Dissecting Contract Breach Terminology, Warranties, and Remedies: Part Two

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Editor's note: This is part two in a series of articles. Part one was published in the last issue of The Construction Lawyer.

Introduction

In part one of this article, we discussed the various inconsistencies and deficiencies within the prevailing nomenclature associated with the classification of contractual breaches and resulting remedies. The focus was on three traditional approaches: first, material breach; second, partial vs. total breach; and finally, a hybrid of a total, partial, and material breach. The chosen conceptual approach is critical to determine the appropriate remedy, such as entitlement to monetary damages, or avoidance of further performance obligations. Therefore, part two of this series of articles offers a proposed solution to the existing problems within the traditional approaches drawing from the unique, process-oriented, practice of construction law.

Contract Breach in Construction—The Solution

Descriptive Nomenclature

Given the shortcomings of the three binary approaches to contractual breach, it is unsurprising that they simply do not work well when applied to process-oriented contracts involving interdependencies between the contracting parties, for example, as encountered in construction. It is for this reason, among others, that the traditional approach to construing contractual breach presents unique challenges in the construction arena. We submit that construction's three-tier approach of substantial breach, material breach, and immaterial/technical breach more accurately reflects what one should encounter from an appropriately descriptive, and logically-consistent, classification of contractual breach.[1] For example, at the highest rung of recovery, a substantial breach entitles one to exercise a termination option **in addition** to recovering damages.[2] Such a breach can only occur in the **absence** of substantial completion of one's performance (how one can substantially breach a substantially performed contract is confusing at best).[3] Following substantial performance, the only breaches are (a) a material breach, allowing the recovery of damages but subject to the limitation of economic waste and diminished value; and (b) an immaterial/technical breach, which does not provide for any monetary relief equal to a material breach where the basis for an award would result in economic waste without any diminution in value.

It would seem appropriate to start the process of developing appropriately descriptive terminology in the world of contractual breach with the simple concept that a breach must at least be **material** to justify any award of damages, or other relief. In other words, the term **material** should not be at the uppermost rung of the ladder, entitling termination, or excusing non-performance, by the nonbreaching party. Instead, it should be one rung lower. Moving it down to the area where monetary damages are available, but excuse of non-performance is not, allows for a more logical classification enabling the highest rung to occupy a **substantial** breach.[4] In this way, a **substantial** breach triggers the right to terminate while also triggering the right associated with any material breach to recover damages for costs to complete, or to cure, subject to the duty to mitigate such damages[5] and application of the economic waste and diminished value doctrines. This approach avoids the inconsistency of having to define material breach as to allow for exercise of two potential remedies (i.e., termination and/or damages), leaving a breach allowing for only one remedy (i.e., damages) relegated to the bin of being classified as an immaterial breach—a problem avoided with the partial breach concept.

It is worthwhile to note that in the construction field, the term substantial is used to characterize a breach entitling the other party to terminate.[6] Courts have also employed this term in non-construction settings,[7] although doing so has been almost always without explanation for abandoning the term material to characterize the breach. Oftentimes, courts use the two terms synonymously,[8] which only leads to confusion as to what is really intended.

A breach should be considered **substantial** only if substantial performance is not achieved. In this way, there would be a common concept of what is, or is not,

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substantial governing both the stage of performance **and** the character of the breach. Some courts have done so.[9] As a practical matter, equating **total** and **substantial** for this category of breach makes much more sense. In other words, once substantial performance has been rendered, there can no longer be a substantial breach. Again, the term substantial is applied with like meaning, whereas material and total do not have a similar benefit in conveying equal concept terminology to both performance and breach. A breach that results in less than a destruction of the essence of the transaction, yet that is significant enough to be more than unimportant, should be considered **material** to support an award of damages, be it the cost to complete or repair, accrual of interest, or diminished value. A breach that is truly unimportant or inconsequential should be classified as a **immaterial** or **technical**. Admittedly, any of these latter terms conveying the concept of insignificance would depend upon an inherent application of the economic waste and diminished value principles such that the diminished value, on its face, would be zero.

Now, would this shift the burden of proof for the breaching party seeking to avoid damages liability? No. If, for example, the owner asserts a damages claim for the cost to correct the construction of a stud wall to move each stud one-quarter inch without any meaningful improvement to the wall's functionality, or structural integrity, the contractor still has the burden of proving the cure for the breach would entail economic waste and would not produce an improvement in market value such that it amounts to a purely technical or immaterial breach. Again, the playground basketball adage of "no harm, no foul" is particularly applicable to this type of breach. Labeling it as an immaterial or technical breach would be more descriptive, although in many cases a detailed analysis of the cost to complete or correct in comparison to any diminishment in market value would still be required to arrive at the same spot—namely, no recoverable damages.[10]

Remedies for Breach

It is hornbook law that absent a contractual provision authorizing one party to make changes to the other's required performance (e.g., a "changes clause"), any ordered change, or changes, amounts to a breach of contract, or potentially, an abandonment. Whether such a change amounts to a substantial, material, or technical/immaterial breach is oftentimes a difficult question to answer. Focus must be paid to whether the unauthorized change involves the addition or deletion of work, plus its relative significance to the overall contractual arrangement. The available remedies for a type of breach of this nature will generally be determined under the same principles as applicable to any other breach.[11]

A rather unique aspect of construction law is the treatment accorded to changes issued under a contractually-sanctioned changes clause and how, in certain instances, that treatment exemplifies aggregating multiple material breaches to amount to a substantial breach, thereby triggering a termination option under the First to Breach rule. This happens via the concept of "death by a thousand cuts," which has been recognized as a legitimate vehicle for concluding that a series of less-than-substantial changes by way of a changes clause, or otherwise, can amount to a "cardinal change."[12] Because, by definition, a cardinal change entitles the contractor to either quit or continue performance,[13] it is functionally equivalent to substantial breach in terms of the remedies available. Yet, no judicial decision specifically equates the two. Nevertheless, this seems to provide fertile ground for establishing that an aggregation, or series, of less-than-substantial breaches can amount to a substantial breach triggering the First to Breach option in areas outside the construction field.

