

QUESTION 3

Dirt, a large excavating company, recently replaced all of its gas-powered equipment with more efficient diesel-powered equipment. It placed the old gas-powered equipment in storage until it could sell it.

On May 1, Builder, a general contractor for a large office development, and Dirt signed a valid written contract under which Dirt agreed to perform all the site preparation work for a fee of \$1,500,000. Dirt estimated its total cost for the job at \$1,300,000. The contract states: "Dirt hereby agrees to commence site work on or before June 1 and to complete all site work on or before September 1." Because no other work could begin until completion of the site preparation, Builder was anxious to avoid delays. To ensure that Dirt would give the job top priority, the contract also states: "Dirt agrees to have all of its equipment available as needed to perform this contract and shall refrain from undertaking all other jobs for the duration of the contract."

On May 29, an unusual high pressure weather system settled over the state.

As a result, on May 30, in an effort to reduce air pollution, the state banned use of all diesel-powered equipment.

On June 2, Dirt told Builder about the ban and stated that it had no way of knowing when it would be lifted. Builder told Dirt to switch to its gas-powered equipment. Dirt replied that using its old gas-powered equipment would add \$500,000 to its costs and asked Builder to pay the increased expense. Builder refused.

On June 4, seeing that no site work had begun, Builder emailed Dirt stating that their contract was "terminated."

On June 8, Builder hired another excavating company, which performed the work for \$1,800,000.

Dirt has sued Builder for terminating the contract. Builder has countersued Dirt for the \$300,000 difference between the original contract price and what it paid the new contractor.

1. Is Dirt likely to prevail in its suit? Discuss.
2. Is Builder likely to prevail in its countersuit? Discuss.

QUESTION 3: SELECTED ANSWER A

Governing Law

The contract involves excavation related to the construction of a large office development. Common law principles, rather than the UCC, will apply as the sale of goods is not implicated.

Dirt's Suit Against Builder for Termination of Contract

Builder's termination of the contract will be wrongful unless one of the relevant grounds for rescission is satisfied. Builder can argue, alternatively, that: 1) Dirt's breach was material; 2) Dirt's comment regarding costs constituted an anticipatory repudiation; 3) Frustration of purpose, or impossibility, gave provided grounds to discharge the K.

Minor versus Material Breach

Breaches of the promises or covenants contained in a contract provide grounds for the non-breaching party to sue for damages. The ability to treat the contract as discharged on the grounds of a breach, however, depends on the nature and extent of the breach itself. A material breach *does* provide the non-breaching party with grounds to discharge the contract. A minor (non-material) breach does not. Whether a breach is material or minor depends on a determination as to whether the non-breaching party received the "benefit of the bargain" sought under the contract. Courts will address an assortment of factors in seeking to arrive at such a determination, including the hardship to the defendant, the reason for the breach, whether the breach was willful or inadvertent, the cost of remedying the breach, the ability of damages to remedy the breach, and the overall degree of completion at the time of the breach.

If a promise or covenant is *implied* into a contract, courts will generally accept substantial performance (as to avoid a breach). If a promise or covenant is *express* in the contract, generally literal compliance is required. However, even when dates are included in a contract, including construction contracts, courts do not construe time to

be of the essence *unless otherwise clearly stated*.

Was Time of the Essence

Here, the contract itself reads "Dirt hereby agrees to commence site work on or before June 1 and to complete all site work on or before September 1." It additionally contains a promise from Dirt to have all equipment ready and to refrain from undertaking other jobs during the duration of the contract. Each party will seek to argue in the affirmative/contrary that time is/is not of the essence. Builder will argue that multiple contractual provisions outlining the importance of expediency and availability of supplies mandate a finding that time is of the essence in the contract. However, Dirt can argue that time of the essence was never explicitly stated in the contract, and that any such reading of such a promise would be implied only. Dirt will additionally argue that, if time is not of the essence, then not having started by June 4 -- three days after the intended start date -- would not constitute a material breach and thus Builder could not treat the contract as discharged. Builder will argue the opposite -- time was of the essence; three days late was therefore a material breach, and therefore the contract can be discharged.

