EQUITABLE DOCTRINES OPERATING AGAINST THE EXPRESS PROVISIONS OF A WRITTEN CONTRACT (OR WHEN BLACK AND WHITE EQUALS GRAY)

by Thomas P. Egan*

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* Thomas P. Egan, B.S., M.B.A., J.D. DePaul University; C.P.A., Mr. Egan is a member of the Illinois Bar and is an associate at the Chicago law firm of Smith Williams & Lodge, Chartered. Mr. Egan is also the recipient of an American Jurisprudence award for contract law.

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say they do not make contracts for the parties, judges regularly use these equitable doctrines to decide cases in a manner inconsistent with a written agreement. To understand why these doctrines exist, the article first discusses the historical and philosophical basis of contract law. Then, the article discusses the elements of an action for breach of contract. Thereafter, the article provides a practical discussion of certain equitable doctrines which can operate against the express provisions of a written contract.

II. OVERVIEW OF THE HISTORICAL AND PHILOSOPHICAL BASIS OF CONTRACT LAW

A comprehensive discussion of the historical and philosophical basis of contract law is beyond the scope of this article. However, some knowledge of this subject is important for understanding the doctrines discussed herein. With such understanding, parties to a contract may better grasp their rights and duties under the contract.

"[M]any of the rules of present day contract [law] can only be explained by looking to their historical origins." 10 The early evolution of the law of contracts is illogical, confusing and need not be detailed here. 11 It is sufficient to note that the common law in England began with the view that promises were generally not enforceable. 12 The narrow and rigid writ system of the common law courts provided only a few status-oriented forms of action which frustrated the demand for claims involving informal, consensual transactions. 13 As such demand increased, the common law

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1. See Friedman, supra note 4, at 15.
2. See infra notes 163-201 and accompanying text.
4. This article looks at doctrines which affect the operation of a contract. Doctrines such as fraud, mistake and duress also operate against an express contract but attack the formation of the contract. Although the doctrines of unconscionability and promissory estoppel are also primarily concerned with the formation of contracts, courts often use such doctrines to strike down particular clauses in a contract. Therefore, unconscionability and promissory estoppel affect the operation or performance stage of many contracts.
courts resorted to the tort theory of assumpsit to enforce certain promises.\footnote{14} Common law courts originally used assumpsit where there was a misfeasance in the performance of an undertaking.\footnote{15} Eventually such courts expanded the action of assumpsit by enforcing a promise to perform if the promisor was guilty of nonfeasance, but only where the promisee detrimentally relied on the promise.\footnote{16} Later, the common law courts made a second expansion of the action of assumpsit by allowing recovery in situations where nonfeasance occurred after the parties merely exchanged mutual promises.\footnote{17} This second expansion was based on the view that a party suffers a detriment when giving a promise since that party’s freedom of action is restrained by such promise.\footnote{18}

The interest of the promisee upon a bare exchange of promises has been described as the “expectation interest.”\footnote{19} “Protection of the expectation interest is justified because it is the most effective way of protecting the available in appropriate cases. In a writ of debt the defendant was ordered to transfer a sum of money, or a fixed quantity of fungible goods.” SCOTT AND LESLIE, supra note 1, at 4-5. \footnote{20} “Another form of the writ of debt, relevant for our purposes, was debt on an obligation.” SCOTT AND LESLIE, supra note 1, at 5. \footnote{21} “The shortcomings of the writ of debt were several. It was subject to the wager of law. It was available only when a sum of money had been fixed at the time of agreement.” SCOTT AND LESLIE, supra note 1, at 5.

14. Farnsworth, \textit{Introduction to Contract}, supra note 12, at 594. “In medieval times ‘trespass’ embodied the concept of a wrong.” SCOTT AND LESLIE, supra note 1, at 5. “The action for misfeasance became known as assumpsit (‘he undertook’). [Originally], [a] mere failure to perform a promise could not secure an assumpsit, for a promise was not an undertaking . . . As the common law courts began to allow assumpsit actions to enforce promises, [the] problem confronting lawyers [became] how to plead an assumpsit that was not defective on the ground that the duty was not owed . . . Instead of debt, lawyers use[d] . . . a form of trespass on the case known as indebitatus assumpsit. The writ merely said that the defendant, being indebted to the plaintiff, had subsequently promised to pay . . . \textit{Indebitatus assumpsit} was popular with plaintiffs for this reason, and because assumpsit actions permitted a jury trial instead of a writ of law even when the obligation was under seal.” SCOTT AND LESLIE, supra note 1, at 6.

15. Scott & Leslie, supra note 1, at 6.

16. Farnsworth, \textit{Introduction to Contract}, supra note 12, at 595. “In a society that depends upon promises for cooperation, there is justification in protecting those who rely on promises by placing the cost of the waste occasioned by broken promises on those that break them through requiring the party in breach to compensate the injured party in an amount sufficient to put him in as good a position as he would have been in had the promise never been made. This interest is called the ‘reliance interest’…” Farnsworth, \textit{Introduction to Contract}, supra note 12, at 595.

17. Farnsworth, \textit{Introduction to Contract}, supra note 12, at 596. It was only through the action of assumpsit that a wide variety of contracts without a sealed instrument became effective. \footnote{16} SAMUEL WILSON, WILSON ON CONTRACTS, \textsection 106, at 368 (rev. ed. 1936) [hereinafter Wilson].


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terest.”\footnote{23} Reliance is often difficult to prove so “[t]o encourage reliance we must therefore dispense with [its] proof.”\footnote{24} As such, recovery should be based on “a promise independent of reliance, both in the sense that in some cases the promise is enforced though not relied on (as in the bilateral business agreement) and in the sense that recovery is not limited to the detriment incurred in reliance.”\footnote{25}

This discussion has so far led to a relatively advanced stage in the development of contract. One commentator succinctly described the stages of such development as follows:

The development of contract, it often has been observed, can be divided into three stages, which correspond to the history of economic and legal institutions of exchange. In the first stage, all exchange is instantaneous and therefore involves nothing corresponding to ‘contract’ in the Anglo-American sense of the term. Each party becomes the owner of a new thing, and his rights rest, not on a promise, but on property [i.e., the title theory of exchange]. In a second stage, [e]xchange first assumes a contractual aspect when it is left half-completed, so that [only] an obligation on one side remains. The third and final stage in the development occurs when the executory exchange becomes enforceable. According to orthodox legal history, when English judges declare at the end of the sixteenth century that every contract executory is an assumpsit in itself,\footnote{23} and that a promise against a promise will maintain an action upon the case, the conception of contract as mutual promises has triumped . . . . Damages were soon assessed . . . not upon the theory of reimbursement for the loss of the thing given for the promise, but upon the principle of compensation for the failure to obtain the thing promised.\footnote{24} The common law courts were still not ready to enforce all promises though. “During the sixteenth century the word ‘consideration’ . . . came to be used as a word of art to express the sum of the conditions necessary for an action in assumpsit to lie.”\footnote{25} Promises became enforceable only under those circumstances in which the action of assumpsit was allowed, i.e., only where there was “consideration.”\footnote{26} Courts, then, used consideration as the test of enforceability of all promises and used it to distinguish


23. Slade v. Morely (Slade’s Case), 4 Co. Rep. 91a, 76 Eng. Rep. 1072 (1602). Slade’s Case provided common law courts with the foundation to replace “the old contract writs with assumpsit as a general contract action for the enforcement of informal promises.” \textit{Teven}, supra note 10, at 50. As a result of \textit{Slade’s Case}, assumpsit became the primary action for breach of contract. SCOTT & LESLIE, supra note 1, at 6.


promises that common law judges deemed significant enough to justify their legal enforcement under assumpsit.  

The idea of an exchange arrived at by way of bargain ("quid pro quo") became the most important element of consideration.  

Although it encompassed most important commercial agreements, "[t]he doctrine of consideration provided no ground for the enforceability of gratuitous promises, for which nothing is given in exchange." Hence, the common law courts seemingly rejected protection of the bulk of the reliance interest at this stage, even though the reliance interest had been a key link in the evolution of合同 law.  

Despite the key role of the doctrine of consideration in the law of contract, the doctrine has been widely criticized and cannot be understood outside of the historical and social context which produced it.  

One commentator said that the basis of the evolution of contract law is that "[a]s freedom became a rallying cry for political reforms, freedom of contract was the ideological principle for the development of the law of contract." However, true freedom of contract did not develop until relatively recently in history.  

"[A]s late as the eighteenth century, contract law was still dominated by a title theory of exchange and damages were set under equitable doctrines that ultimately were to be rejected by modern contract law."  

An excellent summary of the rise of modern contract law by Professor Horowitz deserves quotation:

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27. Farnsworth, Introduction to Contract, supra note 12, at 598. "[T]he common law, in actions of debt and assumpsit, had defined consideration as consisting of any benefit to the promise or detriment to the promisee." Richard E. Speidel, An Essay on the Reported Death and Continued Vitality of Contract, 27 STAN. L. REV. 1161, 1168-71 (1975), reprinted in SCOTT & LESLIE, supra note 1, at 31.  

28. Farnsworth, Introduction to Contract, supra note 12, at 598. In common law debt actions, "[t]he court was necessary to show that the defendant had received some benefit (the 'quid') in return for which (pro quo) the defendant was obligated in Debt." TEEVEN, supra note 10, at 11. "Quid pro quo was an evidentiary requirement, and hence if the plaintiff had a sealed specialty, quid pro quo was not required." TEEVEN, supra note 10, at 11. In cases of misfeasance or non-feasance, the common law courts based recovery on the injury or detriment suffered by the plaintiff due to reliance on the defendant's promise. WILLISTON, supra note 17, at 398. In other cases, the common law courts enforced the defendant's promise due to a debt which originally arose through some benefit received by the defendant from plaintiff. WILLISTON, supra note 17, at 369. "It is from the two classes of cases that the frequently quoted alternative in definitions of consideration, a detriment to plaintiff or a benefit to the defendant, is derived." WILLISTON, supra note 17, at 369.  

29. TEEVEN, supra note 10, at 11.  

30. See supra note 16 and accompanying text. After expansion of assumpsit to cover mutual promises, courts virtually ignored reliance in the development of the doctrine of consideration. See E. ALLAN FARNSWORTH, CONTRACTS 89 (1982) [hereinafter FARNSWORTH].  


32. JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS 5 (2d ed. 1977) [hereinafter CALAMARI & PERILLO]. Commentators are fond of quoting Sir Henry Maine who said that the movement of progressive societies is from status to contract. Id.  

33. Horowitz, supra note 24, at 920.

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Modern contract law is fundamentally a creature of the nineteenth century. It arose in both England and America as a reaction to and criticism of the medieval tradition of substantive justice that, surprisingly, had remained a vital part of eighteenth century legal thought, especially in America. Only in the nineteenth century did judges and jurists finally reject the longstanding belief that the justification of contractual obligation is derived from the inherent justice or fairness of an exchange. In its place, they asserted for the first time that the source of the obligation of contract is the convergence of the wills of the contracting parties.  

