

“Cover All Bases” Annotated Example Memo

TO: Jane Jones

FROM: Sam Smith

Memo Heading

DATE: March 1, 2012

RE: E. Basha Matter No. 12-3345

Commercial Frustration as Grounds to Rescind Lease

Confidential and Privileged Attorney Work-Product

Issue

Under Arizona common law, does the doctrine of commercial frustration allow a lessee to rescind his lease that included a subletting provision when he intended to operate a hockey-themed restaurant in an area near a soon to be built hockey arena, and, after signing the lease, he learned the arena’s completion would be delayed two years because of the city’s decreasing revenue and failed attempts to raise funds?

Issue: This issue follows the “under/does/when” structure.

Brief Answer

No. According to Arizona’s common law application of commercial frustration, four elements are necessary to support a cause of action to rescind a contract. First, the principal purpose must be frustrated. Second, frustration must be substantial. Third, the non-occurrence of the frustrating event must have been a basic assumption. Fourth, the risk of the frustrating event should not be placed on the party seeking relief. Here, the lessee established that his principal purpose was

Brief Answer that starts with a short answer, gives a brief conclusion, briefly describes the relevant law, and summarizes the factual analysis.

to operate a hockey-themed restaurant. However, the two-year delay in the arena’s completion did not substantially frustrate this purpose. Furthermore, the delay’s non-occurrence was not a basic assumption, and the risk of the delay should properly be placed on lessee.

Facts

Our client, Elwood Basha, has asked whether he can rescind his restaurant’s lease because funding difficulties caused a two-year delay in the nearby TumbleDome arena’s construction. Basha currently owns two restaurants in Tucson, but opening a hockey-themed restaurant has always been his dream.

This Facts section paragraph starts with an introduction to the client and his problem.

In February 2010, Tucson’s mayor financially committed to building the TumbleDome, future home of the Tumbleweeds hockey team. One month later, the Tucson City Council passed a motion to reallocate \$10 million from general funds to the TumbleDome’s construction. Despite one council member mentioning budget problems and a failed tax levy to fund the TumbleDome, the council expected increasing tax revenues to cover the \$10 million commitment.

This paragraph begins the chronological discussion of facts. Note the orienting transitions (in orange boxes) that move the reader through the facts.

SportzSkirtz, a real estate developer, is constructing a shopping center in the Arena District. Located around the TumbleDome’s perimeter, the shopping center will be near a major highway in a densely populated, yet underdeveloped, area. Construction will be completed in July 2012.

On July 1, 2011, Basha signed a lease with SportzSkirtz to operate a restaurant in the Arena District. Basha signed the lease with a hockey stick-shaped pen while wearing a Tumbleweeds hockey jersey. At the signing, a SportzSkirtz representative commented: “SportzSkirtz is thrilled to have such a

Note how the writer has quoted key language that will be important to the analysis. The quotes are clearly indicated with quotation marks and any alterations are clearly marked as well.

dedicated Tumbleweeds fan as a tenant. We expect ‘Weeds Penalty Box to be a wonderful place for Tumbleweeds fan[s] to celebrate after the game.’”

When Basha signed his lease, all news reports indicated the TumbleDome would be completed by July 2012, one month before Basha’s three-year lease begins. However, on August 1, 2011, the city announced it would not provide the funding as promised, delaying the TumbleDome’s completion until July 2014.

Basha approached our office because he feels his lease is worthless without the TumbleDome’s hockey crowds. This memorandum will address whether the TumbleDome’s delayed completion was an unforeseeable event that substantially frustrated Basha’s operation of a hockey-themed restaurant, thus entitling Basha to rescind his lease due to commercial frustration.

This paragraph transitions the reader to the Discussion section.

