

# Constructive Conditions and Material Breach

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The parties can explicitly agree on when their performances will become due. They can set a fixed time (Alice will deliver the goods on Monday at 8:00 am) or make it expressly conditioned on another event (Bob will promptly perform after he is notified of a fire). In those cases, once the performance is due, any non-performance is a breach.

This section focuses on more common situations in which the parties did not explicitly specify all the circumstances under which performance is or is not due. In those cases, courts are tasked with determining the time of performance, and they do it by reading constructive (implied) conditions into the parties' agreement.

In this section, we will discuss two important and generally applicable sets of constructive conditions: Those regarding the order of performance and those related to the implications of a breach. In later sections, we will discuss additional constructive conditions: those concerning the anticipation of a future breach and those applicable under the UCC in a sale of goods transactions. We will conclude our discussion on conditions by considering several common law doctrines that might excuse performance when the circumstances significantly change.

## A. Order of Performance

Setting the time of performance is a nonissue when parties exchange immediate acts. Suppose the buyer and seller agree to exchange goods for cash, right here and now, and go their separate ways. In that case, the performances are immediate. (Is this immediate exchange even considered a contract? We are going to resist the temptation of going down this rabbit hole). However, when performance is not immediate, timing becomes important. As a general matter, and if all else is equal, the party who performs first is exposed to the risk of non-performance by the other party. In some respects, contract law's main task and core justification is to mitigate that risk (do you see why?), but it cannot eradicate it. For example, contract law cannot eliminate the risk of insolvency, fraud, or the need to spend significant resources to enforce one's legal rights. For that reason, the order of performance allocates certain risks to certain parties.

Because earlier performance entails risk, the law prefers, as a default rule, simultaneous performance. In other words, unless the parties indicate otherwise, courts will not allocate the risk of non-performance to one of them if such a situation can be avoided. The Restatement gives the following example: "A promises to sell land to B, the deed to be delivered on July 1. B promises to pay A \$50,000, no provision being made for the time of payment. Delivery of

the deed and payment of the price are due simultaneously.” Restatement (Second) of Contracts § 234, *cmt. b*. Simultaneous performance is preferred even if it is only partly possible. Consider the following example, also from the Restatement: “A promises to sell land to B, delivery of the deed to be four years from the following July 1. B promises to pay A \$50,000 in installments of \$10,000 on each July 1 for five years. Delivery of the deed and payment of the last installment are due simultaneously.” Restatement (Second) of Contracts § 234, *cmt. c*.

Simultaneous performance is, however, impossible when one party’s performance requires a period of time while the other party’s performance does not. Service contracts are the archetypal example of such agreements. In such a case, the default rule is that the performance that takes a long period of time is due first. If Alice hires Bob to clean her house, Bob must fully perform first, and unless the contract or circumstances indicate otherwise, he cannot, once the contract is formed, require Alice to pay him as a condition for his performance. Alice’s duty to pay is conditioned on Bob’s full performance but not vice versa. For example, in *Stewart v. Newbury*, 220 N.Y. 379 (1979), the New York Court of Appeals famously ruled that a contractor is not entitled to *any* progress payments during the months he worked on a large construction project.

Note that those principles set forth only the default rules. The contract or the circumstances might indicate a different intent, leading to a different order of performance. For example, suppose a landlord promises to furnish its general contractor a security interest (such as a mortgage) to guarantee payment. In that case, the creation of the security interest (although instantaneous) is obviously, by default, due before the contractor performs. See Restatement (Second) of Contracts § 234, *cmt. f*.

## **B. Material Breach and Self-Help**

Now that we know who must perform first, we can get to the heart of this part of the book: what can a party do after the other party breached? One thing that the breached-against party can do is to sue, often for damages or specific performance. We deal with this possibility in the sections on remedies. This section, however, focuses on self-help measurements that the injured party can undertake without a court order.

As we will see, commencing self-help measurements can be risky, and taking them mistakenly can typically be a breach of contract in itself. For that reason, it is not unusual to consult lawyers before taking such actions. Indeed, your clients might call you to let you know that the other party failed to perform certain obligations that were due. The clients might then ask you if, considering those failures by the other side, they still need to perform their obligations.

Do they need to continue to interact with the breaching party? Can they look for substitute performance from a third party? This section focuses on those questions.

At the heart of the answers to those questions is the important rule stated in the Restatement:

[I]t is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time.

Restatement (Second) of Contracts § 237. The following cases break down this rule.

**K & G Construction Co. v. Harris**

164 A.2d 451 (Court of Appeals of Maryland 1960)

PRESCOTT, Judge.