Beginning with the first English treatise on contract, Powell's Essay Upon the Law of Contracts and Agreements (1790), a major feature of contract writing has been its denunciation of equitable conceptions of substantive justice as undermining the "rule of law." It is absolutely necessary for the advantage of the public at large, Powell wrote, that the rights of the subject should depend upon certain and fixed principles of law, and not upon rules and constructions of equity, which when applied . . . must be arbitrary and uncertain, depending, in the extent of their application, upon the will and caprice of the judge. The reason why equity must be arbitrary and uncertain, Powell maintained, was that there could be no principles of substantive justice. A court of equity, for example, should not be permitted to refuse to enforce an agreement for simple exorbitancy of price because it is the consent of parties alone, that fixes the just price of any thing, without reference to the nature of things themselves, or to their intrinsic value. . . . Therefore, he concluded, a man is obliged in conscience to perform a contract which he has entered into, although it be a hard one. . . . The entire conceptual apparatus of modern contract doctrine — rules dealing with offer and acceptance, the evidentiary function of consideration, and especially canons of interpretation — arose to express this will theory of contract.  

The preceding passage shows the tension between the concepts of individual freedom and social control. This tension ultimately was resolved in favor of individual freedom during the nineteenth century. During such period, American lawmaking was primarily concerned with expanding and strengthening this country's economic markets. Hence, contract law became grounded on the philosophy of the will theory whereby the state enforced contracts merely to accomplish the intent of the "private law established by the parties."

34. Horowitz, supra note 24, at 917-18.  

35. "This conflict is reflected in the two main theories of contractual liability. One, the will theory (also called the bargain or classical theory), emphasizes the autonomy of the individual. The other, the objective theory, bases contractual liability on the social consequences of promise-making. . . ." Friedrich Kessler, Introduction: Contract as a Principle of Order, in FRIEDRICH KESSLER ET AL., CONTRACTS (3d ed. 1986) [hereinafter KESSLER].  

36. Farnsworth, Introduction to Contract, supra note 12, at 599.  

37. Farnsworth, Introduction to Contract, supra note 12, at 599. A commentator provided this philosophical defense of the freedom of contract:

This general regime of freedom of contract can be defended from two points of view. One defense is utilitarian. So long as the tort law protects the interests of strangers to the agreement, its enforcement will tend to maximize the welfare
Nineteenth century theorists viewed the value of goods and services exchanged as subjective. Consequently, they reasoned that the law of contracts should not attempt to assure equity by interfering with private agreements. Instead, they viewed the role of contract law as simply to enforce transactions the parties voluntarily entered into with the expectation of mutual benefit.

Pure freedom of contract, if it ever really existed beyond theory, did not last long. Beginning in the late nineteenth century and continuing into the twentieth century, legislation based on public policy concerns removed many types of transactions and situations from the purview of common law contract doctrine. Specialized bodies of law such as labor law, anti-trust law and insurance law, as well as a host of social welfare legislation, directly intervened in contracts which would otherwise have been private matters. Another large intrusion on classical contract theory was the Uniform Commercial Code, which included provisions dealing with contracts for the sale of goods (Article 2) and the assignment of certain contract rights (Article 9). Courts often apply all the principles set forth in the Code to transactions outside its coverage.

Legislation was not the only means of eroding the principle of freedom of contract. Even in the nineteenth century, courts relied on equity principles in deciding certain types of cases. “The loss of individualism, of the parties to it, and therefore the good of the society as a whole. The alternative defense is on libertarian grounds. One of the first functions of the law is to guarantee to individuals a sphere of influence in which they will be able to operate, without having to justify themselves to the state or to third parties: if one individual is entitled to do within the confines of tort law what he pleases with what he owns, then two individuals who operate with those same constraints should have the same right with respect to their mutual affairs against the rest of the world.


38. Horowitz, supra note 24, at 947.
39. Horowitz, supra note 24, at 947.
40. Horowitz, supra note 24, at 947. A key aspect of this theory is that “the courts should operate as detached umpires or referees, doing no more than to see that the rules of the game were observed and refusing to intervene affirmatively to see that justice or anything of that sort was done. Courts do not, it was said, make contracts for the parties ... and there is to be no softening or blurring of the harsh limitations of contract theory ... .”

GRANT GILMORE, DEATH OF A CONTRACT 15 (1974) [hereinafter GILMORE].

41. FRIEDMAN, supra note 4, at 24.
42. FRIEDMAN, supra note 4, at 24; CALAMARI & PERILLO, supra note 32, at 5. It is argued, though, that these special bodies of law merely establish rules which facilitate private agreements. Gary L. Milhollin, More on the Death of Contract, 24 CATH. U. L. REV. 29, 50 (1974) [hereinafter Milhollin]. For example, disclosure statutes may require clear contract provisions but do not mandate many contract terms. KISSLER, supra note 35, at 11.

43. See CALAMARI & PERILLO, supra note 32, at 16.
44. CALAMARI & PERILLO, supra note 32, at 17.
45. See infra note 353 and accompanying text.

46. TEEVEN, supra note 10, at 217. Gilmore describes promissory estoppel (reliance) as the twin of quasi-contract (unjust enrichment). GILMORE, supra note 40, at 88. Promissory estoppel applies to situations where the plaintiff incurred a loss due to reliance on the defendant’s promise or representation. Quasi-contract applies to situations where plaintiff seeks compensation for a benefit conferred on the defendant. GILMORE, supra note 40, at 89.

47. FRIEDMAN, supra note 4, at 22.
48. Milhollin, supra note 42, at 54.
49. TEEVEN, supra note 10, at 326.

In the time, courts used the concepts of waiver and estoppel in contract actions, especially to counteract abuses associated with insurance contracts. One author argued that society must resort to doctrines such as materiality of breach to adjudicate problems in consensual transactions because legislation cannot encompass all the issues which arise in such transactions. Therefore, “[p]lanners of complex business transactions employ common law contract principles in every contract they draft, and courts must pick and choose between contractual doctrine, intent, and legislative policy in performing their duties . . . .”

III. ELEMENTS OF A BREACH OF CONTRACT ACTION

To establish the basic elements of an action based upon breach of contract, the plaintiff must show that a contract exists, that the defendant breached the contract, and that damages resulted. A party breaches a contract by failing to fulfill an obligation the party agreed to perform.

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brought on by the disparity of bargaining power during the industrial revolution, and the fusion of law and equity, influenced the development of supplemental equitable grounds for relief based on unjust enrichment and reliance.” In time, courts used the concepts of waiver and estoppel in contract actions, especially to counteract abuses associated with insurance contracts. One author argued that society must resort to doctrines such as materiality of breach to adjudicate problems in consensual transactions because legislation cannot encompass all the issues which arise in such transactions. Therefore, “[p]lanners of complex business transactions employ common law contract principles in every contract they draft, and courts must pick and choose between contractual doctrine, intent, and legislative policy in performing their duties . . . .”

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47. FRIEDMAN, supra note 4, at 22.
48. Milhollin, supra note 42, at 54.
49. TEEVEN, supra note 10, at 326.
50. The existence of a contract depends upon mutual assent to an agreement (i.e., offer and acceptance) and consideration. Jackson v. Union-North United Sch. Corp., 582 N.E.2d 854, 857 (Ind. Ct. App. 1991); Redick v. Kraft, Inc., 745 F. Supp. 296 (E.D. Pa. 1990). The signing of a document usually provides sufficient evidence of mutual assent for “when persons who are competent to execute contracts, ... sign their name ... to a written agreement the presumption arises that they knew and understood the nature of the contract.”

Brown v. Indiana Dep’t of Conservation, 225 N.E.2d 187, 191 (Ind. Ct. App. 1967) (citing 17A C.J.S. Contracts § 584 at 1123-24 (1963)). As such, the law of contracts imposes a duty to read a contract. “[O]ne having the capacity to understand a written document who reads it or without reading it ... signs it, is bound by his signature.”

GRANT GILMORE, supra note 32, at 329 (quoting Rossi v. Douglas, 100 A.2d 3, 7 (Md. 1953)).


 Courts may consider an intentional breach to be wilful and wanton. The issue of who breached an agreement is a question of fact. A party who wishes to sue for breach of contract must show that it did not fail to tender its performance. If the plaintiff did not tender performance, the plaintiff must show "that he was ready, willing, and able to comply but has a valid excuse for his nonperformance." For example, if the court finds that the defendant prevented performance by the plaintiff, that performance will be excused. A plaintiff may find a valid excuse for nonperformance in the doctrines of material breach, modification, waiver, good faith, unconscionability and promissory estoppel. Such doctrines, among others, are the subject of the rest of this article.

IV. MATERIALITY OF BREACH

It is important to recognize that "[a] party first guilty of a material breach of contract may not maintain an action against the other party or seek to enforce the contract against the other party should that party subsequently breach the contract." Therefore, even where a party is guilty of a minor or technical (i.e., immaterial) default under a contract, that party's performance may be excused where the party loses the benefit of its bargain due to the other party's default. This section explores the principles, development, and application of the doctrine of material breach.

A. Independent Promises (Covenants) v. Conditions

Contracts involve promises by the parties which define their mutual obligations. Also, contracts often involve conditions on such promises which may be express or implied. A condition is an event, not certain to occur, that gives rise to a duty to perform, and where performance is predicated on such a condition, the nonoccurrence of that condition excuses performance; however, conditions are not favored under law, and performance will be excused only where the intention to create the condition is expressed in clear language or appears by clear implication.

In some contracts, a condition may be the performance of the other party's promise. However, some promises are so plainly independent that a court could never fairly construe such promises to be conditions of one another. In the earliest contract cases, courts considered covenants to be independent. As a result, contractual terms are generally presumed to represent independent promises rather than conditions. No performance is due where a failure of a condition to such performance occurs. A court, then, must determine whether a defendant breached a condition of an agreement excusing the plaintiff's performance or breached an independent covenant not excusing such performance.

One of the most difficult questions regarding a breach of a contract is whether the breach is substantial enough to justify suspension of performance by the other party. A determination that a breach is not material means, in technical terms, that such breach does not have the effect of the nonoccurrence of a contractual condition which would allow the injured party to seek rescission and forfeiture of the contract. An immaterial breach may be compensable in damages though. In determining whether a defendant breached independent covenants or conditions to the plaintiff's performance, a court should recognize that society's interests are served by protecting a party's justified expectations. However, "it is not in society's interest to permit a party to abuse this protection by using an insignificant breach as a pretext for avoiding [the party's] contractual obligations."
B. Substantial Performance Doctrine

At common law, the courts relied on a long standing principle that performance in accordance with the terms of the contract was required in order to recover in an action on the contract (i.e. the "perfect tender rule"). The corollary is that full performance acts as a discharge; anything less does not. This lessened the burden of an injured party who otherwise would have to complete his performance and then sue for rescission. Even so, the courts occasionally ignored minor defects in performance under the principle de minimis non curat lex (the law does not concern itself with trifles).

