

1968

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Recommended Citation

Samuel P. Baird, *Rights of an Injured Party upon Continuing Performance Subsequent to a Breach of the Contract*, 47 Neb. L. Rev. 593 (1968)

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RIGHTS OF AN INJURED PARTY UPON CONTINUING PERFORMANCE SUBSEQUENT TO A BREACH OF THE CONTRACT

In *Western Transmission Corp. v. Colorado Mainline, Inc.*,¹ A. J. Curtis & Company ("Curtis") entered into a contract to construct a pipeline for Western Transmission Company ("Western"). The contract specified that Western was to supply a certain size and quality of pipe to Curtis for use in the construction.² Western employed Gulf Interstate Engineering Company ("Gulf") to act as their agent in the supervision and inspection of the work, and Curtis subcontracted the work to Colorado Mainline Inc. ("Mainline"). Hereinafter, the parties will be referred to as though there were only two, Western and Mainline. Although this results in some technical inaccuracy, it is warranted for the sake of clarity and will not materially affect this discussion of the contractual principles involved.

When the pipe reached the work site, Mainline discovered that because it was not the size or quality specified in the contract, additional expense in the construction would result.³ About the same time, Mainline also discovered that Western had employed as its welding inspector a former employee of Mainline who had been discharged. Because of these problems, the parties, before construction started, met to reach a settlement. The results of the meeting were: (1) that Western would pay an additional five cents per foot to Mainline for the increased expense due to the *variance in size*, (2) an assurance by Western that the welding inspector would perform his duties in good faith, and (3) an agreement that the parties would reach a settlement in the future regarding the additional expenses caused by the *variance in the quality* of the pipe. Although it was known to all the parties at that time that the pipe was not of the specified quality, they did not adjust the con-

¹ 376 F.2d 470 (10th Cir. 1967).

² Other terms of the contract, normal in these situations, were not considered by the court. One of these terms, which could have been material in the case, provided that Western could require Curtis to perform work not otherwise required in the contract; the contract also contained a provision for computing the price of this work if the parties could not agree upon it.

³ For purposes of this discussion, it will be assumed that at this time there was a breach of a material condition which would relieve Mainline from its obligation to complete performance. This was the decision of the District Court and was not an issue in the Court of Appeals. For a discussion of problems relating to this issue see: 17 AM. JUR. *Contracts* §§ 375-78 (2d ed. 1964), and 17A C. J. S. *Contracts* §§ 508-09 (1963).

tract price to compensate for this variance because neither had any idea of how much additional expense would be involved.

Mainline, upon starting construction, found that it could not complete performance at the price and time specified in the contract because of additional work incurred due to defects in the pipe.⁴ During this period, Mainline constantly protested to Western and on one occasion it offered to quit work if Western would compensate it for the work done. Upon Western's assurances that an agreement would be reached, Mainline continued performance stating specifically that the continued performance was not to operate as a waiver of any rights it had against Western. After completion of eighty percent of the work, Mainline decided that negotiation was impossible and thus refused further performance. The parties tried to reach an agreement but failed and Western was forced to employ another contractor to complete the work.

Mainline then brought this action, seeking compensation for: (1) the actual and reasonable cost of the performance it rendered, (2) the actual and reasonable cost of the equipment it supplied, and (3) the loss of profits on the original agreement. Western asserted as a defense that Mainline had waived its rights to assert Western's breach as an excuse for Mainline's failure to perform its obligation to complete performance.⁵

⁴ It was not decided whether this was due to the bad faith of the inspector or the defects in the pipe but apparently at least some of the delays were the result of the inspector's bad faith decisions.

⁵ The court did not discuss at what time Western contended the breach was waived. Since the additional consideration of five cents per foot was to support a waiver of the variance in size, it probably was not argued that this condition relieved Mainline from its obligation. This leaves only the variance in quality and the bad faith of the inspector which could operate as an excuse. Because the inspector's bad faith was of a continuing nature and the Court of Appeals did not discuss this, the bad faith probably was not the breach relied upon by Mainline. Therefore, the only breach upon which the excuse could be based was the variance in the quality of the pipe. Western did not argue that there had been a waiver supported by consideration, *i.e.* Western's promise to pay five cents per foot more, nor that there had been a new or modified contract. Apparently the reason that these arguments were not advanced is that, from facts not included in the opinion, it was obvious that the parties intended the additional five cents as compensation only for the expenses attributable to the variance in size. This did not affect the breach due to the quality variance other than the parties' agreement that they would settle this matter later.

If the additional consideration was intended to support a promise by Mainline to waive all of the breaches, this would have been sufficient to have bound Mainline to finish performance. Another approach could have been that the promise to pay the additional compensa-

The district court charged the jury to find whether there was a substantial breach by Western and:

... whether ... Mainline thereafter continued to receive benefits and assert rights under the contract; that if [it] continued to go on with the contract unconditionally after knowledge of the breach, then such breach cannot be an excuse for [its] nonperformance; but if ... Mainline thereafter continued performance in reliance upon an assurance from Western that [its] right to question the various acts of Western constituting the breach would be preserved until all facts with respect to the performance of the contract were definitely ascertained, then ... Mainline did not waive [its] right to assert claims for additional compensation.⁶

The jury was then instructed to find that if Mainline's continued performance was not so conditioned, Western must have materially and to its prejudice changed position in reliance upon the continued performance before Mainline could be estopped from asserting the breach. The verdict and judgment were for Mainline and Western appealed. Thus, Mainline had two chances; (1) conditional performance, and (2) if not conditional it could still assert the breach if there had been no reliance.