Discussion

Basha is likely not entitled to relief under Arizona’s common law commercial frustration doctrine. In 7200 Scottsdale Road General Partners v. Kuhn Farm Machinery, Inc., the court required a commercial frustration claim to satisfy four elements: (1) the frustrated purpose was the principal purpose; (2) frustration was substantial; (3) the frustrating event’s non-occurrence was a basic assumption; and (4) “the risk of the frustrating [event] should [not] properly be placed on the party seeking relief.” 909 P.2d 408, 415 (Ariz. App. 1st Div. 1995) (stating these four elements from Restatement Second of Contracts § 265 are consistent with Arizona Supreme Court holdings).

These first two paragraphs are roadmap or umbrella paragraphs. They start with the writer’s conclusion, give an overview of the law, and summarize the upcoming analysis. They are structured so that the order of the elements discussed here are in the same order as the discussion of the elements below.

First, Basha likely establishes his principal purpose is to operate a hockey-themed restaurant because SportzSkirtz contracted with this knowledge. Second, the TumbleDome’s delayed completion does not substantially frustrate Basha’s purpose because the delay likely does not render Basha’s lease valueless. Third, the non-occurrence of the TumbleDome’s delayed completion was not a basic assumption because Tucson’s funding difficulties indicated the delay was likely foreseeable. Lastly, the risk of the delay should be placed on Basha because his lease does not contain a provision absolving him of liability. Therefore, the facts likely do not support a commercial frustration action to rescind Basha’s lease.

I. Principal Purpose

The heading reflects the first element and the first sub-issue. Note that this heading could also be sentence stating the point of the section.

For the purpose of establishing a claim of commercial frustration, Basha’s principal purpose for leasing the premises is to operate a hockey-themed restaurant. Principal purpose is established when *both* contractual parties enter the contract with knowledge, or with reason to know, that a specific purpose is so important that without it the contract would be worthless. *Id.* at 415-416.

Principal purpose is not established when only one contractual party knew the purpose. *Id.* In Scottsdale Road, a business contracted with a resort to use the resort’s facilities for a convention. *Id.* at 410. The business contended the presence of European personnel was important to the convention. *Id.* at 415. However, the contract did not mention European personnel, nor did the business communicate their importance to the resort. *Id.* In examining the principal purpose element of the business’s commercial frustration defense, the court held

The writer starts with the writer’s prediction or conclusion on the first element.

Here, the reader explains the basic law of “principal purpose.”

In this paragraph, the writer explains the law of commercial frustration by demonstrating how a key case stands for a legal proposition. The paragraph includes the facts, holding, and reasoning of the key case.

the principal purpose was the presence of some business personnel because this was the only purpose known to *both* the business and the resort. Id. at 416. The court reasoned that because the business did not communicate the importance of European personnel to the resort or mention them in the contract, the resort had no reason to know European personnel were so important to the business's convention that without their presence the contract would be worthless. Id.

The court will likely find Basha's principal purpose for leasing the premises is to operate a hockey-themed restaurant because *both* Basha and SportzSkirtz contracted with knowledge of its importance. First, unlike in Scottsdale Road where the resort did not know European personnel were important, a Tucson Business Gazette article indicates a SportzSkirtz representative knew Basha, a dedicated Tumbleweeds fan, would name his restaurant 'Weeds Penalty Box.' This suggests SportzSkirtz knew hockey is important to Basha's restaurant. Second, SportzSkirtz is strategically constructing the leased premises near the TumbleDome and the aforementioned SportzSkirtz representative acknowledged Basha's restaurant would be a "wonderful place for Tumbleweeds fan[s] to celebrate after the game." These facts suggest SportzSkirtz knew hockey is so important that without hockey the lease would be worthless. Third, Basha's actions at the lease signing gave SportzSkirtz reason to know that hockey is important to his restaurant; he signed the lease with a hockey stick-shaped pen while wearing a Tumbleweeds hockey jersey. Therefore, because *both* Basha and SportzSkirtz knew hockey is important, the court will

This paragraph starts the analysis for the "principal purpose" sub-issue for commercial frustration. The paragraph starts with a conclusion. Then, the writer proceeds to use analogy and explanation to support the conclusion and convey the reasoning.

likely find the principal purpose of the contract is to operate a hockey-themed restaurant.