Eventually, the courts developed the doctrine of substantial performance to deal with the relatively simple case in which the party in breach had finished performing and the injured party refused to pay the price because the performance was slightly defective or incomplete. The doctrine of substantial performance "seems to have been adopted from the rule governing dependent promises where no express condition qualifies the promise of the defendant and his only excuse is the failure of the plaintiff to [fully] perform his promise. In such case, if the plaintiff has substantially performed, the defendant is liable." One effect of the substantial performance doctrine is to reduce "opportunistic claims by removing opportunities to exploit inadvertent breaches."

The substantial performance doctrine was developed in the context of construction contract cases. It is axiomatic today that builders are not required to perform perfectly. This axiom resulted from cases which diverted from the perfect tender rule. In *Spence v. Ham*, the court said that where the builder has made a good faith attempt to comply with the contract and has substantially done so, although there may be slight defects caused by inadvertence or unintentional omissions, he may recover the contract price less the damages on account of such defects.

In *Jacob and Youngs, Inc. v. Kent*, the court clearly established the idea that covenants can be independent. Consequently, a party is bound to perform under an independent covenant regardless of the performance of the other party. By deeming covenants as independent, courts created a basis upon which to require performance by one party where defects in the performance of the other party do not seriously impair the value of the rendered performance. Using such basis, the court in *Winn-Senter Construction Co. v. Katie Franks, Inc.*, recently ruled that substantial performance must be accepted and strict compliance within the contract is not required.

Although the doctrine of substantial performance is more easily applied to building and construction contracts, this doctrine is not limited in its application to such contracts. The following conditions established by one court for application of the substantial performance doctrine implies the doctrine's wide purview: (a) a good faith effort to perform has been made; (b) the results of the tendered performance are beneficial to the other party; and (c) the benefits are retained by the other party. A willful breach is often said to preclude a party from invoking the doctrine of substantial performance. However, the doctrine of substantial performance may possibly be invoked where a breach, although intentional, is due to a belief that performance was not required.

C. Material Breach Doctrine

The doctrine of material breach evolved from the doctrine of substantial performance. The doctrine of material breach is simply the converse of...
the doctrine of substantial performance.87 No material breach can exist where a court finds substantial performance.

Contract law always has distinguished between material and immaterial breaches.88 Jacob and Youngs, Inc. expressed the real reason behind court decisions relying on ancillary doctrines such as waiver: "[S]ome breaches are less important than others and some are so insignificant as not to matter."89 "The materiality of a party's breach is questioned when the injured party seeks to use that breach to justify his own refusal to proceed with performance."90 Only a material breach gives the injured party the right to rescind the contract.91

There are a number of definitions of material breach which all revolve around the same theme.92 For example, one court found a material breach to be one that " touched the fundamental purposes of the contract and defeats the object of the parties in making the contract."93 Other courts find a breach material if it defeats the purpose of the contract "or goes to the heart of the contract."94 Further, a material breach has been defined as one that would justify the other party to suspend his own performance of the contract.95

The foregoing definitions are vague but establish that only a material breach justifies suspension of performance by the non-breaching party.96 As such, a party cannot use an insignificant breach by the other to terminate the contract.97 Furthermore, changes in economic conditions cannot provide a basis for rescission of a contract, nor can the fact that the value of the bargain has decreased be an excuse for non-performance.98

Conversely, if one party materially breaches a contract, the other party need not perform.99 However, if a party suspends performance in response to an immaterial breach, that party commits a breach of the contract.100 Therefore, an injured party takes precipitous action against the other party at its own risk since such action may cause the injured party to become the transgressor.101 This is because the existing rights of the parties to the contract do not change as a result of an immaterial breach.102 Parties should recognize, however, that it is difficult to determine when a party's retaliatory conduct is precipitous, rash, or premature.103

The doctrine of materiality applies to all contracts regardless of the timing of performance.104 The materiality of a contractual breach is a question of fact reserved for the fact finder.105 While it is agreed that there is no single definition of materiality,106 courts usually look to the Restatement (Second) of Contracts section 241 ("Section 241") in determining whether a breach of contract is material.107 Section 241 sets forth the following factors to be used in determining whether breaches are material:

(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 the benefit of which he will be deprived;
(c) The extent to which the party failing to perform or to offer to perform will suffer forfeiture;

87. FARNSWORTH, supra note 30, § 8.16, at 612.
89. HUNTER, supra note 63, § 2.02[1], at 2-8 (citing Jacob and Youngs, Inc., 129 N.E. 889, 891 (N.Y. 1921)).
90. Jacob and Youngs, Inc., 129 N.E. at 891.
92. A material breach of contract "goes to the whole consideration of the contract..." 17 AM. JUR. 2d Contracts § 446 (1964), or goes to the root or essence of the contract. 6 WIListon, supra note 17, § 842.
100. The concept of "first material breach" has been used in many cases. See Licocci v. Cardinal Assoc., Inc., 492 N.E.2d 48 (Ind. Ct. App. 1986); Lawrence v. Cain, 245 N.E.2d 663 (Ind. Ct. App. 1969); K & G Construction Co. v. Harris, 164 A.2d 451 (Md. 1960); Palmer v. Fox, 264 N.W. 361 (Mich. 1936). See also, FARNswORTH, supra note 30, § 8.16, at 611; Restatement (Second) of Contracts § 237 (1981).
105. Canada Dry Corp. v. Nehi Beverage Co., 723 F.2d 512, 517 (7th Cir. 1983); Sahadi v. Continental Ill. Nat'l Bank & Trust Co., 706 F.2d 193, 196 (7th Cir. 1983); FARNswORTH, supra note 30, § 816, at 612.
of a franchise agreement. Similarly, in McKee v. First National Bank of Brighton,115 the court found a material breach where borrower failed to subordinate its interests in land to the bank as required by the construction loan commitment. The foregoing examples show that courts usually focus only on major events to find a material breach. Such major events must impair the substance of the contract and defeat the object of the parties entering into the contract in order to be a material breach.

Numerous cases exist where courts found breaches to be immaterial. Such cases are often based on the fact that courts do not favor express conditions precedent where the condition is not part of the subject matter of the exchange.116 In Jackson v. Richards S & 10, Inc.,117 the court found the express conditions of a contract that plaintiff/buyer of businesses pay off certain minor accounts and provide evidence of having done so bore no substantial relationship to the proposed sale of two businesses. The court held that breach of those conditions did not give defendant/seller the right to exercise a forfeiture clause.118

In Women's Federal Savings & Loan Association of Cleveland v. Nevada National Bank,119 the court held that an Ohio lender was not entitled to rescind a loan participation agreement as the result of a Nevada lender's breach of its obligations to establish custodial and impound accounts and to disclose to the Ohio lender financial data it received concerning the deteriorating financial condition of the borrower. The court said that "a partial failure of performance of a contract will not suffice as a basis for rescission unless it defeats the very object of the contract, or unless the failure concerns a matter of such prime importance that the contract would not have been made if default in that particular had been contemplated."1120

Another case where the court determined a breach to be immaterial is Dr. Franklin Perkins School v. Freeman.121 In Dr. Franklin a parent signed a tuition agreement with the school which was conditional upon the school's application for reimbursement from the State. The court held that the school's failure to make such application was an immaterial breach. The court said that the failure of the school to apply for the reimbursement did not deprive Dr. Freeman of any benefit under the contract since the school continued to educate and care for his child.122

An important case where the court found immaterial breaches is Canada Dry Corp. v. Nehi Beverage Co., Inc.123 In Canada Dry, the court of

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116. CORBIN, supra note 64, § 748.
118. Id. at 895.
120. Id. at 1135.
121. 741 F.2d 1503 (7th Cir. 1984).
122. Id. at 1518 (citing RESTATEMENT (SECOND) OF CONTRACTS §§ 237, 241(a) (1981)).
123. 725 F.2d 512 (7th Cir. 1983).
appeals upheld an award of damages to Nehi resulting from Canada Dry’s wrongful breaches of a franchise agreement. Despite the fact that Canada Dry could cite fourteen breaches of the franchise agreement, the court concluded that “after reviewing the evidence there was sufficient dispute concerning each of the asserted breaches of the franchise agreement that a jury could have reasonably concluded that these alleged breaches were not material and did not justify termination of the franchise agreement.”

The foregoing examples of immaterial breaches show that courts will grant rescission and allow forfeiture of a contract only when there has been a considerable breach which (1) goes to the heart of the agreement, (2) has caused the aggrieved party irreparable injury and (3) involves more than a mere variance of contract terms.

2. Compensation

When considering Section 241(b), courts look to the possibility of damages as an adequate remedy in lieu of complete forfeiture. In Foundation Development. Corp. v. Loehmann’s, Inc., the anchor tenant of a large shopping center was three days late in payment of its lease. The lessor claimed material breach and sought forfeiture of the contract. However, the court held that “as to subsections (a) and (b) . . . [f]oundation at most would be deprived of the benefit of its bargain for two days . . . . Furthermore, it may adequately be compensated by a judgment of damages for any loss of interest.” Due to subsection (b) of Section 241, courts are less likely to find a breach to be material where the transgressing party claimed material breach and sought forfeiture of the contract. However, the court was still concerned about a disproportionate forfeiture and only canceled that portion of the contract which had been directly affected by the breach.

3. Forfeiture

“Courts disfavor what they refer to as forfeiture. In the context of conditions, this means that courts prefer to interpret an agreement in a way that gives effect to the apparent agreement rather than to interpret it in a way that removes the obligation to perform by finding a condition as opposed to a covenant, that has not been performed.”

In Skendzel v. Marshall, the Supreme Court of Indiana expressed its reservations about forfeitures. The Skendzel court held that “it is wholly against conscience to say that because a man has stipulated for a penalty in case of his omission to do a particular act - the real object of the parties being the performance of the act - if he omits to do the act, he shall suffer a loss which is wholly disproportionate to the injury sustained by the other party.” In other words, a court may excuse the nonoccurrence of a condition where a disproportionate forfeiture would occur unless the occurrence of the condition was a material part of the agreed exchange.

In Goff v. Graham, the purchaser contracted for five parcels of land. Pursuant to the agreement, each parcel required insurance. A clause in the document provided for acceleration of payment upon the purchaser’s failure to provide insurance. After payment of the first installment, the purchaser failed to obtain the insurance and also failed to make any further payments. The vendor pressed for forfeiture of the contract and in light of the surrounding circumstances, the court deemed forfeiture appropriate. The court allowed forfeiture of the property because the purchaser had paid only a single installment on the property. Very little time, energy, and money had been invested by the purchaser so a forfeiture would not be disproportionate.