The Tenth Circuit Court of Appeals, affirming, said it was "elementary" that the innocent party "... may continue performance on condition that his right to subsequently assert the breach is preserved. In that event, the right must not only be asserted but must be assented to by the other party."⁷ The court held that the jury could have found that there had not been reliance, "... but appellees' [Mainline's] rescission of the contract could be legally supported by this legal principle *as well as their legal right to continue performance upon condition, after breach.*"⁸

At the time of a breach, the injured party may choose one of several courses of action. He may (1) terminate the contract; (2) rescind it and bring an action for damages; or (3) waive the breach

tion was an offer to Mainline for a waiver that was accepted by its performance. Under either of these theories, if it had been found that Mainline accepted, the only way Mainline could have been excused from its obligation would have been by another breach. To establish such a breach, Mainline could then argue that in addition to the inspector's bad faith Western had breached a promise to use good faith in trying to reach a settlement. Since these theories were not considered in the case, sufficient facts are not available to speculate on what the court's decision would have been had the intent of the parties been to waive all of the breaches.

⁶ Western Transmission Corp. v. Colorado Mainline, Inc., 376 F.2d 470, 472 (10th Cir. 1967).

⁷ Id. at 472 (footnotes omitted).

⁸ Id. at 474 (emphasis added).

by either promising to continue performance or by actually continuing performance. Although a promise to continue performance may be withdrawn, absent estoppel or consideration, the general rule is that when he makes the election by actual performance his choice is final and cannot be withdrawn. Therefore, Mainline's right to continue performance upon condition coupled with the right to assert the prior breach as an excuse after the subsequent performance is not as "elementary" as the court treats it.⁹

The court cited three authorities in support of the principle upon which the decision rested; Professor Williston,¹⁰ *Autrey v. Williams*,¹¹ and *Rocky Mountain Tool & Machine Co. v. Tecon Corp.*¹²

The *Rocky Mountain* case involved a construction contract in which the subcontractor's performance was consistently behind that required by the performance schedule. Although the general contractor made complaints and threatened to terminate the contract, it allowed the subcontractor to continue after being assured that the performance would be brought up to meet the specifications. When it became apparent that the subcontractor would not conform to the contractual specifications, the general contractor terminated its performance, thereafter bringing an action for damages occasioned by the breach. The court disposed of the case by holding that there had been a continuous breach that could have been waived, but because of the protests by the injured party and the assurances by the breaching party there had not been a waiver.¹³

⁹ 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 679 (3d ed. 1961); 3A A. CORBIN, CORBIN ON CONTRACTS § 755 (1960) (treats election to continue performance as a waiver); and RESTATEMENT OF CONTRACTS § 309 (1932) (treats election by continued performance as a recreation of a duty).

¹⁰ 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 688 (3d ed. 1961).

¹¹ 343 F.2d 730 (5th Cir. 1965).

¹² 371 F.2d 589 (10th Cir. 1966).

¹³ The theory, that when the defective performance is divisible there may be a waiver of part of the defective performance but not a waiver of the entire contract is generally accepted although there may be close questions of fact. See 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 741 (3d ed. 1961); 3A A. CORBIN, CORBIN ON CONTRACTS § 755 (1960); RESTATEMENT OF CONTRACTS § 300 (1932). It is interesting that the *Rocky Mountain* case relied upon § 688 of Williston rather than § 741. The only difference between the two is that § 741 bases the breach upon a subsequent failure of condition which although waived earlier as to performance due at the time was not waived as to future performance, and § 688 times the breach at the moment of the first failure. Section 741 is consistent with Corbin § 755 and the

In *Western*, the inspector's actions in bad faith and Mainline's protests concerning these acts could have been a basis for the decision under a theory of a continuing breach, but the court apparently did not rest their opinion thereon. The breach upon which the court relied was the variance in the quality of the pipe. This was not of a continuing nature as in *Rocky Mountain* since all of the pipe had been delivered before Mainline started to work on the job.¹⁴

In *Autry*, one of the subcontractors¹⁵ was asserting a prior breach by the general contractor as an excuse to relieve it from its obligation to complete performance. The subcontractor had continued to perform after the general contractor had not completed one of its obligations on the contract, which would have been sufficient to relieve the injured party of its duty. The breach was not of a continuing nature as in *Rocky Mountain* but the court in *Autry* did not give reasons for its decision that the prior breach had not been waived.¹⁶

The *Western* court adopted the language used in Williston's Section 688 discussing an election to continue performance after a breach.

The principle is general that whenever a contract not already fully performed on either side is continued in spite of a known excuse, the defense thereupon is lost and the injured party is himself liable

Restatement § 300 but Williston § 688 is not. The only difference is in timing and this will not be material other than in determining damages. The *Rocky Mountain* court does not give any reasons why the § 688 theory was used rather than § 741 but since they allowed only the damages relating to the performance before the first breach to be determined by the contract price and those relating to performance subsequent to the first breach to be determined on a *quasi* contract theory, it can be assumed that the court was using the § 688 principle.

¹⁴ Under Williston's § 688 theory it would not matter whether the breach was of a continuing nature or not because, if the right was reserved properly, it would not be lost. If the court used only Williston's § 741 theory this would be a material distinction.

¹⁵ The case was concerned with the rights of several subcontractors. Since only one, Jinks, had protested the breach by the general contractor, he is the only party in this case to whom this discussion relates.

