assume responsibility for completion of such tasks. Common arrangements for redirecting performance are as follows:

- A payment or performance a third party would make to an obligor is redirected to an obligee.
- A payment that an obligee would make to an obligor that, in turn, would perform by paying a third party is redirected to that third party.

The third party's performance in the first instance and the obligee's in the second substitute for the obligor's. The risk that an obligor does or will not have the will or ability to perform is entirely eliminated. The simplicity of the arrangement is that the third party and obligee assume very little additional responsibility: they are already obligated to make the payment, and that obligation is slightly modified by redirecting payments to an obligee or third party.

The following illustrate such arrangements and some of the risks they create.

- *Bituminous Construction, Inc. v. Rucker Enterprises, Inc.*[58]: An owner agreed with a subcontractor to make checks payable to both the contractor and subcontractor. When the owner settled litigation with the contractor by paying the latter the agreed amount, it breached its agreement with the subcontractor, which had not been paid in full under the subcontract. The arrangement protected the subcontractor against diversion by the contractor of payments received from the owner. The owner assumed responsibility for an incremental risk: that it would forget to make the checks payable to both the contractor and subcontractor.
- *In re Halmar Distributors*[59]: A lender required that a borrower's customers make their payments directly to a lockbox under the control of the lender. Such payments included proceeds from the sale of products supplied by a supplier that retained a security interest therein. When the supplier learned of the lockbox, it successfully claimed the lender, by controlling the lockbox, had converted the proceeds of collateral in which it had a security interest.[60] The customers assumed responsibility for the incremental risk they might mistakenly pay the borrower. The lockbox thus protected the lender against diversion by the borrower of payments from its customers but not against the supplier's claim. That was a separate risk, discussed in chapter 11.[61]
- *McDraw, Inc. v. CIT Group Equipment Financing, Inc.*[62]: A lender and borrower agreed the former would directly pay the borrower's supplier the purchase price for equipment the lender would buy from and lease back to the borrower but would not assume any of the

borrower's obligations to the supplier. Before the supplier received the final payment, the borrower defaulted under its agreement with the lender, which refused further advances and eventually foreclosed on the equipment.[63] The arrangement mitigated the risk that the lender would make loans to a borrower that was in default and eliminated any risk the borrower would divert payments intended for the equipment supplier.

A third party can also be brought into the transaction to perform a duty, the obligor's duty, it would not otherwise have to perform. Such a third party contracts with the obligee and thereby assumes an obligation to the obligee it would not have otherwise but for its participation in the arrangement that substitutes for the obligor's performance. Payment through a documentary letter of credit is an example: the issuer of the credit had no obligation to pay the beneficiary before issuing the credit. Payment by the issuer to the beneficiary upon a draw under the credit substitutes for payment by the obligor. The issuer is brought into the transaction to eliminate the risk the obligor account party may be unwilling or unable to pay when payment is due.

However, because a letter of credit or similar instrument is a contract between the issuer and the beneficiary thereof, the demand for payment thereunder must comply with the conditions stated therein. The obligee, as beneficiary under the credit, thus assumes responsibility for a new risk: that its demand thereunder for payment might not comply with such conditions, that the issuer might wrongfully refuse to pay, or a combination of both. In principle, such refusal could be due to an unwillingness or inability to pay, though most often it is due to ineptness in performing under the credit. Responsibility for one set of risks is swapped for another: obligor unwillingness and inability to pay risks are traded for the risks of obligee ineptness in presenting its demand under the credit and the issuer's unwillingness, inability, and ineptness. Such trade is rarely considered a bad one for an obligee.

Philadelphia Gear Corp. v. Central Bank[64] illustrates such a risk swap. A bank issued a documentary letter of credit for the account of a buyer in favor of a seller of goods. The seller demanded payment under the credit for goods it claimed were delivered. Payment was refused because the demand did not conform to the terms of the letter of credit. The defects in such demand, however, were curable, but the bank kept the documents. The bank had been substituted for the buyer as payor for the goods, eliminating the risk the buyer would fail to pay, but creating risks that the seller would fail to demand payment in accordance with the credit and that the bank would incompetently process that demand.[65]