Even a material breach may not be grounds for a disproportionate forfeiture. In Utah International, Inc. v. Colorado-Ute Electric Association, Inc., the parties had entered into a thirty-five year requirements contract to supply fuel. The terms of the agreement were premised upon a specific generator size so that when the defendant increased the size of the generator, a material breach of contract resulted. The Utah International court recognized that “forfeitures pursuant to a forfeiture provision in a contract are not looked upon with favor and will be avoided if possible.” However, the breach was found to be material because it was “more than a mere variance of the contractual terms and . . . threaten[ed] to do irreparable damage to the plaintiff.” Despite the clear material breach, the court was still concerned about a disproportionate forfeiture and only canceled that portion of the contract which had been directly affected by the breach.

4. Time to Cure

The opportunity to cure ensures that immaterial breaches are not used as a pretext for forfeiture of a disadvantageous contract. “Although a
material breach justifies the injured party in suspending performance, it does not of itself justify him in terminating the contract. Fairness ordinarily dictates that a breaching party be allowed a period of time - even if only a short one - to cure the breach if he can.143 Whether a material breach has remained uncured for long enough to justify termination is a question of fact, much like the question whether the breach is material in the first place.144

The Restatement (Second) of Contracts section 237 addresses the principle of curing a defective performance. It states that "[e]xcept as stated in § 240, it is a condition of each party's remaining duties to render performances that may be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance at an earlier time."145 Accordingly, courts consistently rule in favor of a breaching party's right to cure.

In United States v. Packwood,146 a defendant was charged with materially breaching the terms of his plea agreement. The court emphasized the importance of granting a party the right to cure a deficient performance and held that "contract principles ... would seem to require that in a case such as this one where the defendant does not know his inaction is being treated as a breach, the government give him timely notice and an opportunity to cure. The need to give a breaching party notice of the breach and an adequate opportunity to cure it is basic to contract law."147

The opportunity to cure a deficient performance is not without limits. The Restatement (Second) of Contracts section 242 sets forth several significant factors in determining when the opportunity to cure ceases. Such factors include:

(a) those stated in § 241;148
(b) the extent to which it reasonably appears to the injured party that delay may prevent or hinder him in making reasonable substitute arrangements;
(c) the extent to which the agreement provides for performance without delay, but a material failure 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 ... by that day is important.149

The foregoing discussion demonstrates that an injured party to a contract should act upon a breach only after providing the breaching party with an opportunity to cure. Courts may use the absence of a cure period to find that the injured party’s actions were precipitous or premature. An injured party should be justified in canceling the contract where a cure does not result from an opportunity to do so.

5. Good Faith and Fair Dealing

Under subsection (e) of Section 241, another criterion for materiality is whether the conduct of a party is consistent with standards of good faith. A covenant of good faith and fair dealing inheres in most, if not all, contractual relationships.150 When assessing the materiality of a breach, courts look at the intent of the breaching party.151 Intent is significant because it reveals an increased probability that the victim cannot expect proper performance in the future.152

Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness.153154 "[I]nconsistency with the 'justified expectations of the other party' and the violation of 'community standards of decency, fairness or reasonableness' may demonstrate the absence of 'good faith.'"155

In Jacob and Youngs, Inc. v. Kent,151 upon completion of the construction of a new house, the owner discovered that the wrong pipe had been installed. The court rejected the owner's attempt to cancel the contract due to the breach caused by such improper installation. Justice Cardozo refused forfeiture of the contract, in part, because he did not find evidence of bad faith by the builder. However, Cardozo warned the parties that "the willful transgressor must accept the penalty of his transgression."157

In Continental Grain Co. v. Simpson Feed Co.,158 a buyer was 48 hours late in furnishing shipping instructions, so the seller tried to justify cancellation of the contract. The court was influenced by the fact that the delay was neither willful nor negligent and held that the breach was immaterial. Continental Grain shows that courts usually ignore minor variations from the contractually prescribed performance if a party attempts to perform in good faith.

The court relied on subsection (e) of Section 241 in Malone v. United States.159 In Malone, a contractor named Malone was hired by the govern-

139. Farnsworth, supra note 30, § 8.18, at 615.
140. Farnsworth, supra note 30, § 8.18, at 616.
143. Id. at 475. See also Restatement (Second) of Contracts § 241(d) (1981).
144. See supra note 107 and accompanying text.
ment to paint houses at an air force base. The government conditioned this hiring upon the government's acceptance of a sample house to be painted by the contractor. After Malone completed the sample house, he continued painting other houses on the base. The government official never told Malone that his sample house was painted unsatisfactorily, nor did such official prevent the contractor from painting the other houses. When the government ordered him to repaint the unacceptable houses, Malone refused and the government terminated the contract. The court held that "[i]n light of the [government official's] evasiveness, and the consequent interference in Malone's performance, the government's conduct in this case rises to the level of a material breach of contract." 155

The Malone court recognized the implied duty requiring a party to not hinder performance by the other party. 156 The court found the government in violation of this implied duty since the government exhibited improper intentions in declaring Malone's performance inadequate. Consequently, the court deemed the government's behavior to be a material breach and justified termination of the contract by Malone. In contrast, the court found no liability for Malone under the terminated contract.157

D. Restatement Factors Applied in the Lending Context

As just discussed, courts will often utilize the Section 241 criteria when faced with a question concerning material breach. An important context in which the issue of material breach arises is in lender/borrower relationships. The following discussion of Sahadi v. Continental Illinois National Bank & Trust Co. 158 illustrates how courts apply the concept of materiality in resolving disputes arising in such relationships.

In Sahadi, a creditor declared a material breach and foreclosed upon the collateral after a debtor was one day late in tendering his interest payment. The lower court issued summary judgment in favor of the defendant-creditor as a result of a lender liability suit by the debtor. However, the Seventh Circuit remanded the case upon finding genuine issues of material fact with regard to the material breach question. The Seventh Circuit provided this discussion of the concept of materiality:

"The determination of 'materiality' is a complicated question of fact, involving an inquiry into such matters as whether the breach worked to defeat the bargained-for objective of the parties or caused disproportionate prejudice to the non-breaching party, whether custom and usage considers such a breach to be material, and whether the allowance of reciprocal non-performance by the non-breaching party will result in his accrual of an unreasonable or unfair advantage." 159

155. Id. at 1444-46.
156. See supra notes 146-50 and accompanying text.
158. 706 F.2d 193 (7th Cir. 1983).
159. Id. at 196.

The Sahadi court recognized that determining the materiality of a breach would be difficult. The facts presented "a story of financial brinkmanship and opaque dealing in which neither side emerges wholly blameless." 160 However, the bank's conduct in Sahadi apparently went over the brink. The bank accelerated the loan due to an immaterial default despite assurance of full security from its collateral and with no indication the borrower would default in making the payments. The court implicitly recognized that the law of contract draws a distinction between an absolute failure to perform and a failure to timely perform. 161 The court held that a genuine issue of material fact was raised, inter alia, by (1) the de minimis prejudice resulting from the delay in debtor's performance, and (2) the calling of the loan for such a delay was without precedent in the banking community. 162

V. BREACH OF GOOD FAITH

A. Basis of the Good Faith Doctrine

The common law of most states recognizes a covenant of good faith and fair dealing implied by law in all contracts. 163 The drafters of the Restatement (Second) of Contracts incorporated the common law in Section 205 which states that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and in its enforcement." 164 Therefore, many courts find that there is an implied covenant of good faith and fair dealing in every contract such that neither party can do anything which injures the right of the other to receive the benefit of the agreement. 165 A party may even be required to take affirmative steps to cooperate in achieving the goals of the contract. 166

160. Id. at 194.
161. Id. at 198.
162. Sahadi, 706 F.2d at 197.
166. Farnsworth, supra note 30, § 7.17, at 527; Kehm Corp. v. United States, 93 F. Supp. 620 (Cl. Ct. 1950). "The parties to a contract are embarked on a cooperative venture, and a minimum of cooperativeness in the event unforeseen problems arise at the performance stage is required even if not an explicit duty of the contract." AMPAT/Midwest, Inc. v. III. Tool Works, Inc., 896 F.2d 1035, 1041 (7th Cir. 1990) (citing FDIC v. W.R. Grace & Co., 877 F.2d 614, 619-20 (7th Cir. 1989)).
Section 1-203 of the Uniform Commercial Code ("UCC") codifies the common law requirements of good faith, implying that in every contract covered by its terms is an obligation of good faith in its performance or enforcement. However, every state has not included this general good faith obligation in their version of the UCC. For example, Indiana common law does not recognize a general implied covenant of good faith.167

The UCC defines good faith in section 1-201(19) as "honesty in fact and the conduct or transactions concerned." One court ruled that good faith is to be determined by applying the abuse of discretion standard; dishonesty is not required to show bad faith.168 These relatively simple definitions have not led the courts to a uniform doctrine of good faith.169 In many states, the conduct of a party having an obligation to act in good faith is judged by an objective standard.170 However, some states judge such conduct by a subjective standard.171

A mere examination of express contract terms is insufficient to determine whether there has been a breach of the implied covenant of good faith and fair dealing.172 To comply with this implied covenant, a party's actions must be consistent with the agreed common purpose and the justified expectations of the other party.173 "The purpose, intentions and expecta-


169. Manning, supra note 163, § 5.03[3][a], at 5-15.

170. Universal C.I.T. Credit Corp. v. Schepler, 329 N.E.2d 620, 623-24 (Ind. Ct. App. 1975); Brown v. Averco Ins. Corp., 603 F.2d 1367, 1376 (9th Cir. 1979). In Universal C.I.T., pursuant to an insecurity clause in the creditor's agreement to finance the plaintiff's purchase of a vehicle, the creditor repossessed the vehicle. The court remanded the case to the jury to determine whether the creditor had acted in good faith when repossessing the truck. The court placed the burden of proof upon the plaintiff to demonstrate a lack of good faith and further promulgated an objective standard of good faith by considering "the determination ... of [a] 'reasonable man' under the circumstances." Universal C.I.T., 329 N.E.2d at 624.


well as a breach of the underlying contract. Support for a breach of good faith claim against a lender may be found where the lender makes a hindsight reevaluation of a credit after a default.

Lenders often have a right under a contract to take action against a borrower but breach their duty of good faith due to the manner in which such right is exercised. For example, a lender’s decision to terminate a loan agreement based on an insecurity clause is totally within the discretion of the lender. Therefore, courts find that “it is necessary to supply some additional meaning to the terms of contracts that clearly do not contemplate unbound discretion.” The UCC provides some measure of constraint to a lender’s rights of action because:

Section 1-208 of the UCC further defines and applies the good faith obligation to options to accelerate at will and requires that the accelerating party ‘in good faith believes that the prospect of payment or performance is impaired.’

