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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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I. INTRODUCTION

Despite the vital role that agreements play in the functioning of our society, enforcement of agreements by the courts is only conditional. Commentators often say that members of a free society are generally able to make whatever agreements they desire and the law will enforce such agreements.[1] However, a contract is defined as "a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."[2] A policy of selective enforcement is implicit in such definition.[3] "Not all agreements are enforceable through the legal process and a good deal of Anglo-American law of contract is concerned with deciding which agreements are enforceable and why."[4]

It is important to recognize that factors external to the formal aspects of a contract may prevent its enforcement.[5] For example, the law may impose duties on the parties which are outside the express provisions of the contract.[6] Further, subsequent actions of the parties can also "influence the nature and terms of the original agreement."[7]

This article focuses on certain equitable doctrines which may render a contract unenforceable in accordance with its original terms.[8] While judges 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.

1. 1 ROBERT E. SCOTT & DOUGLAS L. LESLIE 16 (1988) [hereinafter SCOTT & LESLIE].
2. RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981).
3. SCOTT & LESLIE, *supra* note 1, at 1.
4. LAWRENCE M. FRIEDMAN, CONTRACT LAW IN AMERICA 15 (1965) [hereinafter FRIEDMAN]. "The first great problem of contract law — usually subsumed under the heading of consideration — is what *kinds* of promises the law should enforce. This problem, however, is tightly linked with another: the *extent* to which a certain kind of problem should be enforced. Indeed, on a deep level the two problems are virtually inseparable. The proposition that promises made as part of a bargain ought to be enforced is relatively straightforward; the real question is to what extent." Melvin A. Eisenberg, *The Principles of Consideration*, 67 CORNELL L. REV. 640, 640 (1982).
5. *See* FRIEDMAN, *supra* note 4, at 15.
6. *See infra* notes 163-201 and accompanying text.
7. Robert D. Rowe, *Written Agreements in the Lender-Borrower Context: The Illusion of Certainty*, 42 VAND. L. REV. 917, 928 (1989).
8. 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.

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.[9] 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

9. This article is primarily designed as a practical guide to certain equitable doctrines affecting a written contract. Those who are interested in scholarly aspects of the law may whet their appetite by reading this section and then pursue elsewhere such subjects as "Contractualism and Metaphysical Individualism." *See* Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 567 (1933).
10. KEVIN M. TEEVEN, A HISTORY OF THE ANGLO-AMERICAN COMMON LAW OF CONTRACT 1 (1990) [hereinafter TEEVEN].
11. An excellent discussion of such evolution is contained in TEEVEN, *supra* note 10.
12. *See* E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 592 (1969) [hereinafter Farnsworth, *Introduction to Contract*].
13. *Id.*; TEEVEN, *supra* note 10, at 20. SCOTT AND LESLIE provide an outstanding summary of the ancient writ system which shall be quoted liberally in footnotes to aid in understanding such system. "A writ served as authorization from the King's Chancery to commence [a] suit." SCOTT AND LESLIE, *supra* note 1, at 3.

"One general classification of writs was the praecipe actions. These writs ordered the defendant to do right or else explain himself. A "right" implied that one was owed a future act, e.g., returning the land. Trespass writs were a second classification. These writs summoned the defendant to come to court to explain why he had done wrong. The "wrong" was necessarily a past act. Contract could have been thought to be either of the praecipe or of the trespass variety." SCOTT AND LESLIE, *supra* note 1, at 4. "The writ of covenant was ordinarily used to recover unliquidated damages on sealed contracts to sell land, but it was open for other uses as well. Wager of law was the form of proof. Wager of law was a ritualistic oath-taking by witnesses who knew the parties, attesting to the character of the parties to the dispute." SCOTT AND LESLIE, *supra* note 1, at 4. "A writ of debt was also

courts resorted to the tort theory of assumpsit to enforce certain promises.[14]

Common law courts originally used assumpsit where there was a misfeasance in the performance of an undertaking.[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.[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.[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.[18]

The interest of the promisee upon a bare exchange of promises has been described as the "expectation interest."[19] "[P]rotection 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. "Another form of the writ of debt, relevant for our purposes, was debt on an obligation." SCOTT AND LESLIE, *supra* note 1, at 5. "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, *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, [t]he problem confronting lawyers [became] how to plead an assumpsit that was not defective on the ground that debt was the proper writ . . . . 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. . . . *Indebitatu assumpsit* was popular with plaintiffs for this reason, and because assumpsit actions permitted a jury trial instead of a wager 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, *Introduction to Contract*, *supra* note 12, at 595.

> "[I]n 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, *Introduction to Contract*, *supra* note 12, at 595.

17. Farnsworth, *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. 1 SAMUEL WILLISTON, WILLISTON ON CONTRACTS, § 106, at 368 (rev. ed. 1936) [hereinafter Williston].

18. Farnsworth, *Introduction to Contract*, *supra* note 12, at 596.

19. Farnsworth, *Introduction to Contract*, *supra* note 12, at 596. *See also* L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 53 (1936) [hereinafter Fuller & Perdue].

reliance interest."[20] Reliance is often difficult to prove so "[t]o encourage reliance we must therefore dispense with [its] proof."[21] 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."[22]

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,[23] and that a promise against a promise will maintain an action upon the case, the conception of contract as mutual promises has triumphed . . . . 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.[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."[25] Promises became enforceable only under those circumstances in which the action of assumpsit was allowed, i.e., only where there was "consideration."[26] Courts, then, used consideration as the test of enforceability of all promises and used it to distinguish

20. Farnsworth, *Introduction to Contract*, *supra* note 12, at 597. Modern courts say that the policy underlying contract law is the protection of the expectation interest. *See* Palco Linings, Inc. v. Pavex, Inc., 755 F. Supp. 1269 (M.D. Pa. 1990).

21. Fuller & Perdue, *supra* note 19, at 61-62.

22. Fuller & Perdue, *supra* note 19, at 61-62.

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." TEEVEN, *supra* note 10, at 50. As a result of *Slade's Case*, assumpsit became the primary action for breach of contract. SCOTT & LESLIE, *supra* note 1, at 6.

24. Morton J. Horowitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 919 (1974) [hereinafter Horowitz].

25. Farnsworth, *Introduction to Contract*, *supra* note 12, at 598.

26. Farnsworth, *Introduction to Contract*, *supra* note 12, at 598.

promises that common law judges deemed significant enough to justify their legal enforcement under assumpsit.[27]

The idea of an exchange arrived at by way of bargain ("quid pro quo") became the most important element of consideration.[28] 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."[29] 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 contract law.[30] 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.[31]

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."[32] 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."[33]

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

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 promisor 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, "[i]t 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].

31. Farnsworth, *Introduction to Contract*, *supra* note 12.

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.

> 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." [I]t 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. . . . [T]herefore, 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.[34]

The preceding passage shows the tension between the concepts of individual freedom and social control.[35] 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.[36] 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."[37]

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.[38] Consequently, they reasoned that the law of contracts should not attempt to assure equity by interfering with private agreements.[39] Instead, they viewed the role of contract law as simply to enforce transactions the parties voluntarily entered into with the expectation of mutual benefit.[40]

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.[41] Specialized bodies of law such as labor law, antitrust law and insurance law, as well as a host of social welfare legislation, directly intervened in contracts which would otherwise have been private matters.[42] 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).[43] Courts often apply all the principles set forth in the Code to transactions outside its coverage.[44]

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.[45] "The loss of individualism,

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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.

Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 293-94 (1975) [hereinafter Epstein].

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 the bargain 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. KESSLER, *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.

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."[46] In time, courts used the concepts of waiver and estoppel in contract actions, especially to counteract abuses associated with insurance contracts.[47] 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.[48] 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 . . . ."[49]

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,[50] that the defendant breached the contract, and that damages resulted.[51] A party breaches a contract by failing to fulfill an obligation the party agreed to perform.[52]

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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.

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." CALAMARI & PERILLO, *supra* note 32, at 329 (quoting Rossi v. Douglas, 100 A.2d 3, 7 (Md. 1953)).

51. Mannion v. Stallings & Co., 561 N.E.2d 1134, 1138 (Ill. App. Ct. 1990); Baxter v. Jones, 529 So.2d 217, 222 (Ala. 1988); Peterson v. Culver Educ. Found., 402 N.E.2d 448, 453 (Ind. Ct. App. 1980).

52. Drinkwater v. Patten Realty Corp., 563 A.2d 772, 776 (Me. 1989); Watson Constr. Co. v. AMFAC Mortgage Corp., 606 P.2d 421, 432 (Ariz. Ct. App. 1979); Indiana Gas & Water Co. v. Williams, 175 N.E.2d 31, 34 (Ind. Ct. App. 1961); Gonsalves v. Hodgson, 237 P.2d 656, 661 (Cal. 1951). "A defendant's failure to comply with the duty imposed by the contract gives rise to the breach." Prevendar v. Thonn, 518 N.E.2d 1374, 1378 (Ill. App. Ct. 1988) (citing Allstate Ins. Co. v. Winnebago County Fair Assoc., Inc., 475 N.E.2d 230, 236 (Ill. App. Ct. 1985)).

Courts may consider an intentional breach to be wilful and wanton.[53] The issue of who breached an agreement is a question of fact.[54]

A party who wishes to sue for breach of contract must show that it did not fail to tender its performance.[55] 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."[56] For example, if the court finds that the defendant prevented performance by the plaintiff, that performance will be excused.[57] 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."[58] 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.[59] 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

53. *Prevendar*, 518 N.E.2d at 1378 (citing Booker v. Chicago Bd. of Educ., 394 N.E.2d 452, 455 (Ill. App. Ct. 1979)).

54. Canada Dry Corp. v. Nehi Beverage Co., 723 F.2d 512, 517 (7th Cir. 1983); Wells v. Minor, 578 N.E.2d 1337, 1345 (Ill. App. Ct. 1991).

55. Strong v. Commercial Carpet Co., 322 N.E.2d 387, 391 (Ind. Ct. App. 1975). *See also* Potomac Ins. Co. v. Stanley, 281 F.2d 775 (7th Cir. 1960); Hooser v. Baltimore & Ohio R.R. Co., 177 F. Supp. 186 (S.D. Ind. 1959), *aff'd*, 279 F.2d 197 (7th Cir. 1960); Stegman v. Chavers, 704 S.W.2d 793 (Tex. Ct. App. 1985); Sutton v. Roth, Wehrly, Heiny, Inc., 418 N.E.2d 229 (Ind. Ct. App. 1981).