Guaranties. A third party can assume secondary responsibility for performance by an obligor by agreeing to perform when the obligor repudiates or fails to perform. Responsibility is secondary because the obligor remains responsible for the initial performance of the obligations and the third party is obligated to perform only after the primary obligor repudiates or breaches the contract. The most common examples of such third-party responsibility are guaranties and surety bonds: A guaranty is "[a] promise to answer for the payment of some debt, or the performance of some duty, in case of the failure of another who is liable in the first instance; a collateral undertaking by one person to be answerable for the payment of some debt or performance of some duty or contract for another who stands first bound to pay or perform."[66]

A guarantor or the like is brought into the transaction by a fresh agreement, such as a guaranty, and the obligee must comply with whatever conditions it includes to make a demand for performance thereunder by the guarantor or surety. Unlike a third party's performance described in the preceding paragraphs that eliminates or reduces the occurrence of a breach, a guarantor, surety, or issuer does not become obligated to perform until after the breach occurs. Such an instrument does not eliminate the risk of repudiation or breach; it reduces the losses the obligee may suffer as a result of the breach. A reliable third party is added to the parties to which the obligee has recourse to mitigate such losses. The addition of a reputable third party as a guarantor, such as a bank, financial institution, or government or international agency, may deter or help to deter an obligor from repudiating or breaching a contract, as the obligor will desire to preserve its reputation among such institutions and agencies.

Private Regulation. A contract can burden an obligor with commitments to do what is necessary or helpful to acquire and maintain its willingness and ability to perform. The obligor thereby promises to take actions that are expected to avoid the occurrence of performance hazards, acts that could dissipate the obligor's willingness and ability. Unlike tasks that when completed contribute to realization of desired benefits by the obligee, the completion of regulatory tasks does not directly contribute to the realization of benefits; such completion preserves or facilitates the acquisition of the ability and willingness to complete such tasks. A breach of a regulatory covenant is an indicator the obligor may or will be unwilling or unable to perform when performance is due. Examples of activities that are occasionally regulated by outright prohibition or other restrictions include

- going out of business and liquidation, which eliminate ability to perform;
- transferring all or substantially all the obligor's assets;
- transferring the material resources that are expected to be used to perform;
- granting security to creditors in its assets, which will give some creditors priority over others and reduce the assets from which the obligee may be able to recover; and
- paying dividends to shareholders, which diverts cash that can be used to pay an obligee or other creditors or otherwise to fund the costs of performance.

A description of the appropriate regulatory covenants for any specific or type of transaction are beyond the scope of this text.

*Prohibitions on Assignments and Changes of Control***.** Regulatory covenants and conditions subsequent are the principal terms by which changes of or in parties are regulated. The most common covenants and conditions include

- a prohibition of the assignment by an obligor of the contract or any interest therein;
- a condition subsequent that states a change of control of the obligor entitles the obligee to terminate the contract or to declare the obligor to have breached or defaulted and to exercise remedies; and
- a prohibition of any change in the obligor's personnel responsible for its performance.

As discussed in chapter 7, such regulation is important to a party when the other party has discretionary decision-making powers under a contract, as such regulation may enable such party to control who has or determines the use of those powers. Regulation is also important to an obligee, as it can also help ensure that when an obligor or control or the key personnel of an obligor has been changed, the obligor will be no less willing and able to perform than before such changes were made.

The following cases illustrate how such prohibitions may be structured and applied:

- *James v. Whirlpool Corp*.[67]: A distribution agreement that was annually renewed required the manufacturer Whirlpool's approval of any changes in the distributor's direct or indirect ownership, management, or control. Another clause allowed Whirlpool, upon a change of control or management of the distributor, to treat the contract as terminated. Whirlpool tightly regulated with whom it did business by reserving the right to terminate annually and by reserving the right to approve transfers of interests in its distributors. A distributor notified Whirlpool that its owners proposed selling its shares and requested Whirlpool's consent, which was refused. At the end of the year, Whirlpool refused to renew the contract.[68] The contract was an asset of the distributor, the value of which could be realized only by a transfer of the contract or sale of the company, allowed only with Whirlpool's consent. Whirlpool could thus deprive the distributor of all value in its contract by refusing its consent. It could also do so by refusing to renew the contract. Responsibility for both risks was assumed by the distributor.
- *Carte Blanche (Singapore) Pte Ltd. v. Carte Blanche International, Ltd*.[69]: A franchise agreement prohibited assignment by either party and required the franchisor's consent for "any transfer of shares within the family of companies belonging to the [named] . . . group." Some of the franchisee's shareholders transferred their shares to a family holding company, and that holding company's shares were transferred to a publicly listed company in Malaysia. The franchisor notified the franchisee that the transfers breached the anti-assignment and share restriction clauses and filed for arbitration. Like the contract in the previous case, the franchise agreement was an asset of the franchisee, the value of which could only be realized by the transfer of that agreement or shares in the franchisee, allowed only with the franchisor's approval. If, as the franchisor claimed, any share transfer breached the covenant, the franchisor enjoyed tight control over who the franchisee included as its owners. But, as the franchisee successfully claimed, transfers within the family did not materially breach the covenant, the franchisor controlled only material changes in the franchisee. The implication was that the franchisor assumed responsibility for the risk of immaterial ownership changes in the franchisee notwithstanding language to the contrary in the franchise agreement.[70]