There is a related issue associated with monetary damages available under the cardinal change rule. While this is a subject beyond the primary focus of this Article, suffice it to say that the question becomes **how** a contractor is entitled to be compensated should such a change occur. Courts generally recognize the contractual scheme for compensating a contractor under a changes clause does not apply in the event of a cardinal change,[14] but instead that the doctrine of quantum meruit applies.[15] The central issue is the extent to which a contractor is **entitled** to that measure of compensation. That is, is a contractor entitled to the reasonable value of the work which was impacted by the cardinal change? Or is a contractor entitled to the reasonable value of the work for the entire project? If the latter, a contractor could salvage a project that is underwater financially and turn it into a profitable one. It might also avoid the need for acceleration at the contractor's ultimate expense if the contractor is behind schedule up to the point of the cardinal change. If the former, the contractor's recovery would be limited to the work impacted by the cardinal change, as has been held in a case specifically rejecting abandonment as a basis for extending quantum meruit to pre–cardinal change work.[16]

The general rule is that specific performance is not available when the injured party can be adequately compensated through an award of monetary damages, which has been found specifically applicable to construction contracts.[17] Most often, this form of relief is relegated to situations where something unique is the subject of promised performance—such as in the case of contracts involving the transfer of land, which is oftentimes deemed unique by its nature.[18] Consequently, it is safe to conclude that for an obligation to be subject to a specific performance remedy, it must be of the essence of the transaction, and its breach in turn would have to be substantial. In short, a simple material breach would not be of such a nature to qualify for this equitable remedy.

The recoverability of punitive damages is also worth considering insofar as it relates to the three types of breaches. Punitive damages obviously would not be

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available for a purely technical or immaterial breach that does not even allow a monetary recovery, although a theoretical exception would exist under a material-immaterial or total-partial construct. In these latter instances, a minor breach that would not allow for recovery of monetary damages due to application of the economic waste and diminished value rules could still conceivably allow for a punitive damages award, although it is difficult to imagine such a situation.[19] That leaves recovery in the event of a material or substantial breach. Generally, punitive damages are not recoverable for contractual breach because the law recognizes the concept of efficient breach, which bars liability beyond making the nonbreaching party whole.[20] If one is entitled to breach a contract intentionally to accomplish an efficient breach, it stands to reason that one is likewise free to breach it negligently or otherwise. At least one court has failed to accept this logic in upholding a punitive damages award when a written seven-day termination notice was not given and "the decision to terminate was made in an unprofessional manner . . . conceived in frustration and consummated in anger."[21] The lesson, to be safe, is that when terminating a contract, do so pleasantly and with a smile on your face.

Finally, several additional issues exist with respect to standard clauses in the American Institute of Architects ("AIA"), Engineers Joint Contract Documents Committee ("EJCDC"), and ConsensusDocs® forms of "General Conditions" relating to an owner's right to terminate for default by the contractor.[22] No authority has been found determining whether the contractually-specified grounds for termination supersede what might be a broader set of situations comprising a substantial breach triggering a common law termination option. In addition, while it seems logical to conclude that the contractual scheme is intended to be exclusive, as specifically provided in the ConsensusDocs®,[23] the existence of cumulative remedy provisions in the other two standard forms strongly indicate the contrary.[24] One might ask: What difference does it make? The answer is that both of these contractual schemes require notice to be effective.[25] If an owner improperly terminates without such a notice, a fallback to the common law ground for the termination might be very advantageous. As yet, there is no case law on the effectiveness of such an approach.

Classification of Warranties and Related Breaches

Applying the three tiers of breach (substantial, material, and immaterial/technical) to warranties is difficult due to the nature of a given warranty or, more accurately, its particular structure. One cannot accurately determine the type of breach without first determining what a warranty really is. Despite the common usage of warranties, the nature of a warranty is not often discussed insofar as the time at which a warranty takes effect, aside from specific contractual triggers.[26] For example, with a simple "warranty against defects in material or workmanship," it is unclear if the warranty is co-extensive with the basic contractual obligation to perform in accordance with contract requirements, or if it is a separate undertaking.[27] There are obviously situations where warranties are given as an independent contractual obligation, in which event the warranty will usually commence upon issuance. Because a warranty breach will occur if and when the obligor fails to perform its warranty obligation and, in virtually all conceivable instances, when the obligee has already been given full consideration for the undertaking, there would not appear to be a situation where a breach by the obligor could be considered substantial so as to trigger a First to Breach option for the recipient. It is even less clear what happens when a warranty is given as an integral part of the overall contractual undertaking without separate consideration—what we call an **integrated warranty**.

