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Reasonable and Adequate: What Are the Requirements for Demanding Adequate Assurances Under UCC § 2-609?

By Melvin A. Brosterman and Francis C. Healy*

There are few hard and fast rules concerning when a promisor's conduct creates reasonable grounds for a demand, or what assurances from the promisor will be considered adequate. But even without such rules, it is helpful to see how courts have decided which party is reasonable, which party is trying to perform under the contract, and which party wants to get out from under the contract.

While parties may enter into contracts with the best of intentions, from time to time, contracting parties may find themselves in the difficult situation where the prospect of their counterparty performing becomes uncertain. A promisee who believes that the promisor cannot perform could choose to declare an anticipatory breach and suspend its own performance. However, if the promisor was actually in a position to perform, the promisee itself could then be liable for breach. Alternatively, the promisee could simply wait for the promisor to actually breach the contract, but, by then, damages from the breach may have increased. If the breach was foreseeable, the promisee runs the risk of having its damages reduced because it failed to mitigate its losses. Neither alternative is particularly attractive. Fortunately, the doctrine of adequate assurances, set forth in Section 2-609 of the Uniform Commercial Code ("UCC"), provides a third option, and some level of security to those parties awaiting performance.[1]

Section 2-609 of the UCC provides that if a promisee has "reasonable grounds" to suspect that the promisor will not be able to perform under a contract for the sale of goods, that party may submit a written demand for "adequate" assurances of the promisor's ability to perform under the contract.[2] If adequate assurances are not provided within a reasonable time specified by the promisee (or 30 days at the latest), the promisee may treat that failure as a

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1 N.Y. U.C.C. Law § 2-609, Official Comment 1 (McKinney 2018).

2 N.Y. U.C.C. Law § 2-609(1) (McKinney 2018).

repudiation of the contract, suspend performance, and sue for whatever damages the breach may have caused.[3] Thus, for contracts to which the doctrine of adequate assurances applies, a promisee does not need to predict with perfect accuracy whether the promisor will be able to perform and may be able to avoid the risks associated with breaching the contract itself, waiting while its damages increase, or failing to mitigate its damages.

The right provided by Section 2-609 can be a valuable tool; however, the application of this doctrine is not without its own risks. If the promisee lacks "reasonable grounds" for such a demand, or asks for assurances beyond what is "adequate" under the circumstances, the promisor is well within its rights to refuse the demand.[4] Moreover, if the promisee unreasonably suspends its performance or overreaches by demanding assurances that far exceed what it was entitled to under the contract, the court may find that it is the promisee who has repudiated the contract.[5] Accordingly, what qualifies as "reasonable grounds for insecurity" and "adequate assurances" is paramount to a promisee when it suspects that its promisor may not perform.

This article attempts to provide some guidance on these crucial questions: what constitutes "reasonable grounds" to demand assurances, what assurances may be demanded, and what assurances are deemed "adequate"? Unfortunately, the most accurate answer is simple: "It depends." Section 2-609(2) states that the "reasonableness" analysis involved in determining both grounds for insecurity and the adequacy of the assurance is based on "commercial standards."[6] And barring extreme circumstances, the finder of fact has the responsibility for determining what "commercially reasonable" means in any given context.[7] Although it is difficult to set any hard and fast rules about what

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[3] N.Y. U.C.C. LAW § 2-609(4) (McKinney 2018); N.Y. U.C.C. LAW § 2-610 (McKinney 2018).

[4] *See Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572, 582 (7th Cir. 1976) (finding no fault for buyer's "rejection of various proposals advanced by [seller] each of which amounted to a rewriting of the contract in the absence of a proper § 2-609 basis").

[5] *Id.* Further, "[u]nder the language of [U.C.C. § 2-610], a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does it invalidate a plain expression of desire for future performance. However, *when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation*." N.Y. U.C.C. LAW § 2-610, Official Comment 2 (McKinney 2018) (emphasis added).

[6] N.Y. U.C.C. LAW § 2-609(2) (McKinney 2018).

[7] *See Enron Power Mktg., Inc. v. Nevada Power Co.*, 03 Civ. 9318(BSJ), 03 Civ. 9332(BSJ) (S.D.N.Y. Oct. 12, 2004) (asserting "[w]hether a buyer has a reasonable ground for insecurity is a question of fact" and "[w]hether or not the assurances offered were adequate, as per commercial

is reasonable or adequate, there is a common thread to the types of assurances demanded, and by reviewing the case law, we can identify a few overarching themes.

IS THE CONTRACT COVERED?

