Contracts - Sample Essay Question – Prof. Regan – 2010 Exam

Dr. Elizabeth Barnes formerly practiced medicine as one of three physicians in a general medical partnership group in State Green. In the summer of 2009, Dr. Barnes decided to leave the practice group and strike out on her own. By amicable agreement with her former partners, Dr. Barnes formally withdrew from the medical group effective September 30, 2009 and opened her own practice effective October 1, 2009. She knew that running her own office as a solo practitioner meant that she would now have to both practice medicine and run the business side of her new medical office. Her chief concern with the business side was ensuring that she could establish office systems and procedures that would be automated as much as possible, thereby freeing up more time for her to practice medicine.

Getting paid for services in the medical profession is a slow and cumbersome process because most patients have some form of medical insurance that covers a substantial part (but typically not all) of their fee. Insurance company payments typically arrive 2 or more months after the services are rendered and clients pay the balance of such fees (*i.e.*, the balance due after insurance coverage) on average, nearly 2 months after the insurance company makes payment. Managing and collecting these unpaid accounts for services already rendered – known in the medical and business world as "accounts receivable" – is a crucial part of the success or failure of a medical practice (or any business, for that matter).

Before departing her former partnership, Dr. Barnes spent part of the summer of 2009 to plan some of the logistics for her life as a solo practitioner. To assist her in automating the management of the accounts receivable in her new solo practice, Dr. Barnes examined the proposed costs and recommendations of a number of specialized software companies. After quality and price comparison shopping, Dr. Barnes decided to engage David Rider to create a customized software system for her medical practice. From their earlier discussions about Dr. Barnes' software needs, Rider was aware that Dr. Barnes was planning to open her new solo practice on October 1 and that she was looking to have the automated software systems in place to manage the accounts receivable from the first day she was open for business.

By written contract signed by both Rider and Dr. Barnes on August 1, 2009, the parties struck a deal. In the contract Rider promised to create and write a customized software system that would automate the handling of accounts receivable in return for Dr. Barnes' promise to pay $30,000 to Rider for his services. The contract provided that Dr. Barnes' promise to pay the $30,000 was expressly conditioned on her being "personally satisfied with the performance of the software system developed by Rider." Rider further promised in the contract that the software system would be fully operational by October 1, 2009 and Dr. Barnes also promised payment of the $30,000 to Rider (subject to the satisfaction condition noted above) by December 1, 2009.

Following execution of the contract, Rider promptly commenced work on the project. Soon into the process, however, he discovered that every attempt he made at

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writing the customized software for Dr. Barnes failed in one degree on the other because of compatibility issues with the existing software on Dr. Barnes' basic computer operating systems. Despite working longer hours on this project than any other comparable contract, Rider was not able to fully eliminate the problems. By early September Rider informed Dr. Barnes of the problems he was experiencing and that he would likely not have the new software ready by October 1. Dr. Barnes reminded him of the importance of the October 1 date to her new practice and encouraged him to keep trying to solve the problems.

Rider did not have the software ready by October 1. Nevertheless, he made steady progress through October and November in creating unique software solutions to the numerous glitches arising from the interaction of the accounts receivable system installed by Rider and the existing operating systems. Meanwhile, because Rider was not ready with the custom software by October 1, Dr. Barnes was forced to "outsource" the management of her accounts receivable by separately hiring an independent physician's management agency, on a temporary basis, at a cost of $10,000 per month. Rider continued to work on the software through the month of October and declared on October 31 that he had finally completed the job. Dr. Barnes therefore terminated the outside agency (having incurred one month of charges, *i.e.*, $10,000, for the agency's services) and on November 1 launched the new software installed by Rider.

Over the next few weeks, the Rider software operated in a mostly acceptable manner but because of the various glitches that had been "patched" by Rider *(i.e.*, glitches for which he wrote unique additional software overrides) the Rider system was not quite as completely automated as promised by Rider. At the end of each two week cycle, Dr. Barnes had to spend about one hour on the computer manually re-entering certain data about various accounts. The Rider software system nevertheless performed the basic functions it was designed to do (automated billing to insurance companies and patients, automated re-billing for aging and overdue unpaid accounts, etc.).