Feeling aggrieved by the action of the trial judge of the Circuit Court for Prince George's County, sitting without a jury, in finding a judgment against it in favor of a subcontractor, the appellant, the general contractor on a construction project, appealed.

The principal question presented is: Does a contractor, damaged by a subcontractor's failure to perform a portion of his work in a workmanlike manner, have a right, under the circumstances of this case, to withhold, in partial satisfaction of said damages, an installment payment, which, under the terms of the contract, was due the subcontractor, unless the negligent performance of his work excused its payment?

. . . The statement, in relevant part, is as follows:

. . . K & G Construction Company, Inc. (hereinafter called Contractor), plaintiff and counter-defendant in the Circuit Court and appellant herein, was owner and general contractor of a housing subdivision project being constructed (herein called Project). Harris and Brooks (hereinafter called Subcontractor), defendants and counter-plaintiffs in the Circuit Court and appellees herein, entered into a contract with Contractor to do excavating and earth-moving work on the Project. Pertinent parts of the contract are set forth below:

Section 3. The Subcontractor agrees to complete the several portions and the whole of the work herein sublet by the time or times following:

(a) Without delay, as called for by the Contractor.

(b) It is expressly agreed that time is of the essence of this contract, and that the Contractor will have the right to terminate this contract and employ a substitute to perform the work in the event of delay on the part of Subcontractor, and Subcontractor agrees to indemnify the Contractor for any loss sustained thereby, provided, however, that nothing in this paragraph shall be construed to deprive Contractor of any rights or remedies it would otherwise have as to damage for delay.

Section 4. (b) Progress payments will be made each month during the performance of the work. Subcontractor will submit to Contractor, by the 25th of each month, a requisition for work performed during the preceding month. Contractor will pay these requisitions, less a retainer equal to ten per cent (10%), by the 10th of the months in which such requisitions are received.

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Section 8. . . . All work shall be performed in a workmanlike manner, and in accordance with the best practices.

Section 9. Subcontractor agrees to carry, during the progress of the work, . . . liability insurance against . . . property damage, in such amounts and with such companies as may be satisfactory to Contractor and shall provide Contractor with certificates showing the same to be in force.

While in the course of his employment by the Subcontractor on the Project, a bulldozer operator drove his machine too close to Contractor's house while grading the yard, causing the immediate collapse of a wall and other damage to the house. The resulting damage to contractor's house was \$3,400.00. Subcontractor had complied with the insurance provision (Sec. 9) of the aforesaid contract. Subcontractor reported said damages to their liability insurance carrier. The Subcontractor and its insurance carrier refused to repair damage or compensate Contractor for damage to the house, claiming that there was no liability on the part of the Subcontractor.

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Contractor was generally satisfied with Subcontractor's work and progress as required under Sections 3 and 8 of the contract until September 12, 1958, with the exception of the bulldozer accident of August 9, 1958.

Subcontractor performed work under the contract during July, 1958, for which it submitted a requisition by the 25th of July, as required by the contract, for work done prior to the 25th of

July, payable under the terms of the contract by Contractor on or before August 10, 1958. Contractor was current as to payments due under all preceding monthly requisitions from Subcontractor. The aforesaid bulldozer accident damaging Contractor's house occurred on August 9, 1958. Contractor refused to pay Subcontractor's requisition due on August 10, 1958, because the bulldozer damage to Contractor's house had not been repaired or paid for. Subcontractor continued to work on the project until the 12th of September, 1958, at which time they discontinued working on the project because of Contractor's refusal to pay the said work requisition and notified Contractor by registered letters of their position and willingness to return to the job, but only upon payment. At that time, September 12, 1958, the value of the work completed by Subcontractor on the project for which they had not been paid was \$1,484.50.

Contractor later requested Subcontractor to return and complete work on the Project which Subcontractor refused to do because of nonpayment of work requisitions of July 25 and thereafter. Contractor's house was not repaired by Subcontractor nor compensation paid for the damage.

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. . . Contractor filed suit against the Subcontractor in two counts: (1), for the aforesaid bulldozer damage to Contractor's house, alleging negligence of the Subcontractor's bulldozer operator, and (2) for the \$450.00 costs above the contract price in having another excavating subcontractor complete the uncompleted work in the contract. Subcontractor filed a counter-claim for recovery of work of the value of \$1,484.50 for which they had not received payment and for loss of anticipated profits on uncompleted portion of work in the amount of \$1,340.00. By agreement of the parties, the first count of Contractor's claim, i. e., for aforesaid bulldozer damage to Contractor's house, was submitted to jury who found in favor of Contractor in the amount of \$3,400.00. Following the finding by the jury, the second count of the Contractor's claim and the counter-claims of the Subcontractor, by agreement of the parties, were submitted to the Court for determination, without jury. All of the facts recited herein above were stipulated to by the parties to the Court. Circuit Court Judge Fletcher found for counter-plaintiff Subcontractor in the amount of \$2,824.50 from which Contractor has entered this appeal.'