¹⁶ Williston's § 688 was cited as authority with *Louisiana Highway Comm'n v. Farnsworth*, 74 F.2d 910 (5th Cir. 1935), *cert. denied*, 294 U.S. 729 (1935). Farnsworth and the line of cases following it are not authority for the conclusion that the right to assert the breach as an excuse was preserved. This case is concerned with the reservation of a right to damages only since the injured party had completed performance.

if he subsequently fails to perform, *unless the right to retain the excuse is not only asserted but assented to.*¹⁷

This statement, but without the caveat, is the general rule in cases involving an election by an injured party to continue performance after breach of the contract. It has been cited as authority in a number of cases in which the caveat was not germane and the right to retain the excuse was not considered. It is important to note that the RESTATEMENT OF CONTRACTS¹⁸ does not include Williston's caveat.

The authority¹⁹ which Williston cites to support his statement is *Northwestern Mutual Life Insurance Co. v. Amerman*.²⁰ This case dealt with a contract wherein the defendant agreed to insure the life of plaintiff's husband. The contract provided that the insurance policy would be "null and void" if the insured was employed as a railroad conductor. At the time the policy was issued, the insured was a clerk, but subsequently his position was temporarily changed to that of conductor on a freight train. After the defendant received notice of this, one of its agents informed the insured by letter the insurance was no longer effective and "[i]n the mean time you may quit braking, when our policy would be good."²¹ When the next premium came due, it was paid by the insured and accepted by the defendant after a conversation between the defendant's

¹⁷ 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 688 (3d ed. 1961).

¹⁸ "Where the duty of a party to a bilateral contract has been discharged by the failure of a condition to exist or to occur or by the actual or threatened non-performance of a return promise, he is again subjected to the duty if he renders any further performance, or assents to the rendering by the other party of any further performance of a condition or promise beyond what is due as the exchange for performance previously rendered, provided that he renders or assents to such further performance (a) with knowledge of the facts establishing his discharge, or (b) without such knowledge, if (i) within a reasonable time after acquiring knowledge he fails to notify the other party that he asserts a discharge, or (ii) the other party, not then having received such notification, materially and reasonably changes his position to such an extent that it would be unjust to allow a discharge." RESTATEMENT OF CONTRACTS § 309 (1932).

¹⁹ Although Williston noted several other cases as authority, in none of them did the court meet the problem of Williston's caveat. See *National School Studios, Inc. v. Mealey*, 211 Md. 116, 126 A.2d 588 (1956) (caveat quoted but not discussed); *S. S. Steiner, Inc. v. Hill*, 191 Ore. 391, 226 P.2d 307 (1951) ("The text quoted is inapplicable to the situation before us.") *Sheehan v. McKinsty*, 105 Ore. 473, 210 P. 167 (1922) (text quoted but the caveat was not applicable).

²⁰ 119 Ill. 329, 10 N.E. 225 (1887).

²¹ *Northwestern Mut. Life Ins. Co. v. Amerman*, 119 Ill. 329, 332, 10 N.E. 225, 226 (1887).

agent and the insured. The insured then, while working as a conductor, sustained injuries resulting in his death and the defendant refused performance upon the policy.

The insured's widow brought an action upon the policy. The defendant attempted to introduce evidence concerning the conversation between the agent and insured prior to the time the premium was paid. Although this conversation showed that the intent of the parties at the time of payment may have been to prevent the policy from lapsing so the insured would not be required to apply for a new policy when he moved to another job, this evidence was excluded from consideration by the jury. The decision was that the defendant had waived its right to insist upon the clause voiding the policy due to the insured's occupation.

On review, the Illinois Supreme Court reversed the lower court's holding that the evidence showing the intent of the parties not to waive the condition should be excluded, and remanded for further proceedings. The reviewing court admitted that,

It has been repeatedly held, . . . that the receipt of the premium by the insurer, after knowledge that the condition of the policy has been broken, would amount to a waiver of the condition. . . . [H]owever, . . . the assured in each case, in paying the premium, was induced to do so, relying on the validity of his policy, and that the act of the company, therefore, in receiving the premium, would estop it from setting up the forfeiture.²²

Concluding that the basis of this rule was to protect the insured from fraud and misrepresentations by the company the court continued,

There can be no fraud if the parties to the transaction are equally informed of all the facts, and act independently upon such knowledge equally possessed by both parties. . . . If the assured knew or understood that the company intended to insist upon the forfeiture for breach of the condition . . . and with such knowledge, . . . paid the premium, the company might rightfully accept it for the purpose for which it was paid, without being guilty of fraud in setting up the breach of such condition, which it had never consented to waive, and which the assured knew it intended to insist upon.²³

It is important to note that the court did not propose a requirement that there be a formal assertion of and assent to the right as suggested by Williston's caveat. Instead it took the view that waiver by estoppel was an equitable doctrine to prevent fraud, and when the intent of one party was clearly expressed to the

²² *Id.* at 335, 10 N.E. at 227 (citations omitted).

²³ *Id.* at 336-37 10 N.E. at 228.

other, the elements of fraud or misrepresentation were lacking. Therefore, it was improper for the trial court to hold that the breached condition had been waived.²⁴

I. WHAT ARE THE RIGHTS OF AN INSURED PARTY WHEN HE CONTINUED PERFORMANCE AFTER BREACH?

One of two situations may arise after the injured party has continued performance subsequent to the breach: (1) the injured party may complete performance and then pursue an action for damages based upon the original breach, or (2) the injured party may terminate performance before completion and bring an action for damages resulting from the original breach. When performance is completed, the question is whether the injured party is entitled to damages. Although the same question is relevant when the injured party terminates before completion, another more complicated issue as to the injured party's obligation to complete the contract is also presented.