Dr. Barnes did not pay Rider on December 1. Rider promptly demanded full payment thereafter but Dr. Barnes refused. In February of this year, Dr. Barnes wrote a letter to Rider declaring that she was not satisfied with the performance of the software system and would not be paying him any money for it. She invited him to make an appointment to remove all software installed by him (if he so desired), but otherwise indicated she would not be further using the Rider software because she recently had a new (and glitch-free) software system installed by a competitor of Rider's at a price of $35,000.

Question: Please discuss and analyze the rights and liabilities of the parties.

Essay Question Analysis: *Accounts Receivable Software for Dr. Barnes*

I. Impracticability: Can Rider excuse his belated and partially imperfect performance on grounds of commercial impracticability?

      A. Rule: Where <u>after a contract is made</u>, a party's performance is made impracticable <u>without his fault</u> by the <u>occurrence of an event</u> the non-occurrence of which was a <u>basic assumption</u> on which the contract was made, his <u>duty</u> to render that performance is <u>discharged</u> (maybe suspended?).

      - the rules contemplates acts of God, extreme and unreasonable difficulty, war, embargo, local crop failure, etc.

      B. Application:
            1. *Act of God or the like?*
                  <u>No</u>, says Dr. Barnes. This is just computer compatibility problems. Nobody declared war. Yes Rider worked harder than normal, but that's not the stuff of extreme difficulty or hardship. The other contractor ($35k) seemed to figure it all out without difficulty.

                  <u>Yes</u>, argues Rider. Sometimes the systems are just not going to jive together. Unusually extra long hours to fix all this. Rider not asking to escape the contract, just to be excused for being late by 30 days, and not perfectly getting the automated features as such.

            2. *Without Rider's fault?*
                  <u>No</u>, says Dr. Barnes. It was Rider's fault. He's the expert. It behooved him to assess her system for compatibility issues going into the deal. He could have seen these problems coming if he'd done his homework.

                  <u>Yes</u>, argues Rider. I am an expert in this arena and reas. did not foresee this kind of problem. I acted in good faith and informed Dr. B asap ahead of time about the delay. Put in huge extra hours to get it solved.

            3. *Basic assumption?* Probably yes. Both parties presumably figured the new software would work fine with the existing operating system. No one assumed Rider would be logging all those extra hours to solve the compatibility problem.

      C. Conclusion:[ok either way if well reasoned; I lean in favor of Barnes on this one.]

II. Anticipatory Repudiation: Did Rider's warning to Barnes in early Sept. constitute an anticip. repudiation?

A. Rules:

- A repudiation a statement – an <u>unequivocal statement</u> – by the obligor to the obligee indicating the obligor <u>will commit a breach</u> that would of itself give rise to a claim for <u>damages for total breach</u>

- effect of repudiation: gives victim of anticip. breach immediate right to offensive and defensive remedies: can sue asap for damages and can also immediately seek altern. perf. to mitigate damages

- repudiator can reclaim the deal, by nullification of repudiation, notice of retraction comes to victim of antic. breach before either (1) victim materially changes position in reliance or (2) indicates that breach is "final"

B. Application.

1. *Unequivocal repud./claim for total breach?*
   <u>Yes,</u> argues Barnes. Rider said he would likely not be on time. He knew that time was of the essence and total breach claim arises because timeliness was material part of this deal.

   <u>No,</u> says Rider. He did not <u>unequivocally</u> say he would not perform on time, only that it was likely. His ongoing efforts to make that deadline were herculean and totally contrary to any notion of repudiation of this deal.

2. *Nullification of repudiation?*
   <u>Yes</u>, argues Rider. Even if conclude (wrongly) that statement is a repud., he kept on plugging away to do the job right. Barnes in early Sept never said breach is "final" you are out etc, /she encouraged him to try to make deadline. She never relied via third party deal until way after Rider finished.

