

Express Conditions

We start our journey into performance by discussing conditions — the traffic signs inside the contract that tell us when a promise needs to be performed. The Restatement defines a condition as “an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due.” Restatement (Second) of Contracts § 224.

Conditions differ from promises. Promises are obligations that the parties took upon themselves, and their non-performance, when due, is a breach of the contract. The non-occurrence of a condition, on the other hand, whether in the control of one of the parties or not, is not a breach of the contract. If it does not occur, the promise (or promises) that are conditioned do not become due, but the contract is not breached.

Consider, for example, the following provision: “AAA promises to send a tow truck to assist the Insured after the Insured notifies AAA of an accident.” The notification is a condition for AAA’s promise to send a tow truck. It is not a promise, which means that a failure to notify AAA is not a breach of the contract, although it prevents AAA’s promise from becoming due.

While conditions and promises can exist as separate elements in an agreement, sometimes a term in a contract is both a promise and a condition. Such a term is sometimes called a *promissory condition*. For example, assume that the agreement states that “The Insured will notify AAA promptly of any accident. Following such notification, AAA will promptly dispatch a tow truck.” Now, the notification is a promissory condition — both a promise and a condition. If the Insured fails to notify AAA, the Insured is in breach of the contract, and AAA’s duty to dispatch a tow truck does not become due.

The conditions we have examined so far were express conditions. As the name suggests, such conditions are stated explicitly in the contract. Conditions can also be implied or constructed by courts, and we will discuss those later in this part. The next few cases, however, deal with express conditions. As you read them, pay close attention to the ways in which courts identify express conditions and the implications of their existence. As you will quickly notice, the rule is that explicit conditions are strictly enforced. But, like most rules, this one also has a few exceptions — escape hatches — that courts use to soften the harshness of those conditions.

Oppenheimer & Co., Inc. v. Oppenheim, Appel, Dixon & Co.

86 N.Y.2d 685 (Court of Appeals of New York 1995)

CIPARICK, Judge.

The parties entered into a letter agreement setting forth certain conditions precedent to the formation and existence of a sublease between them. The agreement provided that there would be no sublease between the parties “unless and until” plaintiff delivered to defendant the prime landlord’s written consent to certain “tenant work” on or before a specified deadline. If this condition did not occur, the sublease was to be deemed “null and void.” Plaintiff provided only oral notice on the specified date. The issue presented is whether the doctrine of substantial performance applies to the facts of this case. We conclude it does not for the reasons that follow.

I.

In 1986, plaintiff Oppenheimer & Co. moved to the World Financial Center in Manhattan, a building constructed by Olympia & York Company (O & Y). At the time of its move, plaintiff had three years remaining on its existing lease for the 33rd floor of the building known as One New York Plaza. As an incentive to induce plaintiff’s move, O & Y agreed to make the rental payments due under plaintiff’s rental agreement in the event plaintiff was unable to sublease its prior space in One New York Plaza.

In December 1986, the parties to this action entered into a conditional letter agreement to sublease the 33rd floor. Defendant already leased space on the 29th floor of One New York Plaza and was seeking to expand its operations. The proposed sublease between the parties was attached to the letter agreement. The letter agreement provided that the proposed sublease would be executed only upon the satisfaction of certain conditions . . .

[The letter agreement required the defendant] to submit to plaintiff, on or before January 2, 1987, its plans for “tenant work” involving construction of a telephone communication linkage system between the 29th and 33rd floors. Paragraph 4(c) of the letter agreement then obligated plaintiff to obtain the prime landlord’s “written consent” to the proposed “tenant work” and deliver such consent to defendant on or before January 30, 1987. Furthermore, if defendant had not received the prime landlord’s written consent by the agreed date, both the agreement and the sublease were to be deemed “null and void and of no further force and effect,” and neither party was to have “any rights against nor obligations to the other.” Paragraph 4(d) additionally provided that . . . the parties “agree not to execute and exchange

the Sublease unless and until . . . the conditions set forth in paragraph (c) above are timely satisfied.”

The parties extended the letter agreement’s deadlines in writing . . . However, plaintiff never delivered the prime landlord’s written consent to the proposed tenant work on or before the modified final deadline of February 25, 1987. Rather, plaintiff’s attorney telephoned defendant’s attorney on February 25 and informed defendant that the prime landlord’s consent had been secured. On February 26, defendant, through its attorney, informed plaintiff’s attorney that the letter agreement and sublease were invalid for failure to timely deliver the prime landlord’s written consent and that it would not agree to an extension of the deadline. The document embodying the prime landlord’s written consent was eventually received by plaintiff on March 20, 1987, 23 days after expiration of paragraph 4(c)’s modified final deadline.

Plaintiff commenced this action for breach of contract, asserting that defendant waived and/or was estopped by virtue of its conduct⁷ from insisting on physical delivery of the prime landlord’s written consent by the February 25 deadline. Plaintiff further alleged in its complaint that it had substantially performed the conditions set forth in the letter agreement.