Conclusion

A court is more likely to find in Dirt's favor based on these facts. Firstly, the contract did not explicitly state time is of the essence, despite multiple references to the timeliness of performance. Secondly, if time was of the essence, it would likely be in regard to the *completion* rather than the *starting* date. Starting three days late would not constitute a material breach; therefore, even if time was deemed of the essence. The conjunctive power of these two arguments likely means Dirt would prevail and would not have deemed to have been in material breach of the contract by failing to start performance by June 4. This would, therefore, make Builder's termination of the contract improper and Dirt would prevail in his suit, subject to the analysis below.

"Having All Equipment Available"

An explicit term of the contract between Dirt and Builder was that Dirt "agrees to have

all of its equipment available as needed to perform this contract..." When Dirt and Builder communicated on June 2, Dirt communicated to Builder that using its old gas-powered equipment would cost an additional \$500,000 and asked for the increased payment. The parties will contest what was meant by the term of the contract, and whether Dirt breached the term of the contract by not having gas-powered equipment ready. Dirt will contest that "all of its equipment" refers to the equipment its business employs in carrying out excavation contracts, which, at present, is diesel-powered equipment. Builder will argue the equipment provision mandated for Dirt to have any and all necessary equipment ready to perform.

Builder *likely* has the stronger argument on these facts. Builder can likely demonstrate that the failure to have the necessary equipment to perform the excavation -- the very purpose for which Dirt was hired -- is a material breach of the contract. It is material, Builder will assert, because it deprives Builder of the entirety of the benefit of its bargain; without proper equipment, the contract cannot even begin to be performed. Therefore, as a material breach, Builder has grounds to terminate the contract. Dirt's counter-argument that it had the *reasonably foreseeable necessary* equipment to begin likely won't succeed -- Dirt did still have gas-powered equipment, although it was in storage; when Builder contracted with Dirt, it could expect that Dirt would employ all equipment that it owned in performing the contract. Therefore, Builder likely has a stronger argument that by not having gas-powered equipment ready Dirt was not able to meet the requirement of the contract to have "all of its equipment available as needed to perform this contract." Such a material breach would give proper grounds to terminate the contract on Builder's part, but Builder's argument is by no means a clear and certain winner.

Anticipatory Repudiation Versus Perspective Inability to Perform

An anticipatory repudiation occurs when one party, in a fully bilateral executory contract, communicates explicitly and unequivocally that it will not be able to perform its duties or obligations under the contract. An anticipatory repudiation discharges the non-repudiating party's duty to perform and that party can 1) treat the contract as discharged

2) sue immediately, 3) wait and sue on the contract date, 4) attempt to urge performance by the other party. A perspective inability to perform is a statement by one party to the other expressing doubts or reservations about a potential ability to perform an obligation or duty under the contract. It differs from an anticipatory repudiation in its explicitness and unambiguousness.

Here, Dirt told Builder that using its old gas-powered equipment would add \$500,000 to its costs and asked Builder to pay the increased expense. Builder refused the request. Nothing in Dirt's language would rise to the level of an anticipatory repudiation -- it made no representation that it absolutely could not perform under the contract or that it would not, despite an increased cost. It merely requested a greater sum of money due to the elevated cost of performance. Builder could not justifiably have treated Dirt's comment as an anticipatory repudiation. Dirt's comment may have constituted a prospective inability to perform, but analysis as to whether it did or not is largely superfluous derivative of the fact that, even if it was, Builder's duties under the contract would only have been suspended. Builder could not treat the contract as discharged via a perspective inability to perform.

Concluding, Builder could not treat the contract as discharged on grounds of an anticipatory repudiation or perspective inability to perform based on Dirt's comments regarding the increased cost of performance.

Frustration of Purpose

Builder can seek to advance the argument that frustration of purpose provided grounds to discharge its contract with Dirt. Frustration of purpose occurs when a supervening event, which was unforeseeable to the parties, and which neither party expressly assumed the risk of, frustrates the purpose of the contract (i.e., deprives the contract of value and benefit.) Builder will seek to argue that the state's banning of diesel-powered equipment frustrated the purpose of its contract with Dirt, as state regulation due to the unusual weather system was unforeseeable, and that the value and purpose of the contract have been frustrated via this unforeseeable event. Builder will seek to argue

neither party assumed the risk, and the change was not foreseeable to the parties at the time the contract was entered into.