The \$3.400 judgment has been paid.

It is immediately apparent that our decision turns upon the respective rights and liabilities of the parties under that portion of their contract whereby the subcontractor agreed to do the

excavating and earth-moving work in 'a workmanlike manner, and in accordance with the best practices,' with time being of the essence of the contract, and the contractor agreed to make progress payments therefor on the 10th day of the months following the performance of the work by the subcontractor. The subcontractor contends, of course, that when the contractor failed to make the payment due on August 10, 1958, he breached his contract and thereby released him (the subcontractor) from any further obligation to perform. The contractor, on the other hand, argues that the failure of the subcontractor to perform his work in a workmanlike manner constituted a material breach of the contract, which justified his refusal to make the August 10 payment; and, as there was no breach on his part, the subcontractor had no right to cease performance on September 12, and his refusal to continue work on the project constituted another breach, which rendered him liable to the contractor for damages. The vital question, more tersely stated, remains: Did the contractor have a right, under the circumstances, to refuse to make the progress payment due on August 10, 1958?

The answer involves interesting and important principles of contract law. Promises and counter-promises made by the respective parties to a contract have certain relations to one another, which determine many of the rights and liabilities of the parties. Broadly speaking, they are (1) independent of each other, or (2) mutually dependent, one upon the other. They are independent of each other if the parties intend that performance by each of them is in no way conditioned upon performance by the other. In other words, the parties exchange promises for promises, not the performance of promises for the performance of promises. A failure to perform an independent promise does not excuse non-performance on the part of the adversary party, but each is required to perform his promise, and, if one does not perform, he is liable to the adversary party for such non-performance. (Of course, if litigation ensues questions of set-off or recoupment frequently arise.) Promises are mutually dependent if the parties intend performance by one to be conditioned upon performance by the other . . .

Professor Page . . . says there are three classes of independent promises left: (1) those in which the acts to be performed by the respective parties are, by the terms of the contract, to be performed at fixed times or on the happening of certain events which do not bear any relation to one another; (2) those in which the covenant in question is independent because it does not form the entire consideration for the covenants on the part of the adversary party, and ordinarily forms but a minor part of such consideration; and (3) those in which the contract shows that the parties intended performance of their respective promises without regard to performance on the part of the adversary, thus relying upon the promises and not the performances.

In the early days, it was settled law that covenants and mutual promises in a contract were *prima facie* independent, and that they were to be so construed in the absence of language in the contract clearly showing that they were intended to be dependent. In the case of *Kingston v. Preston*, 2 Doug. 689, decided in 1774, Lord Mansfield, contrary to three centuries of opposing precedents, changed the rule, and decided that performance of one covenant might be dependent on prior performance of another, although the contract contained no express condition to that effect. The modern rule, which seems to be of almost universal application, is that there is a presumption that mutual promises in a contract are dependent and are to be so regarded, whenever possible. Restatement, Contracts, ¶ 266.

While the courts assume, in deciding the relation of one or more promises in a contract to one or more counter-promises, that the promises are dependent rather than independent, the intention of the parties, as shown by the entire contract as construed in the light of the circumstances of the case, the nature of the contract, the relation of the parties thereto, and the other evidence which is admissible to assist the court in determining the intention of the parties, is the controlling factor in deciding whether the promises and counter-promises are dependent or independent.

Considering the presumption that promises and counter-promises are dependent and the statement of the case, we have no hesitation in holding that the promise and counter-promise under consideration here were mutually dependent, that is to say, the parties intended performance by one to be conditioned on performance by the other; and the subcontractor's promise was, by the explicit wording of the contract, precedent to the promise of payment, monthly, by the contractor. In *Shapiro Engineering Corp. v. Francis O. Day Co.*, 215 Md. 373, 380, 137 A.2d 695, we stated that it is the general rule that where a total price for work is fixed by a contract, the work is not rendered divisible by progress payments. It would, indeed present an unusual situation if we were to hold that a building contractor, who has obtained someone to do work for him and has agreed to pay each month for the work performed in the previous month, has to continue the monthly payments, irrespective of the degree of skill and care displayed in the performance of work, and his only recourse is by way of suit for ill-performance. If this were the law, it is conceivable, in fact, probable, that many contractors would become insolvent before they were able to complete their contracts. As was stated by the Court in *Measures Brothers Ltd. v. Measures*, 2 Ch. 248: "Covenants are to be construed as dependent or independent according to the intention of the parties and the good sense of the case."

