

Question 5

Developer had an option to purchase a five-acre parcel named The Highlands in City from Owner, and was planning to build a residential development there. Developer could not proceed with the project until City approved the extension of utilities to The Highlands parcel. In order to encourage development, City had a well-known and long-standing policy of reimbursing developers for the cost of installing utilities in new areas.

Developer signed a contract with Builder for the construction of ten single-family homes on The Highlands parcel. The contract provided in section 14(d), "All obligations under this agreement are conditioned on approval by City of all necessary utility extensions." During precontract negotiations, Developer specifically informed Builder that he could not proceed with the project unless City followed its usual policy of reimbursing the developer for the installation of utilities, and Builder acknowledged that he understood such a condition to be implicit in section 14(d). The contract also provided, "This written contract is a complete and final statement of the agreement between the parties hereto."

In a change of policy, City approved "necessary utility extensions to The Highlands parcel," but only on the condition that Developer bear the entire cost, which was substantial, without reimbursement by City. Because this additional cost made the project unprofitable, Developer abandoned plans for the development and did not exercise his option to purchase The Highlands parcel from Owner.

Builder, claiming breach of contract, sued Developer for the \$700,000 profit he would have made on the project. In the meantime, Architect purchased The Highlands parcel from Owner and contracted with Builder to construct a business park there. Builder's expected profit under this new contract with Architect is \$500,000.

What arguments can Developer make, and what is the likely outcome, on each of the following points?

1. Developer did not breach the contract with Builder.
2. Developer's performance was excused.
3. In any event, Builder did not suffer \$700,000 in damages.

Discuss.

Answer A to Question 5

This contract is for construction services. As a result, it will be governed by the common law.

Valid Contract

In order to proceed, Builder must establish a valid contract, which requires (1) offer, (2) acceptance, and (3) consideration. The facts state that Builder and Developer reached an agreement and signed a contract. Therefore, there is likely the required offer, acceptance and consideration. The contract does not fall under the Statute of Frauds because it is not: in consideration of marriage, suretyship, contract for real property, sale of goods \$500 or more, or unable to be performed within one year. In any event, the contract was signed, which indicates that it would satisfy the Statute of Frauds anyway. There is a valid enforceable contract.

1. Developer did not breach

A breach of contract occurs when a party to the contract does not perform after performance comes due. Therefore, if performance has not come due, there can not be a breach. Likewise, if the party substantially performs his obligations under the contract, there is no breach. Performance only comes due after the occurrence of all conditions precedent to performance. This contract contained such a condition. The contract contained the condition that obligations were only due once the City approved "necessary utility extensions." Therefore, unless the City approved these extensions, performance is not due.

Builder will argue that the City did approve the extensions, and that performance is due. The fact that the City approved the extensions is true; however, it still may not give rise to performance. Developer will rebut this argument with a claim that Developer and Builder agreed that this condition impliedly included the condition that City reimburse Developer for the cost of the extensions.

Merger and Parol Evidence: A merger clause in a contract indicates that the contract is a final integration of the agreement between the parties. This clause causes the Parol Evidence rule to apply. This rule states that no prior or contemporaneous oral statements are admissible that contradict the final integration between the parties. Builder will argue that the statements by Developer that the condition means that the City must approve and reimburse for the extensions is barred as parol evidence. However, the parol evidence rule does not outlaw all statements. Developer can still admit statements that prove the existence of a condition precedent to the formation of the contract or statements that explain the meaning of a clause in the contract. Both of these rules apply here.

The statements in question represent the agreement by Developer and Builder that the condition in 14(d) means that the agreement is conditioned on reimbursement by the City for the cost of the extensions. This means that there was an additional condition precedent: the contract is conditioned upon reimbursement by the City. This also means that statements that Developer seeks to admit will explain the language of 14(d). Therefore, the statements Developer seeks to admit will [be] admissible by the Parol Evidence Rule.

Because Developer can admit the statement pertaining to reimbursement, he will be able to establish that performance is not due. As a result, his failure to perform is not a breach.

2. Performance was excused

Performance can be excused by the occurrence of a number of events. These include frustration of purpose, impracticability, impossibility, and failure of a condition precedent. Failure of a condition precedent is discussed above.

Frustration of Purpose

Frustration of purpose excuses performance under a contract when performance is still technically possible, but the purpose of the contract no longer exists. In order to prevail, the defendant must show (1) the purpose of the contract was known by the plaintiff at the time of contracting, (2) circumstances that are out of the defendant's control changed, and (3) the change of circumstances caused the original purpose to be unavailable.