Courts have adopted the UCC’s good faith standard and impose this obligation upon lenders to limit their discretion under insecurity and other clauses in many circumstances. For example, discretionary advance clauses are not really discretionary since many courts require lenders to make a decision to halt customary advances or to accelerate indebtedness in a reasonable manner. In K.M.C., the bank refused to lend to the maximum amount on a line of credit, and simultaneously demanded, without notice, repayment of all outstanding monies. The provision for demand was contained in the financing statement rather than in a promissory note. The bank also controlled the borrower’s cash flow through a “blocked account” in which the company deposited all its receipts.

The K.M.C. court invoked the good faith doctrine by describing the bank’s demand as a “kind of acceleration clause.” Accordingly, the court cited UCC section 1-208 as support for its analysis. Since the K.M.C. court was dealing with acceleration under a financing statement, the court’s citation of UCC section 1-208 did not contradict the UCC comment regarding the inapplicability of section 1-208 to demand notes. Evidence of a personality conflict with the loan officer may have influenced the court’s decision to halt the loan.

Finding that the bank violated its duty of good faith in demanding repayment.

Other courts have adopted the reasoning of the K.M.C. court. In Carrico v. Delp, the court held that a discretionary advance line of credit agreement without a specific term gave the lender “reasonable, not absolute discretion” and the lender could not terminate at will. In contrast, a bankruptcy court applying New York law rejected the basis for the K.M.C. holding. This contrast serves to point out the gray area encountered when applying doctrines such as the implied covenant of good faith.

Another important example of bad faith on the part of a lender is found in Brown v. Avemco Investment Corp. In Brown, a bank was found to have breached its duty of good faith when it wrongfully accelerated payments pursuant to a loan agreement. The bank asserted that the value of its contract had been impaired when an airplane, which acted as a security interest, had been leased by the debtor in violation of a provision of the loan agreement. The acceleration was invoked based on an acceleration clause that by its terms could be exercised at the lender’s option. The court held that “[Section] 1.208 applies when a party in interest may accelerate payment ‘at will’ or ‘when he deems himself insecure’ or ‘in words of similar import’ . . . the creditor has power to exercise the option ‘only if he in good faith believes that the prospect of payment or performance is impaired.’” Further, the court said that the facts sufficiently suggested the possibility that the lender “accelerated not out of fear of security impairment but rather from an inequitable desire to take advantage of a technical default.” The Brown court described the acceleration as “a harsh remedy with draconian consequences for the debtor” which must “not be used offensively, e.g. for the commercial advantage of the creditor.”

In Alaska State Bank v. Fairco, the security agreement securing a loan to Fairco contained an acceleration clause. After Fairco missed numerous payments on the loan, the bank discovered that insufficient funds existed to cover the debt. The bank held debt restructuring discussions which were ultimately unsuccessful. The bank immediately accelerated the loan and took possession of the collateral without notice and Fairco sued for damages. The court held that:

190. See K.M.C. Co. v. Irving Trust Co., 757 F.2d 757 (9th Cir. 1985).
191. See K.M.C. Co. v. Irving Trust Co., 757 F.2d 757 (6th Cir. 1985); Reid v. Key Bank, Inc., 821 F.2d 9 (1st Cir. 1987).
192. Id. at 759.
193. Id. at 761.
196. 603 F.2d 1367 (9th Cir. 1979).
197. Id. at 1378 (emphasis added).
198. Id. at 1379 (emphasis added). “Technical” is another word for immaterial. Use of the materiality concept in this case shows that courts can intertwine elements of the doctrines discussed herein in order to avoid what the court perceives to be an inequitable result.
199. Id. at 1376.
Given all the facts and circumstances, the bank's conduct in the handling of the negotiations and in taking possession, its motive, and purpose, this court finds that the Bank was not acting "honestly in fact" and was specifically acting for the purpose of setting an example and putting plaintiffs under duress. 

Missed payments are the most serious defaults under loan documents. If the bank in Fairco violated its duty of good faith in accelerating its loan after a number of loan payments were missed, then other banks are at risk in accelerating their loans for other types of defaults. Fairco demonstrates that any party to a contract must be careful when suspending performance after a default by the other party. 

VI. Modification/Waiver/Estoppel

Courts often confuse the concepts of modification, waiver, and estoppel since each relies upon the proposition that the conduct of a party negates an express condition in a contract. Basically, modification is based upon mutual agreement of the parties to waive certain obligations or conditions. Waiver is based on the intent of the waiving party as evidenced by words or conduct. Estoppel (or waiver by estoppel) is based upon reliance by a party on actions of the other party which justifies negating an express condition. The aforementioned concepts form a hierarchy used by courts to find whether provisions of a contract have been "waived." 

A. Modification

Parties competent to contract may mutually modify or change their executory contracts in their discretion. In contrast to the formation of a new contract, the modification of a contract has been defined as any change or alteration, which introduces new elements into the details, or adds some of them, but leaves the general purpose and effect of the subject matter of a contract intact. . . . In general, any modification must comply with the "requisite elements of a contract," which are mutual consent and consideration. Although contracts may be modified by sub-

1366 (Ind. Ct. App. 1984). When modifying a contract, the "new obligation must be supported by consideration." Myers v. Maris, 326 N.E.2d 577, 582 (Ind. Ct. App. 1975). See also Alaska Am. Lumber Co. v. United States, 25 Ct. Cl. 518 (Ct. Cl. 1992); Little v. Reddi, 88 So.2d 354 (Ala. 1956). These cases reflect the pre-existing duty rule. Under this rule, no consideration exists where a party does or promises to do what that party is already legally obligated to do. CALAMARI & PERILLO, supra note 32, at 145. The pre-existing duty rule has been criticized and courts have invented ways around it. Id. at 146-47. Parties may help courts around the pre-existing duty rule by undertaking even the slightest additional burden beyond their original duties. Care Travel Co. v. Pan Am World Airways, Inc., 944 F.2d 983 (2d Cir. 1991); United States v. Stump Home Specialties Mfg., Inc., 905 F.2d 1177 (7th Cir. 1990). Note that a few jurisdictions have eliminated the prior legal duty rule. CALAMARI & PERILLO, supra note 32, at 148. Furthermore, Section 2-209 of the U.C.C. provides that "[a]n agreement modifying a contract within this Article [2] needs no consideration to be binding." 

Friou v. Phillips Petroleum Co., 948 F.2d 972, 975 (5th Cir. 1991); In re Spangal Enter., Inc., 81 B.R. 337, 353 (Bankr. W.D. Pa. 1987). A written contract can be modified orally despite an express provision requiring a written modification. In re Conticommodity Serv. Inc., 733 F. Supp. 1555, 1580 (Bankr. N.D. Ill. 1990). However, a proponent of an alleged oral modification must prove by clear, unequivocal and decisive evidence that the written contract was so modified. Amerdyne Indus., Inc. v. POM, Inc., 760 F.2d 875, 877 (8th Cir. 1985).


It "permits more flexibility in dealing with the conduct of the party at the
of a condition of a Courts favor the concept of waiver because
is not the relinquishment of a right and the termination of the reciprocal
of courts to interject the
antecedent contract in spite of the non-occurrence of the condition is
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in proportion to the extent and unfairness of the forfeiture in-
lihood of waiver and the pressure to find waiver or other excuse increase
results The use of waiver by the courts "rests in large part on
results when a party has conducted itself in such a way as to make those
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policies against forfeiture and unjust enrichment

privilege.221

d to avoid forfeiture where an agreed modification cannot be found after

as also

EXCLUSION. See supra

See infra

See supra

223. FREDDERICK A. WHITNEY, THE LAW OF CONTRACTS § 89 (6th ed. 1958). See also
100 and accompanying text.
215. Canada Dry Corp. v. Nehi Beverage Co., 723 F.2d 512, 518 (7th Cir. 1983) (quoting
hearnson Hayden Stone, Inc. v. Leach, 383 F.2d 367, 370 (7th Cir. 1968). A waiver is a
udicial device used to avoid forfeiture where an agreed modification cannot be found after
ne party promises not to insist upon express conditions of a contract. See also FREEDMAN,
supra note 4, at 122-24; Clarence Morris, Waiver and Estoppel in Insurance Policy Litigation,
5 U. Pa. L. Rev. 925 (1957). See also Edward L. Rubin, Toward a General Theory of
V; 28 UCLA L. REV. 478 (1981). Accordingly, courts find that waiver occurs when one
arty to the contract manifests an intent not to require the other party to strictly comply
with a contractual duty. Saverslak v. Davis-Cleaver Produce Co., 606 F.2d 206, 213 (7th
ir. 1979), cert. denied, 444 U.S. 1078 (1980).
v. Baker, 137 N.E. 74 (1923)).
218. FARNSWORTH, supra note 30, § 8.5, at 561.
219. FARNSWORTH, supra note 30, § 8.5, at 561.

1982); Wachovia Bank & Trust Co. v. Rubish, 293 S.E.2d 749 (N.C. 1982); Pacific States
Corp. v. Hall, 166 F.2d 668 (9th Cir. 1948).
222. 17A C.J.S. Contracts § 492(1) at 695 (1963); United States Fidelity and Guaranty
Co. v. Binco Iron & Metal Corp., 464 S.W.2d 353, 358 (Tex. 1971); Nussau Trust Co., 436
N.E.2d at 1269.
223. See Nessau Trust Co., 436 N.E.2d at 1265.
1963).
225. CALAMARI & PERILLO, supra note 32, § 11-36, at 447-48 (emphasis added). Detrimental
relance often occurs after a waiver, therefore consideration is not normally a problem. The
real problem is proving a waiver was given. See also RESTATEMENT (SECOND) OF CONTRACTS
§ 84 (1981); John E. Murray, Murray on Contracts § 111 at 631 (1990). In Fordeek,
Kemneth Elec., Inc. v. Helmken, 591 N.E.2d 1035 (Ind. Ct. App. 1992), the court said a
waiver of mechanic's liens should be supported by consideration.
226. See Dennis M. Patterson, Wittgenstein and The Code: A Theory of Good Faith
228. Mannino, supra note 163, § 2.04(4), at 2-18; See Warren v. Ford Motor Credit Co.,
693 F.2d 1373, 11th Cir. 1982). See infra note 304-09 and accompanying text (discussing
anti-waiver clause).
1. General Elements of Waiver