56. Stegman v. Chavers, 704 S.W.2d 793, 795 (Tex. Ct. App. 1985). *See also Sutton*, 418 N.E.2d at 229.

57. *Stegman*, 704 S.W.2d at 797. *See also* Ethyl Corp. v. United Steelworkers, 768 F.2d 180 (7th Cir. 1985), *cert. denied*, 475 U.S. 1010 (1986); O'Hara v. State, 590 A.2d 948, 953 (Conn. 1991); Krukemeier v. Krukemeier Mach. & Tool Co., Inc., 551 N.E.2d 885 (Ind. Ct. App. 1990); Lowy v. United Pac. Ins. Co., 429 P.2d 577, 580 (Cal. 1967) (en banc); Kelley v. Northern Ohio Co., 196 S.W.2d 235, 239 (Ark. 1946); Vandegrift v. Cowles Eng'g Co., 55 N.E. 941, 943 (N.Y. 1900).

58. Licocci v. Cardinal Assoc., Inc., 492 N.E.2d 48, 52 (Ind. Ct. App. 1986) (emphasis added) (citing Lawrence v. Cain, 245 N.E.2d 663 (Ind. Ct. App. 1969)); 17 Am. Jur. 2d *Contracts* § 365 (1964).

59. Restatement (Second) of Contracts § 241 (a) (1981). *See also* Dr. Franklin Perkins Sch. v. Freeman, 741 F.2d 1503 (7th Cir. 1984).

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.[60]

In some contracts, a condition may be the performance of the other party's promise.[61] However, some promises are so plainly independent that a court could never fairly construe such promises to be conditions of one another.[62] In the earliest contract cases, courts considered covenants to be independent.[63] As a result, contractual terms are generally presumed to represent independent promises rather than conditions.[64] No performance is due where a failure of a condition to such performance occurs.[65] A court, then, must determine whether a defendant breached a condition of an agreement excusing the plaintiff's performance or breached an independent covenants 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.[66] 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.[67] An immaterial breach may be compensable in damages though.[68] 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.[69] 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."[70]

60. United States v. McBride, 571 F. Supp. 596, 607 (S.D. Tex. 1983); Girard Bank v. John Hancock Mut. Life Ins. Co., 524 F. Supp. 884, 893 (E.D. Pa. 1981); Restatement (Second) of Contracts § 224 (1981).

61. Courts determine whether a contract term is a condition by inferring the intention of the parties from the language of the contract and the circumstances of its performance. American Original Corp. v. Legend, Inc., 689 F. Supp. 372, 378 (D. Del. 1988).

62. 5 Williston, *supra* note 17, § 805, at 846.

63. Howard O. Hunter, Modern Law of Contracts § 2.02[1], at 2-7 (1986) [hereinafter Hunter].

64. 3A Arthur L. Corbin, Corbin on Contracts § 635 (1960) [hereinafter Corbin]; Williston, *supra* note 17, § 665, at 136 n.14.

65. Hunter, *supra* note 63, § 5.01[1], at 5-3.

66. Hunter, *supra* note 63, § 2.01, at 2-1.

67. *See* Restatement (Second) of Contracts § 241 cmt. a (1981).

68. *Id.*

69. *See supra* note 20 and accompanying text.

70. Farnsworth, *supra* note 30, § 8.15, at 607.

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").[71] "The corollary is that full performance acts as a discharge; anything less does not."[72] 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).[73]

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.[74] 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."[75] One effect of the substantial performance doctrine is to reduce "opportunistic claims by removing opportunities to exploit inadvertent breaches."[76]

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.[77] This axiom resulted from cases which diverted from the perfect tender rule. In *Spence v. Ham*,[78] 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.[79]

71. HUNTER, *supra* note 63, § 2.02[1], at 2-2.

72. HUNTER, *supra* note 63, at § 2.02[1], at 2-2.

73. FARNSWORTH, *supra* note 30, § 8.8, at 575. "Substantial performance might make compliance with an express condition unnecessary, but only when the departure from full performance is an inconsiderable trifle having no pecuniary importance." WILLISTON, *supra* note 17, § 805, at 841 n.2 (quoting Hornbeck v. Askin, 145 N.Y.S.2d 628 (N.Y. 1955)).

74. FARNSWORTH, *supra* note 30, § 8.15, at 606.

75. WILLISTON, *supra* note 17, § 805, at 843-44.

76. SCOTT & LESLIE, *supra* note 1, at 592.

77. *See* J.R. Sinnott Carpentry, Inc. v. Phillips, 443 N.E.2d 597 (Ill. App. Ct. 1982). Construction contracts are a good example of the complex contracts for which the rigid bargain theory of contracts is ill-suited. In every construction project there are technical or minor defects which the contract classifies as defaults. Without the substantial performance doctrine, no building would ever be constructed. Builders cannot risk non-payment due to a minor construction defect.

78. 57 N.E. 412 (N.Y. 1900).

79. Williston and other courts may have interpreted this principle very strictly when formulating their views on substantial performance. *See supra* note 73 and accompanying text.

In *Jacob and Youngs, Inc. v. Kent*,[80] 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.*,[81] 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.[82] 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.[83] A willful breach is often said to preclude a party from invoking the doctrine of substantial performance.[84] 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.[85]

C. Material Breach Doctrine

The doctrine of material breach evolved from the doctrine of substantial performance.[86] The doctrine of material breach is simply the converse of

80. 129 N.E. 889 (N.Y. 1921).

81. 816 S.W.2d 943 (Mo. Ct. App. 1991).

82. Black v. Clark, 243 S.E.2d 808 (N.C. Ct. App. 1978). "The doctrine is applicable to all bilateral contracts for an agreed exchange with the exception of contracts for the sale of goods where any delay or variation in specifications by the seller seems to be deemed material." CALAMARI & PERILLO, *supra* note 32, § 11-22, at 411. The doctrine of substantial performance was even applied to a contract which required a nursing student to lose weight to continue in nursing school. Russell v. Salve Regina College, 938 F.2d 315 (1st Cir. 1991).

83. Alliance Tractor & Implement Co. v. Lukens Tool & Die Co., 233 N.W.2d 299 (Neb. 1975). *See also* Master Palletizer Sys., Inc. v. T.S. Ragsdale Co., 725 F. Supp. 1525 (D. Colo. 1989) (minor deviations from contract that did not materially detract from benefit to other party did not relieve other party from contractual obligations); *In re* Stein, 57 B.R. 1016 (E.D. Pa. 1986) (substantial performance requires court to inquire whether breach goes to the essence of the contract).

84. CALAMARI & PERILLO, *supra* note 32, at 411. *See also* SCOTT & LESLIE, *supra* note 1, at 590. *See infra* note 152.

85. Standard Millwork & Supply Co. v. Mississippi S & I Co., 38 So.2d 448, 450 (Miss. 1949).

86. *See* HUNTER *supra* note 63, § 2.02[1], at 2-8.

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 "touches 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

87. FARNSWORTH, *supra* note 30, § 8.16, at 612.

88. Aldape v. Lubcke, 688 P.2d 1221, 1222 (Idaho Ct. App. 1984).

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.

91. Stephenson v. Fazier, 399 N.E.2d 794 (Ind. Ct. App. 1980). *See infra* notes 96-109 and accompanying text.

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 WILLISTON, *supra* note 17, § 842.

93. Rogers v. Relyea, 601 P.2d 37, 41 (Mont. 1979).

94. Ogle v. Wright, 360 N.E.2d 240, 244 (Ind. Ct. App. 1977). *See also* Macon Mining & Mfg., Inc. v. Lasiter, 658 P.2d 505 (Or. Ct. App. 1983).

95. Lanvin, Inc. v. Colonia, Inc., 739 F. Supp. 182 (S.D.N.Y. 1990); 12 WILLISTON, *supra* note 17, § 1467, at 186.

96. *See* Eastern Ill. Trust & Sav. Bank v. Sanders, 631 F. Supp. 1393 (N.D. Ill. 1986); RESTATEMENT (SECOND) OF CONTRACTS § 229 (1981).

97. *See* Casio, Inc. v. S.M. & R. Company, Inc., 755 F.2d 528 (7th Cir. 1985).

98. Magnetic Copy Servs., Inc. v. Seismic Specialists, Inc., 805 P.2d 1161 (Colo. Ct. App. 1990); Ruff v. Yuma County Transp. Co., 690 P.2d 1296 (Colo. Ct. App. 1984).

99. Applied Genetics Int'l., Inc. v. First Affiliated Sec., Inc., 912 F.2d 1238, 1244 (10th Cir. 1990); Kaiser Trading Co. v. Associated Metals & Minerals Corp., 321 F. Supp. 923, 929 (N.D. Cal. 1970). A material breach means a party failed to substantially perform the contract and the other party is thereby discharged from performing its obligation under the contract. Jafari v. Wally Findlay Galleries, 741 F. Supp. 64, 68 (S.D.N.Y. 1990).

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;

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).

101. Walker & Co. v. Harrison, 81 N.W.2d 352, 355 (Mich. 1957).

102. Aldape v. Lubcke, 688 P.2d 1221, 1222 (Idaho Ct. App. 1984).

103. Wright v. Vickaryous, 611 P.2d 20, 22 (Alaska 1980). *See infra* notes 139-45 and accompanying text (discussing opportunity to cure).

104. RESTATEMENT (SECOND) OF CONTRACTS § 241 cmt. a (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.

106. Cleveland Cliffs Iron Co. v. Chicago & N. W. Transp. Co., 581 F. Supp. 1144, 1153 (W.D. Mich. 1984). One test for material breach requires consideration of whether the matter in respect to which failure of performance occurs is of such a nature and of such importance that a contract would not have been made without it. Trapkus v. Edstrom's, Inc., 489 N.E.2d 340, 345 (Ill. App. Ct. 1986).

107. RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981); Heritage Bank & Trust Co. v. Abdnor, 906 F.2d 292, 301 (7th Cir. 1990); Ferrell v. Secretary of Defense, 662 F.2d 1179, 1181 (5th Cir. 1981); *In re* Convenient Food Mart, Inc., No. 89 C 7326, 1990 U.S. Dist. LEXIS 3992, at *7 (N.D. Ill. Apr. 9, 1990); Bernstein v. Nemeyer, 570 A.2d 164, 168 n.8 (Conn. 1990); McKnight v. Midwest Eye Inst., 799 S.W.2d 909, 915-16 (Mo. Ct. App. 1990); Bailie Communications, Ltd. v. Trend Business Sys., 765 P.2d 339, 342-43 (Wash. Ct. App. 1988); Churchwell v. Coller and Stoner Bldg. Co., 385 N.E.2d 492, 495 (Ind. Ct. App. 1979).

(d) The likelihood that the party failing to perform or offer to perform will cure its failure taking account all the circumstances including any reasonable assurances; and
(e) The extent to which the behavior of the party failing to perform or offer to perform comports with the standards of good faith and fair dealing.

All of the issues raised in Section 241 must be resolved with reference to the intent of the parties as evidenced by the full circumstances of the transaction.[108] In addition to the Restatement factors, some courts have looked to the extent of partial performance, the relative hardship on the parties and the willful, negligent or innocent behavior of the party failing to perform.[109] In order to understand how courts apply the Section 241 factors, the following analysis of certain cases for each factor is presented.