We hold that when the subcontractor's employee negligently damaged the contractor's wall, this constituted a breach of the subcontractor's promise to perform his work in a 'workmanlike

manner, and in accordance with the best practices.’ And there can be little doubt that the breach was material: the damage to the wall amounted to more than double the payment due on August 10. 3A Corbin, Contracts, § 708, says: “The failure of a contractor’s [in our case, the subcontractor’s] performance to constitute ‘substantial’ performance may justify the owner [in our case, the contractor] in refusing to make a progress payment. . . . If the refusal to pay an installment is justified on the owner’s [contractor’s] part, the contractor [subcontractor] is not justified in abandoning work by reason of that refusal. His abandonment of the work will itself be a wrongful repudiation that goes to the essence, even if the defects in performance did not.’ See also Restatement, Contracts, § 274. Professor Corbin, in § 954, states further: “The unexcused failure of a contractor to render a promised performance when it is due is always a breach of contract . . . . Such failure may be of such great importance as to constitute what has been called herein a ‘total’ breach. . . . For a failure of performance constituting such a ‘total’ breach, an action for remedies that are appropriate thereto is at once maintainable. Yet the injured party is not required to bring such action. He has the option of treating the non-performance as a ‘partial’ breach only . . . .” In permitting the subcontractor to proceed with work on the project after August 9, the contractor, obviously, treated the breach by the subcontractor as a partial one. As the promises were mutually dependent and the subcontractor had made a material breach in his performance, this justified the contractor in refusing to make the August 10 payment; hence, as the contractor was not in default, the subcontractor again breached the contract when he, on September 12, discontinued work on the project, which rendered him liable (by the express terms of the contract) to the contractor for his increased cost in having the excavating done—a stipulated amount of \$450

Judgment against the appellant reversed; and judgment entered in favor of the appellant against the appellees for \$450, the appellees to pay the costs.

### Notes and Questions

1. It is common in cases of self-help that both parties stop performing certain promises at some point, and the court is charged with deciding which failure was justified, meaning which promises were and were not due. Identifying the first party who had breached the contract is typically vital in figuring out which of the parties is at fault. In K&G, the bulldozer accident on August 9 set the events in motion. By the time the case got to the Court of Appeals, it was already established that the subcontractor’s negligence caused it, which means that it breached the “workmanlike manner” provision of the contract.



Shortly thereafter, the general contractor did not perform its promise to pay the subcontractor on the 10<sup>th</sup> of each month. This is a form of self-help, also called *suspension* of performance. Note that the general contractor had to decide whether to suspend its performance almost immediately. Consider what the legal implications of a mistake would have been. For example, what would the implications be if the jury had determined that the bulldozer accident was not the subcontractor's fault? The decisions to suspend performance under those circumstances are the type of judgment calls that parties—and quite often with their lawyers—need to make during performance.

2. Not every breach allows a party to suspend its performance. A party can suspend its performance only after an uncured *material breach* of a *dependable promise*. The court in *K&G* discusses materiality quite briefly, possibly because the harm that the bulldozer accident caused was quite significant compared to the value of the contract. Restatement (Second) of Contracts § 241 includes a list of factors that can be considered when materiality is more controversial. The subcontractor's main claim, however, was that the two promises—the subcontractor's promise to provide workmanlike work and the general contractor's promise to pay—were independent. As the court notes, accepting such a claim would have put the general contractor in a weak position and exposed it to a significant risk of non-performance, and it is hard to see why it would have been consistent with the parties' intent. As the court notes, the modern approach assumes that when the contract includes promises by both parties, those promises are dependable. The Restatement, for example, suggests that this presumption can be defeated only when "a contrary intention is clearly manifested." Restatement (Second) of Contracts § 232.
3. The subcontractor in *K&G* decided to stop working after not being paid for two months. While this decision might be understood intuitively, it is nevertheless a separate breach of the contract. Because the subcontractor refused to cure its earlier breach (meaning, refused to fix the wall that its bulldozer damaged), the general contractor was well within its right when it refused to pay. Therefore, the subcontractor had no legal excuse not to perform. In other words, all the conditions for its continued performance were met.
4. The general contractor in *K&G* did not *terminate* the contract and did not hire another subcontractor immediately. Not every breach, not even a material breach of a dependable promise, allows the non-breaching party to terminate the agreement immediately. The law prefers to give the breaching party a chance to *cure* the breach. As the Restatement explains, a breach "discharges those duties if it has not been cured

during the time in which performance can occur.” Restatement (Second) of Contracts § 237, cmt. a. Section 242 of the Restatement lists circumstances that are significant in determining when the contract can be terminated (“discharge” the duties as the Restatement calls it). Moreover, even in those cases in which the breached-against party can terminate the contract, it is allowed to still give the breaching party the option to cure the breach.