Dirt will likely have a winning counter-argument to Builder's claim of frustration of purpose. While the state regulation has changed the cost of the contract -- and has changed the cost of the contract *to Dirt alone* -- the underlying value and benefit of the contract has remained. The purpose for which the parties contracted is still achievable, and increased cost alone does not frustrate the entire purpose of a construction contract.

A court is more likely to favor Dirt's argument, especially because Builder, in seeking to advance an argument of frustration of purpose, is not in fact the party enduring hardship in this contract from increased cost. While the cost of performance has changed via the state regulation, the basic purpose and value of the contract remains -- the land can be excavated for the purpose of constructing a building subsequently.

Impossibility

Builder could seek to argue, ultimately unsuccessfully, that impossibility and impracticability should allow the contract to be terminated. Impossibility refers to the situation where a subsequent event, which was unforeseeable, which undermined a material element of the contract (or a basic assumption upon which it was formed), and which neither party assumed the risk of, has rendered performance of the contract (by one or both parties) illegal. One form of impossibility is illegality, occurring where the subject matter of the contract has subsequently become illegal after the contract was entered into.

Builder's arguments are likely to fail because, despite the intervening illegality of the use of diesel-powered equipment, the contract itself, and the purpose for which it was formed, has not been rendered illegal. A required-by-law change in the instrumentality used to carry out the contract would not render the contract itself dischargeable on grounds of impossibility. Impossibility would therefore not serve as a viable grounds for

discharge of the contract on the part of Builder.

Damages

If Dirt successfully prevails in its suit against Builder on the grounds that Builder impermissibly breached the contract, Dirt can recover its lost profits under the contract. As a general rule in construction contracts, Builder can recover lost profits if the owner breaches prior to commencement of the construction; if the owner breaches during construction, the builder can recover the contract price - the cost of completion. Here, Dirt would receive lost profits -- that is the \$1,500,000 - \$1,300,000 = \$200,000.

Overall Conclusion

Builder's strongest argument to justify terminating the contract was that Dirt's breach of the material term of the contract to have all equipment available needed to perform the contract constituted a material breach by Dirt, and therefore provided grounds for discharge. This is not a clear-cut certainty, however. Impossibility, impracticability, frustration of purpose, and breach of the time for performance clause all would not be winning arguments to justify termination of the contract *for Builder*. However, even if Builder can show Dirt was in material breach of the contract, Dirt likely has some persuasive counter-arguments to avoid liability, found below.

Builder's Countersuit

Much of the analysis regarding potential avenues for Builder to seek to have the contract discharged (rescission) apply to excuse Dirt's performance under the contract. Frustration of purpose, impossibility, and impracticability all provide grounds by which a party's performance under a contract is excused, in addition to providing potential grounds by which a contract can be discharged between the parties. However, as we established above, the contract was likely rightfully discharged because Dirt breached a material term regarding having "all supplies available." That being said, if Dirt's performance was *excused* for a valid reason, Dirt will not be held liable for damages (amount discussed below) under the contract.

Impracticability

Dirt likely has a strong argument for impracticability. Impracticability encompasses the situation where a subsequent event, which was unforeseeable, and has a material effect on an element of the contract or a basic assumption upon which the contract was formed, and which neither party assumed the risk of, has rendered one party's performance extremely or unreasonably difficult or expensive. Here, Dirt will argue that the subsequent enactment of law was unforeseeable because it was the result of an unusual weather system, and that it was inherently unforeseeable. Furthermore, it has had a material effect on the contract (Dirt's cost of performance), and neither party expressly assumed the risk of the event. Builder can counter that Dirt assumed the risk of increased cost of performance via restrictions on the use of certain types of machines by law, but Builder's argument is not overly persuasive. Rather, the cost of increase in Dirt's performance will likely be determinative in the eyes of the court.