Even though an integrated warranty might be an essential component of a contract necessary for formation purposes, unless its operability commences upon execution of the contract, it is difficult to imagine how its breach could be considered a substantial one. Presumably, the obligation to perform work free from defects in material and workmanship is co-extensive with the warranty undertaking until substantial completion is achieved. The integrated warranty seems to offer little, if anything, of value to this point, but with one possible exception. For purposes of determining the existence of a substantial breach of the base contract, thereby triggering a termination option, the focus is on the importance of the obligation insofar as the essence of the transaction is concerned. It would seem that there could not be a breach of the companion warranty obligation independent of the nature or significance of the base contract obligation being unfulfilled.

If a critical obligation is breached, it does little to say the companion warranty obligation is also breached unless one asserts that, within the four corners of the warranty, there is a substantial breach independent of the underlying contract breach. If this were the case, a material breach of the base contract could be considered a substantial breach of the warranty—which seems to make little sense. Consequently, it seems safe to conclude that an integrated warranty will not confer any additional rights worth considering by a obligee prior to substantial performance of the base contract. It is presumed that the warranty, although not so stated on its face, actually speaks as of the date of substantial performance. If that is true, then a subsequent breach of the integrated warranty cannot be considered a substantial breach triggering a termination option for an owner even though it was an essential term of the contract.[28] The owner might exercise such option, for example, to avoid any remaining payment obligations, although common law offset rights would probably have the same effect.

The primary importance of the onset of a breach of an

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integrated warranty is the fact that such date will establish the commencement of limitation periods for instituting formal legal action.[29] To make such a determination, the specific terms of the warranty must be carefully analyzed because they will control the overall final decision. Variants from a basic "warranty against defects in material or workmanship" are several, including the presence or absence of provisions related to a time period after which the warranty is extinguished and (i) defects arising during the warranty period without a requirement for notice to activate a cure obligation or (ii) defects arising during the warranty period wherein the warrantor receives written notice of the claim within the specified time period. Additional common features can include (i) the absence of a specifically stated obligation that the warrantor must repair or replace the defect, (ii) a provision giving the warrantor an option to correct the deficiency prior to the recipient acting on its own if the recipient wants to hold the warrantor responsible, and (iii) a provision that specifies whether or not the warranty is the recipient's sole remedy in the event of defects. If notice is required to trigger a warranty performance obligation, a breach could not occur nor a limitation period start running until a reasonable time following such notice without an appropriate cure.

When Is Warranty Performance Due?

If a party wrongfully terminates, or is properly terminated, prior to substantial performance in a non-sales transaction, both its base contract obligation as well as its warranty obligations should survive that event. So far, no conclusive authority has been found on this point, nor does the case law focus on the character of the breach of one's warranty obligation.[30] Prior to substantial completion of the base contract, both the integrated warranty and underlying performance obligation are essentially the same. Courts generally look to the date that the installation or other performance is substantially completed before any limitation period for filing claims commences. This, obviously, has a distinct advantage in terms of simplicity rather than addressing potential complexities present with the actual warranty obligation. Rarely are warranties crafted with specific terms addressing time for performance and completion of the warranty obligation.

One impact of the date of a warranty breach is commencement of the statute of limitations for contract claims (including warranty claims). In other words, if there is a six-year statute of limitations for breach of contract claims, it may make a significant difference if the warranty is deemed breached upon substantial completion, due to defects in materials or workmanship, for example, or at some later date. If a warranty provides the obligor an opportunity to cure defects of which it receives notice within a one-year warranty period, there are several issues that should be addressed. For example, if the obligor receives notice on the last day of the warranty notice period, it obviously must have the right to perform its warranty obligation following the expiration of that period.[31] Another issue is whether the warranty is breached if the obligor fails to cure the defect on its first attempt, or whether it is entitled to multiple attempts and over what period of time.

At this point, there is little if any authority on the issue of whether it is "one strike and you're out," apart from the context of commencement of the statute of limitations for breach of a cure warranty. A few cases discussing the statute of limitations applicable to warranty breach claims have concluded that when there are multiple unsuccessful attempts to cure, the limitations period does not start until the obligor "refuse[s] to make repairs."[32] Several cases have recognized that there are multiple ways in which a cure warranty can be breached: (a) repudiating the obligation before or after a demand to cure is made or notice of defect is given; (b) failing to undertake repairs within a reasonable time after the requirement is triggered; (c) expressly refusing to repair; or (d) after undertaking a repair, abandoning the effort prior to completion.[33] One court has gone so far as to state that a refusal to repair defective work under the base contract will result in a separate contractual breach for which its own limitations period and remedies will apply.[34]

A similar series of issues arise with an open-ended warranty covering defects that "arise or exist within" a given warranty period regardless of when the condition first becomes apparent.[35] This type of warranty is perpetual in that a construction defect will exist on the day of substantial completion regardless of when it becomes apparent. Without a requirement for notice of the condition within a specified time period, the warranty will continue to run forever, regardless of when the condition first becomes evident.[36] Regarding this particular type of warranty, the same questions exist as to the time for commencement and completion of warranty performance. Must cure efforts be started within a certain period of time following notice of the claim, or can an obligor wait until near the end of the warranty period before undertaking the cure?[37] Presumably, the implied obligation of good faith would require commencement of cure efforts within a reasonable time following notice.[38] An issue also arises with respect to a warranty obligor's liability for any direct or consequential damages that are sustained following notice and prior to a final effective cure.[39]

Another issue, as referenced above, involves the question of whether a warranty obligor is entitled to make multiple attempts to cure the problem before a breach actually occurs—and, if so, how many and over what period of time.[40] While a warranty recipient's obligation to mitigate its damages may require allowing the obligor subsequent cure efforts, there is unlikely to be any provision in the warranty itself addressing this question. Absent specific contractual language in the warranty, the question of mitigation is not one of breach of a recipient's

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warranty obligation to allow multiple cure efforts but rather one of limiting or precluding the recipient's damages recovery.

