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CHAPTER XI

THE PROBLEM OF "CANCELLATION"

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OF THE NEW YORK BAR

I. "CANCELLATION" FROM THE LEGAL VIEWPOINT

Between September, 1919 and April, 1920, while prices generally were rising, more orders and larger orders were the rule. This was natural, because ordinarily prices rise only when demand increases, and increased demand expresses itself in more orders and larger orders.

Between May, 1920 and May, 1921, while prices generally were falling, fewer orders and smaller orders were the habit. This alone would have brought about the general price decline. But the decline was accelerated, and throughout almost the entire period assumed the velocity and steepness of a drop, because of the widespread prevalence of "cancellation."

"Cancellation," colloquially and in the sense here used, means notification by the buyer before delivery that he cancels, wholly or in part, the order which he has previously placed with the seller. If the seller has accepted the order when it was placed—and this happens almost always—what is then called the order is really a legal contract. This contract obligates the seller to deliver to the buyer the merchandise specified in the accepted order and obligates the buyer to pay to the seller the price specified in that order. When, therefore, the buyer "cancels" the order, in effect he notifies the seller that he considers himself relieved, in whole or in part, of his legal obligation to take and pay for the merchandise which he has contracted to buy.

If the seller acquiesces, the "cancellation" wipes out the contract and all its legal rights and obligations. If the seller does not acquiesce, the "cancellation" constitutes a repudiation and breach of the contract. The seller then has ground for a lawsuit against the buyer, in which the seller only occasionally can compel the buyer to take and pay for the merchandise; and usually can only obtain judgment against the buyer for the difference between the price specified in the accepted order and the "open market" price (as determined by the jury) of merchandise of the same general class at the time and place of delivery specified in the order.

II. THE PREVALENCE OF "CANCELLATIONS" IN 1920-1921

Manufacturers, producers, and sellers, between June, 1920 and May, 1921, were everywhere complaining of "cancellation." If contemporary testimony may be believed, the prevalence of "cancellation"—"cancellitis" as it was humorously called—exceeded anything that had been experienced for years. No commercial country escaped it, though British merchants professed that it was less common in Great Britain than in other countries. American merchants, on the other hand, declared that it was less common in American domestic trade than in export trade. No line of business escaped, though perhaps it was most noticeable in those in which the period is longest between the time of placing the order and the time for delivery. Trade associations, in conventions and committees, adopted resolutions against "cancellation," exhorted their members to sue all customers who attempted to "cancel orders," and in several instances proposed agreements binding their members to such action. "Cancellation" nevertheless continued and was one of the chief phenomena, and perhaps one of the chief accelerants, of the price decline throughout that period.

Since "cancellation" is legally nothing but repudiation and breach of contract, the question may be asked: Why does any commercial community tolerate it?

In some lines of business, "cancellation" is practically unknown. A banker, who would attempt the "cancellation" of his commitment to purchase and pay for the securities of a tire manufacturer whom he had undertaken to finance would promptly find himself ostracized. If a member of a Stock Exchange, after selling on the floor some securities to another member and receiving the latter's confirmation, should later receive a "cancellation" of it, he would promptly sell the securities for the latter's account and hold the latter liable for any deficiency. No financial stringency or trade condition would justify failure by the banker or the Stock Exchange member to fulfill his legal obligations under these transactions.

But if a dealer had ordered \$10,000 worth of tires from this same tire manufacturer, or if the tire manufacturer had ordered \$25,000 worth of fabric from a textile manufacturer, and a price decline had followed, the dealer and the tire manufacturer might at any time before delivery attempt "cancellation" of their respective orders with relatively little danger of moral opprobrium. And if their respective sellers should resist "cancellation," without offering some reduction in price, or some "adjustment" to "absorb" or "split" part of the loss, trade sympathy would largely favor the buyer as against the unyielding seller.

In some sections of the business community, accepted orders for merchandise seem to lack most of the sanctity that belongs to contracts generally.

In certain lines of business, in normal times, an accepted order, in spite of its legal status as a contract, may before delivery be cancelled by the buyer almost at will without objection by the seller. So long as buyers and sellers, in normal times, commonly disregard the legal significance of accepted orders, it is not surprising that their legal enforcement in abnormal times seems to the buyer wholly unjust.

