THE VA'S NIGHTMARE BREACH: PART I

"Material Breach" and Walking Away

INTRODUCTION

Much has been written about the now infamous Department of Veterans Affairs' (VA) medical facility construction project in Aurora, Colorado, which is projected to have over **$1 billion in cost overruns** (projected final cost of approximately $1.7 billion). The storylines include Kiewit-Turner Joint Venture (KT) walking away from the project after an alleged "material breach" of the contract, and the litigation that ensued contains valuable lessons regarding material breach and stopping work, which will be discussed here.

This Part I of a two-part series will focus on what constitutes a "material" breach, highlighting the specific examples in the appeal of *Kiewit-Turner, a Joint Venture v. Dep't of Veterans Affairs,* C.B.C.A. 3450 (Dec. 9, 2014). Part II will focus on the consequences of a material breach for both the non-breaching and breaching parties to the contract, focusing on the right to stop work on a project in light of a material breach.

WHAT IS A MATERIAL BREACH?

What is a "material breach" of contract, and what are some **common circumstances** under which material breach is found? Under contract law, a material non-compliance with the terms of the contract will be considered a material breach. A breach is considered "material" when it affects the essence of the contract or a matter of vital importance. Whether a failure to comply with the terms of a contract is material is generally a **mixed question of law and fact:** contract interpretation is a question of law, and what the parties did or did not do is a question of fact.

The courts have historically relied on the following considerations when determining whether a breach is material or not:

a) The extent to which the injured party will be deprived of the benefit that he reasonably expected;
b) The extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
c) The extent to which the party failing to perform or to offer to perform will suffer forfeiture;
d) The likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
e) The extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing. (Restatement (Second) of Contracts § 241 (1981))

Accordingly, courts have found material breach for failure to construct the work in a workmanlike manner, failure to maintain bonding, failure to obtain and maintain liability insurance, the unjustified nonpayment of amounts due, or the presence of a cardinal contract change.

Conversely, some breaches, such as a GC's failure to make a relatively small progress payment, are not considered material. Again, the question of materiality depends heavily on the facts of a given case and contract interpretation and will likewise depend on various factors including the relative size of the breach and the breach's impact on the continued performance on the contract.

BRIEF FACTS OF THE *KIEWIT-TURNER* APPEAL

The VA awarded Kiewit-Turner (KT) a contract for pre-construction services for its medical center campus in Aurora, Colorado in 2010. The contract was an integrated design-and-construct type contract (which the VA had never used before). Despite this type of contract being designed to involve KT at an early stage, the design of the medical center was well underway when KT began its involvement. On the day of the award to KT, the VA set the project's funding limit, or Estimated Construction Cost at Award (ECCA) at $582,840,000. The ECCA was based upon design drawings that were established without any input from KT and were only 50% complete.

Soon after award, the estimated cost of completion rose significantly, and KT informed the VA that the project could not be built for the ECCA amount. In fact, when the design drawings were 65% complete, KT estimated that construction costs would be $76 million more than the ECCA amount. In light of KT's warnings, the VA asked KT to submit a firm target price proposal for construction on the project at a price that would not be more than $603 million. KT submitted a proposal for less than that amount, based on the condition that the VA would implement $23 million worth of engineering design changes.

After the VA refused to implement the engineering design changes, the parties entered into bilateral modification SA-007, which required that both parties make efforts to keep the price under $604 million, and required the VA to ensure that its design team would produce a design that could be constructed for the ECCA amount of $582,840,000.

After the 100% drawings were submitted (although still incomplete), KT estimated that the cost of construction would be $200 million more than the ECCA amount. In spite of this estimate, the VA continued to refuse to implement any value engineering changes and ordered KT to proceed with construction.

After failing to come to an agreement, KT requested a decision from the Contracting Officer as to whether the VA breached the contract by failing to provide a design that could be built for the ECCA amount. The Contracting Officer denied the allegation and ordered KT to continue with the work. KT did continue to perform, **under protest** (which was well documented).

KT then appealed the Contracting Officer's Final Decision decision to the Civilian Board of Contract Appeals (Board), in *Kiewit-Turner, a Joint Venture v. Dep't of Veterans Affairs,* C.B.C.A. 3450 (Dec. 9, 2014). The Board found that, as of June 2014, KT had performed $20 million worth of work for which it had not been paid. Based on testimony at the hearing, the Board found that the VA did not have any plans to redesign the project, had only $630 million appropriated for construction, and did not have any plans to seek additional funding.

(For a more in-depth summary of the project's factual background, See Living in a Material World: Kiewit-Turner, Material Breach, and Implications for Breaching and Nonbreaching Parties, Burke and Dockery, *The Construction Lawyer*, Spring 2015.)

THE VA BREACHED ITS CONTRACT

In *Kiewit-Turner*, the Board made **three specific findings** regarding whether the VA materially breached the contract and the results of the alleged breach:

First, the Board found that the contract required the VA to provide an ECCA-compliant design, and that modification SA-007 required the VA to provide a design that could be constructed for the ECCA amount. The Board determined that modification SA-007 clearly required the VA to provide a design that could be constructed

for the ECCA amount of $582,840,000. In making this finding, the Board decided that the ECCA amount was material (and "critical"), and rejected the VA's argument that the ECCA was not material because KT's firm target price proposal was subject to scope changes.

Second, the Board found that the VA materially breached the contract by failing to provide a design that could be constructed for the ECCA amount. Considering the five factors listed above, the Board reasoned that KT could not be adequately compensated for the lack of an appropriate design because the VA did not have sufficient funding to pay for the design, nor did it intend to ask for more. The Board also stated that the VA was not likely to cure its breach, citing the fact that the VA insisted that it would not redesign the project. The Board considered the VA's behavior in this regard to be a violation of its duty of good faith and fair dealing (which is a breach of contract in and of itself).

Third, the Board found that the VA's material breach justified KT to stop work on the project. This finding and its implications will be discussed more in depth in next week's blog post.

The Board's finding of material breach saved KT from spending more of its own money to continue construction on the project, and ultimately resulted in the two sides negotiating a settlement that allowed the parties to continue work on the project.

CONCLUSION

When a breach of contract is alleged, a contractor must determine **whether the breach is material** and **assess its options.** Determining one's rights and options in light of a material breach is often a technical analysis involving contract interpretation and fact analysis. As is often the case, Kiewit-Turner was able to exercise its legal rights because of its detailed documentation of its requests, responses, and protests to the VA – all of which were timely. The help of an experienced consultant in these technical and time sensitive matters can be vital to ensuring that all of the administrative requirements are met, and that all of the options are available under the circumstances.

In the end, you will be glad you made the call; by the way, it's a FREE CALL.

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