Mitigation of Losses

Mitigation of damages is a legal doctrine that "induc[es] a plaintiff, after an injury or breach of contract to make reasonable efforts to alleviate the effects of an injury or breach."[71] Independent of such duty, an obligee might plan its efforts to minimize the losses it could suffer from a failed transaction and, to the extent permitted, to maximize its recovery of compensation from the breaching party.

Self-Help Remedies. A self-help remedy is defined as "[an] attempt to redress a perceived wrong by one's own action rather than through the normal legal process."[72] The advantage to an obligee of such remedies is that because their exercise is outside the legal process, the obligee, not the courts or other official or institution, controls the execution of the process and has the potential to save time and cost since the legal process is usually more cumbersome and expensive.

Such actions include:

- suspension of performance, defined, in part, as "[an] act of
- temporarily delaying, interrupting, or terminating something,"[73]
- set-off, defined, in part, as "[a] debtor's right to reduce the amount of a debt by any sum the creditor owes the debtor; the counterbalancing sum owed by the creditor,"[74]
- step-in rights, defined as performance by the obligee or its representative for the benefit of the obligor an obligation it failed to perform or ineptly performed,
- enforcement of security or foreclosure, defined as "[to] terminate a mortgagor's interest in property,"[75] and
- termination of the contract, defined as the "act of ending something."[76]

The following illustrate such self-help remedies:

- *Clem Marine Towing, Inc. v. Panama Canal Co*.[77] illustrates a right to suspend performance, which right was implied: The lessee of a vessel learned the lessor had missed a payment on the leased vessel mortgage and had encumbered the vessel with two additional mortgages. The lessee, concerned that it would not be able to buy the vessel when it exercised its purchase option, notified the lessor it was suspending payments until it received assurances the lessor was able to pay its mortgage payments.[78]

- *In re SemCrude, L.P.*[79] illustrates the exercise of broad setoff rights. The contracts between a refiner and service provider and three subsidiaries of the parent debtor provided

  > in the event either party fails to make a timely payment of monies due and owing to the other party, or in the event either party fails to make timely delivery of product or crude oil due and owing to the other party, the other party may offset any deliveries or payments due under this or any other Agreement between the parties and their affiliates.

  When the service provider and its subsidiaries filed for bankruptcy, the refiner owed $1,405,878.40 to one subsidiary and was owed $3,302,806.03 and $10,228,439.34 by two other subsidiaries, respectively. The refiner applied to the bankruptcy court to set off what it was owed by the debtor against what it owed the debtor's affiliates. The court denied the petition on the grounds that the debts were not "mutual debts" within the meaning of section 553 of the Bankruptcy Code, as only debts owing to and from the same persons are mutual. Nevertheless, such triangular setoff rights might be permissible when the party against whom such rights are exercised is not insolvent.

- *Charter Practices International, LLC v. Robb,*[80] which is summarized in chapter 3,[81] illustrates step-in rights to operate a business: A "charter practice" or franchise agreement for a pet hospital provided:

  > In order to prevent any interruption of the operation of the Hospital that would cause harm to the Hospital or to the reputation of the Network, You [the franchisee] authorize [the franchisor] CPI or its designee to step in to operate the Hospital if, in CPI's reasonable judgment: . . . CPI decides that significant operational problems exist which require CPI to operate the Hospital for a time.

  The franchisor moved for a temporary restraining order to prevent a franchisee interfering with its taking over the franchisee's operations in response to the practice of administering half-doses of vaccines and using the remaining dose on other animals. The order was granted. The case also illustrates how an obligee may have to resort to legal process to exercise a step-in right when the obligor resists the same.