It is important to note that not every contract governed by New York law is subject to the adequate assurances doctrine. Because the doctrine and its requirements are set forth in Article 2 of the UCC, contracts for the sale of "Goods," as defined in Section 2-105(1), are clearly covered. While other states have chosen to incorporate the adequate assurances doctrine into their common law of contracts, New York has chosen to do so in only very limited circumstances.[8] In *Norcon*, the seminal case in New York on the issue, the New York Court of Appeals extended application of the doctrine of adequate assurances to a contract to purchase electricity because it was deemed analogous to contracts for the sale of goods governed by the UCC.[9] However, the decision in *Norcon* was narrow, limiting the doctrine's applicability "to the type of long-term commercial contract between corporate entities entered into by [the utility] and [producer] here, which is complex and not reasonably susceptible of all security features being anticipated, bargained for and incorporated in the original contract."[10]

While the Court of Appeals recognized that the adequate assurances doctrine can be useful in avoiding the anticipatory breach conundrum in contracts other than for the sale of goods, it stated that the common law should not be altered

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standards and under the circumstances, is a question of fact"); *Phibro Energy, Inc. v. Empresa De Polimeros De Sines Sarl*, 720 F. Supp. 312, 322 (S.D.N.Y. 1989) ("Whether a party has 'reasonable grounds for insecurity' is a question of fact. . . . A review of the sparse case law reveals that the standard is high for a finding of insecurity as a matter of law."); *BAII Banking Corp. v. UPG, Inc.*, 985 F.2d 685, 702 (2d Cir. 1993) ("It is generally a question of fact whether a buyer has reasonable grounds for insecurity under § 2-609. . . . There are circumstances, however, where this issue may be resolved as a matter of law.").

[8] *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656, 661 (N.Y. 1998) ("New York, up to now, has refrained from expanding the right to demand adequate assurance of performance beyond the Uniform Commercial Code.") (citations omitted).

[9] *Id.* The Court of Appeals was persuaded to extend the doctrine to the sale of electricity in *Norcon* because "a useful analogy" could be drawn "between the contract at issue and a contract for the sale of goods." *Id.*; *cf. Bank of New York v. River Terrace Associates, LLC*, 804 N.Y.S.2d 728, 729 (N.Y. App. Div. 2005) (holding that a construction loan agreement, unlike agreement for the sale of electricity in *Norcon*, was not sufficiently like a contract for the sale of goods to warrant the extension of the adequate assurances doctrine).

[10] *Norcon Power Partners, L.P.*, 705 N.E.2d at 662.

by leaps and bounds. Instead, the Court of Appeals proceeded cautiously, and New York courts have been "reluctant to extend the right to demand adequate assurances of performance beyond insolvency settings, contracts for the sale of good governed by the Uniform Commercial Code, and closely analogous contracts."[11] Though some New York Supreme Court and federal court decisions have relied on dicta from *Norcon* to extend the doctrine to other non-UCC contracts, no decision from a New York appellate court has extended the doctrine since *Norcon*.[12]

Nevertheless, though the doctrine of adequate assurances does not extend to most non-UCC contracts, parties to a contract are free to include provisions specifically allowing for demands of adequate assurances. Given its usefulness, they often do. Currently, the EEI Master Contract governing the sale of electricity and the NAESB and the GISB contracts for the sale of natural gas all contain provisions allowing parties to seek adequate assurances.[13] And while no such provision is automatically included in the ISDA master agreement for exchanges of swaps and derivatives, parties may decide to add such a provision themselves.[14]

WHAT ARE REASONABLE GROUNDS FOR A DEMAND?

When determining what constitutes reasonable grounds for demanding an

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[11] *Jordan v. Can You Imagine, Inc.*, 485 F. Supp. 2d 493, 502 n. 5 (S.D.N.Y. 2007) (citations omitted).

[12] *Compare Peng v. Willets Point Asphalt Corp.*, 27 Misc. 3d 1210(A), *4 (Sup. Ct. N.Y. Cty. 2010) (Trial court stating that *Norcon* extended the doctrine of adequate assurances "as part of the common law of contracts") *with Peng v. Willets Point Asphalt Corp.*, 915 N.Y.S.2d 878 (N.Y. App. Div. 2011) (holding that the lower court had erred in determining that the doctrine of adequate assurances was applicable to a contract for the sale of real property). Some federal courts have extended the application of the doctrine of adequate assurances to non-UCC contracts. *See*, *e.g.*, *Palco Telecom Service, Inc. v. Global Warranty Group*, LLC, No. 14-cv-4818 (ADS)(SIL),fn 1 (E.D.N.Y March 31, 2015) (finding it "reasonable to apply the 'reasonable assurance' doctrine" to a contract to repair, refurbish and/or remanufacture cell phones, which the court found "analogous to a contract for the sale of commercial goods"); *In re Asia Global Crossing, Ltd.*, 326 B.R. 240, 250 (S.D.N.Y. 2005) (stating that in *Norcon*, the "Court of Appeals adopted the U.C.C. rule of adequate assurance as part of the common law of contracts").

