

# Crossing the Rubicon – Contract Termination for Total or Material Breach

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## Introduction

While most construction projects do not end up in contention and acrimony, some do. Unexpected costs or delays can cause strife, and if trust or confidence is lost, the Owner will naturally question the Contractor's judgment, if not its motives. Payment applications that were routinely approved will face heightened scrutiny and will frequently be reduced. Retainage that was reduced or even eliminated will be reinstated, and the cash-flow to the Contractor will be reduced. Payments to lower-tier subcontractors and suppliers will be affected, and slowly but inextricably, the project will become a dysfunctional mess. As additional performance issues arise, default letters will be issued, leading to consideration of contract termination.

Contract termination is a very draconian remedy. It inevitably leads to delays in the completion of the project, the incurrence of added costs and the filing of lawsuits or demands for arbitration. For the Owner, termination will cause additional direct damages in the form of additional construction and financing costs, and likely result in the incurrence of consequential damages resulting from the delay in obtaining beneficial use and occupancy of the project.

For the Contractor, termination can be even worse, and is frequently characterized as a death sentence. At a minimum, the Contractor will be out of pocket the costs incurred since the last payment from the Owner, and the Contractor will also have direct and indirect overhead costs. The Contractor may also have consequential damages, as cash-flow from the project, as well as expected revenues, are no longer available. The Contractor may have no option but to draw on its line of credit or infuse additional capital into the company. It also has to worry about answering proposal requests that ask about any prior terminations, and if it has outstanding surety bonds, a termination can cause the surety relationships to founder.

Termination puts in motion a chain of events that is expensive and time consuming, and it may also unleash a series of unanticipated consequences, not the least of which may be a judicial determination that the termination was wrongful and without basis. Before heading down this path, it is essential to understand that not every breach of a contract authorizes or entitles the non-breaching party to terminate the contract, and that only a total or material breach justifies the remedy of termination. This naturally raises the question of what exactly is a total or material breach, how does one determine whether a breach is total or material and what are the consequences of wrongfully declaring a termination for material breach?

## What Is a Total or Material Breach?

Contract termination is only appropriate if there had been a total or material breach of the contract, so this naturally raises the question—what exactly is a total or material breach? Many courts have addressed this question, and while the definitions they provide vary slightly, a total or material breach is generally characterized as a (i) substantial failure to perform, (ii) a breach so substantial as to defeat the purpose of the contract, or (iii) one so substantial as to defeat the object of the contract.<sup>1</sup> Other courts characterize the breach as one that goes to the root<sup>2</sup> or essence<sup>3</sup> of the contract, or a breach of such significance or materiality as to preclude adequate compensation in money damages.<sup>4</sup>

According to *Williston*:

[A] "material" breach is a failure to do something that is so fundamental to a contract that the failure to perform that obligation defeats the essential purpose of the contract or makes it impossible for the other party to perform under the contract. In other words, for a breach of contract to be material, it must "go to the root" or "essence" of the agreement between the parties, or be "one which touches the

<sup>1</sup> *Brazell, v. Windsor*, 682 S.E.2d 824, 826 (S.C. 2009); *UHS-Qualicare, Inc. v. Gulf Coast Cmty. Hosp., Inc.* 525 So. 2d 746, 756 (Miss. 1987); *Wiljeff, LLC, v. United Realty Mgmt. Corp.*, 920 N.Y.S.2d 495, 497 (App. Div. 2011); *Cent. Ark. Found. Homes, LLC v. Choate*, 383 S.W.3d 418 (Ark. Ct. App. 2011).

<sup>2</sup> *Vidalia Outdoor Prods., Inc. v. Higgins*, 701 S.E.2d 217, 219 (Ga. Ct. App. 2010); *Forsyth Cnty. v. Waterscape Servs., LLC*, 694 S.E.2d 102, 110-112 (Ga. Ct. App. 2010).

<sup>3</sup> *D'Andrea Bros. v. United States*, No. 08-286C, 2013 WL 500346 (Fed. Cl. Feb. 8, 2013).