However, SportzSkirtz could argue the only purpose it knew was Basha's purpose to operate a restaurant. First, like the contract in Scottsdale Road that did not mention European personnel, Basha's lease does not mention hockey-themed restaurant; it only mentions the premises will be used to "operat[e] a restaurant/bar establishment." Thus, SportzSkirtz could argue it did not have knowledge that hockey was important to Basha's restaurant. Second, because the TumbleDome will host conventions and concerts in addition to hockey games, SportzSkirtz could argue the potential business from after-event crowds in general, not hockey fans in particular, was important to Basha's decision to lease near the TumbleDome. Third, SportzSkirtz could argue that expanding Basha's business presence was important to his lease because Basha already owns two restaurants and there is a demand for restaurants in the underdeveloped area surrounding the TumbleDome.

Ultimately, that argument fails because the facts show SS knew that hockey, not the TumbleDome's concert crowds or the area's demand for restaurants, was important to the lease. Therefore, the court will likely find the principal purpose of the lease between Basha and SportzSkirtz is the operation of a hockey-themed restaurant because *both* parties contracted with knowledge of hockey's importance.

Here, the writer is offering the reader another possible outcome under the law and then explaining why the writer does not think this outcome is likely.

II. Substantial Frustration

A two-year delay in the TumbleDome’s completion likely does not substantially frustrate Basha’s principal purpose to operate a hockey-themed restaurant. To constitute substantial frustration, an event must render one party’s performance valueless to the other; it is not enough that the event diminishes the contract’s value. Id. When determining value, one must examine the lease terms and the location of the premises; if the premises are located in a desirable area and the lease allows the tenant to sublet the premises, the lease retains value. Lloyd v. Murphy, 153 P.2d 47, 52 (Cal. 1944) (finding no substantial frustration because premises were located on a main street in Los Angeles and the landlord allowed tenant to sublet premises).

Frustration is not substantial when an event merely diminishes the contract’s value. Scottsdale Road, 909 P.2d at 414. In Scottsdale Road, a business contracted with a resort to hold a convention. Id. at 410. After the Gulf War commenced, the business cancelled the contract and sought relief due to commercial frustration. Id. The business claimed terrorist threats substantially frustrated its purpose by preventing its personnel from travelling to the convention. Id. at 416. The court held the contract was not substantially frustrated because “the value of the resort’s counter-performance [in providing the resort’s amenities for the convention] was not totally or nearly totally destroyed.” Id. at 417. The court reasoned the contract retained value because over one hundred business personnel registered for the convention despite terrorist threats. Id. Thus,

The remainder of the memo follows the same pattern as the “principal purpose” section, moving through the outcome on each element.

there was no substantial frustration because the terrorist threats did not render the contract valueless. Id.

The TumbleDome's delayed completion likely does not substantially frustrate Basha's principal purpose to operate a hockey-themed restaurant. First, like the business in Scottsdale Road that was able to have some personnel attend its convention despite terrorist threats, Basha is able to operate a hockey-themed restaurant despite the TumbleDome's absence. In both cases, the frustrating event only diminished the value of the other party's performance; it did not render the performance valueless. Second, Basha's lease permits subletting and the location is desirable: a densely populated area near a major highway where there is a demand for restaurants. Thus, his lease retains value because he can likely find a tenant to sublet the desirable premises.

Conversely, one could argue that operating a hockey-themed restaurant without the TumbleDome is valueless to Basha because his dream of operating a hockey-themed restaurant requires hockey fans. Unlike Scottsdale Road where some business personnel were able to attend the convention, there are no pre- or post-game hockey fans to frequent Basha's restaurant. Additionally, subletting may be valueless because a tenant may not desire the location's proximity to the noise, dust, and unsightliness of the TumbleDome's ongoing construction. These facts suggest SportzSkirtz' performance in providing the leased premises may be valueless.