Here, the purpose of the contract was to make money on the development of a residential community. Builder, who knew that he was expected to build single family homes, was aware of the purpose of the contract. Circumstances did change pertaining to the development. The City had a long-standing policy of reimbursing the cost of extensions to new areas. After this contract was entered into, the City changed this policy. Therefore, the second element is met. Lastly, Developer must show that the change in circumstances made the purpose of the contract unavailable. City's change in policy made Developer bear the cost of the extensions. However, Developer could still build the extensions, and therefore, build the residential development. It would cost Developer more money; however, the purpose of the contract was still available. Therefore, the purpose of the contract was not frustrated. It may have been less appealing to Developer, but it was not frustrated.

Impracticability

Performance of a contractual obligation is impracticable when (1) circumstances affecting the contract have changed, (2) the change is not due to any act by the defendant, and (3) the change of circumstances causes undue hardship on the defendant. Here, as discussed above, circumstances did change: City changed a long-standing policy. This was out of Developer's control. Therefore, Developer need only demonstrate undue hardship to prevail with this claim. The change of the policy meant that Developer would bear the burden of financing the extensions required to build the community. This cost was "substantial," and

made the project unprofitable for Developer. Making a project unprofitable is probably inadequate for a court to find impracticability. Developer would have to establish more than simple unprofitability. If Developer could show that the cost is so burdensome that he would be forced out of business, that would establish impracticability. However, simply unprofitability is probably inadequate. Therefore, this element is not met. The court will probably not find that performance was excused by impracticability.

Impossibility

Impossibility occurs when (1) circumstances affecting the contract have changed, (2) the change is not due to any act by the defendant, and (3) the change of circumstances causes performance to be impossible for the defendant. As discussed above, the change in circumstances makes performance unappealing, but not impossible. Impossibility will not excuse performance.

Developer should be able to successfully argue that performance should be excused by failure of a condition precedent.

3. Builder did not suffer \$700,000 in damages

A plaintiff in breach of contract claim can pursue damages that put the plaintiff in the position he would have been in had the defendant fully performed. This is generally established by expectation damages, incidental damages, and consequential damages, minus any mitigation available to the plaintiff. These damages are not available to the plaintiff if there is a valid liquidated damages clause. This contract did not have a liquidated damages clause, so that will not apply. Punitive damages are not available in a contract cause of action.

Expectation Damages

For a seller or provider of services, these damages typically equal the amount of profit the plaintiff expected to make. Here, that is clearly established as \$700,000.

Incidental Damages

These damages are the damages that the plaintiff incurred as incidental to the defendant's breach. They typically include the cost of finding a replacement buyer and administrative costs incurred because of the breach. Here, the facts do not indicate any incidental damages. However, if Builder incurred any costs in contracting with Architect to construct a business park, such as lawyer's fees, etc., these would be covered as incidental damages.

Consequential damages

These are the damages that occurred as a foreseeable result of the breach. In order to recover these damages, the plaintiff must establish that the parties contemplated these damages at the time the contract was formed. Builder does not appear to have incurred any consequential damages.

Mitigation

Generally, a plaintiff is required to mitigate damages. He is not allowed to sit by after a breach and allow himself to incur more damage than is necessary. Here, the original contract required Builder to build residences for Developer on The Highlands. After the alleged breach by Developer, Architect hired Builder to build a business park on the Highlands. This contract would not be available to Builder had he performed for Developer. If it would have been possible for Builder to perform both contracts, then this would not be mitigation. However, that would be impossible. Therefore, this is proper mitigation of damages. The other issue involved with mitigation is time. If the work for Developer would have taken 9 months, and the work for Architect takes 12 months, Builder could argue that the entire \$500,000 profit should not be considered for mitigation. However, no facts indicate the time required for either job, so the court will assume equal performance for both contracts.

Builder's damages for the alleged breach are \$700,000. However, because Builder is required to mitigate his damages, the \$500,000 from the contract with

Architect will be applied to the damages. Therefore, Builder's total damages due to the alleged breach are \$200,000.

Answer B to Question 5

1. Developer did not breach the contract with Builder.

Parol Evidence Rule

Although Developer will assert that he was not obligated to perform under the contract with Builder unless the City followed its usual policy of reimbursing for installation costs, Builder will argue that this condition precedent is not part of the agreement between the parties and therefore Developer has breached the contract by failing to perform. Builder's argument will rest on the parol evidence rule.

The parol evidence rule provides that the terms of a written agreement cannot be varied by prior or contemporaneous oral terms where the writing represents the party's final agreement. Consistent additional terms may supplement the writing if the contract is not complete, and extrinsic evidence may also be introduced to interpret ambiguous terms as long as the terms are reasonably susceptible to the proffered meaning.