<sup>4</sup> *Campbell v. Shaw*, 947 S.W.2d 128, 131 (Mo. Ct. App. 1997) (quoting *Curt Ogden Equip. Co. v. Murphy Leasing Co.*, 895 S.W.2d 604, 608-09 (Mo. Ct. App. 1995)).

fundamental purpose of the contract and defeats the object of the parties in entering into the contract.” A breach is “material” if a party fails to perform a substantial part of the contract or one or more of its essential terms or conditions, the breach substantially defeats the contract’s purpose, or the breach is such that upon a reasonable interpretation of the contract, the parties considered the breach as vital to the existence of the contract.<sup>5</sup>

A breach that is incidental or subordinate to the main purpose of the contract, or one that is not so substantial and fundamental as to defeat the object of agreement, is not a material breach.<sup>6</sup>

Courts have also been asked to determine what constitutes a “substantial breach” since, according to widely utilized AIA forms, a substantial breach by one party entitles the other party to terminate a contract for cause.<sup>7</sup> In attempting to make this determination, courts have noted that the AIA forms fail to define the term “substantial breach”, and courts have also held that the term is ambiguous.<sup>8</sup> Consequently, some courts have interpreted the phrase to be the equivalent of a “material breach.”<sup>9</sup>

Thus, even when dealing with highly standardized construction industry forms, a court will have to evaluate the overall facts and circumstances to determine whether there has been a material, or substantial, breach entitling the owner to terminate the contractor. If—or perhaps more appropriately, when—the declaration of termination is challenged in court or in arbitration, a finder of fact (be it a judge, jury or arbitration panel) will decide after the fact whether the breach was sufficiently material so as to justify termination of the contract.<sup>10</sup> When making this inquiry, the finder of fact will look not at the subjective beliefs or understandings existing at the time the termination decision was made, but instead, will determine whether the decision was justified based on an objective evaluation of the facts as they actually existed at the time the termination decision was made.<sup>11</sup>

### The Likelihood of Future Performance and the Adequacy of Money Damages

In recognition that the definitions or characterizations of a total or material default are not particularly helpful when determining whether a particular breach justifies termination, the Restatement (Second) of Contracts § 241 offers a list of significant circumstances to be considered when making this determination. As stated in the Restatement:

In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

- 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 part of that benefit of which he will be deprived;
- c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.<sup>12</sup>

Comment (a) to § 241 acknowledges the obvious: the standard of materiality is necessarily imprecise and flexible, and is to be applied in the light of the facts of each case and in such a way as to further the purpose of securing for each party its expectation of performance. The Comment also emphasizes that these are circumstances, not rules, to be considered in determining whether a particular failure of performance is material.<sup>13</sup>

<sup>5</sup> 23 *Williston on Contracts* § 63:3 (4th ed. 2000).

<sup>6</sup> *Id.*

<sup>7</sup> Article 14.2 of the AIA General Conditions A-201 (2007 ed.) addressing Termination by the Owner for Cause simply provides that “The Owner may terminate the Contract if the Contractor otherwise is guilty of *substantial breach* of a provision of the Contract Documents” without defining “substantial.”

<sup>8</sup> *Schott v. Medrea*, No. 106007153, 2011 Conn. Super. LEXIS 2769, at \_\_\_ (Conn. Super. Nov.1, 2011).

<sup>9</sup> *Id.*

<sup>10</sup> *Wiljeff*, 920 N.Y.S.2d at 497; *Madden Phillips Constr. Inc. v. GGAT Dev. Corp.*, 315 S.W.3d 800 (Tenn. Ct. App. 2009); *Premier Golf Mo., LLC v. Staley Land Co.*, 282 S.W. 3d 866, 873 (Mo. Ct. App. 2009); *Venture Props., Inc. v Parker*, 195 P.3d 470, 489 (Or. Ct. App 2008); *Mustang Pipeline Co. v. Driver Pipeline Co.*, 134 S.W.3d 195 (Tex. 2004).

<sup>11</sup> *McDonnell Douglas Corp. v. United States*, 323 F.3d 1006, 1016 (Fed. Cir. 2003).

<sup>12</sup> Restatement (Second) of Contracts § 241 (1981).

<sup>13</sup> *Id.* cmt. A.