[13] *See*, *e.g.*, http://www.eei.org/resourcesandmedia/mastercontract/Documents/contract0004.pdf.

[14] In *Merrill Lynch Intern. v. XL Capital Assur. Inc.*, 564 F. Supp. 2d 298, 306 (S.D.N.Y. 2008), the court found "a credit default swap to have very little in common with a sale of goods, and hence conclude[d] that New York would not extend the doctrine of adequate assurance" to a situation involving the early termination of a credit default swap based on conduct with respect to other swaps and a failure to receive an adequate assurance of performance.

assurance of performance, the Official Comments to Section 2-609 are a useful place to start.[15] The comments explain that a buyer falling behind in its account with the seller, a seller producing precision parts that do not meet specifications, and a manufacturer breaching its exclusive dealing agreement with a distributor could all provide a reasonable basis on which to demand assurances.[16] The comment further clarifies that the grounds for insecurity need not even arise under the specific contract at issue.[17] Thus, for example, if a buyer falls behind on other accounts it has, or a seller starts shipping defective precision goods to other buyers with similar needs, a demand for adequate assurances under the contract would still be reasonable.[18] If the demand is not satisfied, the promisee would be justified in withholding performance and declaring a breach.

Courts have generally followed the Official Comments. In *Reich v. Republic of Ghana*, the residual fuel oil purchase and transport contract at issue provided for escalation payments in the event that the market price increased.[19] However, for the first 26 cargoes it received, the purchaser paid only the base contract price, disputing the escalation payments under the agreement. The bankruptcy court held that the buyer's failure to make such escalation payments provided "reasonable grounds for insecurity," entitling the seller to suspend future sales of fuel oil until the buyer provided assurances that it would pay the past amounts owed in full.[20]

Likewise, in *Creusot-Loire Intern., Inc. v. Coppus Engineering Corp.*, a buyer contracted to purchase heavy fuel oil burners for its ammonia plant in Yugoslavia.[21] After delivery of the burners but before installation, the buyer learned that similar burners manufactured by the seller in other ammonia plants had serious problems satisfying performance specifications, which could not easily be modified or repaired. Because the seller was obligated to provide burners that would operate under specified conditions, the court determined that the buyer was justified in demanding assurances that the burners that had

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[15] N.Y. U.C.C. Law § 2-609 Official Comment 3 (McKinney 2018).

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] No. 98 CIV. 7862 (BSJ) (S.D.N.Y. Jan. 31, 2002), *aff'd*, 56 Fed. Appx. 25 (2d Cir. 2003) (unpublished).

[20] *Id.*

[21] 585 F. Supp. 45, 47 (S.D.N.Y. 1983).

been delivered would perform.[22] In *Starchem Laboratories, LLC v. Kabco Pharmaceuticals, Inc.*, the court determined that the buyer's poor payment history with both the seller and its sister company constituted grounds for insecurity, justifying the buyer's right to demand adequate assurances of payment.[23] And in *Kaiser-Francis Oil Co. v. Producer's Gas, Co.*, the seller of natural gas had reasonable grounds for insecurity and could suspend its performance under a contract where the buyer refused to pay for gas taken and would not perform unless the seller agreed to modify the contract.[24]

Unfortunately, the fact that a promisor has engaged in the type of conduct described in Official Comment 3 is no guarantee that a court will find reasonable grounds for insecurity as a matter of law. For instance, in *Phibro Energy Inc. v. Empresa De Polimeros De Sines Sarl*, a buyer of polypropylene demanded an assurance of performance from the seller after the seller's plant had reportedly suffered multiple shutdowns over several months, resulting in the seller's failure to make a scheduled delivery.[25] Recognizing "that the standard is high for a finding of insecurity as a matter of law," the court determined it was a question of fact as to whether the buyer had reasonable grounds sufficient to justify a demand for adequate assurances and denied the buyer's motion for summary judgment.[26]

Courts have, however, found reasonable grounds for insecurity of performance as a matter of law when there are multiple acts by a promisor that, when combined, justify a promisee's demand for adequate assurances. For example, in *Hornell Brewing Co., Inc. v. Spry*, the court determined that the plaintiff had reasonable grounds to be insecure about the defendants' ability to perform under a beverage distribution contract where they "were substantially in arrears almost from the outset of their relationship with plaintiff, had no financing in place, bounced checks, and had failed to sell even a small fraction of the product" they originally projected.[27] Similarly, in *Turntables, Inc. v. Gestetner*, the appellate court found that "reasonable grounds for insecurity obviously existed" and justified the seller's demand for adequate assurance of performance

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[22] *Id.* at 49–50.