At the outset of trial, the court issued an order *in limine* barring any reference to substantial performance of the terms of the letter agreement. Nonetheless, during the course of trial, the court permitted the jury to consider the theory of substantial performance, and additionally charged the jury concerning substantial performance. Special interrogatories were submitted. The jury found that defendant had properly complied with the terms of the letter agreement, and answered in the negative the questions whether defendant failed to perform its obligations under the letter agreement concerning submission of plans for tenant work, whether defendant by its conduct waived the February 25 deadline for delivery by plaintiff of the landlord’s written consent to tenant work, and whether defendant by its conduct was equitably estopped from requiring plaintiff’s strict adherence to the February 25 deadline. Nonetheless, the jury answered in the affirmative the question, “Did plaintiff substantially perform the conditions set forth in the Letter Agreement?” and awarded plaintiff damages of \$1.2 million.

Defendant moved for judgment notwithstanding the verdict. Supreme Court granted the motion, ruling as a matter of law that “the doctrine of substantial performance has no

⁷ Plaintiff argued that it could have met the deadline, but failed to do so only because defendant, acting in bad faith, induced plaintiff into delaying delivery of the landlord’s consent. Plaintiff asserted that the parties had previously extended the agreement’s deadlines as a matter of course.

application to this dispute, where the Letter Agreement is free of all ambiguity in setting the deadline that plaintiff concededly did not honor.” The Appellate Division reversed the judgment on the law and facts, and reinstated the jury verdict. The Court concluded that the question of substantial compliance was properly submitted to the jury and that the verdict should be reinstated because plaintiff’s failure to deliver the prime landlord’s written consent was inconsequential.

This Court granted defendant’s motion for leave to appeal and we now reverse.

II.

Defendant argues that no sublease or contractual relationship ever arose here because plaintiff failed to satisfy the condition set forth in paragraph 4(c) of the letter agreement. Defendant contends that the doctrine of substantial performance is not applicable to excuse plaintiff’s failure to deliver the prime landlord’s written consent to defendant on or before the date specified in the letter agreement and that the Appellate Division erred in holding to the contrary. Before addressing defendant’s arguments and the decision of the court below, an understanding of certain relevant principles is helpful.

A condition precedent is “an act or event, other than a lapse of time, which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises” (see, Restatement (Second) of Contracts § 224). Most conditions precedent describe acts or events which must occur before a party is obliged to perform a promise made pursuant to an existing contract, a situation to be distinguished conceptually from a condition precedent to the formation or existence of the contract itself. In the latter situation, no contract arises “unless and until the condition occurs.”

Conditions can be express or implied. Express conditions are those agreed to and imposed by the parties themselves. Implied or constructive conditions are those “imposed by law to do justice.” Express conditions must be literally performed, whereas constructive conditions, which ordinarily arise from language of promise, are subject to the precept that substantial compliance is sufficient. The importance of the distinction has been explained by Professor Williston:

Since an express condition . . . depends for its validity on the manifested intention of the parties, it has the same sanctity as the promise itself. Though the court may regret the harshness of such a condition, as it may regret the harshness of a promise, it must, nevertheless, generally enforce the will of the

parties unless to do so will violate public policy. Where, however, the law itself has imposed the condition, in absence of or irrespective of the manifested intention of the parties, it can deal with its creation as it pleases, shaping the boundaries of the constructive condition in such a way as to do justice and avoid hardship. 5 Williston, Contracts § 669, at 154 [3d ed].

In determining whether a particular agreement makes an event a condition courts will interpret doubtful language as embodying a promise or constructive condition rather than an express condition. This interpretive preference is especially strong when a finding of express condition would increase the risk of forfeiture by the obligee (see, Restatement (Second) of Contracts § 227(1)).

Interpretation as a means of reducing the risk of forfeiture cannot be employed if “the occurrence of the event as a condition is expressed in unmistakable language” (Restatement (Second) of Contracts § 229, comment a, at 185; see, § 227, comment b [where language is clear, “(t)he policy favoring freedom of contract requires that, within broad limits, the agreement of the parties should be honored even though forfeiture results”]). Nonetheless, the nonoccurrence of the condition may yet be excused by waiver, breach or forfeiture. The Restatement posits that “[t]o the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange” (Restatement (Second) of Contracts § 229).

Turning to the case at bar, it is undisputed that the critical language of paragraph 4(c) of the letter agreement unambiguously establishes an express condition precedent rather than a promise, as the parties employed the unmistakable language of condition (“if,” “unless and until”). There is no doubt of the parties’ intent and no occasion for interpreting the terms of the letter agreement other than as written.

Furthermore, plaintiff has never argued, and does not now contend, that the nonoccurrence of the condition set forth in paragraph 4(c) should be excused on the ground of forfeiture.⁸ Rather, plaintiff’s primary argument from the inception of this litigation has been that defendant waived or was equitably estopped from invoking paragraph 4(c). Plaintiff argued

⁸ The Restatement defines the term “forfeiture” as “the denial of compensation that results when the obligee loses [its] right to the agreed exchange after [it] has relied substantially, as by preparation or performance on the expectation of that exchange” (§ 229, comment b).

secondarily that it substantially complied with the express condition of delivery of written notice on or before February 25th in that it gave defendant oral notice of consent on the 25th.

Contrary to the decision of the Court below, we perceive no justifiable basis for applying the doctrine of substantial performance to the facts of this case. The flexible concept of substantial compliance stands in sharp contrast to the requirement of strict compliance that protects a party that has taken the precaution of making its duty expressly conditional. If the parties “have made an event a condition of their agreement, there is no mitigating standard of materiality or substantiality applicable to the non-occurrence of that event” (Restatement (Second) of Contracts § 237, comment d, at 220). Substantial performance in this context is not sufficient, and if relief is to be had under the contract, it must be through excuse of the non-occurrence of the condition to avoid forfeiture.