The subsequent enactment of new law has increased the cost of Dirt's performance by \$500,000, out of an initial cost of \$1,300,000 -- a cost increase of less than 50%. Courts, historically, have generally been unwilling to excuse performance under a contract due to the increased cost in performance unless such an increase is excessive and extreme. Here, a less than 50% increase in cost may not meet that standard; although the increase does make the performance on the contract a profit-negative transaction for Dirt, the increase in cost may not be so unreasonable as to excuse performance, a court may find. Nevertheless, Dirt can and should advance the argument -- likely, however, it will be a losing one.

Impossibility

As discussed in detail above, impossibility -- via illegality -- will not serve as a valid excuse to Dirt's performance because the contract itself did not become illegal, rather merely one means by which the contract could be performed became illegal. A court is unlikely to extend the reasoning so far as to entirely excuse Dirt's performance because diesel-powered equipment has been subject to regulation, especially considering the fact that Dirt has gas-powered equipment available. Dirt's arguments will fail on

impossibility grounds.

Frustration of Purpose

Dirt's arguments regarding frustration of purpose will similarly fail for the reasons outlined above -- the value, benefit, and purpose of the contract remains despite an increased cost to Dirt. The essence of the contract and its purpose was the excavation, not what type of machine Dirt used in the process. Dirt's arguments will fail on frustration of purpose grounds.

Mutual Mistake

Dirt could seek to argue that his performance is excused via mutual mistake. Mutual mistake applies when both parties are mistaken as to a basic assumption, material to the contract, upon which the contract was formed. Here, Dirt would argue mutual mistake occurred in regards to "equipment available." Dirt could seek to argue there is ambiguity in the term, as Dirt meant diesel-powered equipment while Builder expected the use of all of Dirt's equipment. Dirt's argument will likely not fail -- the term is plain on its face -- "all of its equipment" -- and would be interpreted to require of Dirt to employ all the equipment it owns, which includes gas-powered equipment. While Dirt may have intended a different meaning for the term, because the term is plain on its face and there was not an actual "mistake" regarding the meaning of the term, Dirt's argument will fail. Dirt's subjective belief will not constitute a mutual "mistake" in the eyes of the court.

Damages

An owner's countersuit in a construction contract which has not been fully performed by the breaching party can recover damages in the amount of the difference between the contract price (with the breaching party) and the cost of completion (obtained via the hiring of a third party.) Here, that would provide Builder with the \$300,000 damages outlined as the amount of its lawsuit.

Conclusion

If Builder succeeds in showing that failure to have all equipment available was a material breach by Dirt, it can rightfully treat the contract as discharged. Furthermore, it can recover damages from Dirt *if* a court determines that the difficulty to Dirt did not rise to the level of impracticability (the most likely finding). Alternatively, if no grounds existed to discharge the contract because the court does not find Dirt has breached a material term, then Dirt can recover the profits it would be entitled to from the contract. If the contract was rightfully discharged but Dirt's performance *did* rise to the level of impracticability, then Dirt would not be paid to force damages. Builder prevailing in regard to both breach and damages is the most likely outcome.

QUESTION 3: SELECTED ANSWER B

Introduction

Applicable law

The issue is whether the UCC applies. The UCC applies to the sale of goods. Goods are things movable and identifiable at the time of contracting. Here, the contract is for the performance of construction services. Construction services are not goods. Therefore, the UCC does not apply. Therefore, the common law governs.

1. Is Dirt likely to prevail in its suit?

Anticipatory repudiation by Builder

The issue is whether Builder anticipatorily repudiated the contract. Anticipatory repudiation occurs when one party unambiguously and clearly states that it will not perform the contract. An anticipatory repudiation counts as a breach. The non-breaching party can either find someone else to do the performance, sue the breaching party, or do nothing. Anticipatory repudiation generally applies to executory contracts. In the event that the contract is wholly executory, then the non-repudiating party can immediately sue for damages, regardless of the date of performance. If the non-breaching party has already performed, then it cannot sue until the time for the other party's performance is due. For anticipatory repudiation in construction contracts before anything has begun, the general measure of damages is the non-breaching party's expected lost profits.