Here, the agreement between Developer and Builder has been reduced to writing. Under the Williston rule, a court will look at the contract and determine whether the parties likely intended it to be the final and/or complete expression of the agreement given the detailed or specific nature of the terms. In this case, the contract provides for the construction of 10 single family homes and has several sections (including section 14(d)) describing aspects of the venture. Importantly, the writing contains a merger clause which states that "This written contract is a complete and final agreement between the parties hereto." Courts typically find that the parol evidence bar to extrinsic evidence presumptively applies where the writing contains a merger clause.

Accordingly, a court will likely find that the parol evidence rule applies. Developer's best arguments, therefore, are exceptions to the parol evidence rule. These exceptions include where extrinsic evidence show (1) fraud, (2) subsequent modification of the contract, (3) absence of consideration and other formation defects, (4) to interpret ambiguities, (5) to show a collateral agreement, (6) to show the existence of a condition precedent.

Exception to Parol Evidence Rule – Conditions Precedent

One exception to the parol evidence rule's bar on extrinsic evidence that may be helpful to Developer is the exception permitting a showing of conditions precedent. A condition precedent modifies a promise to perform; the promise to perform will not mature until the condition is satisfied, and accordingly a party cannot be in breach of said promise unless the condition precedent occurs.

Developer can argue that the City's following of its ordinary policy of reimbursing utility installation was a condition precedent to the obligations under the contract, and therefore the parol evidence rule does not bar him from presenting evidence on the existence of this condition.

However, Builder will have a good argument in response; specifically, Builder will point to section 14(d), which provides "All obligations under this agreement are conditioned on approval by City of all necessary extensions." Section 14(d) clearly is a condition precedent to Developer's performance, but it is expressly provided for in the written contract. Under the Williston Rule of contract interpretation, Builder will argue that since the contract included written terms covering conditions precedent, it is reasonable to presume that the parties would include all such agreed upon conditions precedent in the writing.

Accordingly, in light of these arguments, the "condition precedent" exception to the parol evidence rule is probably not Developer's best argument, although a

court that mechanically applies the exceptions to the parol evidence rule could be sympathetic. Developer should raise it and hope for the best.

Exception to Parol Evidence Rule – Explaining Ambiguity

Another exception to the parol evidence rule is extrinsic evidence admitted to explain an ambiguity in the written contract. Some jurisdictions, such as California, permit a party to also introduce extrinsic evidence to first demonstrate the existence of the ambiguity. This exception will be helpful to Developer in light of the difficulties presented by section 14(d) above.

Under this exception, Developer will argue that the term “conditioned on approval by City of all necessary utility extensions” implicitly included the City’s willingness to pay for utility installation. To support his argument, Developer will utilize the general commercial construction customs and understandings in the community, which may likely include the fact that any reasonable builder or developer operating in City would interpret “approval by the city of necessary utility extensions” to include, as a matter of course, funding to install the utility extensions. Developer will particularly be likely to avail this exception to the parol evidence rule in jurisdictions like California, since this ambiguity is not clear from the face of the contract.

Builder, however, will argue that section 14(d) is not reasonably susceptible to the meaning proffered by Developer. Availing the Williston Rule, Builder will likely harp on the fact that the sophisticated, commercial parties would insert such a material condition if it was in fact part of the agreement, especially where the writing contains a merger clause.

Ultimately, Developer’s arguments supporting the introduction of the prior negotiations will likely be successful; courts are loath to ignore clear, understood commercial patterns in an industry in contracts between sophisticated parties. Merger clauses are typically inadequate in such circumstances unless they

explicitly except course of dealing, course of performance, usage of trade from being permissible interpretive tools for the contract.

Exception to Parol Evidence Rule – Collateral Agreement

Developer may also argue that he did not breach the contract because it was controlled by a separate, collateral agreement. However, this argument will likely fail. Although collateral agreements are exceptions to the parol evidence rule, a court must conclude that the parties would reasonably have made the proffered collateral agreement separate from the primary contract.

Here, interpreting the condition of receiving installation funding from the City as a collateral agreement would be unreasonable. First, it is intimately related with the primary contract, and it is unlikely that Builder and Developer would fashion it separately from the main agreement. Second, it is unclear whether the proffered “collateral agreement” could even be an enforceable contract, as there would not be any consideration—i.e., bargained-for-legal detriment—flowing to support the agreement.

Accordingly, although the “collateral agreement” arguments is available to Developer to argue that the failure of a condition precedent did not mature his obligation to perform, it is one of his weakest arguments.

Mistake Due to Ambiguity

Mistake due to ambiguity is a contract formation defect. Developer could foreseeably argue that no contract was formed because of his mistake as to the meaning of a material term in the contract. Mistake due to ambiguity usually does not obtain relief for a party (typically the form of rescission or reformation) unless the other party was aware of the ambiguity.