Also, warranties frequently do not specify a right for the obligor to attempt a cure of the defect, although it seems implicit and is explicit in major standard-form contracts.[41] Absent such a clear right, a recipient should be entitled to engage a third party to cure the deficiency and seek recovery of the related expenses.[42] Doing so, however, could jeopardize the recipient's right to recover a portion or all of any other direct damages arising from the defect, in addition to inviting a failure to mitigate defense by the warranty obligor.

A related issue is whether the base contract's warranty against defects arising within, for example, one year also creates a new one-year warranty regarding defects in the purported cure that is performed. Only one set of the major standard-form contracts specifically provides for a one-year warranty on warranty work.[43] Absent such a clear contractual solution to the issue of defectively performed warranty work, it seems clear that any purported warranty "fix" that is later discovered to be an ineffective cure should result in a breach of the obligor's warranty obligation whenever discovered during the period of the relevant statute of limitations.[44] Otherwise, a purported cure implemented on the last day of the warranty period might fail on the next day without the recipient having any further recourse if the integrated warranty was designated the exclusive remedy. In support of this position is the general rule that ambiguities are construed most strictly against the drafter. Because the obligor invariably drafts the warranty provision, it should bear the risk associated with such extended coverage for the recipient. This is not to say persuasive arguments might be crafted to the contrary, although there does not appear to be any definitive guidance in this respect. Finally, thought should be given to whether the structural operation of the warranty can amount to a frustration of purpose so as to invalidate the problematic features.[45]

Other issues arise with respect to a recipient's right to partially correct a defect as a part of its mitigation obligation while awaiting warranty performance by the obligor without jeopardizing its right to recoup expenditures in that effort. If the warranty is structured as an exclusive remedy for the recipient, this becomes particularly troublesome. A savvy practitioner will recognize this potential problem and craft language to mitigate or eliminate such an effect. Likewise, an owner should accept an exclusive integrated warranty with a limitation on its term only if it excludes claims for latent defects first appearing after the exclusivity period expires so that recourse can be available under the base contract for the full period of the applicable statute of limitations or repose.

The Designer's Implied Warranty

As any seasoned practitioner knows, an owner impliedly warrants the adequacy of a design specification furnished by its designer.[46] The obvious problem for the owner is that by virtue of a deficiency in the design documents, it may be faced with a contractor's claim for extra compensation. Yet, if the owner cannot recoup that liability from its designer, it will be left with an unexpected bill to pay without having budgeted the expense. To successfully pass through that liability to its designer, the owner will look to enforce the implied warranty that it receives from the designer. But what is the nature of that implied warranty? One case describes in some detail the underlying rationale for denying an implied warranty of "a satisfactory result" amounting to strict liability for designers absent the failure to satisfy the negligence standard of care.[47] This is so regardless of whether a claim is pursued on the basis of contract or tort obligations.[48] An attempt to close the gap, so to speak, by imposing via contract a standard of care higher than what an ordinary prudent designer would have exercised under the same or similar circumstances[49] creates a significant problem for both the designer and the owner. Namely, the designer's errors and omissions insurance coverage would, in all likelihood, be inapplicable, leaving the designer "naked" from a coverage point of view.

The scope of a warranty creates problems as well. While the usual warranty covers workmanship and materials, this overlooks the issue of design. For example, the builder of a spec home provided an extensive set of warranties regarding the structure and equipment components; the home happened to be built in the midst of an underground stream, necessitating installation of a sump pump system. Unfortunately for the new owner, the system was grossly undersized such that the sump pump ran 24 hours a day, seven days a week, and burned out in short order. In addition, the sump pit was too small to handle the influx of water. The builder asserted that it was not responsible for the condition, insisting that there was no express or implied warranty as to the adequacy of the system's design and that the components of the system were neither defective in workmanship or materials. Ultimately, in that case, the builder recognized that the law would in all likelihood imply a warranty of adequate design, thereby prompting a settlement of the dispute.[50]

Subcontractor Warranty Issues

Little, if anything, has been written or judicially promulgated when it comes to the issues surrounding a subcontractor's integrated warranty that its work will be free from defects in materials or workmanship.[51] The most basic inquiry has to do with the question of when a subcontractor's warranty performance obligation commences. Is it with the substantial completion of its work, or of the entire project (the latter being the traditional trigger for the general contractor's obligation)? If it is deemed to commence upon completion of the subcontractor's work, then when does it expire? While the specific

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terms of that warranty are important for making such determinations, in all likelihood, contractual specificity on these issues will be lacking. That, however, may be of little practical significance because if a subcontractor fails to perform its work free from such deficiencies, the prime contractor may simply assert a claim of breach under the base subcontract.

One obvious additional issue revolves around whether a prime contractor can have a First to Breach option insofar as its subcontractors are concerned.[52] There is no reason that a prime contractor should not have that remedy in the event of a substantial breach by the subcontractor. In such event, the prime contractor could use the breach as a means of discharging the subcontractor from the job, while also potentially relieving the prime contractor from further obligations on its part and holding the subcontractor to the warranty obligations under the subcontract. Of course, the question of substantial breach of a subcontract can only occur if there is not substantial completion of that subcontract, regardless of the stage of completion of the project as a whole. There does not seem to be any basis for applying a different scheme of breach labels to subcontracts than one would use with respect to the prime contract.