5. If a breaching party cures before the contract is terminated, both parties need to resume performance. Indeed, section 237 of the Restatement notes that the condition to the performance is the lack of “uncured material failure by the other party,” meaning that once the failure is cured, the condition for performance for the non-breaching party is met. Do you think that the rules concerning cure are consistent with what most parties would have chosen?

However, it is important to note the exact effect of a cure: it only means that the parties have to resume performance and cannot exercise self-help anymore. But it does not erase the breach, and in particular, it does not prevent the breached-against party from suing for breach of the contract. A breach like this one, which does not result in the termination of the contract, is called *a partial breach*. The other type of breach, one that results in termination, is called *a total breach*. See Restatement (Second) of Contracts § 236.

6. The contract in *K&G* included periodic progress payments. As a result, after the contract was breached and terminated, and after the general contractor hired another subcontractor, the general contractor suffered significant monetary harm. It was compensated according to the rules concerning expectation damages (which we discuss in the remedies chapter).

Let’s change the facts. Assume that the general contractor was not required to make progress payments but to instead pay \$10,000 when the work is completed. Toward the end of this project, the subcontractor negligently causes an accident, which, like the one in *K&G*, results in \$3,400 damage. Because of this material breach, the general contractor suspends its performance (meaning, its duty to pay), and after the subcontractor fails to fix the harm it caused, terminates the contract. Is it fair to leave things where they are, or should the subcontractor be compensated for the work it has done? Even if it is unfair, how can the subcontractor be compensated? His source of compensation—the general contractor’s contractual duty to pay—never became due, right? The answer is found in the realm of unjust enrichment law, which will likely

allow the subcontractor to be paid for the value of its work (minus, of course, the harm it caused). See Restatement (Second) of Contracts § 377; Restatement (Third) of Restitution and Unjust Enrichment § 54.

7. The notion of material breach is very closely related to that of substantial performance, commonly identified with the decision of the New York Court of Appeals in *Jacob & Youngs v. Kent* (which you might see in the chapter on remedies). The plaintiff in that case built a house for the defendant. The contract stated that the contractor would use pipes manufactured by Reading Manufacturing Company, but he used the pipes of another company, which were of comparable quality, appearance, and value. The defendant refused to make the last payment on the house unless this breach was cured. But at that stage, because the pipes were installed in the wall of a finished house, replacing them would have been extremely expensive.

Writing for a 4-3 majority, Judge Cardozo ruled that “an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture.” *Jacob & Youngs v. Kent*, 230 N.Y. 239, 241 (1921). In this case, he continued, “we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing.” *Id.* at 245.

There is more than one way to understand the majority opinion. It can be perceived as one about dependable promises and constructive conditions. The contractor promised to use Reading pipes, but he did not. That is undoubtedly a breach. The landlord’s promise to pay was a dependable one, and the question is, therefore, whether that promise became due considering the contractor’s earlier breach. Cardozo held that it did, which is consistent with the approach we saw in *Ke & G*. In *Ke & G*, we learned that only a material breach allows the injured party to suspend its performance, and here, quite similarly, the court ruled that once a promise is *substantially performed* even dependable promises need to be performed. The Restatement cites *Jacob & Youngs* as supporting illustration 11 to section 237—the core section on material breach.

However, a close reading of the contract in question in this case, including parts thereof that Cardozo did not cite, might suggest that the use of the Reading Manufacturing Company pipes was an express condition for the landlord’s promise to pay. If that is how the opinion is to be understood, maybe the heart of it has to do with excusing express conditions. Interestingly, *Jacob & Young* is also listed as the first illustration to

Restatement (Second) of Contracts § 229, which deals with excusing express conditions to avoid forfeiture.

We might also ask how do we know that the breach in *Jacob & Young* was “trivial”? From an objective perspective, it obviously was. But is the objective standard the right one? Doesn’t contract law allow parties to enter agreements to promote their idiosyncratic preferences, even if those are different from those of the reasonable person? And if the test is subjective, how can one prove whether a breach is trivial? How can parties with uncommon preferences protect themselves? One way to do it is to state in the contract what types of breaches would be considered material.