Here, it is undisputed that plaintiff has not suffered a forfeiture or conferred a benefit upon defendant. Plaintiff alludes to a \$1 million licensing fee it allegedly paid to the prime landlord for the purpose of securing the latter’s consent to the subleasing of the premises. At no point, however, does plaintiff claim that this sum was forfeited or that it was expended for the purpose of accomplishing the sublease with defendant. It is further undisputed that O & Y, as an inducement to effect plaintiff’s move to the World Financial Center, promised to indemnify plaintiff for damages resulting from failure to sublease the 33rd floor of One New York Plaza. Consequently, because the critical concern of forfeiture or unjust enrichment is simply not present in this case, we are not presented with an occasion to consider whether the doctrine of substantial performance is applicable, that is, whether the courts should intervene to excuse the nonoccurrence of a condition precedent to the formation of a contract.

The essence of the Appellate Division’s holding is that the substantial performance doctrine is universally applicable to all categories of breach of contract, including the nonoccurrence of an express condition precedent. However, as discussed, substantial performance is ordinarily not applicable to excuse the nonoccurrence of an express condition precedent....

III.

In sum, the letter agreement provides in the clearest language that the parties did not intend to form a contract “unless and until” defendant received written notice of the prime landlord’s consent on or before February 25, 1987. Defendant would lease the 33rd floor from plaintiff only on the condition that the landlord consent in writing to a telephone communication linkage system between the 29th and 33rd floors and to defendant’s plans for construction effectuating that linkage. This matter was sufficiently important to defendant that it would not

enter into the sublease “unless and until” the condition was satisfied. Inasmuch as we are not dealing here with a situation where plaintiff stands to suffer some forfeiture or undue hardship, we perceive no justification for engaging in a “materiality-of-the-nonoccurrence” analysis. To do so would simply frustrate the clearly expressed intention of the parties. Freedom of contract prevails in an arm’s length transaction between sophisticated parties such as these, and in the absence of countervailing public policy concerns there is no reason to relieve them of the consequences of their bargain. If they are dissatisfied with the consequences of their agreement, the time to say so [was] at the bargaining table....

Accordingly, the order of the Appellate Division should be reversed, with costs, and the complaint dismissed.

KAYE, C.J., and SIMONS, TITONE, BELLACOSA, SMITH and LEVINE, JJ., concur.

Notes and Questions

1. The heart of the decision in *Oppenheimer* has to do with the significance of paragraph 4(c). The court states that it “obligated plaintiff to obtain the prime landlord’s written consent to the proposed tenant work and deliver such consent to defendant” by a certain date. Why did the court hold it to be an express condition and not, for example, a promise or an express promissory condition?
2. The court in *Oppenheimer* allowed the defendant to walk away from the agreement because the plaintiff failed to provide a timely written notice even though an oral notification was provided. Do you think that this difference was meaningful? Does the written notification serve a purpose that the oral notification cannot? Should courts engage in such an inquiry?
3. The story of Mark Dove is another example of the harshness of express conditions. Dove, a law student, worked at Rose Acre Farms in the summer of 1979. The parties entered a “bonus agreement” that stated that if Dove worked for at least five full days per week for ten weeks, he would be given a \$5,000 bonus. In the tenth week, Dove came down with strep throat. On Thursday of that week, he reported to work with a temperature of 104. Dove’s boss told him that if he went home, he would forfeit the bonus, but Dove left to seek medical treatment and missed the last two days of the tenth week. When the farm refused to pay the bonus, Dove sued, pointing out that (i) during those ten weeks he often stayed late at work and overall worked at least 750

hours instead of the 500 that were required by the contract, and (ii) the farm completed the construction project on which he worked on time. Dove lost. The court ruled:

[T]he bonus rules at Rose Acre were well known to Dove when he agreed to the disputed bonus contract. He certainly knew [his boss's] strict policies and knew that any absence for any cause whatever worked a forfeiture of the bonus. With this knowledge he willingly entered into this bonus arrangement . . . If the conditions were unnecessarily harsh or eccentric, and the terms odious, he could have shown his disdain by simply declining to participate, for participation in the bonus program was not obligatory or job dependent . . . No fraud or bad faith has been shown on the part of Rose Acre, and no public policy arguments have been advanced to demonstrate why the bonus contract should not be enforced as agreed between the parties . . . we are not at liberty to remake the contract for the parties.

Dove v. Rose Acre Farms, Inc., 434 N.E.2d 931, 935 (Ind. Ct. App. 1982). By the way, Mark Dove is now a practicing lawyer.

4. The court in *Oppenheimer* (like the court in *Dove*) refused to consider a condition satisfied when it was merely partly or even substantially satisfied, noting that only constructive conditions can be excused in that way. Courts, nevertheless, use a variety of other tools to soften the harshness of some express conditions, and the court in *Oppenheimer* mentioned some of them: “waiver, breach or forfeiture.” We discuss waiver and forfeiture in the next two comments. The impact of a breach on existing conditions will be discussed later in this chapter when we consider material breaches.
5. Some conditions to a promise can be waived by the promisor. Let’s assume that after Dove reported to work sick, his boss promised him that his rights to receive the bonus would not be lost if he left to seek medical help. This promise would likely be considered a waiver of the condition and would have been binding. Note that waivers do not need to be supported by consideration nor be relied on. However, the Restatement explains that waivers apply “primarily to conditions which may be thought of as procedural or technical, or to instances in which the non-occurrence of condition is comparatively minor.” Restatement (Second) of Contracts § 84, cmt. d. The rule does not apply to alleged waivers of material parts of the agreement. For example, a buyer would not be obliged to pay for goods it did not receive because it allegedly waived the

condition that payment is due after delivery. Was the condition in *Oppenheimer* waivable? If so, why didn't it help the plaintiff?