Here, under these facts, Developer might argue that Builder was aware that section 14(d) was ambiguous and would not necessarily be interpreted to have

the meaning that Developer intended. Further, Developer would argue that the term was material to the contract, as the failure of the city to pay for the utility installation would drastically alter the expected benefits he would receive. If Developer can demonstrate these facts persuasively, he may be able to argue that there was either no “meeting of the minds” or that the contract should be reformed to match the “innocent party’s” interpretation of the contract. Under either scenario, Developer would not be in breach.

Unconscionability

Unconscionability is another contract formation defect, which is determined at the time of formation. There are two types, procedural and substantive. No facts suggest that the terms of the contract were so prolix as to amount to procedural unconscionability, but Developer may argue that the absence of a condition requiring reimbursement from the City makes the bargain so one-sided as to “shock the conscience” of the court.

Such an argument will likely not succeed in this case; the parties are sophisticated, commercial parties who are able to fend for themselves. Developer’s unfortunate circumstances are not of the type that would raise to unconscionability.

2. Developer’s performance was excused.

Impossibility

Developer may try to argue that his performance under the contract, even if matured because the court does not recognize his proffered condition precedent, was excused under the doctrine of impossibility.

Impossibility excuses performance of the contract where performance would be objectively impossible, i.e., not only can the party asserting the defense not perform, but no one could perform the contract under the unforeseeable circumstances that have arisen.

Here, impossibility will not be a helpful argument because not only could other developers potentially execute the agreement Developer has with Builder, Developer himself could do so, but simply at a large loss because he would have to pay for the utility installations.

According, the Developer's performance is unlikely to be excused by impossibility.

Nonetheless, Developer could successfully argue impossibility in that the subject matter of the contract can no longer be obtained by him because it was sold by Owner to Architect.

Impracticability

Developer may be better suited to prevail under the argument that performance was excused under the doctrine of impracticability. Impracticability is a subjective test that examines whether performance would be commercially unreasonable due to subsequent circumstances unforeseeable at the time of contract formation.

Here, Developer will argue that City's long-standing policy of paying for utility installation was a reasonable assumption by both parties. Further, the policy had been so ingrained in the community and understood by commercial developers and builders that a change in the policy was practically beyond the realm of possibility. Builder will respond that Developer's reliance on the permanence of the policy was misplaced, and he assumed the risk that the City could easily change its discretionary policy if economic requirements warranted. Ultimately, if Developer is able to persuasively argue his position, he may ultimately prevail on his argument of impracticability.

Frustration of Purpose

Developer may try to argue that the failure of the City to reimburse for construction costs constituted frustration of purpose. Frustration of purpose arises where circumstances unforeseeable at the time of contract formation arise that destroy the purpose of the contract, and that this purpose was known by both parties involved.

Here, Developer is unlikely to prevail on his frustration of purpose argument. Although, both Developer and Builder were aware of the purpose of the contract, the purpose of the contract—namely to construct ten single-family homes on the Highlands—was not “destroyed” by the City’s decision not to reimburse for utility installation. Accordingly, whether or not the City’s decision was foreseeable, it would not constitute frustration of purpose. Accordingly, this argument by Developer would fail.

3. Builder did not suffer \$700,000 in damages.

The purpose of compensatory damages is to place a non-breaching party in as good a condition as he would have been had the breach not occurred. The requisite showing in order to obtain compensatory damages is (1) breach, (2) causation, (3) foreseeability, (4) certainty, and (5) unavailability.

Applicability of “Lost Volume Seller” Rule

Builder may try to argue that he is a “lost volume seller,” and accordingly the fact that he was hired by Architect should not reduce his damages in the slightest because, had the contract with Developer been performed, he would have made both \$700,000 and \$500,000 in profits.

Builder’s argument is unlikely to succeed. Lost volume sellers must, in effect, have “unlimited supply” of whatever good or service they provide. Builder is not properly viewed as a car or TV salesman; he builds structures, and therefore his

services are in limited supply. Accordingly, a lost-volume seller type argument by Builder will be unavailing.

Certainty Requirement

In order to recover compensatory damages, such damages must be relatively certain. If the contract provided that Builder's payment was in any way contingent on the ultimate sale of the homes, his damage may well be too uncertain to permit recovery.

Unavoidability / Mitigation Requirement

A non-breaching party is required to mitigate his damages. Although failure to mitigate will not eliminate one's damages, it can reduce them to the amount that would have been incurred had proper mitigation been pursued.

Here, Builder did not fail to mitigate his damages; rather, he sought employment by Architect to construct a business park for \$500, 000. By mitigating, Builder was only damaged by the alleged breach to the extent of \$200,000, because only \$200,000 is needed for Builder to obtain the "benefit of his bargain" with Developer.