A. MAY AN INJURED PARTY COMPLETE PERFORMANCE AFTER A BREACH AND THEN RECOVER DAMAGES RESULTING FROM THE BREACH?

The authorities²⁵ in the area seem to indicate that an injured party does have the right to complete performance and recover damages resulting from the breach, assuming that there had not been an express waiver of damages. However, the courts have not followed a uniform rule and some distinguish between performance when given under protest and when the injured party con-

²⁴ In comparing this theory to the language used in *Western*, "[a]pellees' rescission of the contract could be legally supported by this legal principle [the fact that there had been no justifiable reliance] as well as their legal right to continue performance upon condition, after breach," 376 F.2d 470, 474 (10th Cir. 1967), the reader is left with the impression that the principle can operate although there was reliance. This is impossible because it is necessary that the right must be asserted and assented to. Therefore, the breaching party could not *reasonably* rely upon the performance when he knows that it is not intended as a waiver unless the court would hold that by not getting a substitute contract there had been reliance, an argument which the *Western* court refused to accept.

²⁵ "A waiver of a condition removes a limitation on the duty of the party who does the waiving. It does not discharge an already existing duty of the other party to make compensation for a breach that he has committed." 3A A. CORBIN, CORBIN ON CONTRACTS § 766, at 538, (1960); 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 700 (3d ed. 1961).

tinues in silence.²⁶ Two of the areas in which the problem arises are in connection with construction contracts and in the sale of goods.

In cases involving construction contracts in which the continued performance after the breach was made under protest or subsequent to assurances by the breaching party that the defect would be corrected, many courts have held that the injured party does not have an action for damages.²⁷ In cases involving known defects in construction where performance was not under a formal protest, there are only a few cases²⁸ which hold that the injured party has an action for damages. However, when the breach in a similar contract was a delay in performance rather than defective construction, courts may be more inclined to award damages even when there had not been a formal protest.²⁹

It may appear that the courts should be more inclined to award damages in the case where the performance is defective than when only slow because a greater loss is possible assuming such a distinction should even be made. The reason that the injured party may be favored when performance was slow might have been that even if he had protested, the damage had been done, while if there had been a prompt protest about the defective performance, the breaching party might have been able to correct the situation at that time with little expense. Although the party who breached by rendering defective performance may not be able to assert the defense of estoppel since his only reliance was in completing the contract, he should be allowed to show that the damages would have been less if the injured party had protested or terminated the contract at the time he learned of the defect.

In the area of sales, the cases prior to the uniform acts generally did not distinguish between the situations in which the buyer was silent after receiving the goods and when he protested.³⁰

²⁶ Annot. 115 A.L.R. 65 (1938); 66 A.L.R.2d 572 (1959); 41 A.L.R.2d 1175 (1955).

²⁷ Annot., 115 A.L.R. 65 (1938) and 66 A.L.R.2d 572 (1959).

²⁸ *Leonard v. Home Builders*, 174 Cal. 65, 161 P. 1151 (1916); *Sparling v. Housman* 96 Cal. App. 2d 159, 214 P.2d 837 (1950); *Hattin v. Chase*, 88 Me. 237, 33 A. 989 (1895); *Wiebener v. Peoples*, 44 Okla. 32, 142 P. 1036 (1914); Annot., 66 A.L.R.2d 572 (1959).

²⁹ *Louisiana Highway Comm'n v. Farnsworth*, 74 F.2d 918 (5th Cir. 1935), *cert. denied*, 294 U.S. 729 (1935); *Selden Breck Constr. Co. v. Regents of Univ. of Michigan*, 274 F. 982 (E.D. Mich. 1921); and Annot., 115 A.L.R. 65 (1938).

³⁰ Annot., 41 A.L.R.2d 1175 (1955).

Sitlington v. Fulton, 281 F.2d 552 (10th Cir. 1960), decided the rights of a vendor and vendee of real property under a sales contract.

The cases did allow reasonable use of the chattel by the purchaser under assurances by the seller that the defect would be corrected.³¹ The UNIFORM COMMERCIAL CODE provides that "[a]cceptance does not of itself impair any other remedy provided by this Article for non-conformity."³² However, the Code does require that after tender has been accepted, the buyer must within a reasonable time notify the seller of the defects or he will be barred from all remedies.³³

The requirement of protest by the injured party or assurances by the breaching party that the defect will be corrected, is consistent with the rationale of *Northwestern* that the doctrine of waiver was promulgated to protect the breaching party from fraud or misrepresentations. When the injured party had let it be known that he was not satisfied with the performance or when the breaching party had agreed to correct his error, the intentions of the injured party are clear and it cannot be said that the breaching party had been misled.

Many cases in which the injured party is awarded damages although continued performance was not under protest seem to have a common factor. The courts may overlook the fact that the injured party did not protest if at the time of breach it would have created a hardship upon him or greatly increased damages if the injured party had terminated and immediately brought the action. The most obvious example is when the owner of a structure which is being remodeled must either vacate or be charged with waiver by his continued possession.³⁴ Similar situations have arisen when a party purchased a defective heating system which would require great expense to remove,³⁵ or when it would require a large expenditure to move machinery and personnel substituting them with those of another contractor after the breach of a construction contract, as in *Western*.