- *Jackson Trak Group, Inc. v. Mid States Port Authority*[82] illustrates step-in rights exercised to remedy defective construction work. In reliance upon the following provision in a contract for construction work, the owner seized equipment belonging to the contractor:

  > OWNER MAY CORRECT DEFECTIVE WORK. If contractor fails within a reasonable time after written notice of ENGINEER to proceed to correct and to correct defective Work or to remove and replace rejected Work as required by ENGINEER in accordance with paragraph 00713.11, or if CONTRACTOR fails to perform the work in accordance with the Contract Documents (including any requirements of the Progress schedule), OWNER may, after seven days' written notice to CONTRACTOR, correct and remedy any such deficiency. . . . To the extent necessary to complete corrective and remedial action, OWNER may exclude CONTRACTOR from all or part of the site, take possession of all or part of the Work, and suspend CONTRACTOR'S SERVICES RELATED THERETO, TAKE POSSESSION OF CONTRACTOR'S tools, appliances, construction equipment stored at the site or for which owner has paid CONTRACTOR but which are stored elsewhere. CONTRACTOR shall allow OWNER, OWNER'S representatives, agents, and employees such access to the site as may be necessary to enable OWNER to exercise his rights under this paragraph.

  While the authority had given notice to the contractor to correct defective work, the contractor disputed that the work was defective and ultimately prevailed in arbitration.

Security. Security can serve as an obligee's sword, ensuring that assets will be available for recovery by the obligee should it have to recover compensation from the obligor. Enforcement of security is also a self-help remedy when the obligee can seize and sell the collateral without legal process. Security also serves as a shield, earmarking and protecting from the claims of the obligor's other creditors assets to pay the obligee's claims; security protects the priority of its claim relative to other creditors. Security thus mitigates the risks that the obligee will not recover compensation due it and that other creditors will reduce that recovery.

The greater the ease with which collateral may be liquidated, the more attractive as security it will be to the obligee. Cash and cash equivalents held by an obligee will be the most attractive security because the obligee has little more to do than apply such cash to the amounts owed to it by the obligor. Cash and cash equivalents held by a third party as a stakeholder will be a slightly less effective self-help remedy because, while the collateral is still liquid, the terms on which the stakeholder is permitted to use or release the cash will likely restrict the obligee's ability to receive payment.[83] Marketable securities will be slightly less liquid, only because they must be sold before cash is available to apply to the obligations. The risk is that such securities will be difficult to liquidate or realize less value than expected. An account or other debt owed by a third party to an obligor in which the obligee has security is less liquid than marketable securities because the account debtor's obligation, willingness, and ability to pay will be uncertain until a demand for payment is made. Still, such collateral is relatively liquid because self-help is limited to notifying the account debtor that payment should be made to the obligee and collecting payment if the account debtor fails to pay. The number of obligors and difficulty collecting payment will increase the effort required by the obligee and make the remedy less attractive.

Other intangible assets, such as patents, trademarks, copyrights, trade secrets, licenses to use the foregoing, licenses to operate a business, and securities not traded on a market, will be less liquid because an effort to locate a buyer will have to be made, and their disposition may be subject to rules that ensure their value is realized. Moveable tangible assets with a ready market, such as nonperishable inventory, equipment, and consumer goods, such as motor vehicles, may be attractive collateral because a ready market of buyers exists; however, potential difficulties locating, collecting, and selling such collateral may be subject to restrictions that make such items less attractive. Other moveable tangible assets, such as artworks, may be less liquid and require more effort to sell. Immoveable assets, such as real property and land, may also have a market in which disposition may be easily carried out but the rules for disposition may restrict how a sale is conducted and may limit the obligee's recourse for any deficiency following the sale. Disposition of a large infrastructure project may be possible in a limited market, making the task of enforcing security daunting. Collateral that requires a special license to own, use, or operate, such as a business selling alcoholic beverages or operating a television or radio station or a pharmaceutical business will have a limited market of potential buyers and additional regulatory hurdles to be overcome for enforcement of security. The risk mitigation effected by security depends on the value relative to the debt to be collected and the liquidity of the collateral.