Prime contractors who employ blanket "flow down" clauses in their subcontracts create potential hidden problems for their subcontractors. The operative effect of a "flow down" is to pass down to the subcontractor all obligations relating to the subcontracted work that the prime contractor has to the owner under the prime contract.[53] Absent some limiting language, this would include all integrated warranty obligations. No court decision has addressed the extent of a subcontractor's warranty obligation in such an event. Nevertheless, should the prime contractors warranty be open-ended, running perpetually, then so too would the subcontractor's warranty with respect to its work. An experienced construction practitioner reviewing a subcontract for her client will carefully examine not only the scope of the "flow down" clause, but also the particular structure of the prime contractor's own warranty obligation in order to determine if appropriate revisions are required to the subcontract so as to avoid this exposure. The issues surrounding an open-ended warranty obligation should therefore be worthy of considerable attention.

Conclusion

People normally have little time to immerse themselves in the implications of inconsistent and deficient terminology in the field of jurisprudence. Nevertheless, an understanding of the existing inconsistencies and deficiencies in the nomenclature surrounding contractual breach is a worthwhile undertaking in view of its significant impact on the proper creation, or assessment, of a party's rights and liabilities. The law of contractual breach in the construction field offers a solution to the deficiencies inherent in the traditional approaches. Lawyers knowledgeable in this field should be mindful of not only the issues surrounding the subject of breach, but also the need to export the underlying terminology to areas beyond construction so that eventually the courts will "get it right" and thereby provide a commonsense basis for juries to arrive at factual determinations, while avoiding the risk of misleading practitioners.

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Endnotes

1. It is interesting to note that *Black's Law Dictionary*, in discussing substantial performance, draws a distinction between *material* and *substantial* without explanation of the difference. *Substantial Performance*, Black's Law Dictionary 1281 (5th ed. 1979) (". . . the contract has been honestly and faithfully performed in its material and substantial particulars").

2. *See, e.g.*, U.S. for the Use & Benefit of Aucoin Elec. Supply Co. v. Safeco Ins. Co. of Am., 555 F.2d 535 (5th Cir. 1977); Ditmar v. Beckham, 86 S.W.2d 801, 802 (Tex. Civ. App. 1935); 5 Corbin on Contracts § 1110 (1964); Ehlinger v. Bodi Lake Lumber Co., 36 N.W.2d 311, 316 (Mich. 1949) ("[H]e who commits the first substantial breach of a contract cannot maintain an action against the other contracting party for failure to perform.").

3. *See* J.M. Beeson Co. v Sartori, 553 So. 2d 180, 182 (Fla. Dist. Ct. App. 1989); Reliance Ins. Co. v. Utah Dep't of Transp., 858 P.2d 1363, 1370 (1993, *abrogated on other grounds by* Com. Real Est. Inv., L.C. v. Comcast of Utah II, Inc., 285 P.3d 1193, 1203 (Utah 2012); *c.f.* All Seasons Constr., Inc. v. Mansfield Hous. Auth., 920 So. 2d 413, 416 (La. 2006) (stating that substantial completion was "referred to also as substantial performance" and "can result even though deficiencies exist").

4. *See* Providence Wash. Ins. Co. v. Beck, 255 N.E.2d 600 (Mass. 1970) (holding failure to comply with a seven-day notice of termination was "a substantial breach").

5. Reid v. Mut. of Omaha Ins. Co., 776 P.2d 896, 906 (1989). Mitigation is generally required when damages are sought in tort cases, as well as in contract cases. *See, e.g.*, Angelos v. First Interstate Bank of Utah, 671 P.2d 772, 777 (1983); Jankele v. Tex. Co., 54 P.2d 425, 428 (Utah 1936); Restatement (Second) of Torts § 918(1) (Am. L. Inst. 1979).

6. *See* Am. Inst. of Architects, AIA 201-2017, General Conditions of the Contract for Construction § 14.2 (2017) [hereinafter AIA Documents].

7. *See* Nowicki-Hockey v. Bank of Am., 2017 Mich. App. LEXIS 1069 (2017) (applying substantial breach in the context of a loan transaction); Oak St. Funding, LLC v. Ingram, 749

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F. Supp. 2d 568, 574 (2010) ("[H]e who commits the first substantial breach of a[n] [employment] contract cannot maintain an action against the other contracting party for failure to perform." (quoting Chrysler Int'l Corp. v. Cherokee Exp. Co., 134 F.3d 738, 742 (6th Cir. 1998) (quoting *Ehlinger*, 36 N.W.2d 311)).

8. Flaig v. Gramm, 1999 MT 181, ¶ 25 (1995) ("A substantial or material breach is one which touches the fundamental purposes of the contract and defeats the object of the parties in making the contract."); *see also* Gas Sensing Tech. Corp. v. New Horizon Ventures Pty Ltd, 2020 WY 114 (2020) (finding "material" breach and "substantial" breach to be synonymous for purposes of justifying termination by the nonbreaching party).

9. *See, e.g.*, Eagle Ridge L.L.C. v. Albert Homes, L.L.C., 2009 WL 3837413 (Mich. Ct. App. 2009) (first to breach must be "substantial" to justify application of the First to Breach defense); *Flaig*, 1999 MT 181, ¶ 25 ("A substantial or material breach is one which touches the fundamental purposes of the contract and defeats the object of the parties in making the contract.").