When the injured party allows the other party to continue performance after a breach, this is a mere gratuity which the breaching party has no right to demand although he does have the

Although the vendor could not give total possession at the time specified in the contract, the vendee went into possession of part of the property. Later the vendee repudiated and the vendor brought an action for specific performance which was not granted. However, the court awarded the vendee damages resulting from the delay.

³¹ Annot., 41 A.L.R.2d 1175 (1955).

³² UNIFORM COMMERCIAL CODE § 2-607(2).

³³ UNIFORM COMMERCIAL CODE § 2-607(3)(a).

³⁴ See note 28 *supra*.

³⁵ *Holland Furnace Co. v. Korth*, 43 Wash. 2d 618, 262 P.2d 772 (1953); Annot., 41 A.L.R.2d 1175 (1955).

right to refuse.³⁶ Also, the injured party may agree to release his right to damages resulting from the breach, but he should not be forced to do so if he wishes the contract to continue. If the breaching party has been induced to rely upon a representation by the injured party that he would not demand damages another issue is presented and the question of estoppel and reliance will then be relevant.

There is some authority that when a contract to build or remodel a structure, particularly a home, has been breached by the contractor, possession or payment by the owner does not constitute a waiver of damages as a matter of law although the possession or payment was not under protest.³⁷ The decisions holding that possession is not a waiver can be based either on the hardship exception or the fact that the owner of the property has a legal right to possession. However, the decisions holding that payment is not a waiver present a problem that can not be explained by either the hardship exception nor general contractual theories. These decisions, although few, do lend support to an argument that the courts should be more concerned with what risks the parties assumed, what their expectations were after the breach, and whether one party had an undue or fraudulent advantage, rather than applying an absolute rule in all situations.

A persuasive argument for allowing the injured party to recover damages is that he may under certain circumstances, be forced to permit the party who breached to continue performance. Although not universally accepted, there is authority to the effect that the injured party must, after a breach, mitigate damages by taking the most advantageous offer to complete the contract *even if this requires accepting an offer by the party who originally*

³⁶ Generally the breaching party may force the other to stop work upon the contract. The reason for the rule is well illustrated by *Rockingham County v. Luten Bridge Co.*, 35 F.2d 301 (4th Cir. 1929). See, Annot., 66 A.L.R. 745 (1930).

³⁷ "Where a contract is made with the owner of land to erect a building on the land, and there is a breach, by the contractor, of his covenant to build it in a good and workmanlike manner, neither the occupation of the house by the owner, after its supposed completion, nor the payment of the price, though accompanied by knowledge by the owner of the defective construction, is sufficient, taken alone, to operate as a waiver of the breach of the covenant." *Leonard v. Home Builders*, 174 Cal. 65, 68, 161 P. 1151, 1152 (1916). See *Sparling v. Housman*, 96 Cal. App. 2d 159, 214 P.2d 837 (1950); *Hattin v. Chase*, 88 Me. 237, 33 A. 989 (1895); *Wiebener v. Peoples*, 44 Okla. 32, 142 P. 1036 (1914); Annot., 66 A.L.R.2d 572 (1959).

breached.³⁸ This doctrine is limited to cases in which there will be no personal humiliation nor great inconvenience to the injured party. This rule, combined with the theory that the injured party loses the right to damages by continuing performance would result in allowing a party to breach and then to offer the same services at a higher price which the injured party would be required to accept and by so doing lose his right to damages. This inequitable result could occur, for example, when a contractor's performance was delayed but since he had the necessary men and equipment at the job site the work could be completed at a much lower expense, or when the breaching party was selling a unique product.

Although the rules giving the injured party a right to damages when he continues performance subsequent to the breach are not settled, most courts require that the injured party protest before he has even a possibility of recovery. This requirement is neither inconvenient nor unreasonable and in addition to resulting in a complete disclosure of the expectations of each party, it takes the defense of estoppel from the breaching party. What will constitute protest will vary depending upon the facts but a formal statement should not be required. Acts and statements by the injured party indicating that he expects compensation for the defective performance should be satisfactory.

B. IS AN INJURED PARTY WHO HAS ELECTED TO CONTINUE SUBSEQUENT TO A BREACH OBLIGATED TO COMPLETE THE CONTRACT?

There are two approaches which may be taken by a court in determining that the injured party who has continued performance after the breach is not obligated to complete performance: (1) the injured party has not waived the breach as an excuse when this is contrary to the expressed intent of both parties, or (2) the injured party has a reasonable time in which to make his election whether to excuse the breach or terminate, and during this period he can continue to perform or receive performance. Under either approach it may be necessary (returning to Williston's caveat) to consider whether the injured party's right to later assert the breach was assented to by the breaching party. There are strong policy considerations which indicate that both theories are acceptable in the appropriate circumstances.