However, because security is always enforced to pay a debt, that debt must be liquidated. A debt is liquidated when its amount has been determined by agreement or by operation of law.[84] An obligation to repay a loan is nearly always liquidated because the amount of the debt is easily calculated; if the maturity of the debt can be accelerated, the debt will include the unpaid principal balance of the loan, accrued and unpaid interest thereon, and any unpaid fees and costs that the obligor is obligated to pay. When a secured obligation is the payment of damages that flow from a breach of contract, the amount of such damages may not always be liquidated at the time of breach because the amount of such damages may be uncertain; the amount of the debt to be paid from the security will be unknown. In the absence of obtaining a judgment or arbitral award for the damages resulting from the default, the obligee will have to estimate the amount it is owed. It runs the risk of demanding too much or too little when seeking to enforce its security. One solution is to agree on the amount of the liquidated damages at contract formation, thus eliminating the uncertainty about the amount that will be owed upon breach or repudiation and that can be realized through enforcement of the security. Because liquidated damage clauses are not always effective, the use of such a clause to liquidate the damages may trade uncertainty over what is owed for uncertainty over whether the liquidated damages clause is effective; the liquidated damages clause may swap one uncertainty risk for another. The risks associated with liquidated damages provisions are discussed in the chapter 9.[85]

Suspension and Termination. By suspending its commitment in response to a performance hazard, an obligee can avoid or minimize further investment in a transaction until it has determined the obligor is willing and able to perform. By terminating its commitment in response to a performance hazard, an obligee stops all further investment in the transaction. As previously discussed, the contract must either vest discretion in the obligee to decide when a hazard has occurred that permits it to suspend or terminate or describe clearly the incidents that will permit it to do so. The longer an obligee must wait to decide if a performance hazard will result in inability or unwillingness to perform, the more difficult it may be to avoid the breach and the resulting losses. A contractual term that allows an obligee to declare breach sooner rather than later enables it to reduce the chance of not realizing its desired benefits and the extent of its losses. For example, if the general contractor in *McCloskey & Co*.[86] had the right to declare the subcontractor in breach and terminate at the first sign that the subcontractor was having difficulty, it would have been able to bring in replacement suppliers and subcontractors and complete the project on time, thus realizing the benefits it expected to realize from the subcontract. At the same time, a term that allows the obligee to declare a breach and terminate after waiting for events to more clearly demonstrate a loss of willingness or ability allocates to it responsibility for the risk of waiting for so long and no longer: the loss of potential benefits may become irreversible with the passage of the period the obligee must wait. It also allocates to the obligor responsibility for the risk that it may be able to retrieve itself and complete performance when due. The obligor assumes responsibility for this risk when the contract allows the obligee to declare a breach and terminate before the loss of willingness or ability is irreversible.

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1 BLACK'S LAW DICTIONARY 1319 (10th ed. 2014).

2 *Id*. at 507.

3 4 N.Y.2d 403, 176 N.Y.S.2d 259, 151 N.E.2d 833 (N.Y. 1958).

4 Unable to sue on the contract, which had not been reduced to writing as required by the statute of frauds, the buyer sued for fraud. The New York Court of Appeals held the action should be allowed. "If the proof of a promise or contract, void under the statute of frauds, is essential to maintain the action, there may be no recovery, but, on the other hand, one who fraudulently misrepresents himself as intending to perform an agreement is subject to liability in tort whether the agreement is enforcible (sic) or not." *Id*. at 408.

5 155 B.R. 616 (Bankr. R.I. 1993).

6 Long submitted a claim for breach of contract in the bankruptcy proceeding for Newport. The trustee opposed the claim and the bankruptcy court found Newport was negligent in repairing Long's vessel and breach the contract with Long.

7 706 P.2d 1028 (Utah 1985).

8 See text accompanying ch.3, notes 65 and 66

9 Supra ch. 3, note 66.

10 193 A.2d 72 (D.C. App. 1963).

11 TWA canceled the contract and, when sued, unsuccessfully claimed mistake of fact and impossibility as defenses. The court, unsympathetic to TWA, held, regarding the mistake defense, "If there were a mistake in the case before us, it was not mutual. Trans World knew, or should have known, of the superior right of the third party to which it had previously sold the subject matter." Likewise, the court dismissed the impossibility defense: "The inability to perform was the sole responsibility of appellant, brought about by its negligent and careless omission to check over a period of time that the subject matter offered and sold to appellee was still in its possession."

12 224 Ark. 407, 273 S.W.2d 533 (Ark. 1954).

13 Their income from their car business had so declined they could not qualify for the loan.

14 805 F.2d 351 (10th Cir. 1986).