The existence of a waiver depends on the acts and conduct of the party subsequent to the making of the contract.229 Clearly, strict performance of the terms of a contract on the part of one party may be waived by the other party to the contract.230 However, the proponent has the burden of proving a waiver exists.231 The existence of a waiver is a question of fact.232 “A waiver may be express or may be inferred from actions, conduct, or course of dealings.”233 For example, continued receipt by a defendant of performance not in conformance with a contract without any objection may constitute a waiver of a right to strict performance.234 However, mere consent to a delay in performance after a request from the person required to perform may not constitute a waiver.235 Neither is waiver established where an injured party merely fails to notify the other party about the injured party’s knowledge of the breach.236

Provisions of a contract may be waived even where the contract provides that the contract shall be null and void if certain conditions are not met.237 “Contracting parties can expressly or implicitly waive performance violations and assent to contractually proscribed [actions].”238 Once a condition precedent has been waived and the waiver has been acted upon, the failure to perform the condition cannot be insisted upon as a forfeiture of the contract.239 “[A]lthough there may have been repeated violations of a contract by either party, if either party elects to consider it unbroken and

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229. 17A C.J.S. Contracts § 492(1) at 691 (1963).
235. 17A C.J.S. Contracts § 492(1) at 696 (1963); Seymour v. Detroit Copper & Brass Rolling Mills, 23 N.W. 186, 187 (Mich. 1885).
237. Botti, 432 N.E.2d at 297.
be unjust.261 "The retracting party must either give notice while there is still reasonable time to permit the other party to cause the condition to occur or must give an extension of time."262 However, if the time for performance of a condition has expired, the party waiving the condition may be subject to the concept of election.263 "Courts hold that a party who chooses to disregard the nonoccurrence of a condition is bound by his election to treat his duty as unconditional; he cannot restate the condition even if the other party has not relied on this choice."264

The word "election" signifies a choice which is often binding on the party making the choice.265 As such, Professor Farnsworth makes a distinction between ordinary waiver and election waiver.266 Courts may find that any act by a party to a contract indicating an intention to continue under the contract after a failure of strict performance by the other party will operate as a conclusive election to waive strict performance by the other party.267

Courts have most often bound insurance companies by election waivers.258 For example, where a life insurer sent forms for notice and proof of loss to a beneficiary although the policy was conditioned on the insured not entering the military259 courts have often bound the insurer from later asserting a different reason.260 For example, where a life insurer sent forms for notice and proof of loss to a beneficiary although the policy was conditioned on the insured not entering the military259 courts have often bound the insurer from later asserting a different reason.260

As such, Professor Farnsworth makes a distinction between ordinary waiver and election waiver.266 Courts may find that any act by a party to a contract indicating an intention to continue under the contract after a failure of strict performance by the other party will operate as a conclusive election to waive strict performance by the other party.267

A party must also be careful when relating an objection to the other party's performance. Where a party gives an insufficient reason for rejecting the performance of the other party, and the other party reasonably understands that to be the exclusive reason, a court may treat the giving of that reason as a promise not to assert other reasons.251 This is fair in most cases because the other party will fail to entirely cure due to the insufficient reason given for rejection of performance.262 Furthermore, courts may find that specific objections waive any other objection to the other party's performance.262

If a party wants to demand strict performance after waiver, he must give reasonable notice to the other party.263 In Gorbett v. Estelle,264 the court denied forfeiture under a conditional land sale contract which provided for forfeiture for late payments. The court said that the seller waived this provision by consistently accepting late payments.265 The court also said that if the seller wishes to invoke the forfeiture provisions he must give notice to the buyer that all future payments must be timely.267 The foregoing discussion shows that when a party intends to insist upon forfeiture, the party should commit no act inconsistent with that right and, if so, the party should give timely notice that it will thereafter require strict performance.268

3. Forfeiture

The law abhors forfeitures, therefore every reasonable presumption is against a forfeiture.269 As such, forfeitures are not favored, and are allowed only when intent is clear and no other reasonable construction is possible.270 Even slight evidence may prevent forfeiture.271 In other words, "[f]orfeitures are not favored, courts will enforce forfeiture provisions where the right [to forfeiture] is clearly shown and injustice will not result."272 Most courts have a long standing policy against forfeitures and favor a party standing in an inferior bargaining position.273


252. Farnsworth, supra note 30, § 8.5, at 563.

253. Farnsworth, supra note 30, § 8.5, at 564; Murray, supra note 225, § 111.


256. Farnsworth, supra note 30, § 8.5, at 565.

257. See Pasqual v. Owen, 186 F.2d 263 (8th Cir. 1950); Government Sys. Advisors, Inc. v. United States, 21 Cl. Ct. 400 (Cl. Ct. 1990) (election to continue may result from the illure of the injured party to take action).

258. Farnsworth, supra note 30, § 8.5, at 564.


261. Farnsworth, supra note 30, § 8.19, at 626. See also Restatement (Second) of Contracts § 248 (1981).


264. Rembold Motors, Inc. v. Bonfield, 293 N.E.2d 210, 218 (Ind. Ct. App. 1973). However, observance of an idle formality is not required, especially after the party for whose benefit the requirement was made has rendered conformity thereto superfluous. Quigley v. Stanton, 35 A.2d 848, 848 (Conn. 1944). As such, where the object of notice is to inform the other party "and if the information is obtained in any way other than formal notice, the object of the notice is attained." Vole, Inc. v. Georgacopoulos, 538 F.2d 205, 210 (7th Cir. 1977) (quoting Owens v. Second Baptist Church, 516 F.2d 826 (1969)).


Materiality often enters into a court's analysis since a forfeiture term will not be enforced unless the breach is material. In equity trivial mistakes, grievances and even breaches of contract rights are ignored to protect [greater] rights and obligations. Courts are aware of the possibility of the inequitable dispossession of property and exorbitant monetary loss and therefore approach forfeitures with great caution. For example, bankruptcy courts, as courts of equity, "look with disfavor on contract forfeitures, especially if a forfeiture would imperil a debtor's reorganization efforts." Despite courts' dislike of forfeiture, provisions of some contracts will be strictly applied. For example, the court will strictly apply the requirements of an option contract governing the manner of acceptance; he discharges the contract right applies when a party to a contract deliberately misleads another party into believing that he does not have to comply strictly with a contractual duty and then sue for nonperformance in an action on the contract. Moreover, waiver of a contract right applies when a party to a contract deliberately misleads another party into believing that he does not have to comply strictly with contractual requirements. Even where a party, knowing the facts, does something inconsistent with its intention to require strict compliance with the conditions precedent of a contract, the party may be treated as having waived the performance of the conditions. In Barton v. Chemical Bank, the court said that a party who stands silent while the other party to the contract fails to perform a condition will be estopped from later asserting the condition. To permit defendants to "lull the plaintiff into a false sense of security by a reliance upon [defendant's] promise to pay and [defendant's] acceptance of [plaintiff's] work would be unconscionable . . . and the court should seize upon these very circumstances to imply a waiver by the defendants . . ." The principles of waiver and estoppel do not allow a party to a contract to lull the other party into a false sense of assurance that the party will not require strict compliance with a contractual duty and then sue for noncompliance.

Generally, a party waives a breach when that party permits the breaching party to perform. Express waiver, when supported by reliance thereon, excuses nonperformance of the waived [contractual] condition. In Waxonman Industries, Inc. v. Trustco Development Co., a lessee waived any default in a lease arising from a slight difference in square footage or dimensions of the premises as represented in a lease and as actually existing by execution of a document stating that no default by either party or grounds for cancellation existed.

Other conduct by a party may also give rise to a waiver. A party cannot retain fruits of a contract while awaiting future developments to determine whether it will be more profitable to affirm or disaffirm. For example, in Porras, the defendant purchaser's continuing possession and efforts to sell some land after he discovered that there were misrepresentations respecting the water supply on the property and before he attempted to rescind the contract constituted conduct inconsistent with the intent to disaffirm the contract.

As discussed, a party waives the right to rescind where the party, after discovery or knowledge of facts which would allow rescission, treats the

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281. Id.
282. 6 CORBIN, supra note 64, § 1265, at 52.
286. 577 F.2d 1329 (5th Cir. 1978).
288. Vandevier v. Mulay Plastics, Inc., 482 N.E.2d 377, 380 (Ill. App. Ct. 1985). Where a party dealing with another has by its course of dealings through leniency or otherwise led the other party into a sense of security, the party cannot escape liability after a loss by falling back upon the strict terms of a contract, since the party liable on the contract has led the other party to believe the terms would not be strictly enforced. See also Satcher v. Woodmen of the World Life Ins. Soc., 18 S.E.2d 523 (S.C. 1942); Kentucky Natural Gas v. Indiana Gas, 129 F. Supp. 17 (7th Cir. 1942).
contract as a subsisting obligation and leads the other party to believe the contract is still in effect.293 However, courts find that a party does not waive undiscovered defects in performance by acceptance of the performance.294 Further, acceptance of performance with knowledge of defects is not a waiver if the acceptance is premised on the defects being remedied.295 Silent acceptance of performance with knowledge of the defect may be deemed a waiver.296 Also, the party seeking rescission of a contract because of fraudulent representations of the other party "waives the right of rescission by accepting the consideration of the contract after full knowledge of the alleged fraud."297

Courts may view a party’s course of conduct in similar situations involving the other party as evidence of a waiver in a particular contract.298 However, not all misleading conduct will rise to the level of waiver. In Continental Mortgage Investors v. Quail Run Associates,299 the court left undisturbed the special referee’s finding that an internal memorandum from the lender stating that a draw request was properly prepared and submitted for a loan program not currently in default "was simply file doctoring" and was not evidence that the lender did not have objections to the draw request.

A party’s contractual right will be deemed waived if the party has acted inconsistently with the right and the other party would be prejudiced.300 "While parties to a contract are free to [ignore their contract provisions], they must also understand that they may bear the consequences of such disregard when breach becomes a fact of life."301 Generally, if parties mutually adopt a mode of performing their contract which differs from its strict terms or if they mutually relax the contract’s terms by adopting a loose mode of executing it, neither party can resurrect the strict terms of the contract and claim a breach because the contract was not performed to the letter.302


Cases have shown that actions can speak louder than words. In John Price Associates, Inc. v. Davis,303 the court held that owners of property waived any claim of damages for delays in construction under a construction contract. Although the owners carefully added a provision in change order #2 saying that the owners did not waive any claim for damages arising from delays in construction, the owners later executed change order #4 without such a provision. Moreover, the owners thereafter countersigned a certificate of substantial compliance and authorized final payment even though the original contract provided that final payment constituted a waiver of all of the owners’ claims.