1. Benefit of the Bargain

The most significant factor in determining materiality of a breach is the extent to which the breach will deprive the injured party of the benefit that such party justifiably expected from the exchange.[110] In fact, courts most often cite subsection (a) of Section 241 when determining questions of materiality.[111] Subsection (a) appears to relate to the doctrine of consideration due to its concern for the benefit of the bargain.

A good example of the application of subsection (a) of Section 241 where the court found a material breach is *Clanton v. Smith*.[112] In *Clanton*, the court ruled that there was a material breach where a sale/leaseback contract and the subsequent deed, mortgage and bond were properly rescinded due to the lessor's failure to execute a lease that conformed with the provisions of the contract. The court said that such failure to perform was so fundamental that it defeated the object of the parties in making the contract.[113]

Another good example of a breach which was material under subsection (a) is found in *Truglia v. KFC Corp.*[114] In *Truglia* the court found that the franchise's failure to tender royalty payments and failure to cure upon receiving notice of default until well after expiration of a grace period was a material breach rather than a technical default and justified termination

108. *Sahadi*, 706 F.2d at 196.
109. *Cleveland Cliffs Iron*, 581 F. Supp. at 1150; *Churchwell*, 385 N.E.2d at 495. *See also Trapkus*, 489 N.E.2d at 345 (test of materiality is whether the matter, in respect to which the default occurs, is of sufficient importance that the contract would not have been made without it).
110. FARNSWORTH, *supra* note 30, § 8.16, at 612.
111. Eric G. Anderson, *A New Look At Material Breach and the Law of Contracts*, 21 U.C. DAVIS L. REV. 1074 (1988).
112. 567 N.Y.S.2d 67 (N.Y. App. Div. 1991).
113. *Id.* at 68.
114. 692 F. Supp. 271 (S.D.N.Y. 1988).

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 5 & 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."[120]

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

115. 581 N.E.2d 340 (Ill. App. Ct. 1991).
116. CORBIN, *supra* note 64, § 748.
117. 433 A.2d 888 (Pa. Super. Ct. 1981).
118. *Id.* at 895.
119. 607 F. Supp. 1129 (D. Nev. 1985).
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. 723 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."[124] 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.[125]

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.*,[126] 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."[127] Due to subsection (b) of Section 241, courts are less likely to find a breach to be material where the transgressing party can pay damages for the breach.[128]

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."[129] It is clear that forfeiture cannot be based on a technical breach of a contract.[130]

In *Skendzel v. Marshall*,[131] the Supreme Court of Indiana expressed its reservations about forfeitures. The *Skendzel* court held that "it is wholly

124. *Id.* at 517.
125. United States v. McBride, 571 F. Supp. 596, 606 (S.D. Tex. 1983).
126. 788 P.2d 1189 (Ariz. 1990).
127. *Id.* at 1198.
128. *Id.*
129. HUNTER, *supra* note 63, at 5.02[2]. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 227 cmt. b, 229 cmt. b (1981).
130. Champlain Oil Co. v. Trombley, 476 A.2d 536, 539 (Vt. 1984).
131. 301 N.E.2d 641 (Ind. 1973).

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."[132] 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.[133]

In *Goff v. Graham*,[134] 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.[135]

Even a material breach may not be grounds for a disproportionate forfeiture. In *Utah International, Inc. v. Colorado-Ute Electric Association, Inc.*,[136] 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."[137] 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."[138] 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

132. *Id.* at 644 (quoting JOHN N. POMEROY, EQUITY JURISPRUDENCE, § 433 (5th ed. 1941)) (emphasis added).
133. *Sahadi v. Continental Ill. Nat'l Bank & Trust Co.*, 706 F.2d 193, 199 (7th Cir. 1983) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 229 (1979)).
134. 306 N.E.2d 758 (Ind. Ct. App. 1974).
135. *Id.* at 766.
136. 425 F. Supp. 1093 (D. Colo. 1976).
137. *Id.* at 1099.
138. *Id.* at 1100.

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."[139] "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."[140]

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 to 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."[141] Accordingly, courts consistently rule in favor of a breaching party's right to cure.

In *United States v. Packwood*,[142] 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."[143]

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;[144]
> (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.[145]

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

139. FARNSWORTH, *supra* note 30, § 8.18, at 615.
140. FARNSWORTH, *supra* note 30, § 8.18, at 616.
141. RESTATEMENT (SECOND) OF CONTRACTS § 237 (1981) (emphasis added).
142. 687 F. Supp. 471 (N.D. Cal. 1987).
143. *Id.* at 475. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 241(d) (1981).
144. *See supra* note 107 and accompanying text.
145. RESTATEMENT (SECOND) OF CONTRACTS § 242 (1981).

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.[146] When assessing the materiality of a breach, courts look at the intent of the breaching party.[147] Intent is significant because it reveals an increased probability that the victim cannot expect proper performance in the future.[148]

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.'"[149] "[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.'"[150]

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."[152]

In *Continental Grain Co. v. Simpson Feed Co.*,[153] 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 or 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*.[154] In *Malone*, a contractor named Malone was hired by the govern-

146. RESTATEMENT (SECOND) OF CONTRACTS § 241(e) (1981).
147. St. Benedict's Dev. Co. v. St. Benedict's Hosp., 811 P.2d 194, 199 (Utah 1991).
148. *See id.* at 199.
149. RESTATEMENT (SECOND) OF CONTRACTS § 231 cmt. (a) (1958).
150. Gram v. Liberty Mut. Ins. Co., 429 N.E.2d 21, 29 n.10 (Mass. 1981).
151. 129 N.E. 889 (N.Y. 1921).
152. *Jacobs and Youngs*, 129 N.E. at 891.
153. 102 F. Supp. 354 (E.D. Ark. 1951).
154. 849 F.2d 1441 (Fed. Cir. 1988).

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:

> [T]he 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 1445-46.
156. *See supra* notes 146-50 and accompanying text.
157. *Malone*, 849 F.2d at 1446.
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 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.
163. Edward Mannino, Lender Liability and Banking Litigation, § 5.03[3](a), at 5-15 (1992) [hereinafter Mannino]. *See* AMPAT/Midwest, Inc. v. Illinois Tool Works, Inc., 896 F.2d 1035 (7th Cir. 1990) (noting that the duty of good faith is read into every express contract in Illinois).
164. Restatement (Second) of Contracts § 205 (1981).
165. Wagner v. Benson, 161 Cal. Rptr. 516 (Cal. Ct. App. 1980); St. Benedict's Dev. Co. v. St. Benedict's Hosp., 811 P.2d 194, 199 (Utah 1991); Bastian v. Cedar Hills Inv. and Land Co., 632 P.2d 818, 821 (Utah 1981). Since parties to a contract are obliged by good faith to cooperate and perform in accordance with the express intent of the contract, one party cannot, by willful act or omission, make it impossible or difficult for another to perform and then invoke the other's lack of performance as a defense. Cahoon v. Cahoon, 641 P.2d 140, 144 (Utah 1982).
166. Farnsworth, *supra* note 30, § 7.17, at 527; Kehm Corp. v. United States, 93 F. Supp. 620 (Ct. Cl. 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. Ill. 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-

167. Van Bibber v. Norris, 419 N.E.2d 115 (Ind. 1981). But Indiana's Uniform Commercial Code (the "Indiana Code") establishes a general obligation of good faith for parties to a secured transaction. Section 26-1-1-203 of the Indiana Code imposes the duty to act in good faith upon all contracts and transactions within its purview. IND. CODE ANN. § 26-1-1-203 (Burns 1984 & 1991 Supp.); *Cf.* Warner v. Konover, 553 A.2d 1138, 1141 (Conn. 1989); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). As such, good faith applies to "secured part[ies]" and "security agreement[s]" by operation of Sections 26-1-9-105(4), 26-1-9-105(1)(l), and 26-1-9-105(1)(m) of the Code. Indiana courts, in turn, recognize that parties to a secured transaction must act in accordance with standards of good faith and "honesty in fact in the conduct or transaction." *See Van Bibber*, 419 N.E.2d at 122 (citing IND. CODE ANN. § 26-1-1-201 (Burns 1984 & 1991 Supp.)).

168. K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 760 (6th Cir. 1985).

169. MANNINO, *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. Avemco Inv. 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 truck, 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.

171. Quality Automotive Co. v. Signet Bank/Maryland, 775 F. Supp. 849, 852 (D. Md. 1991); Watseka First Nat'l Bank v. Ruda, 552 N.E.2d 775, 782 (Ill. 1990). *See* Jeffrey A. Shapiro, Note, *Illinois Standard of Good Faith Under Section 1-208 of the U.C.C.:* Watseka First National Bank v. Ruda *Creates A Subjective Standard*, 4 DEPAUL BUS. L.J. 191 (1991).

172. St. Benedict's Dev. Co. v. St. Benedict's Hosp., 811 P.2d 194, 200 (Utah 1991); Steven Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 371 (1980) [hereinafter Burton].

173. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981).

tions of the party should be determined by considering the contract language and the course of dealings between, and conduct of, the parties."[174] The duty of good faith extends to enforcement as well as to performance of a contract.[175]

B. *Breach of the Good Faith Doctrine*

An implied covenant of good faith and fair dealing is breached when one party uses discretion conferred by the contract to act dishonestly or to act outside of accepted commercial practices to deprive the other party of the benefit of the contract.[176] In other words, a contract would be breached "by a failure to perform in good faith if a party uses its discretion for a reason outside the contemplated range — a reason beyond the risks assumed by the party claiming a breach."[177] Although inexact, the duty of good faith may provide a remedy for a party's abuse of its discretion.[178] Further, "[s]ubterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified."[179]

The duty of good faith does not extend to obligate a party to a contract to accept material changes in terms, nor does it inject substantive terms into a contract.[180] Thus, the duty arises only in connection with the terms agreed to by the parties.[181] As previously discussed, the failure by one party to perform an independent covenant or immaterial condition of a contract will not excuse performance by the other party, especially where the failure to perform does not involve bad faith.[182]

C. *Application of the Good Faith Doctrine*

An important context in which courts often employ the implied covenant of good faith is in contractual relations between lenders and borrowers.[183] "Good faith requirements in banking are not new and have been implied by common law."[184] A breach of the duty of good faith may be a tort as

174. *St. Benedict's*, 811 P.2d at 200.

175. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. e (1981).

176. Mann Farms, Inc. v. Traders State Bank, 801 P.2d 73, 76 (Mont. 1990).

177. Southwest Sav. & Loan Assoc. v. Sunamp Sys., Inc., 1992 Ariz. App. LEXIS 70, at *16 (Mar. 26, 1992) (quoting Burton, *supra* note 172, at 385-86). See RESTATEMENT (SECOND) OF CONTRACTS § 176 and accompanying comments for a discussion of circumstances under which threats by a party against the other may be a breach of good faith.

178. *Southwest Sav.*, 1992 Ariz. App. LEXIS 70, at *16.

179. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d (1981).

180. Badgett v. Security State Bank, 807 P.2d 356, 360 (Wash. 1991).

181. *Id.* at 362.

