

Lesson from the Sports Page: Do Not Terminate a Contract Unless the Breach Was Material

By James E. Smith

Ohio State University knows what it takes to run a big-time college sports program, and how hard it is to comply with those NCAA recruiting rules. In fact, Ohio State specifically wrote into the employment agreement of its former men's basketball coach, James O'Brien, that he must comply with the NCAA rules. After learning that Mr. O'Brien broke those rules, the university fired him. Mr. O'Brien, claiming that his actions did not warrant firing, sued Ohio State for wrongful termination of the employment agreement. To Ohio State, it seemed to be a simple case of termination based on breach of the employment agreement's terms. An Ohio judge, however, disagreed, and found that Ohio State was wrong in firing the former coach.

Once again, the sports page provides a good lesson in the application of an important business law principle; a breach of a contract must be "material" before it can be the basis for termination of the contract. The trial judge ruled that Mr. O'Brien did, indeed, break NCAA rules, but the judge also ruled that Ohio State violated the employment agreement by firing him, because Mr. O'Brien's breach was not "material."

As commercial relationships become more complicated, it is often very difficult to determine if a breach of a contract will support termination of that contractual relationship. Generally, for the non-breaching party to have the right to terminate a contractual relationship, the breach must be material. However, the determination of whether a breach was material can be very difficult. At times, the information necessary to determine if the breach was material will not be available to the non-breaching party. Thus, the non-breaching party may be taking a big risk in terminating a contract, even based on a clear breach, because if a court later determines that the breach was not material, the terminating party could be liable for large damages due to the improper termination.

Mr. O'Brien had been recruiting a Serbian-born basketball player living in the United States. Mr. O'Brien admitted that he personally loaned money to the Serbian player. Usually, loaning money to a recruit would be a serious violation of NCAA rules. However, the loan occurred under some extenuating circumstances. At the time of the loan, Mr. O'Brien arguably had determined that the player was not eligible to play at an NCAA institution because he had received money for playing basketball in Serbia. Mr. O'Brien testified that, when he made the loan, he determined that the player was already a professional. Therefore, at the time, Mr. O'Brien felt that the loan was not to a potential recruit and therefore should not be viewed as a violation of NCAA rules. Mr. O'Brien also claimed that he had humanitarian reasons for making the loan; the player's father had died in a poor, war-torn Eastern European country, and the family lacked money for funeral expenses.

Despite the circumstances, Ohio State believed that the loan had violated NCAA recruiting rules and fired him. Mr. O'Brien then sued Ohio State, claiming that the firing was wrong because he had not violated NCAA rules, or, if he had indeed breached the employment agreement, any breach was not material.

After a five-day trial, the judge ruled that Mr. O'Brien's actions were, indeed, a breach of his employment agreement. At the time of the loan, the NCAA was still reviewing the player's status (it rejected an appeal as to the player's status months later), thus making the player still a recruit. Moreover, Mr. O'Brien did not report the loan or otherwise seek guidance regarding the applicability of NCAA rules to this situation. However, the judge also ruled that the breach "was not a material breach" and, therefore, Ohio State "did not have cause to terminate plaintiff's employment." The judge noted that "this single, isolated failure of performance was not so egregious as to frustrate the essential purpose of that contract and thus make future performance by defendant [Ohio State] impossible."

A court will determine whether or not a breach is "material" based on the applicable state law. Generally, courts look at factors such as those in The Restatement (Second) of Contracts § 241.:

1. The extent to which the non-breaching party will be deprived of the benefit reasonably expected;
2. The extent to which the non-breaching party can be adequately compensated for the loss;
3. The extent to which the breaching party will suffer forfeiture;
4. The likelihood that the breaching party will cure; and
5. The extent to which the behavior of the breaching party comports with standards of good faith and fair dealing.

Even when a party realizes that its counterparty has breached the agreement, it will not always be readily apparent whether the breach was material. For example, the non-breaching party may not know if the breaching party's behavior comported with standards of good faith and fair dealing. The non-breaching party may not know if the breaching party can adequately compensate the non-breaching party for the loss, nor will the non-breaching party necessarily know if the breaching party can cure the breach. Also, the non-breaching party may not know the extent to which the breaching party will suffer significant losses due to the forfeiture of the contractual relationship. Given all of these circumstances, it is often difficult for the non-breaching party to determine if the breach was material. Most notably, states generally do not have any monetary amount to determine materiality, and in the context of a large contractual relationship, a breach of thousands and perhaps millions of dollars could still be held not to be material, and thus would not allow for termination.

In the case of former Ohio State basketball coach O'Brien, the court ruled that Ohio State was wrong in terminating the contractual relationship, and the court awarded O'Brien almost \$2.5 million for the wrongful termination of the employment contract. Ohio State's appeal was unsuccessful, despite friend of the court briefs in support of Ohio State from eighteen other universities, the Big 10, Big 12 and Pac 10 conferences. The Ohio Supreme Court refused to hear the case, thus giving Ohio State no choice but to pay. The ruling shows that a determination of breach of contract is not enough for the non-breaching party to terminate the contractual relationship. The breach must be material, and it is often very difficult to determine if a breach is material.