A number of courts have applied the Restatement factors or circumstances when evaluating claims of material breach.<sup>14</sup> Notwithstanding the guidance from the case law and from the Restatement, material breach remains a fact-based determination focused on the adequacy of performance to date and the likelihood that the non-breaching party will obtain substantial performance of the contract from the breaching party. As stated by Bruner & O'Connor:

[A]n unexcused breach is material only if it reasonably compels a clear inference of unwillingness or inability of one party to meet substantially the contractual future performance expectations of the other party. . . .<sup>15</sup>

Another significant factor or circumstance is the adequacy of money damages as compensation for the breach. Any breach entitles the non-breaching party to recover damages for the breach, but a material or total breach is so significant that even the recovery of money damages fails to provide the non-breaching party an equivalent to full performance. Stated another way, if money damages can provide an equivalent to full performance, then the breach is not material and does not warrant or authorize termination.<sup>16</sup> As stated by the Missouri Court of Appeals:

Where a party fails to perform according to the terms of the contract, it must be determined whether the breach is material. If the breach is material or if the breaching party's performance is a condition to the aggrieved party's performance, the aggrieved party may cancel the contract. If the breach is not material, the aggrieved party may sue for partial breach, but may not cancel. *In determining whether a breach is material, an important consideration is the degree of hardship on the breaching party and the extent to which the aggrieved party has received the substantial benefit of the promised performance and the adequacy with which he may be compensated for partial breach by damages.* [Emphasis added.]<sup>17</sup>

An Owner or Contractor considering contract termination should focus on the impact of the breach upon the future contract performance it is owed. What is the likelihood of the breach being cured, and the likelihood of the remaining contract obligations being performed? Also focus on the adequacy of money damages as compensation for the breach. The more egregious the breach, the more unlikely future performance will occur, and thus the more inadequate money damages as compensation for the breach.

### Failure of Payment as a Material Breach

The prompt flow of funds is essential to any construction project and is probably the Owner's most important obligation. Payment of subcontractors by the Contractor is equally important. In both instances, the prompt payment of funds necessary to pay for ongoing work is necessary for the other contracting party to honor its reciprocal performance obligations.

The failure to comply with contractual payment obligations can quickly derail a contractual relationship, and more importantly, constitute a material breach of contract. For example, in *Manganaro Corp. v. HITT Contracting, Inc.*,<sup>18</sup> a subcontractor ceased performance when the general contractor failed to pay timely for change order work. The subcontract contained language making receipt of payment from the owner a condition precedent to the contractor's payment obligation to the subcontractor, but an addenda to the subcontract provided that the contractor had the obligation to pay the subcontractor within a reasonable time, regardless of the payment status with the owner. When change order work was not funded, the subcontractor suspended performance for nonpayment, and the contractor terminated the subcontract.

The court in *Manganaro* held that the contractor's failure to honor the payment provision in the subcontract constituted a material breach and thus justified the subcontractor's cessation of performance.<sup>19</sup> Emphasizing the importance of the steady flow of funds on any construction project, the court, citing *Corbin on Contracts*, stated as follows:

"There is a special factor to be considered in the case of a building contract, or any other contract the financing of which requires a progressive expenditure in the course of performance. In these cases, one reason for providing for installment payments as construction proceeds is to supply the funds necessary for the agreed performance; and failure to pay one or more installments is more likely to cause inconvenience and difficulty to the building contractor. Therefore, a failure to make one of the progress payments, even though

<sup>14</sup> *Mustang*, 134 S.W.3d at 199; *Madden Phillips*, 315 S.W.3d at 823; *Venture Props.*, 195 P.3d at 489-90.

<sup>15</sup> 5 Philip L. Bruner & Patrick J. O'Connor, Jr., *Construction Law*, §18:4.

<sup>16</sup> *Vidalia*, 701 S.E.2d at 219; *Mayor of Douglasville v. Hildebrand*, 333 S.E.2d 674 (Ga. Ct. App. 1985).

<sup>17</sup> *Campbell*, 947 S.W.2d at 131 (quoting *Curt Ogden Equip. Co.*, 895 S.W.2d at 608-09).

<sup>18</sup> 193 F. Supp. 2d 88 (D.D.C. 2002).

