Scribbles Squibs #22 – November 22, 2013 – Issues Relating to Claimed Material Breaches of Contract (Fifth in a Series)

by Attorney Jonathan Sauer

I. INTRODUCTION.

OK. In previous *Squibs* in this series, seven part series we have talked about what a contract is. *Squib number seventeen, first in this series.* We've talked about some common forms of contract. *Squib number eighteen, second in this series.* We've talked about how to modify this contract. *Squib number nineteen, third in this series.* We've talked about the need to substantially perform the terms of a contract in order to preserve maximum contractual rights. *Squib number twenty, fourth in this series.* (If you have missed any of these, they can be found at our website *www.sauerconstructionlaw.com*.) Now, we need to talk about what is a 'material breach' of contract and how this impacts the contracts that you sign and perform.

The issue of 'material breach' is important for **two** reasons. The ***first*** reason, of course, is that a party materially breaching its contract is not entitled to any recovery under the contract even where a recovery might otherwise be owed. (If you are unfairly terminated short of substantial completion, you are probably able to get paid for the fair and reasonable value of your work.) The ***second*** reason is that generally when the one party breaches the contract, the non-breaching party is excused from further performance under the contract.

An analysis of this issue might have both offensive and defensive ramifications. Namely, from an offensive standpoint, your contracting party's material breach of contract could justify *your* termination of *them* with possible claims and remedies you might pursue against them and, if applicable, their bonding company. However, from a defensive standpoint, your contracting party's claiming that *you* have materially breached the contract lead to termination issues as to you and, possibly, your bonding company. Either way, this is *very* serious business!

This article does not deal with situations which are more or less clear collection cases, where this is a more or less uncontested debt. The thrust of this article is to discuss the issues related to what happens when a party's actions or inactions are claimed to be so egregious as to amount to a material breach of contract with the consequences that flow thereafter. And, this article will address in a very brief way some ideas on how to handle difficult *current* performance issues when an ultimate determination of 'material breach' is not absolutely crystal clear.

II. WHAT IS A 'MATERIAL BREACH OF CONTRACT'?

As we have discussed earlier, courts are pretty strict in enforcing contracts that parties have freely and voluntarily entered into. Society could not function without contracts and with people generally honoring their requirements. But, parties breach contracts every day of the week. The question becomes, what makes a breach *material?* And, what are some of the things that happen with material breaches?

The following may be the most important sentence in this article: *There is no general or 'one size fits all' definition of what may be 'material' with regard to a claimed breach.* This is made all the more complicated because of the fact that something that might be 'material' on one job may not be 'material' on another job because of the differences between the jobs.

Here's a definition of 'material breach' from a leading legal dictionary: "A breach of contract that is significant enough to permit the aggrieved party to elect to treat the breach as total (rather than partial), thus excusing that party from further performance and affording it the right to sue for damages." This, at least, provides an *idea* about what is involved but may not be as clear or as comprehensive as one might like.

Massachusetts court references are similar. One case defines this thusly: "A material breach of a contract by one party generally excuses the other party from further performance." Another judicial definition from a case: "Material breach" of an agreement occurs when there is a breach of an *essential* and *inducing* feature of the contract." (Emphasis added) Another case said this: "Generally, an intentional departure from precise requirements of a contract is not consistent with a good faith endeavor fully to perform it, and unless such departure is so *trifling* as to fall within rule *de minimis*, it bars all recovery." ('*de minimis'* means minor. Emphasis added). So, to be a material breach, what was done (or not done) has to be significant, essential and not trifling.

The next case had the following to say in defining what was 'material':

> "A breach is material where it is so serious and so intimately connected with the substance of the contract as to justify the other party in refusing to perform further. . . . In the construction contract context, the nonpayment of a substantial sum of money owed under the contract has been held to constitute a material breach warranting termination of the contract. . . (owner's failure to pay contractor monthly payments for work performed was material breach); (contractor's nonpayment of $25,000 owed to subcontractor was material breach of subcontract where contractor had been paid by owner for the work) . . . . (contractor's two week failure to put job site in condition for subcontractor's immediate and continuous work was material breach of subcontract) . . . . Indeed, whether a breach is material or immaterial is normally a question for the fact finder to decide based on the circumstances of each case. . . . . .

> In determining materiality, the fact finder may consider the factors set forth in the Restatement: (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected; (b) the extent to which the injured party can be adequately compensated for the benefit of which he was deprived; (c) the extent to which the breaching party will suffer forfeiture; (d) the likelihood that the breaching party will cure his failure; and (e) the extent to which the breaching party's failure to perform comports with standards of good faith and fair dealing . . . . One construction law commentator suggests the following guideposts: an unexcused breach is not material unless it reasonably compels a clear inference of unwillingness or inability of one party to *substantially* meet the other party's contractual expectations of future performance and need to mitigate damages; a breach is not material if the contract has been substantially performed; a breach is not material if it is redressable by compensatory damages and raises no justifiable insecurity as to future performance; a breach is not material if waived; and even if material, a breach may be excused for legally recognized reasons such as impracticability, fraud, and mistake. . . ."