   <u>No</u>, says Barnes. True I did encourage him to try, but I also warned him how important the Oct. 1 deadline was.

C. Conclusion: [ok either way if well reasoned; I lean in favor of Rider on this one; probably not a repudiation; probably nullified anyway even if.]

III. Express Condition: Can Barnes avoid any liability to Rider based on express condition requiring her personal satisfaction?

A. Rules:

– conditions are risk shifting devices, that permit a part to avoid the performance they have otherwise promised to deliver upon the happening (or non-occurrence) of an established event

– A condition is an event, not certain to occur, which must occur, unless it non-occurrence is excused, before performance under a contract is due.

– express conditions must be strictly satisfied or the party's duty on the contract is discharged.

– substantial performance (see constructive conditions below) is not sufficient to satisfy an express condition.

– preference is to avoid forfeiture if possible so doubts on interpretation of contract are to be resolved in favor of reducing the risk of forfeiture

– a promise is not rendered "illusory" simply because it is conditionally given, even if it's a personal satisf. condition, so long as the party does not have a free way out; if they can breach and we can measure that breach, the promise is real and there is mutuality of obligation

– personal satisfaction conditions: we prefer an objective reas. person test for measuring breach, but if multiplicity of factors/variables, we allow subjective satisfaction, subject to a good faith test.

B. Application

1. *Is "Personal Satisf." req't an* *express* *condition requiring strict performance?*

> Yes, says Barnes. Contract explicitly says so. No ambiguity here. True, Restatement looks to avoid forfeiture, but only where "resolving doubts" and there are no doubts here on this one.
>
> No, says Rider. Policy against forfeiture is very strong.
>
> [hard to get around fact this is express condition]

2. *Does Barnes have grounds for asserting not satisfied? Either via subjective good faith test or preferred reasonable person test?*
> Yes, says Barnes. He was way late, and he knew how imp. it all was. He also know how imp. fully automated system was to solo med. practice. Playing with computer and extra hour every two weeks is not what I bargained for.
>
> No, says Rider. Software is notoriously tricky, espec. when interfacing two different systems. I worked killer extra hours to make this work, and I pulled it off, at least in a way any reasonable person could accept.

3. *Is promise to be ready by October 1 a promise or condition?* (This one looks more like a promised delivery aspect, not an express condition. As such, via constructive conditions of exchange, substantial perf is sufficient. Being late by one

month is still subst'l perf. given probable multi-year use of software. {assuming can get past satisf. condition} Rider would get contract rate, less damages (incl. probably reduction for $10k temp agency).

C. Conclusion: [ok either way if well reasoned]

IV. Damages

A. Rules

- victim of breach has "<u>duty</u>" to mitigate – *i.e.*, can't recover damages that could have been avoided thru reas. efforts to mitigate

- norm is <u>expectation</u> or benefit of bargain measure.

- <u>reliance</u> (pre contract position is alternative measure)

- <u>consequential</u> damages: also avail. if naturally and foreseeably arise from breach, or if fully disclosed risks for special econ. risks in the balance pending performance of contract

B. Application

1. If <u>Barnes</u> prevails:
<u>Expn.</u> measure: $5k on diff. between what bargained for with Rider (30k) and what in fact had to pay competitor to get promised performance.
<u>Conseq.</u>: $10k for foreseeable costs (if reas.); Rider was specifically on notice going into deal how important this start date was.

2. If <u>Rider</u> prevails:
<u>Exp'n</u>: $30k promised payment for his perf., Rider is deemed to have performed in objectively satif. manner; less than that if he wins most of the deal via subst'l perf. (<u>less the $10k conseq.</u> for being late; and less something reasonable for less than perfectly automated system); <u>note</u>: under a Rider-wins scenario, Barnes can't setoff the $30k she spent – in effect, needlessly – on third party competitor software

C. Conclusion: [ok either way if well reasoned]