Ultimately, that argument is not persuasive. Although Basha may feel operating a restaurant without pre- and post-game hockey fans is valueless, the

fact remains that Basha is likely to have some customers, perhaps even hockey fans, because there is a demand for restaurants. Thus, Basha's lease retains value. Furthermore, the population density and demand for restaurants indicate the premises are desirable. Until Basha attempts to sublet and fails, the subletting option retains value. Thus, the court is unlikely to find substantial frustration because the TumbleDome's delayed completion only diminishes the contract's value; it does not render the contract valueless.

III. Non-occurrence of Frustrating Event as Basic Assumption

The court will likely find the non-occurrence of a delay in the TumbleDome's completion was not a basic assumption. To determine this, Arizona courts rely on whether the frustrating event was foreseeable. See Garner v. Ellingson, 501 P.2d 22, 24 (Ariz. App. 1st Div. 1972) (finding that a government order requiring tenants to install sprinklers in an adjacent building was unforeseeable, so tenants did not assume the risk); Mohave County v. Mohave-Kingman Estates, Inc., 586 P.2d 978, 983-84 (Ariz. 1978) (finding that a change in zoning regulations was foreseeable, so buyer assumed the risk). If the surrounding circumstances indicate the frustrating event might occur, then its occurrence is reasonably foreseeable and its non-occurrence is not a basic assumption. Id. Conversely, if the surrounding circumstances do not indicate the frustrating event might occur, then its occurrence is not reasonably foreseeable and its non-occurrence is a basic assumption. Garner, 501 P.2d at 24.

A frustrating event is not reasonably foreseeable when it is a deviation from an established pattern. Matheny v. Gila County, 710 P.2d 469, 471 (Ariz.

Here is an example of using parenthetical explanations to support a summary of the law.

App. 2nd Div. 1985). In Matheny, Matheny contracted with Gila County to “provide ambulance service for the county’s [indigents].” Id. at 469. When the parties contracted, Arizona’s legislature had a six-year pattern of failing to fund the state’s indigent health system. Id. at 471-72. Subsequently, the city passed funding legislation, and Gila County no longer required Matheny’s services. Id. at 469. Matheny sued for breach of contract, and Gila County asserted a commercial frustration defense. Id. The court held commercial frustration entitled Gila County to relief. Id. at 472. The court reasoned it was unforeseeable that the legislature would enact legislation to fund the indigent health system because for years such legislation had failed. Id. Furthermore, the court implicitly reasoned that because funding legislation was unforeseeable, its non-occurrence was a basic assumption: Gila County assumed the legislature would continue the pattern of failing to pass funding laws. See id.

The non-occurrence of a delay in the TumbleDome’s completion likely was not a basic assumption because the delay was foreseeable. First, unlike the frustrating event in Matheny that was a deviation from the legislature’s pattern, the TumbleDome’s delayed completion resulted from funding difficulties that were consistent with the city’s pattern of decreasing tax revenues and failing to pass a special tax levy. Basha could have foreseen that this pattern of funding difficulties might delay the TumbleDome’s completion because the TumbleDome’s construction relied on city funds. Thus, because the TumbleDome’s delayed completion due to inadequate funding was likely foreseeable, its non-occurrence was not a basic assumption.

However, one could argue the delay was unforeseeable. Despite prior funding difficulties, the City Council members indicated a commitment to opening the TumbleDome. Like the legislature in Matheny that had a pattern of failing to pass legislation, the Tucson City Council had a pattern of financially supporting the TumbleDome's completion. Despite two years of decreasing tax revenues and a failed special tax levy, the City Council reallocated \$10 million to the TumbleDome. These facts suggest that, even when faced with funding difficulties, the City Council would continue to fund the TumbleDome's completion. Thus, the Council's postponement of the \$10 million commitment was a deviation from its pattern of financially supporting the TumbleDome, and such deviation was unforeseeable.