[23] 988 N.Y.S.2d 525 (Suff. Sup. Ct. 2014).

[24] 870 F.2d 563, 568 (10th Cir. 1989).

[25] 720 F. Supp. 312, 314 (S.D.N.Y. 1989).

[26] *Id.* at 322; *see also Enron Power Marketing, Inc.*, (reversing and remanding bankruptcy court finding for a determination of whether buyer's demand for assurance was reasonable based on seller's credit downgrade, even where the downgrading of a party's credit was listed in the contract as an event which may trigger the other party's insecurity).

[27] 664 N.Y.S.2d 698, 701–03 (N.Y. Sup. Ct. 1997).

where the "buyer was in arrears in payment for goods already delivered; its 'Fifth Avenue Showroom' turned out to be a telephone answering service; its Island Park factory turned out to be someone else's premises, to which [the buyer] did not have a key, and [the buyer] did not lease space, had no employees, payroll, machinery or equipment therein; another supplier told [the seller] it had been stuck with an unpaid bill of [the buyer]'s; [the buyer] had a bad reputation for performance or payment, etc."[28]

The assignment of a promisor's contractual obligations can also give rise to reasonable grounds for a demand in certain circumstances, even when the promisee has no evidence that the assignee will not perform. In *Koch Materials Co. v. Shore Slurry Seal, Inc.*, part of the relevant contract provided that Shore would purchase all of its required asphalt from Koch, with a guaranteed minimum purchase each year.[29] Shore then attempted to sell and assign its assets, including its obligation under the contract, and Koch requested adequate assurances of performance. The court held that, given the importance of counterparty risk in requirements contracts, the proposed assignment constituted reasonable grounds for a demand as a matter of law.[30]

A party's financial troubles, including insolvency, may also provide reasonable grounds for a demand for assurances. In *Koursa, Inc. v. manroland, Inc.*, the court determined that the insolvency of a printing press manufacturer, which impacted the ability of its sales representative to timely deliver under a contract, gave the buyer reasonable objective grounds for insecurity.[31] Similarly, in *S & S, Inc. v. Meyer*, the court held that farmers had a right to demand assurances of future performance by a grains dealer under a contract where the dealer had filed for bankruptcy, was actually insolvent for a period of time, and had certain checks returned to it for insufficient funds.[32]

Courts have even held that rumors of a promisor's troubled finances may serve as reasonable grounds to demand assurances, even if those rumors prove to be false.[33] Under Section 2-609, the "standard is one of reasonable insecurity,

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[28] 52 A.D.2d 776, 777 (1st Dep't 1976).

[29] 205 F. Supp. 2d 324, 327 (D.N.J. 2002).

[30] *Id.* at 331.

[31] 971 F. Supp. 2d 765, 790 (N.D. Ill. 2013) ("Insolvency of the other party may constitute reasonable grounds for insecurity when the circumstances surrounding the insolvency suggest that it will impair the insolvent party's ability to perform.").

[32] 478 N.W.2d 857, 862 (Iowa Ct. App. 1991).

[33] *Turntables*, 382 N.Y.S.2d at 799 (seller "was entitled to the benefit of [Section 2-609] even though the sale was on credit and even though his suspicion that plaintiff was insolvent may have been inaccurate"). Further, Official Comment 4 to Section 2-609 explains, citing *Corn Products*

not absolute certainty," and the party demanding adequate assurances does not have a duty to perform "due diligence" before making the demand.[34] That being said, if the rumor is too vague, or contradicted by more credible evidence, courts will not find the demand for assurance reasonable.[35] There must be an "objective factual basis for the insecurity, rather than a purely subjective fear that the party will not perform."[36]

WHAT ARE UNREASONABLE GROUNDS FOR A DEMAND?

While courts generally acknowledge the usefulness of the demand for assurances in keeping parties from breaching, they are wary of parties who might try to use the demand for assurances as a way to get out of an uneconomic contract. As a result, courts are given "broad discretion" in applying Section 2-609 to guard against its "flagrant use . . . as a weapon to avoid unprofitable contracts."[37] If a promisee's demand for assurance is insincere, courts will reject it even if there may have been objective grounds for the demand.

This risk most clearly arises in cases where the promisee's own conduct prevents the performance for which it is seeking adequate assurances. In *BAII*, which concerned contracts for the purchase of petroleum products, the seller's ship was ready to discharge its cargo in compliance with the contract but was not permitted to berth due to instructions from the buyer, which proceeded to demand an assurance of performance one and one-half hours later.[38] The court held that "no reasonable fact-finder could have found that [buyer] had 'reasonable grounds' for insecurity" because the buyer could not "rely upon its own conduct in not permitting the Kanopolis to berth and discharge its cargo

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Refining Co. v. Fasola, 109 A. 505 (1920), that rumors that a buyer's financial condition was shaky, although false, were enough to justify a seller's demand for security under the contract.