182. Lutz v. Currence, 112 S.E. 506 (W. Va. 1922). *See supra* notes 100-02.

183. *See, e.g.*, Wagner v. Benson, 161 Cal. Rptr. 516, 520 (Cal. Ct. App. 1980); Wyatt v. Union Mtg. Co., 598 P.2d 45, 50 (Cal. 1979).

184. Janine S. Hiller, *Good Faith Lending*, 26 AM. BUS. L.J. 783, 798 (1985).

well as a breach of the underlying contract.[185] 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.[186]

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.[187] 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."[188] 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.'[189]

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.[190] 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.[191]

The *K.M.C.* court invoked the good faith doctrine by describing the bank's demand as a "kind of acceleration clause."[192] 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

185. Gruenberg v. Aetna Ins. Co., 510 P.2d 1032 (Cal. 1973).

186. MANNINO, *supra* note 163, § 10.02[1][e] (citing Meyer v. Travelers Ins. Co., No. 10147 (Wy. Distr. Converse Co. Dist. Ct. Sept. 24 1987)).

187. Cochea & Clark, *Lenders Better Watch Your Bucks*, A.B.A. BANKING J. 31, 32 (Nov. 1986).

188. Mark Snyderman, Comment, *What's So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending*, 55 U. CHI. L. REV. 1335, 1367 (1988). *See also* Vaughn v. Crown Plumbing & Sewer Serv., Inc., 523 S.W.2d 72 (Tex. Ct. App. 1975).

189. Brown v. Avemco, 603 F.2d 1367, 1376 (9th Cir. 1979).

190. *See* K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985); Reid v. Key Bank, Inc., 821 F.2d 9 (1st Cir. 1987).

191. *K.M.C.*, 757 F.2d at 759.

192. *Id.* at 760.

finding that the bank violated its duty of good faith in demanding repayment.[193]

Other courts have adopted the reasoning of the *K.M.C.* court. In *Carrico v. Delp*,[194] 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.[195] 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.*[196] 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.'"[197] 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."[198] 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."[199]

In *Alaska State Bank v. Fairco*,[200] 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:

193. *Id.* at 761.

194. 490 N.E.2d 972 (Ill. App. Ct. 1986).

195. Spencer Cos., Inc. v. Chase Manhattan Bank, 81 B.R. 194 (D. Mass. 1987).

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.

200. 674 P.2d 288 (Alaska 1983).

> 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 . . . . [T]he Bank's conduct was willful, wanton, outrageous, reckless, and without regard to the interests of the plaintiff.[201]

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 on the proposition that the conduct of a party negates an express condition in a contract.[202] 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 obligation or condition.[203] 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.[204] 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 cancels some of them, but leaves the general purpose and effect of the subject matter of a contract intact. . . ."[205] In general, any modification must comply with the "requisite elements of a contract," which are mutual assent and consideration.[206] Although contracts may be modified by subsequent oral agreement,[207] modifications must also comply with the Statute of Frauds, if applicable.[208]

201. *Id.* at 297.

202. "[W]aiver and estoppel are directly related to the question of excuse of conditions." CALAMARI & PERILLO, *supra* note 32, at 444.

203. *See* J.R. Hale Contracting Co. v. United N.M. Bank, 799 P.2d 581, 585 (N.M. 1990).

204. Fort Wayne Bank Bldg., Inc. v. Bank Bldg. and Equip. Corp. of Am., 309 N.E.2d 464, 466-67 (Ind. Ct. App. 1974); Commercial Acceptance Co. v. Walton, 176 N.E. 244, 245 (Ind. Ct. App. 1931). *See also* Peoples Bank & Trust Co. v. Coleman, 736 F.2d 643 (11th Cir. 1984).

205. Evans v. Henson, 37 S.E.2d 164, 168 (Ga. Ct. App. 1946). *See also* Chicago College of Osteopathic Medicine v. George A. Fuller Co., 776 F.2d 198 (7th Cir. 1985).

206. *See supra* note 50. *See also* Medicare Glaser Corp. v. Guardian Photo Inc., 936 F.2d 1016, 1019-20 (8th Cir. 1991); Burras v. Canal Constr. and Design Co., 470 N.E.2d 1362, 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 (Cl. Ct. 1992); Little v. Redditt, 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 1117 (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."

207. Friou v. Phillips Petroleum Co., 948 F.2d 972, 975 (5th Cir. 1991); *In re* Spagnol 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).

208. IND. CODE ANN. § 32-2-1-1 (Burns 1980). If an oral modification meets the requirements of a waiver the Statute of Frauds may not be applicable. *See infra* note 310. However, oral modifications related to credit agreements are increasingly becoming unenforceable due to credit agreement statutes. For example, the following portion of the Illinois Credit Agreement Statute seems to preclude any oral modification of a credit agreement:

> Section 2. Credit agreements to be in writing. A debtor may not maintain an action on or in any way related to a credit agreement unless the credit agreement is in writing, expresses an agreement or commitment to lend money or extend credit or delay or forbear repayment of money, sets forth the relevant terms and conditions, and is signed by the creditor and the debtor.

209. FARNSWORTH, *supra* note 30, § 8.3, at 544.

210. FARNSWORTH, *supra* note 30, § 8.3, at 544.

211. FARNSWORTH, *supra* note 30, § 8.3, at 544.

212. Parrish v. Terre Haute Sav. Bank, 431 N.E.2d 132, 135 (Ind. Ct. App. 1982); Jahnke v. Palomar Fin. Corp., 527 P.2d 771, 774 (Ariz. Ct. App. 1974).

B. Waiver

In many cases, a party may be required to perform a contractual duty which is conditional upon events outside the contract even though the condition precedent to such performance has not occurred or is late.[209] Under such circumstances, "[t]he occurrence of the condition, or its occurrence within the required time, is then said to be 'excused.'"[210] One of the primary ways a condition may be excused is by waiver.[211]

Once a waiver of a breach has occurred, the injured party cannot rely on the breach as a grounds for forfeiture of the contract.[212] Generally, "whenever a contract, not already fully performed on either side is con-

tinued in spite of a known excuse for not continuing, any defense for such excuse is lost, and the injured party is himself liable if he subsequently fails to perform."[213] Improper termination of a contract is a breach of contract as a matter of law.[214]

"Waiver is basically an equitable principle used by courts to avoid harsh results when a party has conducted itself in such a way as to make those results unfair."[215] The use of waiver by the courts "rests in large part on the policies against forfeiture and unjust enrichment . . . [and] [t]he likelihood of waiver and the pressure to find waiver or other excuse increase in proportion to the extent and unfairness of the forfeiture involved. . . ."[216] The courts have defined waiver as the "intentional relinquishment of a known right involving both knowledge of the existence of the right and the intention to relinquish it."[217] However, "[w]hat is involved is not the relinquishment of a right and the termination of the reciprocal duty but the excuse of the nonoccurrence or of a delay in the occurrence of a condition of a duty."[218] Courts favor the concept of waiver because it "permits more flexibility in dealing with the conduct of the party at the performance stage than would the rules of contract law that are designed for the negotiation stage."[219]

The *Restatement (Second) of Contracts* was influenced by the tendency of courts to interject the concept of materiality into the waiver analysis. "[A] promise to perform all or part of a conditional duty under an antecedent contract in spite of the non-occurrence of the condition is binding, whether the promise is made before or after the time for the condition to occur, unless . . . [it] was a material part of the agreed exchange. . . ."[220] As such, courts generally recognize that waiver need not rest upon consideration or agreement where it is a waiver of a formal, or immaterial, right or privilege.[221]

213. FREDERICK A. WHITNEY, THE LAW OF CONTRACTS § 89 (6th ed. 1958). *See also* Southern Pipe Coating, Inc. v. Spear & Wood Mfg. Co., 363 S.W.2d 912 (Ark. 1963).

214. Gunter Hotel, Inc. v. Buck, 77 S.W.2d 689, 697 (Tex. Ct. App. 1989). *See supra* note 100 and accompanying text.

215. Canada Dry Corp. v. Nehi Beverage Co., 723 F.2d 512, 518 (7th Cir. 1983) (quoting Shearson Hayden Stone, Inc. v. Leach, 583 F.2d 367, 370 (7th Cir. 1978)). A waiver is a judicial device used to avoid forfeiture where an agreed modification cannot be found after one party promises not to insist upon express conditions of a contract. *See also* FREIDMAN, *supra* note 4, at 122-24; Clarence Morris, *Waiver and Estoppel in Insurance Policy Litigation*, 105 U. PA. L. REV. 925 (1957). *See also* Edward L. Rubin, *Toward a General Theory of Waiver*, 28 UCLA L. REV. 478 (1981). Accordingly, courts find that waiver occurs when one party 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 208, 213 (7th Cir. 1979), *cert. denied*, 444 U.S. 1078 (1980).

216. RESTATEMENT (SECOND) OF CONTRACTS § 84 cmt. a (1981).

217. Phillips v. Green Street Corp., 237 N.E.2d 590, 595 (Ind. Ct. App. 1968) (quoting Shelt 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.

220. RESTATEMENT (SECOND) OF CONTRACTS § 84(1) (1981).

221. *See* Nassau Trust Co. v. Montrose Concrete Prod., 436 N.E.2d 1265 (N.Y. Ct. App. 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).

Likewise, "[w]aiver has been said to be a voluntary act which does not depend on estoppel, or require or depend on a new contract or a new consideration, at least where the doctrine is invoked to prevent a forfeiture. . . ."[222] This is also true where a party elects to abandon some provision or condition inserted in the contract for his benefit or where some element of estoppel exists.[223] Waiver is the equivalent of performance and excuses failure to perform, but is not the substitution of a new contract.[224] However, "[i]t is well settled that a waiver of all or part of a condition which forms a material part of the agreed exchange after the contract is made, but before its performance is due, is ineffective unless the waiver is supported by consideration or its equivalent *or induces detrimental reliance* so as to give rise to an estoppel."[225]

Looking again to the lending context, the reason a party to a contract grants a waiver is readily seen. Loan agreements normally reserve in the lender the right to terminate a contract upon the occurrence of events of default. This right of termination is designed to protect the lender against any materially adverse changes in the borrower's creditworthiness and to compel the borrower's compliance with the loan agreement.[226] However, waivers are valuable to lenders as a means of "minimizing costs. . . [, reaching] more expeditious resolutions . . . [,and avoiding] certain losses of goodwill."[227] Courts, therefore, may hold that "a lender waives, or is estopped from exercising, default remedies if it has engaged in a course of dealing which is inconsistent with the provisions of the loan documentation . . . even when the loan documentation expressly declares no waiver of rights occurs or provides that the lender may terminate the credit without notice of default."[228]

222. 17A C.J.S. *Contracts* § 492(1) at 695 (1963); United States Fidelity and Guaranty Co. v. Bimco Iron & Metal Corp., 464 S.W.2d 353, 358 (Tex. 1971); *Nassau Trust Co.*, 436 N.E.2d at 1269.