10. This disregards the potential impact of aesthetics as a critical or nonessential component of the transaction. While color may have significance to its function, in many cases it is purely a question of aesthetics. The significance of aesthetic considerations involves consideration of the subjective value of the aesthetic component. In those jurisdictions where the courts have focused on subjective value, cost of repair has been the measure of damages regardless of diminished value. *See* Gory Associated Indus. v. Jupiter Roofing, 358 So. 2d 93 (Fla. Dist. Ct. App. 1978); Lyon v. Belosky Constr. Inc., 247 A.D.2d 730, 669 N.Y.S.2d 400 (N.Y. App. Div. 3d 1998); Advanced Inc. v Wilks, 711 P.2d 524 (Alaska 1985); Fox v. Webb, 268 Ala. 111 (1958).

11. *See* U.S. for Use of Morgan & Son Earth Moving, Inc. v. Timberland Paving & Constr. Co., 745 F.2d 595, 599–600 (9th Cir. 1984); *c.f.* Olwell v. Nye & Nissen Co., 173 P.2d 652, 654 (Wash. 1946). An exception applies in the construction field as a result of the almost unavoidable use of changes to the original contract terms. Basic contract liability for consequential damages is limited to the extent that such damages were foreseeable at the time the contract was entered into. So far, no authority has been found to resolve the question of whether entry of a change order moves the foreseeability determination date forward from the original contract entry date. However, in a recent case, the U.S. District Court for the Middle District of Pennsylvania apparently ignored change order requests submitted by a contractor when construing the foreseeability of office overhead damages incurred on a library construction project. Scartelli Constr. Servs., Inc. v. Chesapeake Bldg. Components, Inc., No. 3:18-CV-01164, WL 3493145, slip op. at *5 (M.D. Pa. 2021) ("[H]ere, Scartelli has provided evidence . . . that the other change order requests on the project were related to the truss system delay . . . but it has not provided any evidence to show that office overhead damages were a foreseeable result of that delay.").

12. *See, e.g.*, Durr Mech. Constr., Inc. v. PSEG Fossil, LLC, 516 F.Supp. 3d 407, 414 (D.N.J. 2021) (stating that a cardinal change occurs when there is a such a drastic change in the work that it effectively "requires the contractor to perform duties materially different from those bargained for" (quoting Rumsfeld v. Freedom NY, Inc., 329 F.3d 1320, 1332 (Fed. Cir. 2003)); Krygoski Constr. Co., Inc. v. United States, 94 F.3d 1537, 1537 (Fed. Cir. 1996) (holding extent of changes sufficiently extensive where contract price effectively doubled); *c.f.* Baistar Mech., Inc. v. United States, 128 Fed. Cl. 504, 504 (2016) (stating cardinal change results in a breach of contract).

13. Becho, Inc. v. United States, 47 Fed. Cl. 595, 595 (2000) (finding cardinal change and allowing contractor option to either terminate or continue performance and receive compensation for extra work on a time and materials basis); Big Chief Drilling Co. v. United States, 26 Ct. Cl. 1276, 1276 (1992) (finding government insistence that contractor perform work with a defective design specification constituted cardinal change and supported contractor's election for damages).

14. *See, e.g.*, Allied Materials & Equip. Co., Inc. v. U.S., 215 Ct. Cl. 406, 410 (1978) (rejecting argument that changes clause limited the scope of damages recoverable where cardinal change doctrine applied).

15. *Becho, Inc.*, 47 Fed. Cl. at 595 (holding damages to reasonable services rendered under a time and materials scheme); *Big Chief Drilling Co.*, 26 Ct. Cl. at 1276 (1992) (holding damages to the reasonable value of changed work performed).

16. *See* Amelco Elec. v. City of Thousand Oaks, 27 Cal. 4th 228, 228 (2002). However, it appears that while not specifically recognizing changes by the term *cardinal*, the concept of abandonment has been used to address changes mid-project while granting quantum meruit relief for the entire project. *See* Olbert v. Ede, 38 Wis. 2d 240, 243 (1958).

17. *See, e.g*, Yonan v. Oak Park Fed. Sav. & Loan Ass'n, 27 Ill. App. 3d 967, 972 (stating universal rule that in construction contracts specific performance will not be enforced as (1) there are adequate damages remedies at law and (2) courts lack capacity to act as superintendents on construction projects); 71 Am. Jur. 2d *Contracts* § 90 ("[A]s a general rule, contracts for building construction will not be specifically enforced. . . .").

18. However, courts generally require that the land transfer be described with specificity in the parties' agreement. *See* Boardwalk at Daytona Dev., LLC, v. Paspalakis, 220 So. 3d 457, 459 (Fla. 2016).

19. Punitive damages are generally not permitted absent at least some monetary damages award, albeit a slight one. *E.g.*, State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 426 (2003).

20. *See* Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 751 (7th Cir. 1988) ("[E]ven if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses. If he is forced to pay more than that, an efficient breach may be deterred, and the law doesn't want to bring about such a result.").

21. Cuddy Mountain Concrete, Inc. v. Citadel Constr., Inc., 824 P.2d 151 (Idaho 1992) (stating that post-termination revision of daily work records was "another factor which may indicate that Cuddy Mountain is entitled to punitive damages," but without any explanation as to a jurisprudential basis for so

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Prime contractors who employ blanket "flow down" clauses in their subcontracts create potential hidden problems for their contractors.

concluding).

22. AIA Documents, *supra* note 6, § 14.2; Eng'rs Joint Contract Documents Comm., EJCDC C-700, Standard General Conditions of the Construction Contract § 16.02 (2018) [hereinafter EJCDC Documents]; ConsensusDocs®, Standard Agreement and General Conditions Between Owner and Contractor § 11.2 (2014).