[34] *Clem Perrin Marine Towing, Inc. v. Panama Canal Co.*, 730 F.2d 186, 191 (5th Cir. 1984).

[35] *See, e.g.*, *Eastman Kodak Co. v. Collins Ink Corp.*, 821 F. Supp. 2d 582, 584 (W.D.N.Y. 2011) (holding that an ink supplier's purported demand for assurance, based on its subjective doubts and nervousness concerning Kodak's present financial circumstances and "recent news reports," was not reasonable); *BAII Banking Corp v. UPG, Inc.*, 985 F.2d 685, 703–04 (2d Cir. 1993) (party's reliance on rumor that counterparty was unable to perform not reasonable when, at the time demand for assurance was made, counterparty's ship had prepared its notices of readiness to discharge its cargo and party stood to gain financially from the avoidance of the agreements).

[36] *In re Pacific Gas and Electric Co.*, 271 B.R. 626, 640 (N.D. Cal. 2002) (citations omitted).

[37] *BAII*, 985 F.2d at 704 (internal citations and quotations omitted).

[38] *Id.* at 703.

as a basis for a claim of its own insecurity."[39] The court further noted that the buyer's "potential gain from the avoidance of the agreements at issue provided an incentive to avoid performance of the agreements."[40] In a similar case, the court concluded that a buyer's insecurity was not reasonable under Section 2-609 where it stopped payment on a check for goods it had already received, after obtaining assurances of the seller's continued performance under the contract.[41] The "buyer could not rely on its own nonpayments as a basis for its own insecurity."[42]

Courts will also reject as unreasonable any alleged grounds for insecurity that are based on circumstances known to or negotiated by the promisee at the time the contract was formed.[43] The time for dealing with such known issues is during the formation of the contract. Section 2-609 is not "a pen for rewriting a contract."[44] In *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, the seller had contracted for the sale and installation of an industrial water tank. Though the original proposed contract called for installment payments of 60 percent upon receipt of materials, 30 percent upon completing of erection, and 10 percent upon completion of testing or within 30 days after the tank had been made ready for testing, the final contract provided that 100 percent of the contract price was due and payable within 30 days after testing and acceptance.[45] Thereafter, upon being informed that the buyer had received (but, in fact, was negotiating) financing for the project, the seller demanded an assurance that the full amount of the purchase price would be held in escrow prior to completion or a personal guarantee of payment from the buyer's president, or else the project would be held in abeyance.[46] The court rejected this demand, finding that the buyer's actions "lacked the necessary predicate of reasonable grounds for insecurity" because it was not based on any change of financial condition

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[39] *Id.*

[40] *Id.* at 703–04.

[41] *Cherwell-Ralli, Inc. v. Rytman Grain Co., Inc.,* 433 A.2d 984, 986–87 (Conn. 1980).

[42] *Id.* at 987.

[43] *See, e.g.*, *Field v. Golden Triangle Broad., Inc.*, 305 A.2d 689, 696 (Pa. 1973) (the fact that a corporation to be formed later would be performing a portion of the contract did not give rise to reasonable grounds for insecurity where the demanding party was aware of that fact when the contract was signed).

[44] *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572, 582 (7th Cir. 1976).

[45] *Id.* at 573–74.

[46] *Id.* at 574.

bearing on the buyer's ability to perform its payment obligations.[47]

Furthermore, even where there are objective grounds for a demand, courts may nevertheless hold that that there is no reasonable basis for a demand if other facts negate the potential insecurity. For example, in *In re Beeche Systems Corp.*, the seller of scaffolding equipment filed for bankruptcy one week after entering into the contract at issue, but never informed the buyer.[48] While, generally, a promisor's insolvency may justify a demand for adequate assurances, the court adjudicated that the bankruptcy proceeding was not a sufficient basis for the demand because by the time the buyer learned of the bankruptcy filing, the seller had already performed all that had been required by that point under the contract and had given no indication that it did not intend to fulfill its other obligations.[49]

Similarly, continuous problems with performance might not provide reasonable grounds for a demand if the defects in performance have been waived or excused by a promisee. In *Cassidy Podell Lynch, Inc. v. SnyderGeneral Corp.*, the contracts at issue set forth payment terms for 30 days after delivery.[50] However, the course of performance between the parties revealed that the payments were consistently made and accepted approximately 90 days after shipment. The court affirmed the jury's finding that, in light of its acquiescence to the buyer's payment on 90-day terms, the seller was not justified in demanding adequate assurance of payment before the expiration of the 90-day period.[51]