<sup>19</sup> *Id.*

the contract is not divisible into pairs of separate equivalents and the installment unpaid is only a small part of the whole consideration, is more likely to justify suspension of performance by the builder, or even total renunciation of further duty.”<sup>20</sup>

While *Manganaro* addressed a Contractor’s failure to pay its subcontractor, and the subcontractor’s right to terminate the subcontract for nonpayment, a Contractor’s nonpayment of its subcontractors can also lead to the Owner’s termination of the prime contract. This is what happened in *In re Stone & Webster, Inc.*, where the bankruptcy court held that Stone & Webster’s failure to timely pay its subcontractors constituted a material breach entitling the Owner to terminate its contract with Stone & Webster for the decommissioning of a nuclear power plant.<sup>21</sup>

When evaluating payment applications, Owners and Contractors certainly have the right to ensure that monies requested have actually been earned or actually are owed, and refusing to make payment when a good faith basis exists to challenge the payment request does not constitute a material breach. A good example is *Pack v. Case*,<sup>22</sup> where the Owner engaged the Contractor to replace a roof and the parties agreed to a unit price based upon square footages. The Owner and the Contractor came up with different square footage amounts since the Owner excluded the footage associated with a skylight and the Contractor did not. The contract provided that nonpayment voided any warranties, and when the roof subsequently leaked, the Contractor refused to honor the warranty due to the unresolved payment issue, claiming the Owner’s nonpayment of the disputed amounts constituted a material breach.

The court held that the Owner’s refusal to pay the disputed amounts did not constitute a breach of the contract and did not excuse the Contractor from honoring its warranty obligations. The court found the contract ambiguous as to how square footage of the roof would be measured (with or without the skylight), and notwithstanding the nonpayment of the disputed amount, the Contractor had substantially obtained the benefits it reasonably expected under the contract. Also important to the court’s analysis was the fact that the Contractor could be compensated in money damages for any benefit under the contract it was deprived. Since it had obtained substantially what it was entitled to receive under the contract, and money damages would adequately compensate the Contractor, the Owner’s nonpayment was not a material breach and did not justify the Contractor’s refusal to honor its warranty obligations.<sup>23</sup>

As these cases make clear, payment obligations are very important, and are certainly viewed as essential elements or terms of any construction contract. Nonpayment, if authorized under the terms of the contract, or a nonpayment that does not substantially deprive a party of the benefits of the contract, will not justify termination and does not constitute a material breach. Nonpayment that is at odds with the requirements of the contract, or nonpayment that substantially deprives a party of the benefits of a contract, can constitute a material breach and can justify contract termination.

### Failure to Follow the Design Documents or Specifications as a Material Breach

As important as the flow of funding is to the Contractor, following the design or specifications can be of equal importance to the Owner. A structure or project that does not meet the Owner’s expectations and is not in conformity with the design deprives the Owner of the benefit of the contract and can constitute a material breach. Two cases illustrate this point: *Strouth v. Pools by Murphy & Sons*.<sup>24</sup> and *Winter v. Pleasant*.<sup>25</sup>

In *Strouth*, a homeowner contracted for the construction of a peanut-shaped pool and a circular spa, but when the work commenced, the pool contractor laid out and started to construct a kidney-shaped pool and an almond-shaped spa. The homeowner stopped the work shortly thereafter, and while the contractor offered to change the shape of the spa, it never offered to reconfigure the shape of the pool. The court affirmed the trial court’s conclusion that a kidney shaped pool was a substantial deviation from the shape required by the contract and constituted a material breach of the pool construction contract. The pool contractor’s refusal to change the layout of the pool so as to comply with the contract made it unlikely that the owner would ever obtain future performance in substantial compliance with the contract and thus justified terminate.<sup>26</sup>

<sup>20</sup> *Id.* at 97 (quoting 3A Arthur L. Corbin, *Corbin on Contracts* § 692, at 269 (1960)).

<sup>21</sup> 279 B.R. 748, 779-780 (Bankr. D. Del. 2002).

<sup>22</sup> 30 P.3d 436 (Utah Ct. App. 2001).

<sup>23</sup> *Id.* (citing Restatement (Second) of Contracts § 237 (1981)).

<sup>24</sup> 829 A.2d 102 (Conn. App. Ct. 2003).

<sup>25</sup> 222 P.3d 828 (Wyo. 2010).

<sup>26</sup> 829 A.2d at 104-06.