223. *See Nassau Trust Co*, 436 N.E.2d at 1265.

224. Southern Pipe Coating, Inc. v. Spear & Wood Mfg. Co., 363 S.W.2d 912, 914 (Ark. 1963).

225. CALAMARI & PERILLO, *supra* note 32, § 11-36, at 447-48 (emphasis added). Detrimental reliance 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 *Fordeck-Kemerly Elec., Inc. v. Helmkamp*, 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 Performance and Enforcement Under Article Nine*, 137 U. PA. L. REV. 335, 395 (1988).

227. Edward L. Rubin, *Toward a General Theory of Waiver*, 28 UCLA L. REV. 478, 488 (1981).

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

229. 17A C.J.S. *Contracts* § 492(1) at 691 (1963).

230. White River Conservancy Dist. v. Commonwealth Eng'rs, Inc., 575 N.E.2d 1011, 1016 (Ind. Ct. App. 1991); Fraternal Order of Police Lodge No. 52 v. City of Elkhart, 551 N.E.2d 469, 471 (Ind. Ct. App. 1990); Community Convalescent Center v. First Interstate Mtg. Co., 537 N.E.2d 1162, 1164 (Ill. App. Ct. 1989); Turner v. Williams, 19 N.W.2d 100, 101 (Mich. 1945).

231. Ogle v. Wright, 360 N.E.2d 240, 245 (Ind. Ct. App. 1977).

232. Boston Helicopter Charter v. Augusta Aviation Corp., 767 F. Supp. 363, 372 (D. Mass. 1991); Southwest Plaster & Drywall Co. v. R.S. Armstrong & Bros. Co., 304 S.E.2d 500, 501 (Ga. Ct. App. 1983).

233. 17A C.J.S. *Contracts* § 492(1) at 691-92 (1963); *See* First Nat'l Bank v. Acra, 462 N.E.2d 1345 (Ind. Ct. App. 1984); Selective Builders, Inc. v. Hudson City Sav. Bank, 349 A.2d 564 (N.J. 1975); Life Sav. & Loan Ass'n v. Bryant, 467 N.E.2d 277 (Ill. App. Ct. 1984); Botti v. Avenue Bank & Trust Co., 432 N.E.2d 295 (Ill. App. Ct. 1982); Parrish v. Terre Haute Sav. Bank, 431 N.E.2d 132 (Ind. Ct. App. 1982).

234. *See* Sokoloff v. Highway Steel Prods. Co., 82 N.E.2d 509 (Ill. App. Ct. 1948); Morrison v. Walker, 103 S.E. 139 (N.C. 1920); Old Mill Printers v. Kruse, 392 N.W.2d 621 (Minn. Ct. App. 1986).

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).

236. 17A C.J.S. *Contracts* § 492(1) at 696 (1963); Cox v. Fleisher Constr. Co., 223 N.W. 521, 526 (Iowa 1929).

237. *Botti*, 432 N.E.2d at 297.

238. Johnson v. E.V. Cox Constr. Co., 620 P.2d 917, 920 (Okla. Ct. App. 1980).

239. Parrish v. Terre Haute Sav. Bank, 431 N.E.2d 132, 136 (Ind. Ct. App. 1982).

proceeds under it, the other cannot be considered as having been in default."[240] In addition, dependent covenants in a contract may be waived without affecting the operation of the other provisions.[241] "Where a contract contains concurrent severable covenants, one may be waived without waiving the others."[242]

In summary, a party to a contract may generally terminate the contract upon the failure of a condition to the party's performance.[243] However, if one party's duty is conditioned upon performance by the other party, the first party can waive the condition by promising to perform without satisfaction of the condition.[244] Such party is then precluded from using the breach as a ground for termination of the contract.[245]

Courts often say that to constitute waiver of a contract right, a party's actions or conduct must be distinctly made, must evidence in some unequivocal manner an intent to waive and must be inconsistent with any other intent.[246] However, this is misleading because intent to waive contractual obligations or conditions may be *implied* by (1) a party's representations which do not amount to an express declaration of waiver or (2) the party's conduct.[247] Courts often infer the promise forming the basis of a waiver.[248] In addition, courts may infer an intent to waive a contract right from "a party's acts or conduct, even though there was an actual but undisclosed intent to the contrary."[249] It is equally important to note that the party against whom waiver is claimed need not know the legal effect of his actions, it is only necessary that he possess knowledge or have reason to know the facts of the breach.[250]

2. Retraction

In general, a party may retract a waiver and reinstate the condition unless the other party has relied to such an extent that retraction would

240. 17A C.J.S. *Contracts* § 491 at 689-90 (1963) (emphasis added).

241. 17A C.J.S. *Contracts* § 491 at 691 (1953); Griggs v. Moors, 47 N.E. 128, 129-30 (Mass. 1897).

242. 17A C.J.S. *Contracts* § 491 at 691 (1963); Broumel v. Rayner, 11 A. 833, 834 (Md. Ct. App. 1887).

243. FARNSWORTH, *supra* note 30, § 8.18, at 620.

244. FARNSWORTH, *supra* note 30, § 8.18, at 620.

245. FARNSWORTH, *supra* note 30, § 8.18, at 620.

246. Lone Mountain Prod. v. Natural Gas Pipeline Co., 710 F. Supp. 305, 310 (D. Utah 1989). A waiver of a default in a loan obligation "is inferred from conduct only when the conduct evidences that a party does not stand upon its right to declare a default." Continental Mtg. Investors v. Quail Run Assoc., 312 S.E.2d 272, 277 (S.C. 1984). For example, when a lender undertakes "preservation funding," which is funding to protect the value of an asset while a default situation exists, the lender evidences no intent to relinquish any right to declare a loan in default. *Id.*

247. J.R. Hale Contracting Co., v. United N.M. Bank, 799 P.2d 581, 585 (N.M. 1990) (emphasis added).

248. FARNSWORTH, *supra* note 30, § 8.5, at 562.

249. 17A C.J.S. *Contracts* § 492(1), at 696 (1963).

250. RESTATEMENT (SECOND) OF CONTRACTS § 93 (1981); WILLISTON, *supra* note 62, § 685 ("blameworthy ignorance is sufficient").

be unjust.[251] "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."[252] However, if the time for performance of a condition has expired, the party waiving the condition may be subject to the concept of election.[253] "Courts often 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 reinstate the condition even if the other party has not relied on this choice."[254]

The word "election" signifies a choice which is often binding on the party making the choice.[255] As such, Professor Farnsworth makes a distinction between ordinary waiver and election waiver.[256] 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.[257]

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 military service (which he had done), a finding of waiver was justified.[259] Further, a denial of liability for one reason may preclude an insurer from later asserting a different reason.[260]

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.[261] This is fair in

251. FARNSWORTH, *supra* note 30, § 8.5, at 563; *See also* U.C.C. § 2-209(5); RESTATEMENT SECOND) OF CONTRACTS § 842 (1981). A waiver cannot be revoked to the prejudice of the ther party. Kentucky Natural Gas v. Indiana Gas & Chemical Corp., 129 F.2d 17, 20 (7th ir. 1942). *See* City of Pinehurst v. Spooner Addition Water Co., 424 S.W.2d 485, 487 (Tex. t. App. 1968).

252. FARNSWORTH, *supra* note 30, § 8.5, at 563.

253. FARNSWORTH, *supra* note 30, § 8.5, at 564; MURRAY, *supra* note 225, § 111.

254. FARNSWORTH, *supra* note 30, § 8.5, at 564. *See* RESTATEMENT (SECOND) OF CONTRACTS 84 (1981). Courts have also held that waiver of certain covenants abrogates such covenants. *ee* Thiede v. Tractor Equip. Co., 108 N.E.2d 734 (Ill. App. Ct. 1952).

255. FARNSWORTH, *supra* note 30, § 8.5, at 564; *See* William W. Bierce, Ltd. v. Hutchins, 05 U.S. 340, 346 (1907).

256. *See* FARNSWORTH, *supra* note 30, § 8.5, at 565.

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

258. FARNSWORTH, *supra* note 30, § 8.5, at 564.

259. *See* Bowman v. Surety Fund Life Ins. Co., 182 N.W. 991 (Minn. 1921).

260. *See* Phoenix Ins. Co. v. Ross Jewelers Inc., 362 F.2d 985 (5th Cir. 1966).

261. FARNSWORTH, *supra* note 30, § 8.19, at 626. *See also* RESTATEMENT (SECOND) OF ONTRACTS § 248 (1981).

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.[263]

If a party wants to demand strict performance after waiver, he must give reasonable notice to the other party.[264] In *Gorbett v. Estelle*,[265] 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.[266] 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, "[a]lthough forfeitures 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]

262. FARNSWORTH, *supra* note 30, § 8.19, at 626. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 248 (1981); *see also* New England Structures, Inc. v. Loranger, 234 N.E.2d 888 (Mass. 1968); Cawly v. Weiner, 140 N.E. 724 (N.Y. Ct. App. 1923).

263. *See* National Metal Edge Box Co. v. The Hub, 108 S.E. 601, 603 (W. Va. 1921); Flagship Cruises, Ltd. v. New England Merchant's Nat'l Bank, 569 F.2d 699 (1st Cir. 1978); 17A C.J.S. *Contracts* § 492(1), at 697 (1963).

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 N.E.2d 205, 210 (Ill. App. Ct. 1989) (quoting Owens v. Second Baptist Church, 516 N.E.2d 712 (Ill. App. Ct. 1987)).

265. 438 N.E.2d 766 (Ind. Ct. App. 1982).

266. *Id.* at 769.

267. *Id.*

268. Central Nat'l Bank v. Paton, 439 N.Y.S.2d 619, 622 (1981).

269. Yank v. Juhrend, 729 P.2d 941, 944 (Ariz. Ct. App. 1986).

270. Litchfield Co. v. Kiriakides, 349 S.E.2d 344, 347 (S.C. Ct. App. 1986).

271. *Id.*

272. Vole, Inc. v. Georgacopoulos, 538 N.E.2d 205, 210-11 (Ill. App. Ct. 1989).

273. *See* Thorne v. Aetna Life Ins. Co., 286 F. Supp. 620 (N.D. Ind. 1968), *aff'd*, 407 F.2d 809 (7th Cir.), *cert. denied*, 396 U.S. 826 (1969).