6. While the court in *Oppenheimer* rejected the notion of "substantial" satisfaction of express conditions, it acknowledged that they could be excused to avoid forfeiture. The Restatement states that "[t]o the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange." Restatement (Second) of Contracts § 229. That power is, however, not often used. Courts typically consider whether the forfeiture is "disproportionate," taking into account "the importance to the obligor of the risk from which he sought to be protected and the degree to which that protection will be lost if the non-occurrence of the condition is excused." Restatement (Second) of Contracts § 229, cmt. b. Moreover, as with waivers, this rule applies to conditions that are not material parts of the contract. Why didn't this doctrine help the plaintiff in *Oppenheimer*?

In *J. N. A. Realty Corp. v Cross Bay Chelsea*, 42 N.Y.2d 392 (1977) (a case cited in an omitted part of the opinion in *Oppenheimer*), a lease for a successful restaurant included a 24-year renewal option, which should have been exercised six months before the lease expired. The tenant, negligibly, forgot to give notice until the landlord informed them, four months later, that the lease would soon be terminated. By then, the tenant had invested significant funds improving the space, including some investment during those four months after it forgot to give notice.

The New York Court of Appeals, in a 4-3 decision over a strongly-worded dissent, ruled that "when a tenant in possession under an existing lease has neglected to exercise an option to renew, he might suffer a forfeiture if he has made valuable improvements on the property." In that case, "an equitable interest is recognized and protected against forfeiture . . . if the landlord is not harmed by the delay in the giving of the notice." The case was therefore remanded for trial on the question of whether "after the tenant's default the landlord, relying on the agreement, in good faith, made other commitments for the premises."

The dissent agreed that investment in the leased property might constitute forfeiture but would have excused the condition only in unique circumstances, such as an ambiguity in the contract or a failure of the postal service to deliver the notification. Excusing the condition just because of the tenant's negligence, it argued, "introduces instability in business transactions, and disregards commercial realities."

Who do you think has the better argument? Both the majority and the dissent agreed that the condition would not be excused if the landlord relied on it in good faith. Why wouldn't that be enough to protect its interests and to preserve stability? And shouldn't the duty of good faith play a significant role in such a situation? While courts are generally following *JNA* when it comes to the extension of tenancy, they rarely excuse a delay in giving a notice to purchase real estate (for example, a notice of exercising an option to purchase real estate). Can you explain this distinction?

In *Oppenheimer*, the court ruled that Paragraph 4(c) was an express condition and then, as is the case with most express conditions, strictly enforced it. Another way to avoid the harshness of express conditions is to classify contractual terms as promises rather than express conditions. The next case demonstrates that approach.

Howard v. Federal Crop Insurance Corp.

540 F.2d 695 (4th Cir. 1976)

WIDENER, Circuit Judge.

Plaintiff-appellants sued to recover for losses to their 1973 tobacco crop due to alleged rain damage. The crops were insured by defendant-appellee, Federal Crop Insurance Corporation (FCIC) . . . The district court granted summary judgment for the defendant . . . Since we find for the plaintiffs as to the construction of the policy, we express no opinion on the procedural questions.

Federal Crop Insurance Corporation, an agency of the United States, in 1973, issued three policies to the Howards, insuring their tobacco crops, to be grown on six farms, against weather damage and other hazards.

The Howards (plaintiffs) established production of tobacco on their acreage, and have alleged that their 1973 crop was extensively damaged by heavy rains, resulting in a gross loss to the three plaintiffs in excess of \$35,000. The plaintiffs harvested and sold the depleted crop and timely filed notice and proof of loss with FCIC, but, prior to inspection by the adjuster for FCIC, the Howards had either plowed or disked under the tobacco fields in question to prepare the same for sowing a cover crop of rye to preserve the soil. When the FCIC adjuster later inspected the fields, he found the stalks had been largely obscured or obliterated by plowing or disking and denied the claims, apparently on the ground that the plaintiffs had

violated a portion of the policy which provides that the stalks on any acreage with respect to which a loss is claimed shall not be destroyed until the corporation makes an inspection.

There is no question but that apparently after notice of loss was given to defendant, but before inspection by the adjuster, plaintiffs plowed under the tobacco stalks and sowed some of the land with a cover crop, rye. The question is whether, under paragraph 5(f) of the tobacco endorsement to the policy of insurance, the act of plowing under the tobacco stalks forfeits the coverage of the policy. Paragraph 5 of the tobacco endorsement is entitled Claims. Pertinent to this case are subparagraphs 5(b) and 5(f), which are as follows:

“5(b) It shall be a condition precedent to the payment of any loss that the insured establish the production of the insured crop on a unit and that such loss has been directly caused by one or more of the hazards insured against during the insurance period for the crop year for which the loss is claimed, and furnish any other information regarding the manner and extent of loss as may be required by the Corporation. (Emphasis added)”

“5(f) The tobacco stalks on any acreage of tobacco of types 11a, 11b, 12, 13, or 14 with respect to which a loss is claimed shall not be destroyed until the Corporation makes an inspection. (Emphasis added)”

The arguments of both parties are predicated upon the same two assumptions. First, if subparagraph 5(f) creates a condition precedent, its violation caused a forfeiture of plaintiffs' coverage. Second, if subparagraph 5(f) creates an obligation (variously called a promise or covenant) upon plaintiffs not to plow under the tobacco stalks, defendant may recover from plaintiffs (either in an original action, or, in this case, by a counterclaim, or as a matter of defense) for whatever damage it sustained because of the elimination of the stalks. However, a violation of subparagraph 5(f) would not, under the second premise, standing alone, cause a forfeiture of the policy.