Similarly, in *Winter v. Pleasant*,<sup>27</sup> the contractor stopped the work and eventually terminated the contract when the owner withheld payments, but the evidence at trial showed that the owner stopped paying due to the contractor's failure to follow the specifications. The evidence showed that the contractor installed rotated embed plates, failed to install all of the specified embed plates and constructed the building out of plumb. All of these conditions were substantially in violation of the specifications and constituted a material breach by the contractor of its contractual obligations.

In all cases involving termination, but particularly when compliance with the design or specifications is at issue, the doctrine of substantial performance will apply. The doctrine of substantial performance applies to all contracts involving bilateral promises. Where a contract is for an exchange of performance, such as performance of the work in exchange for the payment of compensation, the common law required strict and literal compliance by the party required to first perform, and the failure to strictly comply with the contract terms discharged the reciprocal promise by the second performer. Courts of equity have relaxed this requirement, and now the rule is that substantial performance with the first promise requires performance of the second promise, and precludes termination for default, since the promisee has obtained substantially what it contracted for, and any deficiencies in performance can be adequately compensated in damages.<sup>28</sup>

In construction cases, the Contractor is not required to be perfect, but it must substantially comply with the contract. The Contractor has substantially performed if any deficiencies in its performance can be remedied, and the Owner made whole, by an offsetting allowance against the contract price. The rule applies if the Owner can use the property as intended even though relatively minor matters remain to be completed or corrected, so that the Owner has obtained substantially the benefit of the bargain. The rule does not apply if significant defects exist that are not readily repaired or the defects resulted in a complete frustration of the purpose of the contract.<sup>29</sup>

As stated by the court in *Curtis Construction Co. v. American Steel Span, Inc.*:<sup>30</sup>

The doctrine of substantial performance allows a contractor to recover on a contract even when it has not fully complied with the contract, as long as it has performed the contract in good faith and has mostly performed its responsibilities under the contract, except as to unimportant omissions or deviations, which are the result of mistake or inadvertence, and were not intentional, and which are susceptible of remedy, so that the other party will get substantially the building he contracted for. The contractor's default must not be willful, and the defects in its work must not be so serious as to deprive the property of its value for the intended use nor so pervade the whole work that a deduction in damages will not be fair compensation. If a contractor has failed to substantially perform, it cannot recover an amount due under the contract. A contractor has not substantially performed when the defects are intentional, willful, or so serious as to deprive the property of its value or intended use.

The remedy allowed when a contractor has substantially but not fully performed is an adjustment of the amount the property owner is required to pay the contractor to allow for the defects. Generally, if the defects can be repaired without reconstructing a substantial portion of the project, the contractor can recover the contract price less the expense required to repair the defects. When the defects cannot be remedied without substantial reconstruction, however, the remedy is the value of a properly constructed project less the value of the project as actually constructed.<sup>31</sup>

## Timeliness of Performance as a Material Breach

Timeliness of performance as a basis for termination is another frequently litigated topic. A delay in completing the work by the contractual completion is not a material default and does not justify termination unless the time of performance is specified in the contract to be of the essence or unless the circumstances under which the contract was negotiated demonstrate an intention by the parties to make the timeliness of performance an essential or material term.<sup>32</sup>

<sup>27</sup> 222 P.3d 828.

<sup>28</sup> 15 *Williston on Contracts* § 44:52 (4th ed.).

<sup>29</sup> 15 *Williston on Contracts* § 44:57 (4th ed.); *Denver D. Darling, Inc. v. Controlled Env'ts Constr., Inc.*, 108 Cal. Rptr. 2d 213 (Ct. App. 2001) (under doctrine of substantial performance, substantial performance is sufficient and justifies an action on the contract, although the other party is entitled to a reduction in the amount called for by the contract, to compensate for defects); *Bentley Sys., Inc. v. Intergraph Corp.*, 922 So. 2d 61 (Ala. 2005) (substantial performance permits recovery for a breach-of-contract by a party that has not performed all of its obligations under a contract, so long as its performance has been substantial); *Dexter v. Brake*, 269 P.3d 846 (Kan. Ct. App. 2012) (doctrine of substantial performance is intended to protect the right to compensation of those who have performed in all material and substantive particulars, so that their right to compensation is not forfeited by reason of mere technical, inadvertent or unimportant omissions or defects).

<sup>30</sup> 707 N.W.2d 68 (N.D. 2005).

<sup>31</sup> *Id.* at 74.