III. TYPES OF SELLERS' CONTRACTS WHICH TEMPT BUYERS TO CANCEL ORDERS

In some lines of business an accepted order, in the form which the sellers have succeeded in imposing upon the trade, binds the buyer so tightly, while permitting the seller such latitude as to time and quantity to be delivered, that the buyer's situation, according to his own opinion at least, is almost intolerable, unless he be allowed by custom considerable latitude in "cancellation."

In the textile industry, orders frequently are accepted "subject to release for all or part of same in case of fires, strikes, lock-outs or other unavoidable delay caused by casualties or occurrences over which we have no control," or on condition that in event of "unavoidable casualty, the deliveries shall only be made proportionate to the production."

In the canning industry, orders frequently are accepted on condition that the seller guarantee delivery only "of the pro rata amount of each item on this order, such as the total quantity ordered from all sources of said item bears to the seller's total season's pack thereof," and that the buyer "shall accept delivery of any portion of this order at such times as seller is able to deliver."

Whoever has collected sales contract forms adopted or recommended by trade associations must be impressed by the frequency with which clauses like these are imposed by sellers upon buyers.

Under such clauses sellers may, in the events specified, which necessarily are for the most part solely within the sellers' knowledge, deliver only a part, or none, of the quantity ordered.

During the period of rising prices, between the summer of 1919 and the spring of 1920, court calendars, which frequently are a significant index of disturbed business conditions, abounded in cases in which buyers charged sellers with unscrupulous conduct under contracts containing clauses similar to these, and the Federal Trade Commission was flooded with complaints against sellers who, it was charged, were utilizing these and similar clauses to withhold deliveries on orders that had been accepted at low prices many months before, and were selling surreptitiously the quantities so withheld to new purchasers at greatly increased prices.

Just as excessive harshness in criminal statutes breeds laxity in their observance and enforcement, so excessive harshness in sales contracts breeds the spirit that leads to "cancellation."

IV. ECONOMIC CONSEQUENCES OF THE PRACTICE

But even if harsh sales contracts were abolished, "cancellation" would still exist.

So long as eager sellers, competing with one another to obtain more and larger orders, encourage buyers to order too much rather than too little, and so long as eager sellers, competing with one another to obtain the good-will of buyers, dare not offend buyers by resisting "cancellation," "cancellation" will continue. As prosperity approaches high tide and the probability of turning over merchandise at a profit diminishes, buyers are thus induced to continue ordering, knowing that "cancellation" will be tolerated and that at any time before delivery they can avoid their losses and throw them back upon the sellers. This is the real evil of "cancellation."

In extreme cases, buyers at the peak of the boom, expecting that they will receive only a moderate quota of what they order, place orders for two or three times the quantity of goods they need, or order the full bill from two or three different houses. Such practices would be exceedingly risky were orders generally treated as contracts. As matters stand, the practice is not only common, but also has been encouraged in some cases by over-zealous salesmen who wish to book the business. These inflated orders may deceive the wholesale merchants and manufacturers regarding the extent of the demand and lead them in turn to place larger orders for goods or materials than they can use. Thus the practice of "cancellation" aggravates the business errors committed in boom periods.

The other side of the practice becomes obvious after the tide has turned. "Cancellation" then wipes out the demand expressed in the order, and destroys the support which the order gave to the price level. And since "cancellation," like any other repudiation or breach of contract is always a disappointment and frustration of hope, "cancellation" accelerates the general price decline much more than refusal originally to place the order could possibly have done.

If accepted orders for merchandise had everywhere the same sanctity that belongs to contracts generally, and if "cancellation" were wholly abolished, prices would nevertheless rise and fall, and speculation would continue. Our Stock Exchanges prove that speculation exists even when contracts are strictly enforced. But imagine what speculation on the Stock Exchange would be if repudiation and breach of contracts were tolerated! Here is simply another proof that speculation in industry is undoubtedly more excessive than speculation on any Stock Exchange. If by trade association action, or by trade education, or by recommendation from individual banks and from the Federal Reserve Banks, the practice of "cancellation" could be diminished, speculation in industry would be kept within narrower bounds.