Materiality often enters into a court's analysis since a forfeiture term will not be enforced unless the breach is material.[274] "In equity trivial mistakes, grievances and even breaches of contract rights [are] ignored to protect [greater] rights and obligations."[275] Courts are aware of the possibility of the inequitable dispossession of property and exorbitant monetary loss and therefore approach forfeitures with great caution.[276] 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."[277]

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.[278] Such strict compliance has been required with regard to a loan commitment since the commitment is essentially an option contract.[279] It must be recognized, however, that although parties are free to contract upon any mutually agreed terms, courts will only enforce a forfeiture which is clearly provided in the contract.[280] For example, in a lease without an express forfeiture provision, a court will only allow a remedy for a claim for damages, whether the breach concerns nonpayment of rent, nonpayment of taxes, waste or any other breach.[281]

4. Conduct of Non-Breaching Party

In many cases, courts find that the conduct of the non-breaching party is the basis of a waiver. "A promisee who prevents the promisor from being able to perform the promise [cannot] maintain suit for nonperformance; he discharges the promisor from duty."[282] In other words, "one who prevents a condition of a contract cannot rely on the other party's resulting nonperformance in an action on the contract."[283] 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.[284] Even where a party, knowing the facts, does something inconsistent with its intention to require strict compliance with

274. Ogle v. Wright, 360 N.E.2d 240, 244 (Ind. Ct. App. 1977).
275. Berg v. Devore, 141 N.E.2d 481, 482 (Ohio Ct. App. 1953).
276. Johnson v. Rutoskey, 472 N.E.2d 620, 624-25 (Ind. Ct. App. 1984).
277. *In re* Photo Promotion Assocs., Inc., 45 B.R. 878, 882 (Bankr. S.D.N.Y. 1985).
278. Brown-Marx Assocs., Ltd. v. Emigrant Sav. Bank, 703 F.2d 1361, 1368 (11th Cir. 1983).
279. *See* Johnson v. American Nat'l Ins. Co., 613 P.2d 1275 (Ariz. Ct. App. 1980).
280. Hackford v. Snow, 657 P.2d 1271, 1275 (Utah 1982).
281. *Id.*
282. 6 CORBIN, *supra* note 64, § 1265, at 52.
283. Champion v. Whaley, 311 S.E.2d 404, 406 (S.C. Ct. App. 1984).
284. Lone Mountain Prod. Co. v. Natural Gas Pipeline Co., 710 F. Supp. 305, 311 (Utah 1989).

the conditions precedent of a contract, the party may be treated as having waived the performance of the conditions.[285]

In *Barton v. Chemical Bank*,[286] 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. . . ."[287] 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.[288]

Generally, a party waives a breach when that party permits the breaching party to perform.[289] "Express waiver, when supported by reliance thereon, excuses nonperformance of the waived [contractual] condition."[290] In *Waxman Industries, Inc. v. Trustco Development Co.*,[291] 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.[292] 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 recision, treats the

285. *See* Standard Supply Co. v. Reliance Ins. Co., 272 S.E.2d 394, 398 (N.C. Ct. App. 1980).
286. 577 F.2d 1329 (5th Cir. 1978).
287. *Id.* at 1337 (quoting McDaniel v. Mallory Bros. Mach. Co., 66 S.E. 146 (Ga. Ct. App. 1909)).
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).
289. Frei v. Hamilton, 601 P.2d 307, 309 (Ariz. Ct. App. 1979).
290. Udevco, Inc. v. Wagner, 678 P.2d 679, 682 (Nev. 1984).
291. 455 N.E.2d 376 (Ind. Ct. App. 1983).
292. Porras v. Bass, 665 P.2d 1249, 1251 (Ore. Ct. App. 1983).

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]

293. English v. National Casualty Co., 34 N.E.2d 31, 33 (Ohio 1941). An extension of an agreement prior to its expiration may waive any claim for a breach prior to the extension. *See* Proteus Books, Ltd. v. Cherry Lane Music Co., 688 F. Supp. 877 (S.D.N.Y. 1988), *aff'd in part and vacated in part*, 873 F.2d 502 (2d Cir. 1989).

294. *See* Gamble v. Hogan, 76 S.E.2d 658 (Ga. Ct. App. 1953).

295. *See* Savannah Indus. Constructors and Equip. Rental, Inc. v. Sumner, 375 S.E.2d 486, 487 (Ga. Ct. App. 1988).

296. *See* Tisdale v. Elliott, 186 S.E.2d 685, 687 (N.C. Ct. App. 1972).

297. Brown v. Nixon, 203 S.E.2d 200, 203 (Ga. 1974).

298. *See* Southern Life Ins. Co. v. Citizens Bank, 86 S.E.2d 370 (Ga. Ct. App. 1955).

299. 312 S.E.2d 272 (S.C. Ct. App. 1984).

300. Vessel Oil & Gas Co. v. Coastal Refining and Mktg., Inc., 764 P.2d 391, 392 (Colo. Ct. App. 1988).

301. Quinn Blair Enter., Inc. v. Julien Constr. Co., 597 P.2d 945, 952 (Wyo. 1979).

302. *See id.* at 951; *See also* Detroit Greyhound Employees Fed. Credit Union v. Aetna Life Ins. Co., 151 N.W.2d 852, 857 (Mich. Ct. App. 1967), *rev'd*, 167 N.W.2d 274 (Mich. 1969).

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 Antiwaiver 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 jury 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

303. 588 P.2d 713 (Utah 1978). *See also* Westinghouse Credit Corp. v. Shelton, 645 F.2d 869 (10th Cir. 1981).

304. *See* Formall, Inc. v. Community Nat'l Bank, 360 N.W.2d 902 (Mich. Ct. App. 1984); J.E.M. Enter., Inc. v. Taco Pronto, Inc., 244 S.E.2d 253 (Ga. Ct. App. 1978).

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. . . ."[309]

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 Statue of Frauds, since waiver and estoppel operate independently of the statute.[310] Generally, the defense of the Statute of Frauds may be waived by affirmative acts which show an intention to waive.[311] 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."[312]

Furthermore, where there is evidence of fraud the Statute of Frauds is inapplicable.[313] Also, the part performance doctrine allows an oral contract to be removed from the operation of the Statute of Frauds.[314] 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. Acra*, 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 *Acra*, 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 nonperformance of waived contractual condition. *See* Udevco, Inc. v. Wagner, 678 P.2d 679 (Nev. 1984).

308. W.I. Knifeworks v. National Metal Crafters, 781 F.2d 1280, 1292 (7th Cir. 1986) (Easterbrook, J., dissenting).

309. Dennis M. Patterson, *Wittgenstein and the Code: A Theory of Good Faith Performance and Enforcement Under Article Nine*, 137 U. PA. L. REV. 335, 395 (1988).

310. North v. Simonini, 457 A.2d 285, 287 (Vt. 1983); Imperator Realty Co. v. Tull, 127 N.E. 263, 265 (N.Y. Ct. App. 1920); FARNSWORTH, *supra* note 30, § 8.5, at 562-63.

311. Everly v. Equitable Surety Co., 130 N.E. 227, 229 (Ind. 1921); Modern Irrigation & Land Co. v. Neely, 142 P. 458, 461 (Wash. 1914).

312. McQueeny v. Daily, 144 N.E.2d 805, 807 (Ill. App. Ct. 1957). *See also* Anderson v. Creighton, 325 N.E.2d 85, 88 (Ill. App. Ct. 1975), Dunn v. Hoefer, 284 N.E.2d 1, 3 (Ill. App. Ct. 1972).

313. National Importing & Trading Co. v. E.A. Bear & Co., 155 N.E. 343, 348 (Ill. 1927).

314. *See* Lance v. Crane, 104 S.E.2d 439 (Ga. 1958).

sufficiently so that noncompliance by the other party operates as a fraud.[315]

C. *Estoppel*

Even if a party has not waived a known right, the party may be estopped from enforcing it.[316] 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.[317] 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.[318] In contrast to waiver, estoppel may arise even though a party has no intention to relinquish or change a contract right.[319]

The doctrine of estoppel discussed in this section is known as "equitable estoppel."[320] 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.[321] Equitable estoppel can operate without a promise and without the excuse of a condition.[322] For example, if a son forges 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.[323]

315. Purity Maid Prods. Co. v. American Bank & Trust Co., 14 N.E.2d 755, 759 (Ind. Ct. App. 1938).

316. Saverslak 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. *Saverslak*, 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 anit-waiver clause.

318. J.R. Hale Contracting Co. v. United N.M. Bank, 799 P.2d 581, 586 (N.M. 1990). Courts require the person raising estoppel to prove every element of the doctrine since estoppel is not favored. Elvis Presley Enter., Inc., v. Elvisly Yours, Inc., 936 F.2d 889, 895 (6th Cir. 1991). See Dressler Ind., Inc. v. Pyrus AG, 936 F.2d 921 (7th Cir. 1991) for more restrictive elements of estoppel. Estoppel is normally viewed not as a claim or defense but as a means of preventing a party from asserting a claim or defense against another party who detrimentally relied on the party's conduct. ATC Petroleum, Inc. v. Sanders, 860 F.2d 1104, 1111 (D.C. Cir. 1988).

319. Coca-Cola Bottling Co. v. Coca-Cola Co., 769 F. Supp. 599, 669 (D. Del. 1991).

320. *See* CALAMARI & PERILLO, *supra* note 32, at 445.

321. Carpeau Group v. United Farm Workers of Am., 716 F. Supp. 1319, 1325 (C.D. Calif. 1989); Phelps v. Federal Emergency Management Agency, 785 F.2d 13, 16 (1st Cir. 1986).

322. The doctrine requires an admission, statement or act inconsistent with a claim subsequently asserted. Medicare Glaser Corp. v. Guardian Photo, Inc., 936 F.2d 1016, 1021 (8th Cir. 1991).

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.[324] "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."[325] 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.[326] Courts have even invoked the doctrine of unconscionability to add terms to an unfair agreement.[327] 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."[328]

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.[329] The United States Supreme Court recognized the doctrine of unconscionability at least as far back as 1870.[330] However, authorities have not taken the opportunity during the long history of unconscionability to precisely define the doctrine. Unconscionability, therefore, is much like obscenity 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.[331]

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.[332] 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.[333] Case law also lacks a suitable definition of unconscionability.

At least one commentator, though, found *Williams v. Walker Thomas Furniture Co.*[334] to be helpful in defining unconscionability.[335] *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

and Trust Co., 97 N.E. 879 (N.Y. 1912)). *See also* Southmark Prime Plus, L.P. v. Falzone, 776 F. Supp. 888 (D. Del. 1991) (court allowed estoppel where limited partners and their general partners claimed a proxy contest was not over although they stated in previous litigation that the proxy contest was over).

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).

331. Comment 1 to U.C.C. § 2-302 states that the purpose of the section is "to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable." U.C.C. § 2-302, cmt. 1. The comment goes on to say that the section allows a court to rule as a matter of law directly on the unconscionability of a clause or contract. The comment suggests that this direct ruling ability replaces the often circuitous methods courts used to police contracts. Such methods included adverse construction of the language, manipulation of the rules of offer and acceptance and violations of public policy.

332. CALAMARI & PERILLO, *supra* note 32, at 322.

333. "The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable . . . at the time of the making of the contract." U.C.C. § 2-302 cmt. 1. *See also* HUNTER, *supra* note 63, § 12.06[2].

334. 350 F.2d 445 (D.C. Cir. 1965).

