



When the Federal Govt acts badly, but not badly enough to show bad faith - what's a contractor to do?

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In the prior issue of this newsletter, we included an article on the high standard of proof and the practical considerations for a federal government contractor claiming that the federal government acted in bad faith in its contract dealings. You responded with the question, suppose the government acts badly in its contract dealings with the contractor, but not to the level of bad faith ? do we have a remedy? The answer is yes, you do have a remedy ? that remedy being a claim against the government for failing to comply with the implied contractual obligation of good faith and fair dealing with its contractors. If established, the government?s failure to meet the implied obligation can be a material breach of contract, allowing damages for the contractor and relief from further contract performance. This principle and remedy were brought home in the recent Civilian Board of Contract Appeals? decision in *Kiewit-Turner, A Joint Venture v. Department of Veterans Affairs*, CBCA 3450 (December 9, 2014).

The Project

The project at issue in *Kiewit-Turner*?s appeal to the Board of Contract Appeals was the construction of the Veterans Administration (?VA?) medical center campus in Aurora, Colorado. The Board of Contract Appeals? findings of fact paint a dismal picture of the VA?s choice of project delivery method and its management of the project design team.

The VA chose a project delivery method known as an integrated design and construct contract, or IDC type contract, a method the Board characterized as similar to the ?construction management at risk? or ?construction management as constructor? type of project delivery method. With the IDC delivery method, the construction contractor is brought into the project early on to analyze the design and advise the project owner so that the owner can better work with its design team to control estimated construction costs or, alternatively, to procure additional funding. The VA, however, had never before used this project delivery method, and the Board found as a fact that the VA did not properly use the project delivery system from the start. Instead, the VA went into construction with an incomplete design with estimated construction costs far in excess of the available funding, repeated failures to process

change orders, failures to process the design team's joint supplemental instructions used to complete the design, and failures to timely pay the JV contractor.

In the meantime, there had been significant red flags raised over the escalating estimated cost to construct the project. In response, after meetings among the VA, its design team, and the JV contractor, the VA issued a fateful modification to the construction contract. The modification provided that the VA and the JV contractor agreed to a project goal price at or below \$604,000,000. The modification further provided that the VA would ensure that its design team would produce a design that would meet the estimated construction cost of \$582,840,000. The Board found that at the time of the modification, the modification and, in particular, the cost sums were not based on any set of design documents, and certainly not a completed set of design documents.

Eventually, the cost estimate from the VA's design team was about \$781 million, or \$199 million over the modification's specified estimated construction cost. The JV contractor submitted a firm fixed price proposal of \$897 million with clarifications and qualifications. The VA rejected the JV contractor's proposal. Thereafter, the JV contractor advised the VA that the cost could be as high as \$1.085 billion. In response, the VA notified the JV contractor that the contractor was responsible for constructing the project for the firm fixed price established in the contract modification ? \$604,000,000.

The JV contractor requested a Contracting Officer's (?CO?) final decision as to whether the VA had breached its obligation under the contract to provide a design that could be built for the estimated construction cost of \$582 million. The CO issued a final decision denying that the VA had breached the contract and directed the JV contractor to proceed with construction of the project at the modification price of \$604 million. The JV appealed the final decision to the Board of Contract Appeals seeking a declaratory judgment that it was relieved from further performance due to the VA's breach of contract in not complying with its duty of good faith and fair dealing with the JV contractor. The Board agreed with the JV contractor.

The Government's Failure to Comply with its Duty of Good Faith and Fair Dealing with Its Contractor

The Board of Contract Appeals focused on three questions in rendering its decision.

First, did the contract modification obligate the VA to provide the JV contractor a design that could be built for \$582 million? Applying contract interpretation principles, the Board ruled that the modification could not have been more clear; the VA had committed to provide a design that could be built for \$582 million.

Second, did the VA materially breach the contract by failing to provide a design that could be built for \$582 million? The Board ruled that the VA's failure to provide a design that could be constructed for \$582 million was a material breach of contract that went to the essence of the VA's contract with the JV contractor.

In ruling the VA's breach to be material, the Board looked to the implied duty of good faith and fair dealing between the parties to a contract. The Board wrote:

“we find that the behavior of the VA has not comported with standards of good faith and fair dealing required by law. The agency failed to provide a design that could be constructed within the ECCA because it did not control its designer, the JVT. It paid no heed to VE suggestions for cost reductions which were made by KT and Jacobs (or even those which were accepted by the agency's own medical center personnel following the “blue ocean” meeting). The agency delayed progress of construction, such as by delaying the processing of design changes and change orders, as described under factor (a) above. The agency disregarded cost estimates by KT and Jacobs, even to the point of rejecting a Jacobs estimate because it was developed under restrictions which the agency itself had imposed. The agency adopted as an independent government estimate a document which was neither independent (it was developed by a subcontractor to the JVT, an entity which had a strong interest in the result), nor by the Government (it was by the JVT), nor an estimate (it was by admission of the chief estimator an academic exercise), and the number was so far below any previous estimate as to be of dubious accuracy. The agency did this notwithstanding the testimony of every witness who addressed the matter, including several VA witnesses, that an “independent” estimate should not be made by a party with a vested interest in the outcome. The agency ultimately directed KT to continue its construction work for the FTP, even though the agency refused to fund that work appropriately.

We do not know what the cost of construction of this project ultimately will be. It could be nearly \$769 million (as estimated by KT in December 2013), nearly \$785 million (as estimated by Jacobs in January 2013), more than \$897 million (KT's firm fixed price proposal in March 2013), or \$1.085 billion (KT's estimate in June 2013). It could even be only \$630 million (the JVT/RLB estimate in February 2014), although that appears unlikely because this number is so much lower than all the others presented. Whether it is any of these figures, however, it will be significantly in excess of the ECCA of \$582,840,000. We find that beyond doubt, the VA's breach of its contract with KT was material.

Third, upon finding the VA's breach of contract to be a material breach, the Board ruled that the JV contractor had the right to discontinue performance of the contract. The Board rejected in short order the VA's argument that the JV contractor's continued performance vitiated the VA's material breach. The Board found that the JV contractor proceeded with performance to avoid a charge of default while vigorously protesting the directive to proceed and meet the modification's project price. This was sufficient for the Board to reject the VA's “continued performance” argument.

The Takeaway

There are several significant points in the Board's decision for federal construction contractors, including:

- A contractor need not prove the higher standard of bad faith by the government to prove a violation of the duty of good faith and fair dealing;
- The duty of good faith and fair dealing applies to the government as well as to the contractors

contracting with the government. The principle is implied in a contract and imposed on each contract party;

- The duty of good faith and fair dealing requires each party to the contract not only to avoid actions that unreasonably cause delay or hindrance to contract performance, but also to do whatever is necessary to enable the other party to perform; and,
- Though the duty of good faith and fair dealing is an implied contract obligation, the failure to comply is no less a breach of contract than the failure to fulfill a duty imposed by an express promise stated in the agreement.

As a final takeaway, while the contract at issue in *Kiewit-Turner* was a federal government contract, the reasoning of the federal Board of Contract Appeals could be persuasive to courts hearing state and local government contract disputes.

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