<sup>32</sup> *Madden Phillips*, 315 S.W.3d at 817-20; *Merritt v. Anderson*, No. CA2008-04-010, 2009 WL 975749 (Ohio Ct. App. Apr. 13, 2009).



A good example is *Madden Phillips*. In this case involving a residential development outside of Memphis, the site contractor and the owner had an acrimonious relationship from the very start, fighting over the responsibility for, among other things, additional fill materials. The site contractor suspended performance for about 45 days due to the dispute, but eventually resumed performance after the owner agreed to provide the fill materials. The dispute reignited when the contractor began complaining about the amount of fill available, and eventually the owner had enough and terminated the contractor. One of the several issues litigated was the contractor's timeliness of performance.

The owner claimed that termination was justified due to the contractor's delay in completion, caused in part by the time lost due to the suspension of the work. However, the contract did not contain a "time is of the essence" provision, and the absence of such a provision precluded the owner from terminating the contractor for late completion. As stated by the court:

A party's failure to complete a construction project within a time for completion does not constitute material breach absent a provision making time of the essence. The existence of an agreement that "time is of the essence" can be shown by "stipulation, a manifestation of intention from the contract or subject matter involved, or an implication from the nature of the contract or circumstances of the case." "Generally, time is not of the essence of a building and construction contract." Thus, a party to a construction contract will not establish that time is of the essence solely by showing that a contract contained a time or date for completion and nothing more.<sup>33</sup>

### Waiver of a Material Breach

Another very important concept is waiver, as the right to terminate for material breach can be waived if the party having the right to terminate elects not to, by knowingly continuing to receive the benefits of performance from the breaching party.<sup>34</sup> Here again, the site construction case from Tennessee, *Madden Phillips*, is illustrative. There, the owner alleged that the site contractor had breached the contract by suspending performance when the dispute over the fill dirt first arose. After stating the rule that a non-breaching party may waive its right to assert material breach if it accepts the benefits of the contract with knowledge of a breach,<sup>35</sup> the court then discussed the owner's waiver by allowing the contractor to resume work on the site:

GGAT [the owner] waived its right to defend on the basis of *Madden Phillips*' prior material breach. Assuming *arguendo* that *Madden Phillips* wrongfully suspended its performance on July 9, 2004, it returned to the project approximately one-and-a-half months later in August 2004. GGAT thereafter accepted the benefits of *Madden Phillips*' performance upon return for nearly eight full months before terminating the contract. GGAT accepted these benefits after having full opportunity to cancel the contract. Although not written in terms of breach, a letter dated July 14, 2004, expressly offered GGAT an opportunity to terminate the contract. GGAT did not act on this offer, nor did it otherwise give any indication that it believed *Madden Phillips* remained in breach after *Madden Phillips* resumed performance. By allowing *Madden Phillips* to complete ninety percent of the project without further objection, GGAT waived its right to assert *Madden Phillips*' wrongful suspension as the first material breach of the parties' contract.<sup>36</sup>

### The Consequences of a Material Breach – Discharge of Any Further Performance

In addition to authorizing the termination of a contract for default, the other significant consequence of a material breach is that it excuses the non-breaching party from further contractual performance. When faced with a material breach, the non-breaching party has the option to discontinue *any* further performance under the contract, a right that can have significant consequences. As stated by the Texas Supreme Court, "It is a fundamental principle of contract law that when one party to a contract commits a material breach of that contract, the other party is discharged or excused from further performance."<sup>37</sup>

<sup>33</sup> *Madden Phillips*, 315 S.W.3d at 818 (citations omitted).

<sup>34</sup> 23 *Williston on Contracts* § 63:9 (4th ed.).

<sup>35</sup> *Madden Phillips*, 315 S.W.3d at 813.

<sup>36</sup> *Id.* at 816.

<sup>37</sup> *Mustang Pipeline Co.*, 134 S.W.3d at 196. The Restatement (Second) of Contracts § 242 (1981) also provides a list of circumstances significant in determining when remaining duties are discharged due to a prior material default and provides as follows: In determining the time after which a party's uncured material failure to render or to offer performance discharges the other party's remaining duties to render performance under the rules stated in §§ 237 and 238, the following circumstances are significant:

- (a) those stated in § 241;
- (b) the extent to which it reasonably appears to the injured party that delay may prevent or hinder him in making reasonable substitute arrangements;
- (c) the extent to which the agreement provides for performance without delay, but a material failure to perform or to offer to perform on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.