335. *See* FARNSWORTH, *supra* note 30, § 4.28, at 311. In *Williams*, the court noted in dictum that "[u]nconscionability has generally been recognized to include the absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." *Williams*, 350 F.2d at 449.

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.[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."[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.[338] Procedural unconscionability is generally described as some defect in the bargaining process.[339] It is broad enough to include the employment of sharp practices,[340] the use of fine print and complicated language,[341] lack of understanding,[342] and unequal bargaining power.[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).[344] The decision in *Williams* reflects this latter notion.[345]

While unconscionability is primarily used as a defense in consumer cases, the doctrine has been successfully applied in numerous other commercial contexts.[346] It is clear "that businesses, particularly small businesses, can be victimized by unconscionable contracts and will receive judicial protection."[347] Courts are reluctant, however, to strike down a contract in

336. *Williams*, 350 F.2d at 449-50.

337. *Id.* at 449. The buyer in *Williams* was an uneducated woman separated from her husband and supporting herself and seven children on public assistance. The seller used a form contract consisting of extremely fine print. It is hard to imagine any court which would allow repossession of a large portion of the buyer's household possessions under these circumstances.

338. Professor Leff is credited with originating the distinction. *See* Arthur A. Leff, *Unconscionability and the Code - The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967); It should be noted that Leff was extremely critical of the doctrine of unconscionability as codified in U.C.C. § 2-302. He called his article on this section a "study in statutory pathology, an examination in some depth of the misdrafting of one section of a massive codifying statute and the misinterpretations which came to surround it." *Id.* at 485. *See also* Jones v. Asgrow Seed Co., 749 F. Supp. 836 (N.D. Ohio 1990) (discussing the difference between procedural and substantive unconscionability).

339. HUNTER, *supra* note 63, § 12.06[3].

340. Comment 1 to UCC § 2-302 relates that the section was based on the prevention of oppression and unfair surprise.

341. *See* Seabrook v. Commuter Housing Co., 338 N.Y.S.2d 67 (N.Y. Civ. Ct. 1972).

342. *See* Weaver v. American Oil Co., 276 N.E.2d 144 (Ind. 1971).

343. *See* Shell Oil Co. v. Marinello, 307 A.2d 598 (N.J. 1973).

344. HUNTER, *supra* note 63, § 12.06[3].

345. *See supra* note 337 (discussing *Williams*).

346. *See* Graham v. Scissor-Trail, Inc., 623 P.2d 165 (Cal. 1990) (contract to promote concert tour); Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370 (Mass. 1980) (involving a franchise agreement); Weaver v. American Oil Co., 276 N.E.2d 144 (Ind. 1971) (involving gas station lease); Ellsworth Dobbs, Inc. v. Johnson, 236 A.2d 843 (N.J. 1967) (involving real estate brokerage contract). *See also* Epstein, *supra* note 37 and cases cited therein.

347. CALAMARI & PERILLO, *supra* note 32, at 323.

commercial settings where both parties are sophisticated corporations or individuals which have executed the contract after negotiation.[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."[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."[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.[351] The

348. *See* FARNSWORTH, *supra* note 30, at 314 and cases cited therein. *See also* WXON-TV, Inc. v. A.C. Nielsen Co., 740 F. Supp. 1261, 1264 (E.D. Mich. 1990) ("[U]nconscionability will rarely be found in a commercial contract."). Courts will generally hesitate before deeming an agreement unconscionable because "the fact that a bargain is a hard one does not entitle a party to be relieved therefrom *if he assumed it fairly and voluntarily*." 17 AM. JUR. 2D *Contracts* § 192 at 562 (1964) (emphasis added). The court in *Van Bibber v. Norris*, held that "[i]n the absence of extraordinary circumstances demonstrating oppression or grossly unfair dealing or the like . . . or conflict with the public policy of the state . . . the court should not declare [provisions unconscionable]." 419 N.E.2d 115, 123 (Ind. 1981) Unfair dealing has been identified by Indiana courts as "[w]hen[ever] a party can show that the contract, was in fact an unconscionable one, due to a prodigious amount of bargaining power on behalf of the stronger party, which is used to the stronger party's advantage and is unknown to the lesser party, causing a great hardship and risk on the lesser party. . . ." Weaver v. American Oil Co., 276 N.E.2d 144, 148 (Ind. 1972).

349. HUNTER, *supra* note 63, § 12.06[4]. It is arguable, however, that a sophisticated party forced to execute an oppressive contract by unfavorable circumstances known by the other party should be entitled to protection under the doctrine of unconscionability. Circumstances may show the party did not assume the contract "fairly and voluntarily." For example, the accepting party may have no choice but bankruptcy or large losses, so it takes a chance and executes the contract. The ability to recognize that you are being oppressed may be a poor excuse to exclude you from protection under the law. Further, a lopsided contract offered on a take-it-or-leave-it basis allows the offering party to engage in a wide range of mischief during the performance stage of such contract. The opportunity for mischief by the offering party increases with the complexity of the lopsided agreement. *See* First N.Y. Bank for Business v. De Marco, 130 B.R. 650, 654 (Bankr. S.D.N.Y. 1991) ("[U]nconscionability requires some showing of absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.").

350. Jay M. Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 679 (1984) [hereinafter Feinman].

351. GILMORE, *supra* note 40, at 19-21.

bargain theory achieved its dominance during the nineteenth century and "drove reliance-based recovery underground."[352]

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.[353] At this point, legal scholars developed a generalized theory of recovery based on reliance.[354] This theory evolved into Section 90 of the *Restatement (Second) of Contracts*.[355]

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 a system of adjudication in which deductive decisionmaking predominated."[356] The "formal requirements [of consideration] too often lead to results at odds with the reasonable intentions and expectations of contracting parties."[357] In response, Section 90 (of the first *Restatement of Contracts*) became "a substitute for consideration to ameliorate the *Restatement*'s strict bargain requirement. . . ."[358] 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."[359]

352. Feinman, *supra* note 350, at 679.

353. Feinman, *supra* note 350, at 680; FARNSWORTH, *supra* note 30, at 90-92.

354. FARNSWORTH, *supra* note 30, at 89.

355. RESTATEMENT (FIRST) OF CONTRACTS § 90 (1932). Promise Reasonably Inducing Definite and Substantial Action. A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. *Id.* Section 90 was modified in the drafting of the second *Restatement*: § 90. Promise Reasonably Inducing Action or Forbearance. (1) A promise which the promisor should reasonably expect to induce action or forbearance . . . is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires. (2) A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance. RESTATEMENT (SECOND) OF CONTRACTS § 90 (1979). For a discussion on the evolution of Section 90, see Charles L. Knapp, *Reliance the Revised Restatement: The Proliferation of Promissory Estoppel*, 81 COLUM. L. REV. (1981).

356. Feinman, *supra* note 350, at 682 (discussing the evolution of non-bargain theories of contract).

357. Randy E. Barnett and Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities and Misrepresentations*, 15 HOFSTRA L. REV. 443, 449 (1987).

358. Feinman, *supra* note 350, at 680. Professor Gilmore viewed Section 90 differently. He believed that the "death of a contract" is the result of Section 90. Gilmore reasoned that the contradictory doctrine of consideration and reliance-based liability cannot co-exist: "In the end one must swallow the other." GILMORE, *supra* note 40, at 61.

359. Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 275 n.25 (1986) [hereinafter Barnett]. *See also* FARNSWORTH, *supra* note 30, at 89.

Although the bargain theory remains at the core of contract law, reliance can be viewed as an exception or a corrective device.[360]

B. *Application of Promissory Estoppel*

The doctrine of promissory estoppel is used most often in commercial settings, particularly in the area of implicit bargains.[361] These implicit bargains do not rise to the level of formal bargained-for contracts but are business "deals" which the parties believe are mutually advantageous arrangements.[362] In such "deals," recovery by the injured party generally requires a finding of reliance[363] and, of course, the "promisor [must have] made a promise that justifies the promisee's reliance."[364]

Courts apply a strict or flexible approach to the doctrine of promissory estoppel, depending upon, *inter alia*, each court's definition of a promise. Strict application of the doctrine requires a strong distinction between a promise and a statement of belief.[365] A promise relates to the future while a statement of belief relates only to the present.[366] For example, some courts have held a franchisor's representation of a business's earning capacity to be a statement of belief, not a promise.[367]

Courts using a flexible definition of promise[368] determine "whether, given the context in which the statement at issue was made, the promisor should reasonably have expected that the promisee would infer a promise."[369] In construction bidding cases, use of the flexible definition of promise often

360. Feinman, *supra* note 350, at 686.

361. Barnett, *supra* note 359, at 455 (discussing five kinds of commercial situations where promissory estoppel may be employed, including implicit bargains, firm offers, contract modifications, assurances likely to be regarded as part of an overall transaction, and pensions promised at or near retirement). "Promissory estoppel is most often applied where one party signifies his intention to abandon an existing right, leading another to act to his detriment in the event such right is subsequently asserted." Citizens State Bank v. Peoples Bank, 475 N.E.2d 324, 327 (Ind. Ct. App. 1985). The doctrine applies not only to gratuitous promises, but to commercial transactions as well. Lyon Metal Prod., Inc. v. Hagerman Constr. Corp., 391 N.E.2d 1152, 1154 (Ind. Ct. App. 1979).

362. Barnett, *supra* note 359, at 456 (discussing *United Elec. Corp. v. All Serv. Elec., Inc.*, 256 N.W.2d 92 (Minn. 1977), where the defendant had agreed to issue checks in the joint name of the plaintiff and a subcontractor; the defendant's failure to do so in several instances caused the plaintiff to lose $8,000 because of the subcontractor's diversion of funds).

363. Barnett, *supra* note 359, at 457.

364. Feinman, *supra* note 350, at 690 (discussing the application of reliance-based theories to contract suits).

365. *See infra* note 377.

366. Feinman, *supra* note 350, at 691.

367. *Id. See also* Scott-Douglas Corp. v. Greyhound Corp., 304 A.2d 309, 319 (Del. Super. Ct. 1973); Walters v. Marathon Oil Co., 642 F.2d 1098, 1100-01 (7th Cir. 1981) (Indiana law).

368. *See, e.g.*, Mazer v. Jackson Ins. Co., 340 So. 2d 770, 774 (Ala. 1976); Hunter v. Hayes, 533 P.2d 952, 953 (Colo. Ct. App. 1975).

369. Feinman, *supra* note 350, at 692 (discussing the flexible interpretation of promises).

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.[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."[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.[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.[373] Courts have described the essence of promissory estoppel as justifiable reliance on the representations of another.[374] The doctrine of promissory estoppel implies a contract in law where a contract does not exist.[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."[376] Courts do not consider predictions, opinions, or prophecies to be promises.[377]

370. *See, e.g.*, Drennan v. Star Paving Co., 333 P.2d 757 (Cal. 1958); Montgomery Indus. Int'l Inc. v. Thomas Constr. Co., 620 F.2d 91, 97 (5th Cir. 1980) (Texas law); Janke Constr. Co. v. Vulcan Materials Co., 527 F.2d 772, 780 (7th Cir. 1976) (Wisconsin law).