The *Northwestern* case held that estoppel of or waiver by the injured party should depend upon whether the breaching party has

³⁸ 5 A. CORBIN, CORBIN ON CONTRACTS § 1043 (1964); 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1359 (rev. ed. 1937); C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 160 (1935).

been so misled that to hold otherwise would be to allow a fraud. The case also recognized that such a fraud is not possible when the injured party expressed an intent not to forfeit the right to terminate which was conferred upon him by the prior breach.³⁹

However, Professor Corbin states that "[n]evertheless, such a contractor has power to recreate his former duty—sometimes by mere voluntary expression of waiver, and *nearly always* by continuing to render his own performance or by receiving further performance from the other party"⁴⁰ Professor Williston states the rule:

The law simply does not, under the circumstances, permit a party to exercise two alternative or inconsistent rights or remedies. *Even though he expressly states that he intends to reserve a right, he will, nevertheless, lose it if he takes an inconsistent course. . . . unless the right to retain the excuse is not only asserted but assented to by the other party.*⁴¹

Although Corbin escaped an absolute statement by the use of "nearly always," he gives no indication of the type of case in which this exception would apply. Williston's rule does include the caveat which he made a part of his rule of Section 688.⁴² This caveat therefore expressly applies to the situation found in *Northwestern*. The same caveat is found again as the basis for the decision in *Western*. These two statements and the two cases appear to be the only authorities which recognize that there may be an exception based upon intent. However there have been cases in which the general rule of a final irrevocable election was followed even though an unjust result was reached.⁴³

³⁹ Although the *Northwestern* court did not require that the injured party assent to the reservation of the right, the insured has impliedly assented by paying the premium after notice that the insurance company intended to reserve the right. See text accompanying note 24 *supra*.

⁴⁰ 3A A. CORBIN, CORBIN ON CONTRACTS § 755, P. 497 (1960) (emphasis added).

⁴¹ 5 S. WILLISTON, A TREATISE OF THE LAW OF CONTRACTS § 684 (3d ed. 1961) (emphasis added and footnotes omitted).

⁴² 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, § 688 (3d ed. 1961). See text accompanying notes 17-19 *supra*.

⁴³ Perhaps the most dogmatic adherence to this rule without consideration of the equities of the situation occurred in *Gulf, C. & S.F. Ry. Co. v. Settegast*, 79 Tex. 256, 15 S.W. 228 (1891). In this case a landlord refused to accept rent from a substituted tenant for fear he would lose his right under a lease which contained a non-assignment clause. After assurances from both the new and old tenants that this would not happen, he accepted the rent from the assignee. In an action to have the assignment cancelled, the court refused the remedy stating: "It is a case in which actions are more effective than words." *Id.* at 262, 15 S.W. at 230.

The *Northwestern* theory, that waiver is an equitable device to protect the breaching party and there can be no waiver when it is made clear to both parties that such a waiver is not intended, recognizes the risks assumed by the parties in continuing the performance after the breach. When the breaching party knows performance may be terminated at any time, he is not justified in relying upon an assumption that the work will be completed. Although the breaching party may be in a disadvantageous situation since he is at the mercy of the injured party's right to terminate, it was the breaching party's wrongful act which brought about the situation, and in any event he is not required to continue or allow the continued performance after the breach.⁴⁴

If the alleged waiver had been created only by a promise to continue, unsupported by consideration, generally the waiving party would be allowed to withdraw the waiver until there had been actual performance.⁴⁵ Why should there be a distinction between a waiver based on a promise to perform and a waiver by actual performance? By looking at only the performance and refusing to examine the intentions which were clearly expressed, the courts created a situation whereby the party who had been injured by the breach and tried in good faith to make the best of his predicament can lose even more. In order to prevent the injured party from taking advantage of the other, an even more inequitable rule of law was promulgated whereby the party who was in the wrong originally can shift the loss due to his breach onto the innocent party. Although the breaching party deserves *some* protection, this purpose can better be served by the rule as stated in Williston's Section 688, as applied in *Western*, rather than by the rigid rule of election and waiver.

The other theory available upon which the principle stated by Williston and the *Western* case may be based is that the injured party has a reasonable time in which to make his election. It generally is recognized that the injured party does not waive by silence until after the expiration of a reasonable time, but that when there is performance this is treated as a final election.⁴⁶

In *Loew's, Inc. v. Cole*,⁴⁷ an employee invoked the Fifth Amend-

⁴⁴ See note 36 *supra*.

⁴⁵ RESTATEMENT OF CONTRACTS §§ 90, 310 (1932).

⁴⁶ RESTATEMENT OF CONTRACTS § 309(b)(i) (1932).

⁴⁷ 185 F.2d 641 (9th Cir. 1950), *cert. denied*, 340 U.S. 954 (1951). Another Ninth Circuit Court of Appeals case generally in accord with *Loew's* is *Kostalac v. United States*, 247 F.2d 723 (9th Cir. 1957). In this case, after discovering fraud in the inducement to enter into the contract, the injured party continued to receive the benefits for about five

ment⁴⁸ while testifying before the House Committee on Un-American Activities. The employee was allowed to continue in his employment relationship for thirty-three days, at which time the employer finally invoked a provision in the employment contract which allowed it to suspend the employee due to his refusal to testify. Although the employee was aware of his employer's dissatisfaction, the employer had not expressed an intent to reserve the right to dismiss and the employee had not assented to the reservation. The ninth circuit felt that there was sufficient evidence for the jury to consider whether the employer waited an unreasonable time to invoke the contractual provision. Only after this reasonable time had expired would there have been a waiver or election by the continued employment.

The court in *Loew's* impliedly rejected the rule as set forth in *Williston* and in *Restatement*, Section 309,⁴⁹ criticising both:

As soon as Cole [the employee] left the witness stand his conduct was fully known to his employer. Are we to conclude that any use of his services thereafter, no matter how brief, destroys any defense? ... Or, if [the employer's lack of facts as to how the refusal to testify would affect his business] may not be considered, does the party charged with the election have a reasonable time within which to make his choice?⁵⁰

The court continued discussing the evidence which it thought adequate to show that the employee had been given warning that he might be released. After deciding that the employer did not have sufficient facts at the time of the hearing to determine the extent of harm to his business, it was left for the jury to determine whether thirty-three days was an unreasonable delay in making the election.