These judicial gulps suggest various things. The breach must be substantial. This, as compared with being trivial. So, for example, with a contractual requirement to provide submittals in fourteen days but you provide them in sixteen days, this is probably not material. (Your position on such an issue would be improved if you advised your contracting party during the submittal period that they are going to be late and why.) Not supplying workers on scattered days on the job due to issues such as weather and because there is no work to do or not a significant enough amount to perform it economically is probably not material. (Again, telling your contracting party what you are doing and why would be helpful.) Parking your vehicles in a non-designated place is probably not material. Supplying a smaller crew than promised for short periods of time may not be material.

Your contracting party's non-payment to you in accordance with specific contractual provisions may not be material if: (a) there is something that looks like a pay-when-paid clause in your contract and your contracting party has not been paid for your work items; (b) you have overbilled or front-end loaded the job excessively with prior payments being more than they should have been as compared with the amount of work performed; (c) there are problems with your work; (d) your billings don't meet contractual standards in terms of content or substantiation, or; (e) you got your requisition in late. At the same time, there are a variety of cases that say someone clearly improperly not paid has the option of both pulling off of the job and suing to get paid. Depending on how much money is involved and how far you are along in construction may make this a bad decision for reasons discussed below.

As some of the above references state, a determination of what is 'material' is for the 'fact-finder.' What that means is that in many, possibly, most, circumstances, your attempt to obtain summary judgment in any litigation involved with the claimed material breach will be unsuccessful, as the summary judgment procedure is premised on the fact that there are no genuine issues of material facts. Now, the last statistics I have seen indicate that only about one percent of civil cases in the superior court go through a complete trial. But, cases with 'material'

issues of fact may go longer just because there is no clear-cut definition (in many, if not most cases) and each side has its own view. Put another way, the case is likely to be pending longer which has, obviously, increased expense elements and which adds interest to the claim at the rate of usually 12% per year for each year the case is pending, which is important both to the party paying and to the party getting paid.

So, with a 'material breach' issue, this might have to go to the judge (jury-waived trial) or to the jury (jury trial). Either might make a determination that might be different from what another judge or jury might determine. In part, this is because different people see various fact patterns differently. This is also possible because most judges and juries hate construction cases as they take too long, have far too many documents, take too long to try and from either a contractual or legal standpoint go beyond their level of knowledge and experience. In other words, frankly speaking, their *lack* of knowledge about technical construction issues and about basic construction practices and (a recent case I tried for five days) the public bid laws can cause them to make factual determinations which are just plain wrong. In some of the cases I have tried, from all appearances, the judge or the jury simply *guessed* as to the right resolution. Letting a construction issue involving a claimed 'material breach' go to the fact-finder means that before the trial, it is almost impossible to determine what the result might be. In counties having multiple sessions (multiple judges), you can't tell in advance who you are going to get for a judge. This is all the more so because Massachusetts mostly uses a circuit system for the appointment of judges, meaning that judges are rotated in and out of counties on a frequent basis.

Other than difficulties of the fact-finder understanding the subject matter of the dispute, another practical difficulty may be that some of your important witnesses have moved out of Massachusetts. This means that one can't compel their desired witnesses to attend trials as civil case subpoenas have no effect over state lines. Also, essential witnesses may have left your employ on bad terms. I have had several witnesses say to me before trial something to the effect of 'if you call me, you'll be sorry.' Also, while particular job problems seem clear, dramatic or certain as they are presently occurring, with the passage of time, they will appear less serious to the fact-finder. After all, your job and project, one way or another, will likely have been completed. Several years down the road, factual issues which were very important to you while the job was on-going will appear less so to the fact-finder.