15 "Impossibility of performance of a contract may be classified as objective impossibility (the thing cannot be done) or as subjective impossibility (I cannot do it). It is generally well settled that subjective impossibility, that is, impossibility which is personal to the promisor and does not inhere in the nature of the act to be performed, does not excuse nonperformance of a contractual obligation." The B's Co., Inc. v. B.P. Barber & Assoc., Inc., 391 F.2d 130, 137 (4th Cir. 1968). "The impossibility which will, or may, excuse the performance of a contract must exist in the nature of the thing to be done. It must not exist merely because of the inability or incapacity of the promisor or obligor to do it." White Lakes Shopping Center, Inc. v. Jefferson Standard Life Ins. Co., 208 Kan. 121, 124, 490 P.2d 609 (Kan. 1971).

16 391 F.2d 130 (4th Cir. 1968).

17 The first subcontractor claimed the pipes could not be installed according to the plans and specifications, and these were modified for the second subcontractor; as the plans and specifications were implicitly warranted to be correct, the contractor was responsible. The court found the plans and specifications allowed the subcontractor to decide upon the method and did not mandate installation that was impossible to complete. After reviewing the difficulties experienced by the first subcontractor, the court concluded, "[T]he trial judge found that [the work] … was not impossible to perform. It appeared most difficult or perhaps impossible for [the first subcontractor] but apparently a routine operation for an experienced operator in the field, … [the second subcontractor]." *Id*. at 137.

18 360 F.2d 674 (2d Cir. 1966).

19 33 F.3d 925 (8th Cir. 1994).

20 When the franchise business failed, the franchisee sued the franchisor for breach of the obligation in the franchise contract to provide reasonable assistance in the site selection. The jury awarded a verdict in the franchisee's favor; and the appeal court upheld the verdict.

21 24 Misc.3d 843, 878 N.Y.S.2d 602, 2009 N.Y. Slip Op. 29198 (N.Y. S. Ct. 2009).

22 The buyer deposited $180,000, which he agreed to forfeit if he failed to pay the balance. Madoff's fraudulent scheme was discovered between the times the buyer signed and closed, leaving the buyer with no cash and, because he had lost his investments, with no ability to borrow moneys with which to pay the balance. He asked for a refund of the deposit, claiming impossibility excused his performance. The

court, holding for the seller, muddled through the impossibility defense, finding the buyer "has utterly failed to provide any details as to the amounts lost, the nature of his lost investments, or the actual state of his current finances and assets." *Id*. at 848.

23 See text accompanying ch. 10, notes 7 and 8.

24 193 A.2d 72 (D.C. App. 1963).

25 23 How. 420, 64 U.S. 420, 16 L. Ed. 510 (1859).

26 220 F.2d 101 (3d Cir. 1955).

27 The subcontract did not state a date by which the steel was to have been delivered. A clause, however, allowed the general contractor to set the dates for delivery to avoid late completion. The contract also allowed the general contractor to terminate if the subcontractor should "at any time refuse or neglect to supply a sufficiency . . . of materials of the proper quality, . . . or fail, in the performance of any of the agreements herein contained." The general contractor treated the request for help as an anticipatory breach, terminated the contract, procured the steel from Bethlehem, and brought in new subcontractors to do the work contemplated by the agreement with the subcontractor. The general contractor sued the subcontractor for breach. At completion of the trial, the judge granted the subcontractor's motions for judgment on the grounds the general contractor had failed to state a cause of action, holding the subcontractor had not anticipatorily breached by requesting help. The appeal court affirmed.

28 "Despite the circumstances there is no indication in the letter that [the subcontractor] Minweld had definitely abandoned all hope of otherwise receiving the steel and so finishing its undertaking. One of the mentioned producers might have relented. Some other supplier might have turned up." *Id*. at 104.

29 757 F.2d 752 (6th Cir. 1985).

30 KMC had not repudiated or breached. The uncertainty was whether its financial condition had so deteriorated as to indicate it was or would become unable to repay the bank. An inadequate response might increase its risk of default by KMC, though because the bank was fully secured that risk was not considered significant. An overreaction by the bank to the uncertainty would put it in breach, as it did.

31 KMC sued Irving for breach of contract, claiming Irving had a duty to perform in good faith, and that duty was breached by failing to give advance notice it would not make advances when it was fully secured and had a blocked account into which KMC's funds were paid. The magistrate who tried the case awarded a verdict in favor of KMC, and Irving unsuccessfully appealed.