371. Feinman, *supra* note 350, at 717 (discussing scholarly and historical inquiry into the application of the doctrine).

372. *See, e.g.*, Larabee v. Booth, 463 N.E.2d 487, 490 (Ind. Ct. App. 1984); Lyon Metal Prod., Inc. v. Hagerman Constr. Co., 391 N.E.2d 1152, 1154 (Ind. Ct. App. 1979).

373. *See* Crenshaw v. General Dynamics Corp., 940 F.2d 125 (5th Cir. 1991) (Texas law); Doll v. Grand Union Co., 925 F.2d 1363 (11th Cir. 1991) (Georgia law); Budget Mktg., Inc. v. Centronics Corp., 927 F.2d 421 (8th Cir. 1991) (Iowa law); Bowman Agri-Corp v. First Farmers Nat'l Bank, 561 N.E.2d 841, 843 (Ind. Ct. App. 1990) (citing Tipton County Farm Bureau Coop. Ass'n v. Hoover, 475 N.E.2d 38, 41 (Ind. Ct. App. 1985)).

374. *In re* Frontier Airlines, Inc., 121 B.R. 386, 391 (Bankr. D. Colo. 1990).

375. Ruzicka v. Conde Nast Publications, Inc., 939 F.2d 578, 582 (8th Cir. 1991); Fidelity State Bank v. Bedsworth, 769 F. Supp. 1196, 1198 (D. Kan. 1991) (doctrine of promissory estoppel is a substitute for consideration).

376. Medtech Corp. v. Indiana Ins. Co., 555 N.E.2d 844, 847 (Ind. Ct. App. 1990) (quoting Woodall v. Citizens Banking Co., 507 N.E.2d 999, 1000 (Ind. Ct. App. 1987), *trans. denied*, (quoting MURRAY, *supra* note 225, at 2-3)).

377. Security Bank & Trust Co. v. Bogard, 494 N.E.2d 965, 968-69 (Ind. Ct. App. 1986).

The doctrine of promissory estoppel also requires the promisor to reasonably expect that the promise will induce action (reliance) by the promisee.[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.[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,[380] courts often find this requirement satisfied where there has been reasonable reliance by the promisee.[381]

It is essential that the court find the promisee's reliance on the promise to be reasonable for promissory estoppel to apply.[382] The determination of reasonable reliance is a finding of fact.[383] In *Hoo Siong Chow v. Transworld Airlines*[384], 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.[385] Courts have held that one factor in considering "reasonableness" is whether the relying promisee has knowledge of the true facts.[386] 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.[387]

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."[388] Whether injustice will result without enforcement of the promise is necessarily a finding of fact.[389] Although courts must not answer

See also G & M Oil Co. v. Glenfed Fin. Corp., 782 F. Supp. 1085 (D. Md. 1991) (conditional statement of intent to loan by lender was not a basis for reasonable reliance by loan applicant).

378. Tipton County Farm Bureau Coop. Ass'n v. Hoover, 475 N.E.2d 38, 41 (Ind. Ct. App. 1985). Proof of a detriment in reliance on a promise by the promisee is also a key element of promissory estoppel. Fregara v. Jet Aviation Bus. Jets, 764 F. Supp. 940, 949 (D.N.J. 1991).

379. 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. *Security Bank & Trust Co.*, 494 N.E.2d at 968.

381. *See* Hoo Siong Chow v. Transworld Airlines, 544 N.E.2d 548 (Ind. Ct. App. 1989); Citizens State Bank v. Peoples Bank, 475 N.E.2d 324 (Ind. Ct. App. 1985).

382. *Citizens State Bank*, 475 N.E.2d at 327 (citing Marker v. Preferred Fire Ins. Co., 506 P.2d 1163 (Kan. 1973)); Abart Elec. Supply, Inc. v. Emerson Elec. Co., 956 F.2d 1399 (7th Cir. 1992). *See also* Larabee v. Booth, 463 N.E.2d 487, 490-91 (Ind. Ct. App. 1984).

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

384. 544 N.E.2d 548 (Ind. Ct. App. 1989).

385. *Id.* at 549.

386. *Azar*, 777 F.2d at 1270.

387. *See* Public Serv. Co. v. Hudson Light and Power Dep't, 938 F.2d 338 (1st Cir. 1991).

388. First Nat'l Bank of Logansport v. Logan Mfg. Co., 577 N.E.2d 949, 954 (Ind. 1991). *See also* Neumann v. Aid Ass'n for Lutherans, 775 F. Supp. 1350 (D. Mont. 1991).

389. State v. First Nat'l Bank of Ketchikan, 629 P.2d 78, 82 n.4 (Alaska 1981).

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."[390]

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.[391] 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.[392] 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.[393] 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.[394]

"If . . . the language is ambiguous, the meaning of the agreement is a question of fact to be determined by the trier of fact."[395] "The test for determination of whether a contract is ambiguous is whether reasonable persons would find the contract subject to more than one interpretation."[396] 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

390. Corbin, *supra* note 64, § 200.

391. *See* Edward J. Murphy & Richard E. Speidel, Studies in Contract Law 762 (1991). Parol evidence is oral evidence extraneous to the written contract. *See also* Black's Law Dictionary 1117 (6th ed. 1990).

392. Hulse v. Juillard Fancy Foods Co., 394 P.2d 65, 66 (Cal. 1964) (en banc); *See also* Verstandig & Sons, Inc. v. Sobel, 206 N.Y.S.2d 860, 863 (1960); Macke Laundry Serv. Ltd. v. Alleco Inc., 743 F. Supp. 382, 386 (D. Md. 1989); Commercial Movie Rental, Inc. v. Larry Eagle, Inc., 738 F. Supp. 227, 230 (W.D. Mich. 1989); McAllister Bros., Inc. v. Ocean Marine Indem. Co., 742 F. Supp. 70, 78 (S.D.N.Y. 1989) (invoke rules of construction only as a last resort).

393. McQueeny v. Daily, 144 N.E.2d 805, 807 (Ill. App. Ct. 1957); Restatement (Second) of Contracts § 214 (1981).

394. Martin v. Miller, 57 N.W.2d 878, 883 (Mich. 1953).

395. Tomahawk Village Apartments v. Farren, 571 N.E.2d 1286, 1290-91 (Ind. Ct. App. 1991) (citing Piskorowski v. Shell Oil Co., 403 N.E.2d 838, 844 (Ind. Ct. App. 1980)). *See also* Christie v. K-Mart Corp. Employees Retirement Pension Plan, 784 F. Supp. 796 (D. Kan. 1992).

396. Moore Heating & Plumbing, Inc. v. Huber, Hunt & Nichols, 583 N.E.2d 142, 146 Ind. Ct. App. 1991). *See also* Yerdon v. Towery Publishing, Inc., 749 F. Supp. 319 (D. Me. 1990). Conversely, a contract is unambiguous when it is reasonably open to only one nterpretation. Hanssen v. Quantas Airways, Ltd., 904 F.2d 267, 269 (5th Cir. 1990).

parties regarding the contract.[397] However, courts may not rewrite the provisions of a contract nor read provisions into a contract.[398]

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."[399] Another principle used by courts is that ambiguous contract terms are construed against the drafter of such terms.[400]

Courts look to the intent and surrounding circumstances of the parties when forming a contract in order to deduce a proper interpretation.[401] 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.[402] 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.[403]

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

397. 723 F.2d 512, 519 (7th Cir. 1983). Courts may not create an ambiguity. Carey Canada, Inc. v. Columbia Casualty Co., 940 F.2d 1548, 1557 (D.C. Cir. 1991). A contract is not ambiguous merely for failing to address a contingency. Consolidated Bearings Co. v. Ehret-Krohn Corp., 913 F.2d 1224, 1233 (7th Cir. 1990).

398. *In re* Cole, 114 B.R. 278, 285 (Bankr. N.D. Okl. 1990). This position is undermined by the implied duty of good faith and other doctrines.

399. Tomahawk Village Apartments v. Farren, 571 N.E.2d 1286, 1291 (Ind. Ct. App. 1991) (citing *Piskorowski*, 403 N.E.2d at 845)). *See also* BWX Elec., Inc. v. Central Data Corp., 929 F.2d 707 (D.C. Cir. 1991); Cruden v. Bank of New York, 957 F.2d 961 (2d Cir. 1992).

400. *See* Omnibank Parker Road N.A. v. Employers Ins., 961 F.2d 1521 (10th Cir. 1992); Kiewit/Tulsa-Houston v. United States, 25 Cl. Ct. 110 (Cl. Ct. 1992) (doctrine of contra proferentem).

401. City of Westbrook v. Teamster's Local No. 48, 578 A.2d 716, 719 (Me. 1990); Jacobs v. Great Pac. Century Corp., 518 A.2d 223, 224 (N.J. 1986). The primary purpose in interpreting a contract is to give effect to the intent of the parties at the time of contract. Jeff D. v. Andrus, 899 F.2d 753, 760 (9th Cir. 1989).

402. *See* Yamanishi v. Bleily and Collishaw, Inc., 105 Cal. Rptr. 580, 582 (Cal. Ct. App. 1972) (quoting Hertzka & Knowles v. Selter, 86 Cal. Rptr. 23 (Cal. Ct. App. 1970)).

403. 66 Am. Jur. 2d *Reformation of Instruments*, § 118 at 644-45 (1973).

such limits . . . involves still greater costs to the system of justice."[404]

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. . . ."[405] 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.[406]

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 assemble the terms and provisions of contracts. Drafters should fully understand the transactions and clearly describe them. In particular, conditions, defaults, forfeitures and remedies should 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 one 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.*[1]

I. INTRODUCTION

With the passage of the Motor Carrier Act of 1980,[2] Congress accomplished a major reform in the trucking industry that was intended to increase competition and efficiency.[3] 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).[4] As this discounting became more competitive, motor carrier bankruptcies "mushroomed."[5]

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.[6] The difference between the "illegal" tariff actually charged to the shipper, and the "legal" tariff on

1. Perry A. Turnick, *Looking for the Magic Pill*, 32 TRANSP. & DIST. 9 (1991).

2. Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (1980).

3. *See* H.R. REP. No. 1069, 96th Cong., 2d Sess. 3, *reprinted in* 1980 U.S.C.C.A.N. 2285.

4. Regulatory power over the trucking industry is vested in the Interstate Commerce Commission (hereinafter referred to as ICC). *See id.* at 2285.

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).

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.

49 U.S.C. § 10761(a) (1988). Violations of these provisions can lead to a judgment against either the carrier or the shipper. *See* Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 120 n.2 (1990) (citing 49 U.S.C. §§ 11902 - 11904 (1982)).

5. Petition for Writ of Certiorari at 5, Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116 (1990) (Available on LEXIS).

6. 49 U.S.C. § 10761(a) (1988).