Courts may also reject as unreasonable demands for assurance based on vague or unsupported sources of information. As previously described, demanding parties need not perform "due diligence" concerning a promisor's performance before demanding assurances, but they cannot base such demands on unreliable rumors. In *Cherwell-Ralli*, the buyer demanded assurances because he was told by a delivery truck driver, not employed by the seller, that the shipment would be his last delivery.[52] And in *Eastman Kodak*, the seller demanded assurances based on "recent news reports" concerning the buyer's financial condition and his subjective belief that there was a "significant probability" that the buyer could default on its financial obligations.[53] In neither case were the rumors

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[47] *Id.* at 581.

[48] 164 B.R. 12, 14 (N.D.N.Y. 1994).

[49] *Id.* at 16–17.

[50] 944 F.2d 1131, 1137 (3d Cir. 1991).

[51] *Id.* at 1148.

[52] *Cherwell-Ralli*, 433 A.2d at 986.

[53] *Eastman Kodak*, 821 F. Supp. 2d at 584.

supported by any other indication that the promisor would not perform, or actual defects in performance, and in both cases, the demands for assurance were held to be unreasonable.

WHAT ASSURANCES CAN BE DEMANDED?

Once a promisee has determined that it has reasonable grounds for insecurity, the next question is what assurances may be demanded. In some cases, a concerned promisee may demand a general assurance of performance under the contract. For example, in *Koch Materials Co. v. Shore Slurry Seal, Inc.*, where the purchaser under a requirements contract attempted to sell and assign its assets, including its obligation under the asphalt contract, Koch stated it would continue performing "once Shore has provided Koch with adequate assurance of performance of its obligations to Koch."[54] More frequently, however, a promisee will demand specific assurances or performances that are reasonably related to the contract and underlying reason for the insecurity. In contrast, in *Hornell Brewing Co., Inc. v. Spry*, Hornell demanded a "letter confirming the existence of your line of credit" and "personal guarantee that is backed up with a personal financial statement" or "an irrevocable line of credit in the amount of $300,000" before Hornell would release any more product in light of Spry's questionable financial condition.[55]

It is important to note that even if reasonable grounds for a demand are present, a promisee is not necessarily entitled to receive the specific assurances it requests. Once again, the case law generally tends to be consistent with the Official Comments, with courts looking to the nature of the defect when considering what is a reasonable demand for adequate assurance. For instance, in *Reich*, where the buyer had repeatedly fallen behind on his payments to the seller, the court found that the seller's demand that all payments in arrears be made current was reasonable and that the seller was within his rights to suspend performance until the payments were made.[56] In *Creusot-Loire*, the court found that, in response to concerns about defective units being sold to other buyers, the buyer was reasonable in demanding proof that the products that had been delivered would perform under the conditions specified.[57]

However, in cases where a promisee requests assurances that are too burdensome, courts may accept lesser assurances, provided they are still

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[54] 205 F. Supp. 2d at 327–28 (D.N.J. 2002).

[55] 664 N.Y.S.2d at 701.

[56] S.D.N.Y. Jan. 31, 2002, *aff'd*, 56 Fed. Appx. 25 (2d Cir. 2003) (unpublished).

[57] *Creusot-Loire*, 585 F. Supp. at 50.

adequate. For example, in *American Bronze Corp. v. Streamway Prod.*, the seller demanded assurances before it would continue producing castings called for by the contract.[58] Specifically, the seller demanded the payment of all past due amounts, payment of all future invoices within 10 days, a new policy regarding the return of scrap metal, and a liability waiver.[59] In response, the buyer paid all past due amounts and agreed to the future payments terms, but did not agree to the other requests. The court determined that the assurances provided were adequate and, as a result, the seller was bound to perform and its failure to do so rendered it liable for the buyer's losses when it unilaterally rescinded the contract.[60]

Demanding parties also should be wary of demanding assurances that exceed or modify the parties' rights or obligations under the agreement. In one case, where a buyer of natural gas demanded an assurance that the seller provide an unqualified 25-year commitment to supply gas from the plant, the U.S. Court of Appeals for the Eighth Circuit agreed that the demand was invalid because the buyer sought "more than it was entitled to under its Gas Purchase Agreement."[61] Similarly, in *Remuda Jet Five LLC v. Embraer-Empressa Brasileira de Aeronautica, S.A*, a purchaser of several jet aircraft requested "assurances regarding Embraer's ability to deliver a plane that performs adequately," providing several sources of concern that prompted its request for assurance, including brake and flap performance, pressurization issues, and the closing of a service center at an airfield.[62] While the court could not determine whether the purchaser's concerns regarding the brakes, flaps and pressurization were insufficient as a matter of law because they were based in part on anecdotal accounts of other buyers, the court found the purchaser's concern over the service center unreasonable as a matter of law because the contract made no mention of a service center at the airfield. A "buyer cannot ask for reassurance regarding something that a seller has no contractual obligation to provide."[63] And in *Pittsburgh-Des Moines Steel Co.*, the seller's demand for the full purchase price amount to be held in escrow or a personal guarantee of payment was held

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[58] 456 N.E.2d 1295, 1298–99 (Ohio Ct. App. 1982).