32 722 F. Supp. 1087 (S.D.N.Y. 1989).

33 Travellers sought a permanent injunction to prevent termination. The court held neither of the events cited by TWA breached the contract and granted the requested injunctive relief.

34 The court, at the outset of its discussion of the issues, noted, "In an exercise of candor and reality, TWA has urged, appropriately, that the driving force for the termination was the economic effect of the Contract as perceived by Icahn. Regrettably for TWA, however, even assuming the effect was as believed by Icahn, Travellers' profit does not provide a ground for contract termination." *Id*. at 1096.

35 789 F. Supp. 48 (D. Mass. 1992).

36 Comdisco sued for breach of contract; Money Management claimed that because Comdisco would have access to SunGuard's proprietary software and confidential information, the purpose of the contract had been frustrated and performance had become impossible. The court granted Comdisco summary judgment on the issue, holding frustration was not applicable when the party claiming the defense controlled the occurrence of the frustrating event, the event was foreseeable, Money Management's information was protected by the obligation in the contract to keep such information confidential, and Comdisco's performance had not lost its value to Money Management because it still received disaster recovery services.

37 853 F. Supp. 791 (S.D.N.Y 1994).

38 The company sued the publisher for breach. Because a clause in the draft contract that specifically gave the publisher a right to terminate—"[t]he Publisher shall not be obligated to publish the Literary work if, whether before or after acceptance thereof, supervening events or circumstances since the date of this agreement have, in the sole judgment of the Publisher, materially adversely changed the economic expectations of the Publisher in respect to the Literary Work at the time of the making of this agreement"—had been deleted during negotiation, the company argued the publisher could not terminate. The company moved for summary judgment, based in part on the deletion of the quoted clause, but the motion was denied because the court had not received any evidence explaining the deletion.

39 725 F. Supp. 189 (S.D.N.Y. 1989).

40 See text accompanying notes 21–23.

41 See text accompanying notes 10 and 11.

42 8 Exch. 40; 155 ER 1250, 22 L.J. (Ex.) 97 (1852); reversed sub nom. Hastie v. Couturier, 9 Exch. 102, 156 ER 43 (1853); *aff'd* 5 H.L. Cas. 673; 10 ER 1065, 25 L.J. (ex.) 253; 28 L.T. (O.S.) 240; 2 Jur. (N.S.) 1241 H.L.; 12 Digest (Repl.) 414 (1856).

43 See text accompanying note 25.

44 563 F.2d 588 (3d Cir. 1977).

45 *Id*. at 600.

46 *Id*.

47 899 F. Supp. 1490 (E.D. Va. 1995).

48 The generator successfully sued for declaratory relief that the contract had been wrongfully terminated. The court held the utility could not terminate as it purported to do.

49 "It is undisputed that [the utility] . . . suffered no damage as a consequence of the fact that there was no letter of credit in place from June 30, 1995 to July 6, 1995 and that injury, actual or potential, to [the utility] . . . in consequence of the breach was not considered in deciding to terminate the Agreement." *Id*. at 1494.

50 4 N.E.3d 696 (Ind. App. 2014), Med & Med GD (CCH) P 304, 801, *aff'd* in part, vacated in part, 51 N.E.3d 150 (Ind. 2016).

51 *Id*. at 153.

52 *Id*. at 156.

53 *Id*. at 155.

54 The agency sued for breach of contract. The trial court found the agency failed to prove that IBM materially breached the contract and that IBM had substantially performed the contract. The state appeal court reversed the trial court on the material breach issue, finding that IBM materially breached the contract. The Indiana Supreme Court held the trial court erred in finding that IBM had not materially breached the contract, as it ignored evidence that the agency was dissatisfied with IBM's performance.

55 "The reports are replete with instances where company agents, as here, obtained payment of the full annual premium in advance on the broad representation that there would be interim coverage pending the company's investigation of the application and its action thereon." Allen v. Metropolitan Life Ins. Co., 44 N.J. 294, 208 A.2d 638 (N.J. 1965).

56 *E.g.*, Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643,100 S. Ct. 1925, 64 L. Ed. 2d 580 (1980), where beer wholesalers were liable under antitrust laws for price-fixing for allegedly agreeing to require their buyers to pay in advance for wholesale beer deliveries.