23. ConsensusDocs® section 13.8 seems to explicitly provide for noncumulative remedies by specifying that rights under the agreement are exclusive. ConsensusDocs®, *supra* note 22.

24. AIA Documents, *supra* note 6, § 13.3.1; EJCDC Documents, *supra* note 22, § 18.03(A).

25. AIA Documents, *supra* note 6, § 14.2.2; EJCDC Documents, *supra* note 22, § 16.02(B).

26. AIA Documents section 9.8.4 provides that general warranties commence upon substantial completion. AIA Documents, *supra* note 6. EJCDC Documents section 15.08(A) is of like effect. EJCDC Documents, *supra* note 22. In contrast, ConsensusDocs® section 3.8.1 provides commencement upon the date of final payment or the date of certificate of substantial completion. ConsensusDocs®, *supra* note 22.

27. *Compare* Hartford Accident & Indem. Co. v. Scarlett Harbor Assocs. Ltd. P'ship, 647 A.2d 106, 120 (Md. 1996) (treating developer's breach of contract and warranty claims as separate), *with* D.R. Horton, Inc.–Denver v. Bischif & Coffman Constr., LLC, 217 P.3d 1262, 1272–74 (Colo. 2009) (holding that a breach of warranty claim, while of necessity involving a contractual breach, is separate from a breach of base contract obligations and may result in different damages calculations).

28. So far, there is no authority on whether the effective commencement date of an integrated warranty will move the foreseeability determination date from original contract execution to potentially allow for recovery of consequential damages. In fact, nothing has been found addressing the recoverability of consequential damages in the event of a warranty breach, although this might be expected to arise more with an independent warranty.

29. Oftentimes, statutes of limitation are subject to extension by virtue of a discovery rule. Statues of repose, on the other hand, are designed to provide an absolute claim cutoff, not subject to discovery rule extension. Police & Fire Ret. Sys. of City of Detroit v. IndyMac MBS, Inc., 721 F.3d 95, 106 (2d Cir. 2013) ("[I[n contrast to statutes of limitations, statutes of repose 'create[] a *substantive* right in those protected to be free from liability after a legislatively determined period of time.'" (quoting Amoco Prod. Co. v. Newton Sheep Co., 85 F.3d 1464, 1472 (10th Cir. 1996) (emphasis and square brackets added by *IndyMac* court))).

30. Hoagland v. Celebrity Homes, Inc., 572 P.2d 493, 494 (providing the measure of damages for breach of an implied warranty of workmanship with respect to a construction contract without discussing the character of the breach).

31. *See* Antigua Condo. Ass'n v. Melba Invs. Atl., Inc., 517 A.2d 75, 82–84 (Md. 1986) (holding contractor was not required to repair construction deficiencies "instantly" upon its notice to cure, but rather that there was a period of time during which it could "investigate the problem and prepare to perform the actual repair work" before the statute of limitations commenced).

32. Spinoso v. Rio Rancho Ests., Inc., 626 P.2d 1307, 1311 (N.M. Ct. App. 1981) ("During the three years following the first written notification of defects . . . , [the seller] made various attempts at repair[,]" which were unsuccessful. Finally, the seller refused to make further repairs and the purchaser sued.); Roberts v. NVR, Inc., 2015 WL 3745178, at *3–4 (Pa. 2015) (denying the general contractor's motion to dismiss a complaint when the homeowner adequately pled its breach of warranty claim after the homeowner provided the contractor with adequate notice and the contractor failed to correct alleged defects).

33. *See* Presidents & Dirs. of Geo. Coll. v. Madden, 505 F. Supp. 557, 557 (D. Md. 1980), *aff'd in part & appeal dismissed in part*, 660 F.2d 91, 91 (4th Cir. 1981); Beaudry Motor Co. v. New Pueblo Constructors, Inc., 626 P.2d 1113, 1113 (Ariz. Ct. App. 1981); Fowler v. A & A Co., 262 A.2d 344, 344 (D.C. 1970).

34. *Geo. Coll.*, 505 F. Supp. at 557; *see also* Zellan v. Cole, 183 F.2d 139, 139 (D.C. Cir. 1950).

35. This would be the case if the provision merely specifies it "warrants against defects in material and workmanship" or "warrants against defects in material or workmanship arising within (a specified period of time)" without a requirement that would trigger the start of the warranty obligation upon notice to the obligor within a specified time frame.

36. Structuring a warranty on an open-ended basis is a solution to the problem presented with an exclusive time-limited warranty that would preclude relief for latent defects not discoverable prior to the lapse of the warranty period.

37. Antigua Condo. Ass'n v. Melba Invs. Atl., Inc., 517 A.2d 75, 82–84 (Md. 1986).

38. *Id.* at 82; *see also* McClain v. Kimbrough Constr. Co., Inc., 806 S.W.2d 194, 198 (Tenn. 1990) (stating general rule that parties are expected to deal with each other fairly and in good faith even where those principles are not embodied in the party's contract).

39. Liability for consequential damages should be limited by the foreseeability of those damages as of the time the warranty was given as opposed to the time of any breach of that warranty. *C.f.* Hadley v. Baxendale, 9 Exch. 345, 345 (1854) (holding that consequential damages are limited to those foreseeable at the time of contracting).

40. *Antigua*, 517 A.2d at 82; *see also* Magnum Constr. Mgmt. Corp. v. City of Miami Beach, 209 So. 3d 51, 54–55 (Fla. Dist. Ct. App. 3d Dist. 2016) (upholding a public contract provision requiring the owner to provide a period of time within which a period to cure must be performed by a contractor).