5. Effect of Anti-waiver Clause

Under the appropriate circumstances, even an anti-waiver provision of a contract may be subject to waiver or modification as a result of acts of parties. Further, a party may be estopped from relying on an anti-waiver clause to defeat a claim that strict compliance with the provision was not necessary or sufficient.304

The weight of authority is that an anti-waiver clause, like any other term in the contract, is itself subject to waiver and modification by the course of performance and that whether such a waiver or modification has occurred is a question of fact for the fact finder.305 A party’s conduct in toto regarding defaults may be so pervasive that, in the reasonable opinion of the other party, "it [speaks] louder than (the) word."306 This position is consistent with the idea that a defendant "should [not] be permitted to interpose ‘boilerplate’ contract language in an attempt to obtain a result which the court could, on the basis of the evidence presented, reasonably have found to be unduly harsh to [a plaintiff]."307

Most lenders insert a non-modification/non-waiver clause "to protect their agreement[s] against casual . . . remarks [subsequent to signing] and manufactured assertions of alteration."308 As previously mentioned, waivers are valuable to lenders to minimize costs and reach speedy resolutions to problems arising in the operation of a loan agreement. "The specific ‘problem’ posed by anti-waiver clauses is the extent to which they are enforceable against a debtor when the secured party has engaged in conduct

305. Westinghouse Credit Corp. v. Shelton, 645 F.2d 869, 873 (10th Cir. 1981).
306. Id. at 874.
307. Canada Dry Corp. v. Nehi Beverage Co., 723 F.2d 512, 518-19 (7th Cir. 1983) (interpreting Indiana law). The Indiana Supreme Court cut back on the general rule that anti-waiver clauses may be waived by passive conduct. In Van Bibber v. Norris, 419 N.E.2d at 115, the court held that mere acceptance of late payments is not an "outright waiver"
that would, but for the anti-waiver clause, amount to a waiver of the right to accelerate [foreclose] upon default. . . .

It may be unfair to enforce a boilerplate anti-waiver clause in complicated and lengthy contracts, such as a construction loan agreement, where there is competent evidence of a waiver. Construction loan agreements often require waivers during the term of the loan due to the complexity of their operation. Without such waivers, it would be impossible to complete most construction projects. Few waivers, if any, are documented as required by an anti-waiver clause because both parties are under time constraints and a crush of paperwork.

6. Statute of Frauds Inapplicable/Prove by Parol Evidence

Parties should be aware that a waiver which is not in writing does not violate the Statute of Frauds, since waiver and estoppel operate independently of the statute. Generally, the defense of the Statute of Frauds may be waived by affirmative acts which show an intention to waive. In addition, "a party to a written contract may waive certain provisions thereof by parol agreement, and such waiver may be shown by parol testimony or may be shown by facts and circumstances sufficiently indicating an intention to waive."

Furthermore, where there is evidence of fraud the Statute of Frauds is inapplicable. Also, the part performance doctrine allows an oral contract to be removed from the operation of the Statute of Frauds. The Statute of Frauds does not apply where one party has performed an oral agreement which overcomes an anti-waiver clause. What amounts to an outright waiver is not clear. However, First National Bank v. Aera, 462 N.E.2d 1345 (Ind. Ct. App. 1984), shows the inapplicability of Van Bibber in situations where actions go beyond merely passive behavior such as accepting late payments. Id. at 1349. In Aera, the court held for debtor against a foreclosure despite the presence of non-waiver clause since the bank accepted late payment and made oral promises about engaging in a workout for six months. The difference may be that express (oral or written) waiver, when supported by reliance thereon, excuses non-performance of waived contractual condition. See Udevco, Inc. v. Wagner, 678 P.2d 679 (Ne. 1984).


sufficiently so that noncompliance by the other party operates as a fraud. even if a party has not waived a known right, the party may be estopped from enforcing it. Estoppel arises where a party's conduct misleads another to believe that a right will not be enforced and causes detrimental reliance by the other party based on this belief. To sustain an assertion of waiver by estoppel, a party must show that he was prejudicially misled by conduct of the other party and that he honestly and reasonably believed the other party intended the waiver. In contrast to waiver, estoppel may arise even though a party has no intention to relinquish or change a contract right.

The doctrine of estoppel discussed in this section is known as "equitable estoppel." Equitable estoppel is a judicially devised equitable doctrine which adjusts the relative rights of parties in light of justice and good faith due to some improper conduct on the part of one party. Equitable estoppel can operate without a promise and without the excuse of a condition. For example, if a son forgives his mother's signature to a mortgage on the mother's real property, the mother's payments to the mortgagee implied that the mortgage is valid and the mother is estopped from claiming the mortgage is invalid.


316. Siverslak v. Davis-Cleaver Produce Co., 606 F.2d 208, 213 (7th Cir. 1979), cert. denied, 444 U.S. 1078 (1980). See also Barton v. Universal Bank, 577 F.2d 1329 (5th Cir. 1978).

317. Siverslak, 606 F.2d at 213; Sand and Gravel, Inc. v. Martin Marietta Corp., 786 F. Supp. 1442, 1446 (S.D. Ind. 1992). By its nature and the terms of most anti-waiver clauses, estoppel should operate outside of such clauses. It is incongruous to expect someone to sanction bad conduct in advance by eliminating estoppel through an anti-waiver clause.


323. Calamari & Perillo, supra note 32, at 445 (discussing Rothchild v. Title Guaranty
Equitable estoppel can also apply to situations where a promise by one party causes detrimental reliance by the other party. As described earlier, a party promising not to insist on the strict terms of an agreement is estopped from asserting a violation of such terms against the other party. This is a species of promissory estoppel, except that ordinarily the term promissory estoppel is used in reference to the formation of a contract and not to the performance of a contract. However, it is hard to distinguish between promissory estoppel and equitable estoppel involving a promise.

VII. UNCONSCIONABILITY

The equitable concept of unconscionability is yet another doctrine which may affect the enforcement of an express provision of a contract. Unconscionability may also prevent enforcement of the entire contract. Courts have even invoked the doctrine of unconscionability to add terms to an unfair agreement. Courts often supply terms to contracts to give effect to the provisions in the contracts but "if a term will be supplied to prevent unconscionability, a contrary provision in the contract will not be effective." The doctrine of unconscionability has its origins in early Roman and English law. As such, there has always been a check on the freedom of contract. The United States Supreme Court recognized the doctrine of unconscionability at least as far back as 1870. However, authorities have not taken the opportunity during the long history of unconscionability to precisely define the doctrine. Unconscionability, therefore, is much like obscurity in that it depends on the judgment of the beholder.

The modern concept of unconscionability has been embodied in the Uniform Commercial Code. U.C.C. section 2-302 provides:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

The following elements provided in Section 2-302 are applied by courts to contracts both inside and outside the coverage of Article 2 of the Code. First, in order to be unenforceable, a contract clause must have been unconscionable at the time the contract was made. Second, the court need not strike down the entire contract, but may choose not to enforce only the unfair clause. Third, whether or not a contract or clause is unconscionable is a matter of law to be determined by a judge and not a jury. Finally, unconscionability is based on the facts of a particular case. In any case, the parties must be given an opportunity to present evidence regarding the circumstances, purpose and effect of the contract or clause to aid the court in determining whether to enforce it.

Consistent with history, U.C.C. section 2-302 conspicuously lacks a functional definition of "unconscionability." The definition of unconscionability in Section 2-302 and its interpretive commentary does little to aid in understanding the doctrine since it defines unconscionability in terms of itself. Case law also lacks a suitable definition of unconscionability.

At least one commentator, though, found Williams v. Walker Thomas Furniture Co. to be helpful in defining unconscionability. Williams involved an installment sales contract which granted the seller a security interest in the purchased household appliances and all household appliances the buyer had previously purchased from the seller on an installment basis. Thus, if the buyer was to default on the terms of the current sales contract, the seller would have the right to repossess not only the currently purchased appliances, but also the previously purchased appliances. Adopting the

324. See supra note 288 and accompanying text. See also CALAMARI & PERILLO, supra note 32 and accompanying text.
325. CALAMARI & PERILLO, supra note 32, at 445.
326. Although courts occasionally refuse to enforce an entire contract, they normally can reach a fair decision by rejecting an objectionable clause in a contract. See FARNSWORTH, supra note 30, at 309.
327. See, e.g., Vasquez v. Glassboro Serv. Ass'n, 415 A.2d 1156 (1980) (public policy required an implied provision in a migrant farm worker housing contract such that the worker had a reasonable time to obtain alternative housing).
328. FARNSWORTH, supra note 30, at 310 n.20.
329. SCOTT & LESLIE, supra note 1, at 455.
330. In Scott v. United States, 79 U.S. (12 Wall.) 443, 445 (1870), the Supreme Court said that "[i]f a contract be unreasonable and unconscionable, but not void for fraud, a court should give a plaintiff only such damages "as he is equitably entitled to." (emphasis added).
rationale behind U.C.C. section 2-302, the Williams court reversed the trial court which ruled that it could not strike down this provision on the grounds of unconscionability.\textsuperscript{336} The court held that "where the element of unconscionability is present at the time a contract is made, the contract should not be enforced."\textsuperscript{337}

The courts have done little to improve or refine the definition of unconscionability stated in Williams. While courts have now begun to distinguish between "procedural" unconscionability and "substantive" unconscionability, the doctrine still relates to some form of inequity in the contractual relationship.\textsuperscript{338} Procedural unconscionability is generally described as some defect in the bargaining process.\textsuperscript{339} It is broad enough to include the employment of sharp practices,\textsuperscript{340} the use of fine print and complicated language,\textsuperscript{341} lack of understanding,\textsuperscript{342} and unequal bargaining power.\textsuperscript{343} Substantive unconscionability, on the other hand, deals with unfairness in the result of the bargaining process (i.e., the actual contract and its terms).\textsuperscript{344} The decision in Williams reflects this latter notion.\textsuperscript{345}

While unconscionability is primarily used as a defense in consumer cases, the doctrine has been successfully applied in numerous other commercial contexts.\textsuperscript{346} It is clear "that businesses, particularly small businesses, can be victimized by unconscionable contracts and will receive judicial protection."\textsuperscript{347} Courts are reluctant, however, to strike down a contract in commercial settings where both parties are sophisticated corporations or individuals which have executed the contract after negotiation.\textsuperscript{348} Courts will not use unconscionability to impinge on the freedom to contract where the parties have substantially equal knowledge and bargaining power and one party obtains a bad result. Rather, unconscionability seems "more attuned to the protection of weaker, less knowledgeable parties who become involved in an oppressive deal than to the protection of businessmen who have made a bad contract."\textsuperscript{349}

VIII. Promissory Estoppel

A. Development of Promissory Estoppel

"[I]n the eighteenth century promises were often enforced primarily because the promisee had relied on the promise to her detriment or to the promisor's benefit."\textsuperscript{350} In the nineteenth century, however, contract law began to emphasize the "bargain theory" which required a contract to include bargained-for consideration in order to be enforceable.\textsuperscript{351} The
bargain theory achieved its dominance during the nineteenth century and "drove reliance-based recovery underground."  