Generally accepted law provides us with guidelines here. There is a general legal policy opposed to forfeitures. Insurance policies are generally construed most strongly against the insurer. When it is doubtful whether words create a promise or a condition precedent, they will be construed as creating a promise. The provisions of a contract will not be construed as conditions precedent in the absence of language plainly requiring such construction. Restatement of the Law, Contracts, § 261.

Plaintiffs rely most strongly upon the fact that the term “condition precedent” is included in subparagraph 5(b) but not in subparagraph 5(f). It is true that whether a contract provision is construed as a condition or an obligation does not depend entirely upon whether the word “condition” is expressly used. However, the persuasive force of plaintiffs’ argument in this case is found in the use of the term “condition precedent” in subparagraph 5(b) but not in subparagraph 5(f). Thus, it is argued that the ancient maxim to be applied is that the expression of one thing is the exclusion of another.

The defendant places principal reliance upon the decision of this court in *Fidelity-Phenix Fire Insurance Company v. Pilot Freight Carriers*, 193 F.2d 812, 31 A.L.R.2d 839 (4th Cir. 1952). Suit there was predicated upon a loss resulting from theft out of a truck covered by defendant’s policy protecting plaintiff from such a loss. The insurance company defended upon the grounds that the plaintiff had left the truck unattended without the alarm system being on. The policy contained six paragraphs limiting coverage. Two of those imposed what was called a “condition precedent.” They largely related to the installation of specified safety equipment. Several others, including paragraph 5, pertinent in that case, started with the phrase, “It is further warranted.” In paragraph 5, the insured warranted that the alarm system would be on whenever the vehicle was left unattended. Paragraph 6 starts with the language: “The assured agrees, by acceptance of this policy, that the foregoing conditions precedent relate to matters material to the acceptance of the risk by the insurer.” Plaintiff recovered in the district court, but judgment on its behalf was reversed because of a breach of warranty of paragraph 5, the truck had been left unattended with the alarm off. In that case, plaintiff relied upon the fact that the words “condition precedent” were used in some of the paragraphs but the word “warranted” was used in the paragraph in issue. In rejecting that contention, this court said that “warranty” and “condition precedent” are often used interchangeably to create a condition of the insured’s promise, and “(m)anifestly the terms ‘condition precedent’ and ‘warranty’ were intended to have the same meaning and effect.”

Fidelity-Phenix thus does not support defendant’s contention here. Although there is some resemblance between the two cases, analysis shows that the issues are actually entirely different. Unlike the case at bar, each paragraph in Fidelity-Phenix contained either the term “condition precedent” or the term “warranted.” We held that, in that situation, the two terms had the same effect in that they both involved forfeiture. That is well established law. See Appleman, *Insurance Law and Practice* (1972), vol. 6A, s 4144. In the case at bar, the term “warranty” or “warranted” is in no way involved, either in terms or by way of like language, as it was in Fidelity-Phenix. The issue upon which this case turns, then, was not involved in Fidelity-Phenix.

The Restatement [First] of the Law of Contracts states:

“261. Interpretation of Doubtful Words as Promise or Condition.

Where it is doubtful whether words create a promise or an express condition, they are interpreted as creating a promise; but the same words may sometimes mean that one party promises a performance and that the other party’s promise is conditional on that performance.”

Two illustrations (one involving a promise, the other a condition) are used in the Restatement:

“2. A, an insurance company, issues to B a policy of insurance containing promises by A that are in terms conditional on the happening of certain events. The policy contains this clause: ‘provided, in case differences shall arise touching any loss, the matter shall be submitted to impartial arbitrators, whose award shall be binding on the parties.’ This is a promise to arbitrate and does not make an award a condition precedent of the insurer’s duty to pay.

3. A, an insurance company, issues to B an insurance policy in usual form containing this clause: ‘In the event of disagreement as to the amount of loss it shall be ascertained by two appraisers and an umpire. *The loss shall not be payable until 60 days after the award of the appraisers when such an appraisal is required.*’ This provision is not merely a promise to arbitrate differences but makes an award a condition of the insurer’s duty to pay in case of disagreement.” (Emphasis added)

We believe that subparagraph 5(f) in the policy here under consideration fits illustration 2 rather than illustration 3. Illustration 2 specifies something to be done, whereas subparagraph 5(f) specifies something not to be done. Unlike illustration 3, subparagraph 5(f) does not state any conditions under which the insurance shall “not be payable,” or use any words of like import. We hold that the district court erroneously held, on the motion for summary judgment, that subparagraph 5(f) established a condition precedent to plaintiffs’ recovery which forfeited the coverage.