This can become an extraordinarily important issue when both parties to the contract claim the other party breached the contract, excusing their performance of any reciprocal or bilateral promises. A classic example of this rule of law in operation is *Mustang Pipeline Co. v. Driver Pipeline Co.*, where Mustang sued Driver for failing to complete the laying of a 100-mile pipeline by the construction deadline stated in the contract. The performance period was 14 weeks and contemplated the work being performed 11 hours a day, seven days a week. Driver claimed it was delayed due to excessively wet weather and requested additional time to perform. The contract contained language addressing the protection of crews and welds in wet weather, suggesting to the court that the parties contemplated work being performed despite some inclement weather. Fifty-eight days into the 98-day schedule, Driver had completed only 15 miles of pipe and suspended operations. Mustang declared a default and hired another firm to complete Driver's work.

Each party sued the other claiming breach of contract and raising the other party's prior material breach as an affirmative defense. The case went to a jury and it determined that Driver had failed to comply with the time deadlines in the contract. The jury also found that Mustang had breached the contract when it terminated Driver. The jury awarded Mustang \$2.1 million against Driver for its breach of the contract, and awarded Driver \$2.3 million against Mustang for wrongful termination. In post-trial motions, the trial court struck the damages awarded to Mustang and entered a judgment in favor of Driver. The Texas Court of Appeals affirmed and the case then went to the Texas Supreme Court.

The Texas Supreme Court found from its review of the record ample evidence to demonstrate that time was of the essence of the agreement, and that Driver had been the first party to materially breach the contract by failing to lay more than 15 miles of pipe, notwithstanding the passage of over half of the contract time. Given the time requirements of the contract, the Supreme Court determined as a matter of law that Driver's breach was material, and that Driver's prior material breach entitled Mustang to terminate the contract. The court also concluded that Driver's first material breach discharged Mustang from any further duties under the contract, including any obligation to pay Driver for work performed. Driver entered the court with a \$2.3 million judgment in its favor and left owing Mustang \$2.1 million, all because the court concluded that Driver had committed the first material breach.

Another case involving the discharge of further contract performance due to material breach is *Residential Holdings III LLC v. Archstone-Smith Operating Trust*.<sup>38</sup> In this case, the plaintiff-purchasers entered into a series of 11 related agreements with the defendant-sellers to acquire some \$1.2 billion of multifamily housing projects. After closing on seven of the 11 properties, the purchasers refused to close on the purchase of a \$105 million property after it determined that the defendant-sellers had placed door hangers on all of the apartments in the development advising residents of the impending sale and offering a month free rent at an adjacent development owned by the defendant but not being purchased by the plaintiff. The plaintiff claimed that the solicitation violated the purchase and sale agreement and declared a material breach, refusing to close on the sale of the property. Since the purchase and sale agreements contained cross-default provisions, making a default under one a default under all, the plaintiff also refused to close on the purchase of the other three unclosed properties.

Cross-motions for summary judgment were denied by the trial court, leading to this appeal. The appellate court zeroed in on the fact that as of the closing date, only one resident at the 478-unit property had actually moved to the defendant's adjacent property. On its face, this was insufficient to constitute a material breach of the purchase and sale agreement.

Since the plaintiff had refused to close on the subject property, and had also terminated the other three agreements based on the cross-default clause, the plaintiff had materially breached all four agreements, excusing that defendant from further performance. The net effect of terminating the agreement over the loss of one resident was the defendant's retention of more than \$13 million of escrow money the plaintiff had deposited when entering the agreements.

## Conclusion

Termination of a contract for cause can have very serious implications for owners and contractors alike, so making a decision to terminate should not be taken lightly or done impulsively. Unfortunately, there is no bright line rule to follow in making this determination. Instead, a decision must be made based on the totality of the circumstances, focusing on factors like whether money damages are adequate compensation for the breach and whether the breach can be cured and remaining obligations performed. These decisions are often challenged, so it is critical that a party make a reasoned, educated determination as to whether the other contracting party has materially breached the contract such that termination for cause is appropriate.

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<sup>38</sup> 920 N.Y.S.2d 349 (App. Div. 2011).