By the twentieth century it was clear that the bargain theory excluded many promises which fairness required to be enforced. Despite falling into disfavor during the nineteenth century, courts still allowed recovery for reliance on a gratuitous promise in certain cases — gratuitous promises to convey land or to give to charity, as well as gratuitous promises made by bailees or made within a family. At this point, legal scholars developed a generalized theory of recovery based on reliance. This theory evolved into Section 90 of the Restatement (Second) of Contracts. 

A number of commentators actually believe the development of Section 90 advanced the philosophy behind freedom of contract. Requiring strict adherence to the elements of offer, acceptance, and consideration led to a "noninterventionist, nondiscretionary mode of abstract inquiry [that] yielded results . . . ordained." The "formal requirements [of consideration] too often lead to results at odds with the reasonable intentions and expectations of contracting parties." In response, Section 90 (of the first Restatement of Contracts) became "a substitute for consideration to ameliorate the Restatement's strict bargain requirement. . . ." Reliance provides a gap-filling safety valve for recovery in cases "involving non-bargained-for reliance and hereby enables the market oriented bargain requirement to survive."
gives rise to enforceable promises, even though the subcontractor has not received any identifiable consideration (or even acceptance of the offer) from the general contractor. The general contractor’s reliance upon the subcontractor’s quoted price in calculating the prime bid compels courts to use promissory estoppel to hold the subcontractor to that price.\footnote{370}

No universal standard is employed by courts in the application of the doctrine of promissory estoppel. “Although the interpretations and applications are by now numerous, they provide only precedential suggestions rather than clear guides for deciding future cases.”\footnote{371} However, the following discussion of the generally recognized elements of promissory estoppel should help in determining whether the doctrine may be successfully applied.

Courts look primarily to the Restatement (Second) of Contracts section 90 for guidance in questions concerning promissory estoppel.\footnote{372} Courts apply the doctrine of promissory estoppel based upon four elements set forth in Section 90: (1) a promise, (2) which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character, (3) which does, in fact, induce such action or forbearance, and (4) injustice can only be avoided by enforcement of the promise.\footnote{373} Courts have described the essence of promissory estoppel as justifiable reliance on the representations of another.\footnote{374} The doctrine of promissory estoppel implies a contract in law where a contract does not exist.\footnote{375}

Section 90 first requires that a promise exist. “A promise is a voluntary commitment or undertaking by the party making it (the promisor) addressed to another party (the promisee) that the promisor will perform some action or refrain from some action in the future.”\footnote{376} Courts do not consider predictions, opinions, or prophecies to be promises.\footnote{377}

The doctrine of promissory estoppel also requires the promisor to reasonably expect that the promise will induce action (reliance) by the promisee.\footnote{378} This expectation will be reasonable if the action of the promisee was actually foreseen by the promisor, or would have been foreseen by a reasonable person in the position of the promisor.\footnote{379} Although a promisor must reasonably expect the promise to result in action or forbearance by the promisee for the doctrine of promissory estoppel to apply,\footnote{380} courts often find this requirement satisfied where there has been reasonable reliance by the promisee.\footnote{381}

It is essential that the court find the promisee’s reliance on the promise to be reasonable for promissory estoppel to apply.\footnote{382} The determination of reasonable reliance is a finding of fact.\footnote{383} In Hoo Siong Chow v. Transworld Airlines, the court held that it was “reasonable” for a party to rely on the representations of another when the other had “superior communication ability,” and was more familiar with certain policies.\footnote{384} Courts have held that one factor in considering “reasonableness” is whether the relying promisee has knowledge of the true facts.\footnote{385} Courts do not allow third parties to bring an action based on promissory estoppel against a promisor since only the promisee can reasonably rely on a promise.\footnote{386}

The final requirement of Section 90 is avoidance of injustice. “The doctrine of estoppel springs from equitable principles and is designed to aid the law in the administration of justice where, without its aid, injustice might result.”\footnote{387} Whether injustice will result without enforcement of the promise is necessarily a finding of fact.\footnote{388} Although courts must not answer

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379. \textit{Corbin, supra note 64, § 200. See also State v. First Nat’l Bank of Ketchikan, 629 P.2d 78 (Alaska 1981) (finding no reasonable expectancy on behalf of the bank that the state would make a loan if certain assignments were not signed). 380. \textit{Security Bank & Trust Co.}, 494 N.E.2d at 968.


383. \textit{Azar v. United States Postal Serv.}, 777 F.2d 1265, 1270 (7th Cir. 1985); \textit{see also Gill v. United States Rubber Co.}, 195 F. Supp. 837 (N.D. Ind. 1961).


385. \textit{Id. at 549.}

386. \textit{Azar}, 777 F.2d at 1270.


the question of promissory estoppel mechanically, Corbin said: "'[I]f all the other requirements of the stated rule (of promissory estoppel) are satisfied, does not justice always require enforcement of the promise? So far as the Restatement [tells] us, the answer is yes.'"

IX. PAROL EVIDENCE RULE

In contract disputes, courts primarily rely upon the written contract and restrict the admission of extrinsic or parol evidence in order to promote a level of security in transactions. If a definite interpretation of the contract is possible by looking solely at its written provisions, then a court will exclude parol evidence regarding the contract. However, courts rely on parol evidence to interpret a contract in limited circumstances, such as discerning the ambiguity of a term within an agreement, proving the fraudulent inducement of a party's assent to an agreement, or demonstrating that the waiver of a condition or term within an agreement has occurred.

Furthermore, where an agreement rests partly in parol and partly in writing, it is considered a parol agreement and parol evidence of consideration is admissible. "If... the language is ambiguous, the meaning of the agreement is a question of fact to be determined by the trier of fact." The test for determination of whether a contract is ambiguous is whether reasonable persons would find the contract subject to more than one interpretation.

In Canada Dry Corp. v. Nehi Beverage Co., Inc., the court recognized that "[w]hen a contract term is ambiguous, parol evidence is admissible for the purpose of interpreting the instrument but not to expand upon its terms" and allowed evidence of pre-contract negotiations between the parties regarding the contract. However, courts may not rewrite the provisions of a contract nor read provisions into a contract.

Courts use two principles to guide them in interpreting a contract: (1) "words are to be given their usual and common meaning unless, from the entire contract and subject matter thereof, it is clear that some other meaning is intended," and (2) "particular words and phrases of a contract cannot be read alone, the parties' intention must be gathered from the entire contract." Another principle used by courts is that ambiguous contract terms are construed against the drafter of such terms.

Courts look to the intent and surrounding circumstances of the parties when forming a contract in order to deduce a proper interpretation. If an interpretation of a contract will produce an inequitable or unreasonable result, a court should avoid that interpretation, especially if a forfeiture is involved. In any case, a court should admit parol evidence when one party has acted fraudulently to induce the opposing party's consent to that agreement.

X. CONCLUSION

The strict bargain principle of contract law developed in response to the rise of the free market. The bargain principle's real appeal was its ease of administration. Theorists and courts found that rigid rules applied in an objective manner required a lot less inquiry and thought than attempting to inject equity and fairness into a consensual transaction. However, equity and fairness were traditionally part of contract law. Modern judges reestablished such principles by inventing arguments to get around the rigid rules of the bargain principle. Society should be willing to bear the costs associated with limitations on the bargain principle since "[f]ailure to place
such limits... involves still greater costs to the system of justice.”

The doctrines discussed in this article place limits on the freedom of contract because “[c]lassical contract doctrine was developed for cases of discrete, one-shot transactions, but it [is] a poor fit for complex, long-term contracts...” The complexity of most modern agreements insures that such agreements will rarely be fully completed. Therefore, anyone attempting to enforce an agreement is likely to encounter one or more of the doctrines discussed herein.

404. Epstein, supra note 37, at 294.
405. TEEVEN, supra note 10, at 321.

Many judges have a difficult time with contractual disputes for the following reasons: (1) complexity of the documents, (2) rigidity of the classical doctrine, (3) difficulty in justifying application of equitable doctrines, and (4) ignorance of the industries and business customs which underlie contracts. Ideally, special courts presided over by knowledgeable judges should adjudicate contractual disputes especially for industries such as lending, construction and securities. At least many contractual disputes should be required to go through mediation with knowledgeable mediators. If a resolution was not reached, a mediator could give a summary of the case and recommendations to the judge. Equity and fairness should be better served by such a system.

406. Due to the existence of the equitable doctrines, it is important for drafters to carefully select the terms and provisions of contracts. Drafters should fully understand the transactions and clearly describe them. In particular, conditions, defaults, forfeitures and remedies would be clearly identified and explained. Lawyers should insist that their clients carefully review drafts of contracts and should welcome their comments. Without such care, either party or both of the parties may be surprised as to how a court will enforce a contract.

RECOVERABILITY OF TARIFF UNDERCHARGES BY A TRUSTEE IN BANKRUPTCY

Undercharge claims and the Maislin decision by the Supreme Court turned a number of transportation princes into financial frogs.

I. INTRODUCTION

With the passage of the Motor Carrier Act of 1980, Congress accomplished a major reform in the trucking industry that was intended to increase competition and efficiency. As a result of this deregulation, carriers began “discounting” the rates charged to shippers; all under the watchful eye of the Interstate Commerce Commission (hereinafter referred to as ICC). As this discounting became more competitive, motor carrier bankruptcies “mushroomed.”

During the pendency of many of these bankruptcies, it was discovered that carriers had negotiated “illegal” tariff rates that had not been filed with the ICC as required by the new law. The difference between the “illegal” tariff actually charged to the shipper, and the “legal” or “discounted” tariff on

4. Regulatory power over the trucking industry is vested in the Interstate Commerce Commission (hereinafter referred to as ICC). See id. at 2285.
5. The Interstate Commerce Act, 49 U.S.C. §§ 10101 - 11917 (1988), requires motor carriers to file the rates they charge with the ICC. The ICC is charged with the duty of ensuring that the rates are both reasonable and non-discriminatory. See 49 U.S.C. §§ 10101(a), 10701(a), 10741(b) (1988). The ICC also has the authority to determine whether a rate or practice is reasonable. See Texas & Pac. Ry. v. Abilene Cotton Oil Co., 204 U.S. 426, 440-42 (1907) overruled on other grounds, General Am. Tank Car Corp. v. El Dorado Terminal Co., 308 U.S. 422 (1940).
6. The Act specifically prohibits a carrier from providing services at any rate other than the filed (also known as tariff) rate:

Except as provided in this subtitle, a carrier providing transportation or service subject to the jurisdiction of the Interstate Commerce Commission... shall provide that transportation or service only if the rate for the transportation or service is contained in a tariff that is in effect under this subchapter. That carrier may not charge or receive a different compensation for that transportation or service than the rate specified in the tariff whether by returning a part of that rate to a person, giving a person a privilege, allowing the use of a facility that affects the value of that transportation or service, or any other device.