57 "As a general rule, the carrier has the option to demand payment of freight in advance or on delivery. And, as there is a lien on the goods to secure the payment of charges, it is often a matter of indifference whether the freight is collected at the beginning or at the end of the transportation." Wadley Southern Railway Co. v. Georgia, 235 U.S. 651, 59 L. Ed. 405, 35 S. Ct. 214 (1915).

58 816 F.2d 965 (4th Cir. 1987).

59 968 F.2d 121 (1st Cir. 1992).

60 The bankruptcy court ruled in favor of the lender; the supplier successfully appealed. The court held that the supplier had revived the seniority of its security interest in the products it supplied and the proceeds thereof in the lockbox when it objected to the deposit of proceeds from the sale of its products into the lockbox.

61 See text accompanying ch. 11, notes 134–36.

62 157 F.3d 956 (2d Cir. 1998).

63 The supplier sued the lender for the final payment, claiming the lender had been unjustly enriched by its supply of the equipment; the lender moved to dismiss, which motion was granted; and the appeal court affirmed.

64 717 F.2d 230 (5th Cir. 1983).

65 The seller sued the bank. The district court found that, notwithstanding that the demand did not conform as the bank concluded, the bank was liable because the defects in such demand were curable and the bank kept the documents. The appeal court reversed, holding that since a condition of the bank's obligation to pay was tender of documents that strictly conformed, the district court erred in finding the bank liable.

66 BLACK'S LAW DICTIONARY, *supra* note 1, 821.

67 806 F. Supp. 835, 839 (E.D. Mo. 1992).

68 The distributor sued, claiming the refusal of the consent to the sale of its shares breached the contract. Both partiers sought summary judgment. The court granted Whirlpool's motion and denied the distributor's. The court said, "The Agreement does not require Whirlpool to provide justification for its decision to reject transfer." *Id*.

69 888 F.2d 260 (2d Cir. 1989).

70 The arbitrators held that the ownership transfers did not constitute breaches or were immaterial or had been waived. The court affirmed these findings, holding that a share transfer did not violate the antiassignment clause. The court also held a transfer of shares within the family of companies without the required consent was not a material breach and did not justify termination of the contract.

71 BLACK'S LAW DICTIONARY, *supra* note 1, 1154.

72 *Id*. at 1566.

73 *Id*. at 1676.

74 *Id*. at 1581.

75 *Id*. at 762.

76 *Id*. at 1700.

77 730 F.2d 186 (5th Cir. 1984).

78 The lessor filed suit for the missed payment. The lessee, as provided in the lease, tendered the purchase price for the vessel at the end of the lease, subject to the lessor providing merchantable title; the lessor failed to respond. The mortgagees holding the vessel mortgages notified the lessee they intended to foreclose on the vessel; the lessee purchased the mortgages. The district court awarded judgment against the lessee, who appealed; and the appeal court reversed, holding that under Uniform Commercial Code section 2-609, "[the lessee] PCC need only prove it had reasonable doubt that [the lessor] CPMT would provide merchantable title, and need not prove, for example, that CPMT was insolvent, so long as the doubt is otherwise reasonable." *Id*. at 189. The court held the clause providing "Payment of Charter Hire shall not be foregone or suspended by reason of the happening of any event whatsoever except a total loss of the Vessel" was subject to the lessee's right to suspend performance.

79 399 B.R. 388, 171 Oil & Gas Rep. 646, 51 Bankr. Ct. Dec. 20, Bank. L. Rep. P.81 (Bankr. Del. 2009).

80 2014 WL 273855 (D. Conn. 2013).

81 See text accompanying ch. 3, note 28.

82 242 Kan. 683, 751 P.2d 122 (Kan. 1988).

83 *E.g.*, In re Milano Textiles, Inc., 38 B.R. 964 (Bankr. D. Mass. 1984), where a debtor's funds were ordered by a court to be held in escrow in a bank account in the name of one of the secured parties, who paid its attorney fees from the account without authorization from the court. The debtor claimed the payment was an improper use of the funds in the account, and the bankruptcy court agreed, finding, "It is clear from the terms of the intercreditor agreement and the court order that all five secured lenders had an interest in the collateral and that the court did not want the money disbursed until their respective rights could be determined." *Id*. at 967.

84 BLACK'S LAW DICTIONARY, *supra* note 1, 489.

85 See text accompanying ch. 9, notes 2–16.

86 See text accompanying notes 26 and 27.