The situation in *Loew's* is very similar to that in *Western*. In both cases it was agreed that the party who had the right to make an election did not have sufficient facts available at the time of the breach to make an intelligent choice and in both there had been

months. During this period there were negotiations and the injured party did not pay for the benefits as required in the contract. The court held that there had not been an election whereby the injured party lost his right to recind. *Nat'l School Studios, Inc. v. Mealey*, 211 Md. 116, 126 A.2d 558 (1956) is a case similar to *Loew's* but in which the opposite decision was reached. Both *Restatement* § 309 and *Williston* § 688 were cited as authority. Since the court in *Mealey* did not discuss the caveat stated in *Williston* § 688 it is impossible to determine whether it disapproved or ignored the injured party's right to reserve the excuse.

⁴⁸ U.S. CONST. AMEND. V.

⁴⁹ See note 18 *supra*.

⁵⁰ *Loew's, Inc. v. Cole*, 185 F.2d 641, 654 (9th Cir. 1950), *cert. denied*, 340 U.S. 954 (1951).

continued performance. It is important that in *Loew's* there was not an assertion by the injured party reserving the right nor an assent by the breaching party to the reservation. It is difficult to determine whether the court rejected the requirement that the right be asserted or whether it implied the assertion and assent from the actions of the parties. Since the court criticized the theory, it might be inferred that it discarded the requirement that there must be an assertion of the right. Since it later discussed the fact that the employee should have known from the acts of the employer that he was reserving the right, it might just as reasonably be inferred that the court preserved the requirement but relaxed the evidentiary standards required to establish the assertion and assent.

If the court is merely relaxing the requirement that the intent be expressed in words certain to the breaching party and that he assent in a similar manner, this is merely a variation of the *Western* case, in which the court is recognizing and giving effect to the intent of the parties. If this is the case, there is a difference between *Loew's* and *Western* in that the *Loew's* court was concerned with whether the injured party had asserted the breach within a reasonable time, but the *Western* court did not consider this question. In *Western* the parties established a time limitation upon the right until a settlement could be reached. Since it was impossible in *Loew's* to find an express time limitation, it was necessary to establish the reasonable time requirement. Therefore, it can be concluded that if the parties do insert a time limitation or express an intent that the right will exist until completion, there will not be a reasonable time requirement. On the other hand, if it cannot be determined that a period other than a reasonable time was intended, the court will impose such a restriction.

Although determination of what is reasonable is impossible *in vacuus* such determination should rest upon (1) the reason for the delay, (2) whether the parties were trying to negotiate a settlement, and (3) whether the injured party was trying to determine the effect of the breach upon the expectations of value to him in continuing the contract. If the parties were trying to negotiate a settlement, a reasonable time would probably expire upon failure to reach a settlement.⁵¹ If the injured party was merely trying to determine whether his loss due to the breach would be worth terminating the contract, another problem arises because in many cases

⁵¹ If the parties are able to reach a settlement upon which both agree, there will be a novation or modification of the original contract. In such a case problems concerning new consideration and pre-existing duty arise, however, these issues are outside the scope of this discussion.

this cannot be decided with any certainty until after completion of the work. In that situation, a reasonable time will probably last until tests or inquiries can be made so that the injured party can determine with reasonable certainty the effect of the breach. Therefore, in some cases the right to assert the breach as an excuse may last until the work is completed.

II. IS IT NECESSARY THAT THERE BE AN ASSERTION OF AND ASSENT TO A RESERVATION OF THE BREACH?

As has been indicated, Professor Williston's statement which included a requirement of assertion of and assent to the right was apparently based upon the *Northwestern case*.⁵² The cases with which this article is concerned primarily pertain to construction contracts. Because of the unique nature of insurance contracts, rules applicable to them should be closely examined before such rules are applied to other situations.⁵³ In the eighty years since the *Northwestern* decision, the law concerning insurance contracts has changed significantly, but even in 1887 the court was trying to protect the insured and his beneficiaries against forfeiture. Because of this public policy against forfeiture, it may be reasonable to assume that if the case arose today, the insurance company would not have been excused from its obligation. Since performance in construction contracts consists of services and materials which have a determinable value, rather than a conditional promise to perform as in insurance contracts, the parties can be placed in an equitable position under the theory of unjust enrichment or quasi contract. Therefore, many of the policy considerations existing in the insurance cases are not relevant in construction contracts.

The *Loew's* case is the only decision from which it might be inferred that the assertion of the reservation need not be communicated to the breaching party. If the situation had been one in which the breaching party had in fact been injured by his reliance upon the apparent waiver, it is very doubtful that the court would have even implied that there need not be an assertion of and assent to the reservation. Therefore, it can be assumed that if there has been

⁵² See note 19 *supra*.