And, if your contract is secured by payment and performance bonds, you may find that you have little or no control over what your bonding company may choose to do in terms of responding to claims. Bonding companies do not like paying the 12% per annum interest most contract claims provide for. And, in situations where there are claims against your general contractor public payment bond, they are uncomfortable with the fact that if they lose based on your claimed defenses they may have to pay attorneys' fees. The better ones are not wild about 'taking it to the mat' unless the claimant's claimed default is absolutely monumental and almost without question. Also, bonding companies claim that under their general indemnity agreements (GIA), they have sole discretion and authority to make claim decisions as they see fit. Most GIA specifically provide for this and, if you signed it, you have already 'agreed' to such provisions. I have seen various bonding companies claim that based on language in the GIA, they can sign the principal's name to a settlement agreement, even if the principal is

absolutely opposed to the action the bonding company might take. And, recent experience suggests that bonding companies are even more difficult to deal with when they no longer are writing your current bonds. After all, once you have moved on to another surety for whatever reason, the bonding company no longer considers you to be a 'customer'. Irrespective of what many would say, claim departments may be subject somewhat to the directions of 'the underwriters' (the people writing the bonds.) The underwriters may have a lot to say about how claims are handled as to current customers, particularly when such customers generate significant bond premium income. But, once a bond principal has moved on to another surety, such considerations cease to exist. The bond claims people may now be tougher to deal with.

It has been said that 'time heals all wounds.' In our construction context, the passage of time makes a lot of problems simply seem to be less important down the road where they are *past* problems as compared with *current* problems. The same adaptability that allows human beings to recover from significant losses of one kind or another can mean that your fact-finder may not see your situation as important as you do.

Better construction lawyers try to keep their clients out of court in terms of trying cases, if this can be accomplished. Also, better construction lawyers try to exercise 'risk management' principles, meaning, that over a course of several matters, more conservative decisions probably will result in better results as to a group of cases or issues, even though they may not have done so in any particular issue.

Many people say that 'revenge is best served cold'. Making important decisions when one is angry is a bad idea. Pulling off of an ongoing job is often a bad idea. Terminating a general contractor or subcontractor may have a lot of potential consequences. One must keep in mind that if a general contractor or a subcontractor pulls off of the job for any reason, its contracting party will have to have the work completed by *someone*. No one is likely able to complete your work for the same money that would cost you to do it. There is a learning curve for most jobs, which you have and the substituted general contractor or subcontractor does *not* have. And, if that general contractor or subcontractor has to provide a warranty for its work, a lot of money may be carried for this by a substitute general contractor or subcontractor, particularly for work that is buried or behind closed walls.

Those who breach their contracts may be obligated to pay 'consequential damages' other than and in addition to other direct costs to complete your work. What are they?

Some judicial and legal writer definitions. "Consequential damages have been defined, variously, as those that "result [ ] other than in the ordinary course of events. Or, as "losses that do not flow directly and immediately from an injurious act, but that result indirectly from the act." "Those damages that cannot be reasonably prevented and arise naturally from the breach, or which are reasonably contemplated by the parties." The phrase as a whole suggests an understanding of "consequential" damages as being indirect damages, in the sense of understood or contemplated by the parties when a contract is entered into.

Examples. If a Stop & Shop is delivered late, there may have been food deliveries made which cannot be properly sold. Similarly, if a Walmart is delivered late, there may be employees who have been hired who may have to be paid for hours not worked. An office building delivered late can mean that the owner has lost rent for its offices. A franchisee (one holding a franchise) or a mortgagor (a party giving a mortgage to secure its promissory note) may have serious consequences if the job is late. Without limitation, the mortgagor may have to start making payments to the bank on construction income even though it has not received any or the income expected. If a school is delivered late, the local educational authority may find it necessary to either rent mobile home classrooms or send students to other towns for education. And, based on the terms of a collective bargaining agreement, a town may have to pay teachers their salaries and benefits even if they are not teaching irrespective of the fact that the school may not be done. If a home is delivered late, the homeowner will incur costs for lodging (motels, hotels) that he or she would not have incurred had the home been delivered on time.

The fact that your contract doesn't contain a liquidated damage clause does not mean that you might not be subject to actual claimed delay damages. After all, liquidated damages are simply attempts *before the fact* of the entering into a contract to try to determine the cost impact of late performance. In the absence of a liquidated damage clause, a party causing a delay may be subject to delay claims where the other side has to produce some evidence of its damages. Based on the circumstances of a particular job, liquidated damages may be *less* than actual delay damages really are.

A case from our files. A Walmart was being constructed. The site guy was supposed to set grades and have a proper sub-base for the paving guy to pave over. Neither was properly done. In evaluating what action the paver should take, I gave the typical advice I give in such situations. Namely, do not perform work that does not meet the general requirements and customs and usages of your trade, whether such are established by code or otherwise. Doing such because of being subjected to momentary pressure – quite often *extreme* pressure - from your contracting party might mean nothing several years down the road when your case is actually tried. If you didn't follow customary practices and procedures for your trade, this might be seen as a material breach of contract. And, with a store such as a Walmart, I told my guy that if the parking lot failed, the store might be closed for a period of time. Claims for business interruption and lost sales and other factors could be involved that would simply dwarf the cost of paving the lot. So, my guy didn't pave the parking lot. The site guy sued the paver for its increased costs in getting the job done. Years later, the site guy dismissed his claim without any payment being made. Will that necessarily happen in any/all of your disputes? Probably not. But, this seems to be the correct choice to make in many situations.

