

## THE VA'S NIGHTMARE BREACH: PART II

### *"Material Breach" and the Decision to Walk Away*

#### INTRODUCTION

As discussed in last week's post, 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.

**\*Note:** *The U.S. Senate agreed Friday to raise the project's spending cap by \$100 million, enough to continue work for three weeks. Further funding and assurances to continue the project are currently being sought.*

Part I of this two-part series focused 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). This **Part II** will focus on the fallout of a material breach, including the **right to stop work** and the options for both the breaching and non-breaching parties.

#### 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 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 DECISION TO WALK AWAY

When a material breach occurs, **what options do the parties have** and what factors should be considered when making the decision to stop work or continue performance? The Federal Circuit summarized the nonbreaching party's options when facing a material breach:

- (1) Entirely discontinue performance under the contract,
- (2) Explicitly reserve its right to discontinue performance for the material breach (and continue to work), or
- (3) Waive the right and continue performance under the contract.

*Precision Pine & Timber, Inc. v. United States*, 62 Fed. Cl. 635 (2004)(emphasis added). The *Precision Pine* Court summarized these three options from the different approaches to the question as addressed by previous courts. That Court noted that the determination should be **based on the facts** surrounding the breach, as well as the relationship between the parties and whether the breaching party has relied on and been impacted by the nonbreaching party's continued performance on the contract.

Note that under factor (3) the waiver does not need to be a written waiver, but mere continued performance under the contract will constitute a waiver of the contractor's right to stop performance. Conversely, the explicit reservation of rights of factor (2) must be an express reservation.

Before a contractor makes the decision to stop work, it should be confident that the other party has indeed materially breached the contract. The consequences can be severe where a contractor stops work on the project, but it is later determined that no material breach existed. In that type of situation, the contractor could potentially face a default termination and other liabilities associated with possible reprocurement costs.

## KIEWIT-TURNER HAD RIGHT TO "WALK AWAY"

In *Kiewit-Turner*, the Board made three specific findings: (1) that the contract required the VA to provide an ECCA-compliant design, (2) that the VA materially breached the contract by not doing so, and (3) that **KT was justified in stopping work** on the project in light of the VA's material breach.

After KT suspected that the VA materially breached the contract, **it chose to continue performance** on the contract while "explicitly reserv[ing] its right to discontinue performance for the material breach." Indeed, after the Contracting Officer issued his final decision and directed KT to proceed with the work, KT did so "**under protest**," and stated multiple times thereafter that it was continuing to perform under documented protest. KT therefore argued that it was justified in stopping performance even though it had continued to perform, because it expressly reserved the right to do so.

Conversely, the VA argued that KT did not reserve its right to stop work, but merely reserved the right to “suspend work.” The VA also relied on case law which holds that the obligations of both parties remain intact if the nonbreaching party continues to perform on the contract, without protest, even though the government breached the contract. The VA argued in the alternative that even if KT did reserve its right to stop work, the stoppage would result in the VA experiencing an enormous forfeiture and damage to the public in the form of a delayed hospital, which would be an inequitable result. The VA relied on the aforementioned reasons in arguing that KT waived its right to stop work, specifically citing the fact that KT continued to work on the project.

The Board ultimately agreed with KT, noting that the decision to stop work or continue performance is that of the nonbreaching party (KT), and that only in exceptional circumstances will equity require the nonbreaching party to continue with the work. Additionally, the Board pointed out that the VA failed to address the phrase “without protest” in its discussion of the relevant case law and corresponding argument. Citing this oversight, the Board recited the facts showing that KT had sufficiently documented and given notice that it was continuing work on the project “under strenuous protest” (in an effort to avoid the risk of default termination, which effort included the proactive advancement of Value Engineering proposals intended to drive costs down), and therefore adequately reserved its right.

Finally, the Board rejected the VA’s argument that KT reserved only the right to “suspend” and not “stop” performance, noting that what KT requested initially was not the determining factor, but that KT had the right to stop performance as a matter of law. *Id.*

## OPTIONS

When material breach is suspected or alleged, the nonbreaching party has three basic options, as listed above: to stop performance, to continue performance under express protest, or to continue performance and thereby waive its right to stop performance on the contract work. The decision to stop work or continue performance is a business decision for the nonbreaching contractor, and can be an effective leveraging tool of last resort when used properly. The decision to stop work, however, if used improperly, can result in disastrous consequences.

The decision to continue performance after a material breach should be done **under express protest** and be thoroughly documented. While the absence of a written protest may not directly result in a court or board finding waiver of the right to stop performance, it may be a determining factor.

The alleged breaching party should document and notify the nonbreaching party of any reliance it is making as a result of the nonbreaching party’s continued performance. This will strengthen that party’s position that it incurred costs from such reliance.

## CONCLUSION

The *Kiewit-Turner* decision is a good illustration of the factors used to determine whether a material breach has occurred, and the options available to both parties when such allegations arise. Contractors should be cautious about stopping work when material breach is suspected, because the ensuing analysis relies heavily on the facts of each case and the associated risks can be severe.

Contractors should likewise be cautious when deciding to continue performance after a material breach, and take the necessary steps to ensure that it reserves its right to stop work and walk away from the project in the future.

At any rate, contractors facing a material breach situation should consult closely with counsel or a trusted consultant to carefully weigh its options and strategy going forward.

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

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