Ultimately, this argument is weak because the City Council predicated the \$10 million commitment on its expectation that increasing tax revenues would cover the cost. Other than the City Council's hopeful projections, no circumstances indicate that tax revenues were increasing. Contrastingly, the two-year pattern of decreasing tax revenues indicate that tax revenues might continue to provide funding difficulties for the TumbleDome. Thus, a delay in the TumbleDome's completion was reasonably foreseeable. Therefore, its non-occurrence likely was not a basic assumption.

IV. Risk Should Not Be Placed on Party Seeking Relief

The risk of the TumbleDome's delayed completion likely should be placed on Basha. To determine which contractual party bears the risk of the frustrating

event, Arizona courts first rely on whether the frustrating event was foreseeable. E.g. Mohave County, 586 P.2d at 984; Garner, 501 P.2d at 24. If the frustrating event was not foreseeable, then the party seeking relief does not bear the risk, unless the contract contains a provision stating otherwise. See Weyerhaeuser Real Estate Co. v. Stoneway Concrete, Inc., 637 P.2d 647, 651 (Wash. 1981) (suggesting the lease must be examined to determine if the purpose of any provision was to allocate risk to one party).

Conversely, if the frustrating event was foreseeable and the contract does not contain a provision absolving the party seeking relief of liability, then the risk of the frustrating event is properly placed on that party. Mohave County, 586 P.2d at 984. In Mohave County, after a buyer bought residential property from the seller and agreed to make certain improvements on it, the zoning changed to commercial and manufacturing. Id. at 980-83. The court held the buyer was not entitled to relief under commercial frustration. Id. at 984. The court reasoned the buyer had a responsibility to negotiate a provision in the contract to absolve him of liability because zoning changes were foreseeable; absent such provision, the buyer assumed the risk of zoning changes. Id.

The risk of the TumbleDome's delayed completion likely should be placed on Basha. First, like the zoning changes in Mohave County, the delay was likely foreseeable. Subsequently, like the buyer in Mohave County, Basha had a responsibility to negotiate a provision that would allow him to rescind his lease should a delay occur. However, also like the contract in Mohave County, Basha's lease contains no such a provision. Thus, Basha bears the risk of the delay.

However, one could argue the risk of the TumbleDome's delayed completion should not be placed on Basha because the delay was unforeseeable. Unlike Mohave County where the zoning changes were foreseeable, if the delay was unforeseeable, then Basha had no responsibility to negotiate a provision to absolve him of liability because there was no indication the delay might occur. Therefore, even absent a liability-absolving provision, Basha should not bear the risk of the delay because it was unforeseeable.

Ultimately, this argument fails because even if the TumbleDome's delayed completion was unforeseeable, the contract contains a subletting provision, suggesting the risk of a frustrating event should be placed on Basha. If Basha is unable to operate his restaurant, the subletting provision allows him to fulfill his contractual obligation to SportzSkirtz by subletting the premises. Thus, the subletting provision suggests Basha bears the risk of a frustrating event that may impede his ability to operate his restaurant.

In conclusion, Basha is likely not entitled to relief under Arizona's application of commercial frustration because the TumbleDome's delayed completion was foreseeable, the delay did not substantially frustrate Basha's principal purpose to operate a hockey-themed restaurant, and the risk of the delay should properly be placed on Basha.

Conclusion

Basha likely cannot get relief from the contract under Arizona's common law commercial frustration doctrine. Although both Basha and SportzSkirtz contracted with knowledge that Basha's principal purpose is to operate a hockey-themed restaurant, the TumbleDome's delayed completion likely does not substantially frustrate this purpose because Basha's lease retains value despite the absence of the hockey fans he expected. Additionally, the delay's non-occurrence was likely not a basic assumption because two years of decreasing tax revenues indicate a delay due to funding difficulties was foreseeable. Lastly, Basha bears the risk of the delay because his lease's subletting provision allows him to maintain his contractual obligations without personally operating a restaurant. I recommend we advise Basha that he is unlikely to prevail in a commercial frustration action to rescind his lease; his best option is to find another restaurant owner to sublet the premises.

The Conclusion section stands alone and summarizes the Discussion section's conclusion and analysis. It wraps up with a recommendation for further steps.