The explanation defendant makes for including subparagraph 5(f) in the tobacco endorsement is that it is necessary that the stalks remain standing in order for the Corporation to evaluate the extent of loss and to determine whether loss resulted from some cause not covered by the policy. However, was subparagraph 5(f) inserted because without it the Corporation’s

opportunities for proof would be more difficult, or because they would be impossible? Plaintiffs point out that the Tobacco Endorsement, with subparagraph 5(f), was adopted in 1970, and crop insurance goes back long before that date. Nothing is shown as to the Corporation's prior 1970 practice of evaluating losses. Such a showing might have a bearing upon establishing defendant's intention in including 5(f). Plaintiffs state, and defendant does not deny, that another division of the Department of Agriculture, or the North Carolina Department, urged that tobacco stalks be cut as soon as possible after harvesting as a means of pest control. Such an explanation might refute the idea that plaintiffs plowed under the stalks for any fraudulent purpose. Could these conflicting directives affect the reasonableness of plaintiffs' interpretation of defendant's prohibition upon plowing under the stalks prior to adjustment?

We express no opinion on these questions because they were not before the district court and are mentioned to us largely by way of argument rather than from the record. No question of ambiguity was raised in the court below or here . . . Nothing we say here should preclude FCIC from asserting as a defense that the plowing or disking under of the stalks caused damage to FCIC if, for example, the amount of the loss was thereby made more difficult or impossible to ascertain whether the plowing or disking under was done with bad purpose or innocently. To repeat, our narrow holding is that merely plowing or disking under the stalks does not of itself operate to forfeit coverage under the policy.

The case is remanded for further proceedings not inconsistent with this opinion.

Notes and Questions

1. The court in *Howard* cited section 261 of the first Restatement of Contracts, which preferred to consider ambiguous terms as promises and not express conditions. The Second Restatement preserved the same policy in section 227, noting that "The policy favoring freedom of contract requires that, within broad limits (see § 229), the agreement of the parties should be honored even though forfeiture results. When, however, it is doubtful whether or not the agreement makes an event a condition of an obligor's duty, an interpretation is preferred that will reduce the risk of forfeiture." Restatement (Second) of Contracts § 227, Comment b.
2. How much does the *Howard* court rely on the rule preferring promises? Could the same result be reached by using the standard canons of interpretation? Which canon(s) would you bring to bear?

3. Read FCIC's explanation of the significance of Section 5(f). Did interpreting this provision as a promise and not a condition affect the agency's interests in avoiding insurance fraud? What would be the impact of breaching Section 5(f) now that it is merely a promise? Would that impact deter an insured from breaching the section?
4. The preference for promises, as expressed in Restatement (Second) of contracts §227 and in *Howard*, is a rule of interpretation. The Restatement and the caselaw clearly state that the preference cannot be used to avoid an unambiguous express condition. If you were advising FCIC, how would you have redrafted the agreement to avoid the situation the agency faced in *Howard*?
5. If section 5(f) had clearly been drafted as a condition, could that condition be excused to avoid forfeiture (according to the rule discussed in *Oppenheimer* and the notes that followed that case)?

Morin Building Products Co., Inc. v. Baystone Construction, Inc.

717 F.2d 413 (7th Cir. 1983)

POSNER, Circuit Judge.

This appeal from a judgment for the plaintiff in a diversity suit requires us to interpret Indiana's common law of contracts. General Motors, which is not a party to this case, hired Baystone Construction, Inc., the defendant, to build an addition to a Chevrolet plant in Muncie, Indiana. Baystone hired Morin Building Products Company, the plaintiff, to supply and erect the aluminum walls for the addition. The contract required that the exterior siding of the walls be of "aluminum type 3003, not less than 18 B & S gauge, with a mill finish and stucco embossed surface texture to match finish and texture of existing metal siding." The contract also provided "that all work shall be done subject to the final approval of the Architect or Owner's [General Motors'] authorized agent, and his decision in matters relating to artistic effect shall be final, if within the terms of the Contract Documents"; and that "should any dispute arise as to the quality or fitness of materials or workmanship, the decision as to acceptability shall rest strictly with the Owner, based on the requirement that all work done or materials furnished shall be first class in every respect. What is usual or customary in erecting other buildings shall in no way enter into any consideration or decision."

Morin put up the walls. But viewed in bright sunlight from an acute angle the exterior siding did not give the impression of having a uniform finish, and General Motors' representative rejected it. Baystone removed Morin's siding and hired another subcontractor to replace it.

General Motors approved the replacement siding. Baystone refused to pay Morin the balance of the contract price (\$23,000) and Morin brought this suit for the balance, and won.

The only issue on appeal is the correctness of a jury instruction which, after quoting the contractual provisions requiring that the owner (General Motors) be satisfied with the contractor's (Morin's) work, states: "Notwithstanding the apparent finality of the foregoing language, however, the general rule applying to satisfaction in the case of contracts for the construction of commercial buildings is that the satisfaction clause must be determined by objective criteria. Under this standard, the question is not whether the owner was satisfied in fact, but whether the owner, as a reasonable person, should have been satisfied with the materials and workmanship in question." There was much evidence that General Motors' rejection of Morin's exterior siding had been totally unreasonable. Not only was the lack of absolute uniformity in the finish of the walls a seemingly trivial defect given the strictly utilitarian purpose of the building that they enclosed, but it may have been inevitable; "mill finish sheet" is defined in the trade as "sheet having a nonuniform finish which may vary from sheet to sheet and within a sheet, and may not be entirely free from stains or oil." If the instruction was correct, so was the judgment. But if the instruction was incorrect—if the proper standard is not whether a reasonable man would have been satisfied with Morin's exterior siding but whether General Motors' authorized representative in fact was—then there must be a new trial to determine whether he really was dissatisfied, or whether he was not and the rejection therefore was in bad faith.