So, that we are clear, there are at least two potential expense trails a breaching party might encounter and incur. 'Direct' expenses are those expenses which are necessary to complete the defaulting company's performance. 'Indirect' expenses can include one or more of the situations indicated in the previous paragraphs.

Thus, a determination of the 'materiality' of a claimed contract breach may have various factors that appear to be subjective. And, one should consider seeking advice of counsel before

making a determination of 'materiality' that might have dramatic consequences down the road for that contractor.

Declaring someone in material breach of contract can be a very serious thing, particularly as to jobs that are in process (not done) and where you might be chasing money for overdue payments down the road. If you declare the other party to the contract to be in material breach when it actually isn't, that declaration of material breach coupled with subsequent action such as a failure to further perform be considered to be breaches of contract, potentially subjecting *you* to damages. This is especially so in cases where you might be bonded.

A final point, tying our comments on 'substantially performing' one's contract to 'material' breaches of contract. *If* a party materially breaches its contract, almost by definition, it has not substantially performed its contract. And, as we discussed in an earlier *Squib*, only parties who substantially perform their contracts, generally speaking, have rights to seek payments under such contracts. This is why, wherever possible, a party's best choice with regard to preserving its rights under its contract to seek monies in the future is to substantially perform its contract.

III. CONCLUSION.

As we have discussed above, the other side's breach of contract may not be 'material'. In other words, the breach of contract may be factually (and, more importantly, legally) insufficient to justify a termination. Therefore, you may not be excused from withholding further performance of your contract. Even if you are owed money, it is often – possibly even usually – a better thing to complete your work either before or during your seeking payment through legal means. It is unlikely that anyone else can complete your work for anything close to what it would cost you to complete your own work. And, if down the road you find that a judge or jury disagrees with your determination of 'material breach', this might cost you a lot of money. Completing your jobs yourself will usually cost less than another party's doing so. And, by doing so, you may have yourself avoided a potential claim of 'material breach' of contract on your part, maximizing the possibility of a good result should resort to legal remedies prove necessary.

Some suggestions to think about.

1. Whenever possible, don't pull off of jobs as a knee jerk reaction to non-payment. Use options such as mechanics' liens, payment bond claims and demands for direct payment to stimulate payment.

2. Complete your own jobs whenever possible even where your contracting party might be guilty of a material breach of contract. This is all the more so where they are bonded jobs. And, even more particularly so if the surety on your payment and performance bonds is your former surety.

Having done such, you can only improve upon your ultimate position in litigation.

*(These materials are intended as general information only, not as specific legal advice. When confronted with a legal problem you don't understand, seek the assistance of legal counsel. Construction law is something that most 'general' lawyers don't do a lot of. At Sauer & Sauer, we **only** practice construction law. Involvement of a knowledgeable attorney earlier in a problem can often result in a better, quicker and less expensive outcome.)*

SIX QUICK THINGS TO KNOW ABOUT OUR FIRM:

1. No charge to non-clients for quick answers to *general* Massachusetts construction law questions.

2. We guarantee our billing rate for five years in writing for all new clients through the end of this year who mention this offer at engagement.

3. As trials can be expensive, take a great deal of management time and the result of which is uncertain, we make our best efforts towards seeing whether something short of a trial – such as mediation – might be possible for resolving the matter. If a trial is necessary, however, we have a lot of experience trying cases.

4. We endeavor to maintain, wherever possible, possible future business relationships with your contracting party you are currently in a dispute with by emphasizing a fair and reasonable approach to the resolution of disputes, which often helps promote earlier (and cheaper) case resolutions than does lawyers who are 'mean and angry'. And, while you might say now that 'I'd never work for that guy again', a lot of experience over several decades suggests to me otherwise! Given the right job, more than likely, he'd be given another chance. Particularly, if it is a *good* job!

5. We try to defer until later in the case the more expensive elements of discovery – i.e. depositions – in order to try less expensive discovery first. We recently obtained a 1.5 million dollar settlement for a subcontractor against a bankrupt general contractor's payment bond surety on three projects without a single deposition ever being taken and without our client's even having to answer and sign interrogatories.

6. Being a smaller firm, our attention is focused *solely* on our clients and their problems, not on feeding the overhead of a fancy office and many partners, associates and support staff. We only have to feed our six dogs, most of which, however, are *quite large!* Our repeat readers may recall that normally we say here that we have to feed our *five* dogs. Since the 'Puppy Doe' incident happened in Quincy, MA, we have felt the need to honor Puppy Doe by getting a rescue dog who is a pit bull. Thus, six!

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