[59] *Id.*

[60] *Id.* at 1303–04.

[61] *United States v. Great Plains Gasification Assocs.*, 819 F.2d 831, 834 (8th Cir. 1987) (the court determined that the buyer was itself in breach of the agreement when it demanded assurance of future performance, agreeing with the trial court that the demand was "merely a subterfuge to escape its obligations under the Gas Purchase Agreement").

[62] No. 10 Civ. 8369 (NRB) (S.D.N.Y March 27, 2012).

[63] *Id.*

to be invalid because it sought more than to which it was entitled under the contract.[64] Stated otherwise, a demand for assurance under Section 2-609 may not be used as a "pen for rewriting a contract in the absence of those reasonable grounds having arisen."[65]

Depending on how it is worded, an overreaching demand for assurances that modifies a contract could also render the promisee itself liable for breach. Comment 2 of § 2-610 states that a demand for assurances can be considered a repudiation if, "under a fair reading, it amounts to a statement of intention not to perform except on conditions which go beyond the contract,"[66] and in certain circumstances, courts have held that unreasonably high demands may be considered repudiations under Section 2-610. For example, in *Pittsburgh-Des Moines Steel Co.*, the seller's statement that it was holding the order in abeyance until it received a personal guarantee of payment or notice that the full purchase price amount was escrowed was held to be an anticipatory repudiation of the contract under Section 2-610, and the buyer was entitled to damages.[67] Thus, while we view this as a potential risk in only limited circumstances, if there is any concern about the reasonableness of a demand for adequate assurances, a promisee should be careful to phrase its demand in such a way that would not be interpreted as anticipatorily repudiating the contract.

WHAT ASSURANCES ARE ADEQUATE?

Assuming the grounds for insecurity are reasonable, the decision of whether to demand adequate assurances is relatively easy because, as explained, the demand itself likely will not be a breach or repudiation of the contract. The more difficult decision for a promisee is whether to suspend its performance if the assurance provided, if any, is inadequate.

Under the UCC, if the promisee's grounds for the demand are reasonable,

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[64] *Pittsburgh-Des Moines Steel Co.*, 532 F.2d at 581.

[65] *Id.* at 582.

[66] N.Y. U.C.C. Law § 2-610 Official Comment 2 (McKinney 2018).

[67] 532 F.2d at 582 (7th Cir. 1976); *see also Hope's Architectural Products, Inc. v. Lundy's Const., Inc.*, 781 F. Supp. 711, 716 (D. Kan. 1991), *aff'd*, 1 F.3d 1249 (10th Cir. 1993) (seller's demand for prepayment of contract price and waiver of back-charge caused by seller's late delivery held to be unreasonably excessive, and an anticipatory repudiation); *Scott v. Crown*, 765 P.2d 1043, 1047 (Colo. Ct. App. 1988) (demanding payment in full before it was due was an unreasonable demand under Section 2-609 and constituted anticipatory repudiation). *But see Top of Iowa Co-op. v. Sime Farms, Inc.*, 608 N.W.2d 454, 469 (Iowa 2000) (the "mere fact that the Coop demanded performance beyond that required by the contract did not transform its demand into a repudiation as a matter of law.").

the promisor must provide "adequate" assurances of its performance within a reasonable time not exceeding 30 days, or it will be deemed to have repudiated the contract.[68] The adequacy of any assurance provided is measured by the same standard as the demand, namely "commercial reasonableness."[69] Therefore, a promisee is only entitled to assurances that would be sufficient to assuage the concerns of a reasonable party, acting in good faith.[70] Generally speaking, as long as a promisee makes a reasonable demand in good faith according to commercial standards, courts will find any lesser assurances to be inadequate.[71]

As with the definition of "reasonable grounds," the Official Comments to § 2-609 provide a good starting point for determining what types of assurances would be deemed adequate. As the Comments explain, under certain circumstances, mere promises to correct defects or to perform properly in the future may be adequate.[72] Under other circumstances, the promisee may be justified in requiring that prior defects be corrected and suspending its own performance until such assurances are received. Generally, the nature of the defect and the reputation and past performance of the party providing the assurance will factor in the determination of what assurances are adequate.[73]