Here, the parties made a valid contract on May 1st. The contract provided that construction would begin on June 1 and that performance was due on September 1. On June 4, Builder stated that the contract was terminated. Saying that a contract is terminated is an anticipatory repudiation--is unambiguous and clear. Builder had no

intention of following through on the contract at that point. Moreover, the contract was still executory. Dirt had not commenced any sort of performance, and Builder had not paid anything. As a result, Dirt would have the option of suing for breach of contract at the time of breach. Because the contract was completely executory, Dirt would be entitled to its lost expected profits. In this case, the total fee was expected to be \$1,500,000 and the expected cost was \$1,300,000. As a result, the expected profits would be \$200,000. Thus, Dirt would be likely to win \$200,000 if there are no applicable defenses to enforcement.

Mitigating damages-defense

In order for a party to recover damages, they must be certain, causally related to the breach, foreseeable, and unavoidable. Here, the damages are foreseeable and caused by Builder's breach. Had Builder not breached, Dirt would have been paid, and non-payment is a foreseeable consequence of breach. Moreover, the damages here are certain--\$200,000. We generally use expectation damages in contract law, which puts the party in as good of a position as they would have been had the contract been performed. Generally, the non-breaching party is required to mitigate damages, which means that they must try to reduce damages as much as possible. In the context of construction contracts that are anticipatorily repudiated, mitigating damages might involve taking other work during the time in which the party was expecting to work for the breaching party. Thus, Builder might claim that Dirt has failed to mitigate damages. However, the fact that Builder made Dirt refrain from entering into any other contracts during this time might hurt the mitigation argument -- Dirt would probably be able to show that it was unable to mitigate due to this clause in the contract. Had the clause not been present, perhaps Dirt would have been out finding other business.

Anticipatory Repudiation by Dirt-defense

The issue is whether Builder might be able to defend on the basis that Dirt actually repudiated first. However, this argument is likely to fail. On June 2, Dirt merely told Builder about the ban and asked Builder to shoulder the increased expenses, after

which Builder declined. However, this is not sufficiently unambiguous to constitute an anticipatory repudiation. If a party is uneasy about whether the other party can perform (due to an ambiguous situation like we have here), then the party can demand further assurances from the other party, and may temporarily suspend performance for a commercially reasonable time until it receives those assurances. Here, Dirt did not actually say that it was not going to be able to perform. Had Dirt been unambiguous, then perhaps Builder could have deemed it an anticipatory repudiation and hired another party (one of the options when there is an anticipatory repudiation). However, the June 2 conversation was not clear enough. It is perfectly possible that Dirt may perform the contract regardless. Therefore, this defense would be unlikely to be effective.

Breach of Promise/Condition by Dirt-defense

The issue is whether Dirt breached a condition of the contract such that Builder's obligation to perform was discharged. A promise is something that a party is supposed to do under a contract. A condition is an event that, if it does not occur, means the entire contract does not come into effect. Courts generally construe terms as promises as opposed to conditions, because they do not want an entire forfeiture of the contract.

Builder may argue that the June 1 start date was a condition precedent to the contract taking effect. Essentially, they would say that, because Dirt had yet to commence construction by June 1 (indeed, even by June 4), that the condition was not satisfied and the contract did not take effect. However, a court would probably not buy this argument. There are two types of conditions--express and implied. An express condition must be in the contract explicitly in conditional language ("on condition that"), which was not present here. An implied condition may arise from the intent of the parties. Here, Builder was worried about timing, but there is insufficient evidence to infer that the start date was a condition to Builder's entire performance. Thus, a court would likely construe the start date as a mere promise. Indeed, the courts abhor a forfeiture.

In the event that the start date is considered a promise, then the common law doctrine of substantial performance applies. Substantial performance holds that a non-breaching party has a duty to perform if the breaching party has still substantially performed her end of the bargain. There must be a "material breach" in order for the non-breaching party to be completely discharged. When determining whether there has been substantial performance, the courts take into account (i) prejudice to breaching party; (ii) prejudice to breaching party; (iii) amount of performance rendered; (iv) whether the breach was willful; (v) cost of fixing the problem; and (vi) a variety of similar factors.