Some cases hold that if the contract provides that the seller's performance must be to the buyer's satisfaction, his rejection—however unreasonable—of the seller's performance is not a breach of the contract unless the rejection is in bad faith. But most cases conform to the position stated in section 228 of the Restatement (Second) of Contracts (1979): if "it is practicable to determine whether a reasonable person in the position of the obligor would be satisfied, an interpretation is preferred under which the condition [that the obligor be satisfied with the obligee's performance] occurs if such a reasonable person in the position of the obligor would be satisfied." See Farnsworth, *Contracts* 556–59 (1982); *Indiana Tri-City Plaza Bowl, Inc. v. Estate of Glueck*, 422 N.E.2d 670, 675 (Ind. App. 1981), consistently with hints in earlier Indiana cases . . . adopts the majority position as the law of Indiana.

We do not understand the majority position to be paternalistic; and paternalism would be out of place in a case such as this, where the subcontractor is a substantial multistate enterprise. The requirement of reasonableness is read into a contract not to protect the weaker party but to approximate what the parties would have expressly provided with respect to a contingency that they did not foresee, if they had foreseen it. Therefore the requirement is not read into

every contract, because it is not always a reliable guide to the parties' intentions. In particular, the presumption that the performing party would not have wanted to put himself at the mercy of the paying party's whim is overcome when the nature of the performance contracted for is such that there are no objective standards to guide the court. It cannot be assumed in such a case that the parties would have wanted a court to second-guess the buyer's rejection. So "the reasonable person standard is employed when the contract involves commercial quality, operative fitness, or mechanical utility which other knowledgeable persons can judge The standard of good faith is employed when the contract involves personal aesthetics or fancy." *Indiana Tri-City Plaza Bowl, Inc. v. Estate of Glueck, supra*, 422 N.E.2d at 675.

We have to decide which category the contract between Baystone and Morin belongs in. The particular in which Morin's aluminum siding was found wanting was its appearance, which may seem quintessentially a matter of "personal aesthetics," or as the contract put it, "artistic effect." But it is easy to imagine situations where this would not be so. Suppose the manager of a steel plant rejected a shipment of pig iron because he did not think the pigs had a pretty shape. The reasonable-man standard would be applied even if the contract had an "acceptability shall rest strictly with the Owner" clause, for it would be fantastic to think that the iron supplier would have subjected his contract rights to the whimsy of the buyer's agent. At the other extreme would be a contract to paint a portrait, the buyer having reserved the right to reject the portrait if it did not satisfy him. Such a buyer wants a portrait that will please him rather than a jury, even a jury of connoisseurs, so the only question would be his good faith in rejecting the portrait. *Gibson v. Cranage*, 39 Mich. 49 (1878).

This case is closer to the first example than to the second. The building for which the aluminum siding was intended was a factory—not usually intended to be a thing of beauty. That aesthetic considerations were decidedly secondary to considerations of function and cost is suggested by the fact that the contract specified mill-finish aluminum, which is unpainted. There is much debate in the record over whether it is even possible to ensure a uniform finish within and among sheets, but it is at least clear that mill finish usually is not uniform. If General Motors and Baystone had wanted a uniform finish they would in all likelihood have ordered a painted siding. Whether Morin's siding achieved a reasonable uniformity amounting to satisfactory commercial quality was susceptible of objective judgment; in the language of the Restatement, a reasonableness standard was "practicable."

But this means only that a requirement of reasonableness would be read into this contract if it contained a standard owner's satisfaction clause, which it did not; and since the ultimate touchstone of decision must be the intent of the parties to the contract we must consider the actual language they used. The contract refers explicitly to "artistic effect," a choice of words

that may seem deliberately designed to put the contract in the “personal aesthetics” category whatever an outside observer might think. But the reference appears as number 17 in a list of conditions in a general purpose form contract. And the words “artistic effect” are immediately followed by the qualifying phrase, “if within the terms of the Contract Documents,” which suggests that the “artistic effect” clause is limited to contracts in which artistic effect is one of the things the buyer is aiming for; it is not clear that he was here. The other clause on which Baystone relies, relating to the quality or fitness of workmanship and materials, may seem all-encompassing, but it is qualified by the phrase, “based on the requirement that all work done or materials furnished shall be first class in every respect”—and it is not clear that Morin’s were not. This clause also was not drafted for this contract; it was incorporated by reference to another form contract (the Chevrolet Division’s “Contract General Conditions”), of which it is paragraph 35. We do not disparage form contracts, without which the commercial life of the nation would grind to a halt. But we are left with more than a suspicion that the artistic-effect and quality-fitness clauses in the form contract used here were not intended to cover the aesthetics of a mill-finish aluminum factory wall.