⁵³ Although 1 G. COUCH, COUCH CYCLOPEDIA OF INSURANCE LAW § 1:5 (2d ed. 1959) and 7 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900 (3d ed. 1963), both state that an insurance policy is *basically* like other contracts, Williston continues for 660 pages and Couch for 18 volumes discussing the particular rules and principles applicable to insurance law. Of particular interest is Couch's discussion of "Waiver or Modification of Rights Under Nonforfeiture Statutes." 6 G. COUCH, COUCH CYCLOPEDIA OF INSURANCE LAW §§ 32:177-180 (2d ed. 1961).

detrimental reliance upon the acceptance of the benefits or continued performance, the injured party will not be relieved from his obligation to continue. This, however, does not settle the question of whether the injured party can assert the breach as an excuse when there has not been an expressed intent to reserve the right and there was no reliance upon the apparent election. If the breaching party cannot show that he has been injured, there does not seem to be a sufficient reason to shift the loss due to his breach upon the injured party. If there is a requirement that the reservation be assented to in situations where there has been an express reservation, the court is merely requiring a formal expression of intent which can be implied from the acts of the breaching party. If the right has not been reserved, there is a possibility of detrimental reliance, as discussed previously,⁵⁴ and if the breaching party has in fact been injured, the other party should not be relieved of his obligation to complete performance.

Although one may come to the conclusion that if the breaching party has not been injured, he should suffer the consequences of his breach, there is another factor that will influence decisions in this area. That factor is the tendency of courts to find an obligation to which the parties are bound at the earliest possible moment. This view is reflected in the RESTATEMENT OF CONTRACTS⁵⁵ which introduces a presumption that an offer invites a bilateral contract.⁵⁶ The theory that the injured party may render partial performance after the breach and then argue that although he did perform, he did not intend to be bound by a contract, is inconsistent with this tendency to find a binding obligation. Since under a quasi contract theory of unjust enrichment the court can determine the correct compensation for the performance, damages will not be a problem. Although it may be argued that the court is making the contract for the parties and that this is not its proper function, the reservation principle allows the parties time to try to solve their own problems out of court without risking forfeiture. It may also be advanced, as discussed previously,⁵⁷ that the breaching party is put into an uncertain position but this position, if uncertain, was the result of his breach and he may relieve any uncertainty by forcing the injured party into treating the contract as terminated. Therefore, the court should not be concerned by the fact that there was not a binding obligation to complete after the breach because these

⁵⁴ See text accompanying note 44 *supra*.

⁵⁵ RESTATEMENT OF CONTRACTS § 31 (1932).

⁵⁶ The UNIFORM COMMERCIAL CODE also supports the tendency to find as soon as possible an obligation to which both the buyer and seller are bound. See UNIFORM COMMERCIAL CODE § 2-206.

⁵⁷ See note 36 *supra*.

arguments that may be advanced are not sufficient to support such a decision.

The principle of allowing a reasonable time to make the election or an exception to the general rule of election based on an expressed intent, although there had been continued performance in either situation, recognizes the business context in which many of these cases arise. When the election theory became entrenched in the law, contracts were of a simple nature and both parties usually had all the information necessary to make an immediate decision whether to elect to treat the contract as breached or to continue and thereby waive the condition precedent to their performance. Today contracts can involve many parties, many other contractual relationships can be affected by the one contract, and it may be necessary to compile volumes of information or make complicated and time consuming tests before it is possible to even estimate the effect that a variance in specifications will have. It is against all practical considerations to require that a construction project involving many variables be halted while the injured party negotiates and compiles information necessary for him to make an intelligent decision.

Another policy that these two principles advance is that generally it is desirable to encourage the parties to work out their differences outside of the courtroom. Merely entering into negotiations does not result in a waiver and cannot be justifiably relied upon for this very reason.⁵⁸ In view of the previous pressures that bear upon the parties, particularly when relationships with others are involved, it is unreasonable to require a complete halt for fear that there will be a waiver or election that the injured party cannot escape. The statement of the court in *Kostelac v. United States*⁵⁹ reflects this view well.

It would appear that as a matter of policy the law ought to encourage the parties to reach amicable settlements of disputes of this kind, and that a rule of law which penalizes a party who seeks such a settlement by depriving him of his right to rescind is both harsh and contrary to sound policy.⁶⁰

There certainly is not complete agreement on the general issue of when the courts should disregard the intent of the contractual parties as shown by either their expression or actions. However, in

⁵⁸ 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1460 (rev. ed. 1937) states: "Unsuccessful negotiations looking toward performance can hardly be considered inconsistent with a continuing right of rescission. . . ." *Id.* at 4111.

⁵⁹ 247 F.2d 723 (9th Cir. 1957).

⁶⁰ *Id.* at 728.

the situations presented by the cases previously discussed in which fraud or unconscionable advantage are not considerations, the intent of the parties should be of primary concern. When the breaching party agrees to assume the risk presented by allowing the injured party to continue with a reservation of the excuse, there is no reason to shift the loss due to the breach upon the injured party.

III. CONCLUSION

The old theory that when a party has two alternatives open to him after a breach and he pursues one the other is lost, coupled with the rule that "actions are more effective than words,"⁶¹ has produced some cases in which the results are contrary to what seems to be the correct and just decision in view of the facts and surrounding circumstances. The *Western* and *Loew's* cases are situations in which the courts felt an exception to the rule was needed. These cases are far from being the majority but they may be establishing a trend which will result in the courts taking a closer look at the intent and equities of the parties even when there has been continued performance.

Rules must be established governing what the rights of the parties are after a breach. It would be foolish for a contractor to continue performance reserving his right to assert the breach as an excuse in the future, but undoubtedly the situation will arise again. If the courts in these future cases follow the lead of the courts in *Western* and *Loew's*, the injured party may be better able to appraise his position after the other has breached, and he will be in a better position to try to negotiate a settlement which will be satisfactory to both parties.

Samuel P. Baird, '69

⁶¹ See note 43 *supra*.