In *In re Pacific Gas and Electric Co.*, the buyer under an energy agreement demanded that PG&E "provide [it] with reasonable and adequate assurance of PG&E's ability to perform the Agreement" after PG&E failed to deliver power as scheduled on three of the previous six days and disclosed that its debt rating had been downgraded to below investment grade.[74] PG&E responded that it had "fully complied and will continue to fully comply with the terms of the Agreement." The court determined PG&E's assurance to be adequate given the length of the relationship between the two parties, the good faith shown by PG&E, the fact that California had never before experienced an energy shortage of the magnitude at issue, and the provisions in the contract permitting the types of curtailments that PG&E had imposed.[75] Similarly, in *By-Lo Oil Co.,*

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[68] N.Y. U.C.C. LAW § 2-609(4) (McKinney 2018).

[69] N.Y. U.C.C. LAW § 2-609(2) (McKinney 2018).

[70] N.Y. U.C.C. LAW § 2-609 Official Comment 3 (McKinney 2018).

[71] William D. Hawkland & Frederick H. Miller, 2 *Uniform Commercial Code Series* § 2-609:3 (2011); *see also* N.Y. U.C.C. LAW § 2-610 Official Comment 2 (McKinney 2018).

[72] N.Y. U.C.C. LAW § 2-609 Official Comment 4 (McKinney 2018).

[73] *Id.*

[74] 271 B.R. at 641.

[75] *Id.* at 642–43(the court also held that the sellers demand was not sufficiently clear under the UCC because it did not include a statement regarding the consequences of a failure to respond or provide a deadline by which to do so).

Inc. v. Partech, Inc., a purchaser of software programs with concerns about Y2K issues demanded a commitment from the seller by January 31, 1998 that the software would function after December 31, 1999 with no problems.[76] The seller responded that it could give no definitive answer to the question of whether the software would be changed to handle Y2K until upper level management had the appropriate data to make an informed decision. The court held that, as a matter of law, given the fact that the potential Y2K problem was almost two years away, there was no indication that the seller had failed to fulfill its obligations in the past, and no evidence that the seller's reputation provided any cause for concern, seller's assurance that it was evaluating the potential Y2K problem with its software was adequate, despite the fact it was less than requested.[77]

However, in *LNS Inv. Co., Inc. v. Phillips 66 Co.*, the seller had repeatedly provided defective goods and missed production quotas.[78] In response to a demand for assurances, in which the buyer "notified plaintiff of the inadequacies of plaintiff's goods and requested assurance that plaintiff would take steps to rectify the same," the seller stated "we are certain that we will be showing marked improvement in deliveries in the coming week and even more in another two or three weeks," but provided no other assurances. The court found that, in light of the repeated defects, this plain statement was insufficient to assure the buyer.[79] Likewise, an attempt by a promisor to divest itself of its duties and transfer its contractual obligations to another party likely would be deemed an insufficient assurance of performance. In *Consolidated Edison Co. of New York v. Charles F. Guyon, Inc.*, a piping manufacturer informed the buyer that its fabrication division was closing due to labor issues.[80] In response to a written request for confirmation that an order for fabricated piping would be completed as scheduled, the seller assured the buyer that the order would be completed by another manufacturer at no additional cost, but with the understanding that the buyer must look to the replacement manufacturer with respect to any product liability. The court affirmed that such an "attempt to relinquish an obligation does not constitute adequate assurance of due performance under the contract."[81]

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[76] 11 Fed. Appx. 538, 540 (6th Cir. 2001) (not recommended for full-text publication).

[77] *Id.* at 545 (the court further held that the buyer did not have reasonable grounds for insecurity in January of 1998).

[78] 731 F. Supp. 1484, 1485 (D. Kan. 1990).

[79] *Id.* at 1488.

[80] 471 N.Y.S.2d 269, 269 (1st Dep't 1984).

[81] *Id.* at 270.

Again, the determination of whether a promisor's assurance is "adequate" or not is critical to any decision to suspend performance under a contract and will depend on several factors, including, but not limited to, the specific grounds for the insecurity, the reputation and performance history of the promisor, and the kinds of assurances available.

CONCLUSION

As the above discussion shows, there are few hard and fast rules concerning when a promisor's conduct creates reasonable grounds for a demand, or what assurances from the promisor will be considered adequate. But even without such rules, it is helpful to see how courts have decided which party is reasonable, which party is trying to perform under the contract, and which party wants to get out from under the contract. Hopefully this will provide some guidance as to when a demand for assurances is reasonable, when an unreasonable demand may be rejected, and when a provided assurance will be adequate.