If we are right, Morin might prevail even under the minority position, which makes good faith the only standard but presupposes that the contract conditioned acceptance of performance on the buyer’s satisfaction in the particular respect in which he was dissatisfied. Maybe this contract was not intended to allow General Motors to reject the aluminum siding on the basis of artistic effect. It would not follow that the contract put Morin under no obligations whatsoever with regard to uniformity of finish. The contract expressly required it to use aluminum having “a mill finish ... to match finish ... of existing metal siding.” The jury was asked to decide whether a reasonable man would have found that Morin had used aluminum sufficiently uniform to satisfy the matching requirement. This was the right standard if, as we believe, the parties would have adopted it had they foreseen this dispute. It is unlikely that Morin intended to bind itself to a higher and perhaps unattainable standard of achieving whatever perfection of matching that General Motors’ agent insisted on, or that General Motors would have required Baystone to submit to such a standard. Because it is difficult—maybe impossible—to achieve a uniform finish with mill-finish aluminum, Morin would have been running a considerable risk of rejection if it had agreed to such a condition, and it therefore could have been expected to demand a compensating increase in the contract price. This would have required General Motors to pay a premium to obtain a freedom of action that it could not have thought terribly important, since its objective was not aesthetic. If a uniform finish was important to it, it could have gotten such a finish by specifying painted siding.

All this is conjecture; we do not know how important the aesthetics were to General Motors when the contract was signed or how difficult it really would have been to obtain the uniformity of finish it desired. The fact that General Motors accepted the replacement siding proves little, for there is evidence that the replacement siding produced the same striped effect, when viewed from an acute angle in bright sunlight, that Morin's had. When in doubt on a difficult issue of state law it is only prudent to defer to the view of the district judge, *Murphy v. White Hen Pantry Co.*, 691 F.2d 350, 354 (7th Cir. 1982), here an experienced Indiana lawyer who thought this the type of contract where the buyer cannot unreasonably withhold approval of the seller's performance.

Lest this conclusion be thought to strike at the foundations of freedom of contract, we repeat that if it appeared from the language or circumstances of the contract that the parties really intended General Motors to have the right to reject Morin's work for failure to satisfy the private aesthetic taste of General Motors' representative, the rejection would have been proper even if unreasonable. But the contract is ambiguous because of the qualifications with which the terms "artistic effect" and "decision as to acceptability" are hedged about, and the circumstances suggest that the parties probably did not intend to subject Morin's rights to aesthetic whim.

AFFIRMED.

Notes and Questions

1. Consider the following case: Jefferson Gibson promised to create a large picture of Thomas Cranage's deceased daughter to the satisfaction of the latter. Cranage, however, was dissatisfied with the picture, refused to accept it, and told Gibson that he would refuse to accept any similar picture. When Gibson sued, the Michigan Supreme Court sided with Cranage, holding that:

[i]t may be that the picture was an excellent one and that the defendant ought to have been satisfied with it and accepted it, but under the agreement the defendant was the only person who had the right to decide this question . . . Artists or third parties might consider a portrait an excellent one, and yet it prove very unsatisfactory to the person who had ordered it and who might be unable to point out with clearness or certainty the defects or objections. And if the person giving the order stipulates that the portrait when finished must be satisfactory to him or

else he will not accept or pay for it, and this is agreed to, he may insist upon his right as given him by the contract.

Gibson v. Cranage, 39 Mich. 49 (1878). How does Judge Posner distinguish that case in *Morin Building*?

2. Judge Posner partly relied on the rule stated in Section 228 of Restatement, and he cited part of it. In a part that he did not cite, the Restatement suggests that this rule applies “when it is a condition of an obligor’s duty that he be satisfied with respect to the obligee’s performance.” Does that correctly describe the contract between the general contractor and the sub-contractor in *Morin*? Does it make sense to expand the rule to situations like the one in *Morin*? Why and why not?
3. Every contract must be performed in good faith. There was no dispute that in *Morin Building*, General Motors (GM) would breach the contract if it rejected the factory in bad faith. The court, however, repeatedly notes that the defect that GM found in the building’s appearance “may have been inevitable.” Wasn’t it bad faith for GM to reject an unavoidable defect, especially when it later accepted the factory, as completed by another contractor?
4. The *Morin Building* court suggested that “the performing party would not have wanted to put himself at the mercy of the paying party’s whim.” What does the ruling mean for the general contractor? It had to pay for the work twice. Didn’t the decision place the general contractor “at the mercy of the paying party’s whim”? Considering that outcome, is it obvious that “the parties probably did not intend to subject Morin’s rights to aesthetic whim” even when the contract’s language at least seemed to suggest such a result?
5. Judge Posner balked at the idea that the reasonableness rule has anything to do with paternalism. Do you agree? Before you answer, consider the following: In some respect, the issue here is whether the general contractor or the sub-contractor bears the risk concerning the unreasonable actions of the ultimate client (here, GM). Framed that way, *Morin Building* is consistent with a long line of decisions that interpret ambiguous conditions concerning the subcontractor’s right to be paid by the general contractor. For example, subcontracting agreements often include a “pay when paid” provision, stating that the subcontractor will be paid when the general contractor is paid. Unless the contract language unequivocally assigns the risk of nonpayment to the subcontractor, courts typically interpret “pay when paid” provisions to “afford [the]

general contractor opportunity to procure from owner the funds necessary to pay subcontractor, not to require subcontractor to wait to be paid for an indefinite period of time until general contractor had been paid by owner.” *Thos. J. Dyer Co. v. Bishop Int’l Eng’g Co.*, 303 F.2d 655 (6th Cir. 1962). Isn’t it reasonable that soft paternalism is at least a partial explanation for this approach?