41. AIA Documents section 12.2.2.1 requires the owner to

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give notice and a right to cure in order to avoid a waiver of its warranty rights. AIA Documents, *supra* note 6. So does ConsensusDocs® section 3.9.1 and EJCDC Documents section 3.9.1. ConsensusDocs®, *supra* note 22; EJCDC Documents, *supra* note 22. *See* ACE Sec. Corp. v. DB Structured Prods., Inc., 25 N.Y.3d 581, 589 (N.Y. 2015) (holding that the notice to cure as provided by the parties' contract was a substantive condition precedent to filing suit and that plaintiff's failure to provide an opportunity to cure was fatal to its breach of contract claim).

42. *McClain,* 806 S.W.2d 194 at 198 (holding that general contractor may, after giving its subcontractor notice and a reasonable opportunity to cure alleged defects, rescind the subcontract, seek another subcontractor to perform the curative work, and recover damages).

43. EJCDC Documents, *supra* note 22, § 15.08. AIA Documents section 12.2.2 has no comparable provision, nor does ConsensusDocs® section 3.9.4. AIA Documents, *supra* note 6; ConsensusDocs®, *supra* note 22. ConsensusDocs® provides that if there is an unsatisfactory cure of defective work within the correction period, the owner shall give the contractor an option to further correct that work.

44. Roberts v. NVR, Inc., 2015 WL 3745178, at *3–4 (Pa. 2015) (denying general contractor's motion to dismiss complaint as homeowner adequately pled its breach of warranty claim after the homeowner provided the contractor with sufficient notice and the contractor failed to correct alleged defects).

45. For frustration of purpose as a separate theory, see *Cutter Labs, Inc. v. Twining*, 221 Cal. App. 2d 302, 314–15 (1963) (stating elements of a frustration of purpose claim); and *Lloyd v. Murphy*, 25 Cal. 2d 48, 48 (1944) (outlining public policy principles to consider when construing equities in a frustration of purpose claim).

46. United States v. Spearin, 248 U.S. 132, 132 (1918).

47. City of Mounds View v. Walijarvi, 263 N.W.2d 420, 423 (Minn. 1978) ("Architects, . . . engineers, . . . and others deal in somewhat inexact sciences and are continually called upon to exercise their skilled judgment in order to anticipate and provide for random factors which are incapable of precise measurement. . . . Because of the inescapable possibility of error which inheres in these services, the law has traditionally required, not perfect results. . . . If every facet of structural design consisted of little more than the mechanical application of immutable physical principles, we could accept the rule of strict liability which the city proposes. But even in the present state of relative technological enlightenment, the keenest engineering minds can err. . . ." *Id.* at 424.).

48. Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP, 130 A.3d 1024, 1034–35 (Md. 2017) (holding economic loss doctrine precluded contractor's negligence claim against a designer for allegedly defective design work). The significance of the legal theory lies in the respective statutes of limitations in that negligence-based claims traditionally have a considerably shorter period to file suit than contract claims.

49. Examples are requiring the designers abide by the highest or most conservative design standards in the industry.

50. In this case, an equitable principle also came into play. The colloquial version is "as between two innocent parties the guilty one must suffer." More precisely, as stated in *Montgomery Ward & Co. v. Peter J. McBreen & Associates*, "the law abounds in the proposition that as between two innocent parties, the less blameful should prevail." 40 Ill. App. 3d 69, 72 (1976); *see also* Edwards v. Mid-Continent, 252 S.W.3d 833, 838 (Tex. Ct. App. 5th Dist. 2008) ("[C]ourts have held that as between two innocent parties, the party that must suffer the loss is the one that mistakenly created the situation and was in the best position to have avoided it.").

51. *But see* Lockheed Martin Transp. Sec. Sols. v. MTA Capital Constr. Co., 2014 WL 12560868, at *28 (S.D.N.Y. 2014) (denying contractor's motion for summary judgment on its breach of warranty claim against a subcontractor whose warranty period had not yet been triggered). In *Lockheed*, the court noted that MTA had failed to produce any case law to support an anticipatory breach of warranty where the warranty period had not yet been triggered. *Id.*

52. For example, in *Scheck Industrial Corp. v. Tarlton Corp.*, the court, in a breach of warranty claim by a general contractor against its subcontractor, rejected the subcontractor's First to Breach defense that the general contractor's failure to provide access to the contract documents relieved the subcontractor from its warranty breach. *Scheck*, 435 S.W.3d 705, 727–28 (Mo. Ct. App. 2014).

53. The subcontractor, under a "flow down," also acquires all rights against the prime that the prime has against the owner under the prime contract.

BUILDING A THRIVING ORGANIZATION—WHAT'S YOUR ROLE?

(Continued from page 4)

with expertise in a wide range of specialties. As with any good community, we support our own--many of us will only use consultants who actively support the Forum.

All of the attorney/consultant volunteers are guided and supported by the steady hand of our incredible ABA staff. The amount of work that goes "behind the scenes" is astounding. Tamara Harrington, Patricia Harris, Shannon Costis, and Colleen Hardison accomplish a tremendous amount of work to make sure the volunteer attorneys and consultants look organized and polished.

There are too many people to thank them individually, but I am grateful to have such incredible support in my role as Chair. As a parting thought, I would ask you to think about the things you enjoy about the Forum and spend a moment to contemplate all the work that went into making that happen. Then I hope your next thought turns to how you can get more involved to create those special moments for future construction lawyers.

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