In service contracts, time for completion is generally not considered a material breach if performance is completed slightly late. The only time when a complete breach and forfeiture might be found is when there is a "time of the essence" clause, which must be very explicit. There was no such clause in this contract, and the breach only applied to the *start* of performance, so it would be very unlikely for a court to find that Dirt materially breached to the extent that Builder will be completely discharged from performance.

Conclusion

Overall, it appears that Dirt would have a good case against Builder for breach of contract for the amount of \$200,000.

Is Builder likely to prevail in its countersuit?

Anticipatory repudiation by Dirt

This is the same argument as has been described above. Essentially, Dirt's statements over the course of the June 4 conversation are unlikely to constitute a full-blown anticipatory repudiation. Builder should have first demanded further assurances before terminating the contract and hiring someone else.

Breach of promise/condition by Dirt

This is the same argument as has been described above. Essentially, it is unlikely that a court would find the start date to be a condition precedent to effectiveness of the contract. Moreover, it is unlikely that Dirt's failure to start completely on time would count as a material breach justifying Builder's non-performance.

Impossibility-defense

Dirt might argue in defense that it would be unable to perform its end of the contract due to supervening impossibility. Indeed, in many cases, a subsequent law or regulation may render a party's performance illegal or impossible. In such case, that party may be excused from performing. Generally, the party claiming excuse must have not expressly borne the risk.

Here, the government banned all diesel-powered equipment two days before Dirt was supposed to commence performance. This was certainly unexpected, and was the result of the May 29 high-pressure weather system. However, performance is definitely not impossible. Dirt still has its gas-powered equipment, which it could use to complete the project. It might be more expensive to do so, but mere increase in expense is insufficient for an impossibility defense. Therefore, impossibility would not be an effective defense.

Impracticability-defense

Dirt might argue in defense that it should be excused from performance due to supervening impracticability. Impracticability is a defense where the occurrence of an unforeseeable event happens, which renders performance impracticable. The unforeseeable event must affect an underlying assumption of the agreement. The party claiming excuse must not have borne the risk. Generally, the mere inability to make a profit is not sufficient for a claim of impracticability.

Here, the high pressure system was characterized as unusual. Builder might argue that strange weather systems are foreseeable, and that Dirt should have known that this was a possibility. On the other hand, Dirt would claim that a weather system resulting in the banning of all diesel-powered equipment is not foreseeable at all. Overall, it would probably be seen as unforeseeable. Moreover, the ban had an effect on an underlying assumption of the contract. Dirt was expecting to use its diesel equipment--it had put all of its old equipment in storage. Moreover, if Dirt knew that it would have to spend an additional \$500,000, it would not have accepted a \$1,500,000 contract price. There is no evidence that either party expressly assumed the risk (though sellers generally bear the risk in sale of goods contracts, and a court could, by analogy, deem that Dirt was allocated the risk). The key question is whether the ban makes performance impracticable. Dirt is a large excavation company, which presumably has a lot of contracts. If Dirt had to use its gas equipment, it would expect to see a \$300,000 loss on this job. It is unclear the effect that such a loss would have on Dirt, but a court would probably find that such a loss is insufficient to make performance of the contract wholly impracticable. It is possible that a court could find that performance is impracticable, but it is rather unlikely.

Mistake-defense

Dirt might try to argue that there was a mutual mistake, which should lead to discharge of contractual duties. Mutual mistake occurs when both parties were mistaken about a fundamental aspect of the contract. Dirt could argue that both parties mistakenly assumed that Dirt would be able to use its diesel-powered machines. The fact that a basic assumption has been violated (by Dirt having to use gas-powered equipment) could perhaps render the contract unenforceable and both parties would be excused. This is somewhat of a stretch of an argument. It depends on whether Builder actually had diesel as a basic assumption of the contract, and whether either side assumed the risk.

Damages

\$300,000 would be the proper expectation damages. Builder would get the difference between the contract price and the reasonable cover price.

Conclusion

For the reasons mentioned, Builder would be unlikely to win its countersuit.