Published by *Government Contracts Law360* on December 5, 2013. Also ran in *Real Estate Law360*.

Federal Contracts Alter Usual Rules For Commercial Leases

--By Ronald A. Schechter, Amy B. Rifkind and Stuart W. Turner, Arnold & Porter LLP

Law360, New York (December 05, 2013, 1:13 PM ET) -- A recent Civilian Board of Contract Appeals decision provides a reminder of the differences between government and commercial contracts, and that a contractor that does not appreciate these differences acts at its peril. In Kap-Sum Properties, LLC v. General Services Administration, CBCA 2544 (Oct. 31, 2013), the CBCA denied a contractor's claim for damages resulting from the contractor's terminating performance on a real estate lease where the government experienced a significant delay in providing needed drawings to the contractor. Arising in the context of a government lease, this decision highlights the profound effect that unique federal changes and disputes clauses have on a contractor's options in the face of government delays and alterations to the contract.

In early 2010, Kap-Sum Properties won a contract to lease a commercial building in Evanston, Ill., to the U.S. General Services Administration. The lease agreement required that the government provide Kap-Sum with design-intent drawings outlining necessary alterations to the building within 120 working days after lease award in order for Kap-Sum to have the space ready by the estimated occupancy date of Nov. 1, 2010.

Despite continual assurances from the GSA that Kap-Sum would receive the drawings within a short time, Kap-Sum did not receive any drawings until May 2011, nine months late. During this time, a dispute arose between the GSA and Kap-Sum regarding local bus service. Service had previously existed, but was terminated by the local transit authority prior to offer and award. After award, the GSA discovered that service was stopped, and was working with the transit authority to reinstate it, but would not assure Kap-Sum that the GSA would proceed with the lease even if no bus service was available. In June 2011, Kap-Sum declined to provide construction documents in response to the drawings and notified the GSA that Kap-Sum did not intend to proceed with the lease until it received assurances on the bus-stop issue.

It is not clear from the case why Kap-Sum terminated the lease. Although the GSA's delay in providing drawings postponed lease commencement by about a year, the lease provided that the term would run from occupancy and, therefore, Kap-Sum would ultimately receive the full rental stream for which it had contracted. Further, Kap-Sum terminated the lease after it had received the drawings from the GSA, so by the time it terminated it had more control over the timing of completion of the space.

And, Kap-Sum did not have another tenant lined up for the space so terminating did not help bring rental dollars in any sooner than had they continued with the GSA. It may be that Kap-Sum had some issues obtaining the needed debt or equity to do the improvements that the GSA required and once the drawings had been submitted worried that GSA would hold Kap-Sum to a schedule with which, ironically, it may not have been able to comply.

In July 2011, Kap-Sum submitted a claim for almost $1.8 million in lost revenue under the lease and in costs associated with finding a new tenant. After the contracting officer denied the claim, Kap-Sum appealed to the CBCA, asserting that the GSA materially breached its lease with Kap-Sum by failing to deliver the required design-intent drawings within the 120-day period and failing to assure Kap-Sum that

the GSA would proceed even if the transit authority refused to reinstate bus service. The board found that the GSA did not materially breach the lease despite a "significant" nine-month delay in delivering the drawings, and that Kap-Sum could not rely on the GSA's lack of assurance on the bus issue to justify anticipatory repudiation.

In addressing Kap-Sum's arguments, the board weighed various factors to determine if the delay in providing drawings was a material breach. While the board found that the resulting change in the occupancy date might entitle Kap-Sum to certain delay damages, the delay itself was not a material breach when "considered in light of the length and terms of the contract."[1]

In particular, the board stated that the changes clause gave the contracting officer the right to make changes unilaterally within the scope of the contract and that the lease gave the contracting officer the right to revise the occupancy date.[2] The board found that Kap-Sum had the right to compensation for additional costs incurred by the delay, but that under the terms of the contract, no anticipatory breach by the GSA had occurred, and Kap-Sum could not choose to terminate its lease with the GSA. Therefore, the breach damages Kap-Sum claimed — costs for efforts to relet the space and lost rental income — were not available. Because Kap-Sum did not claim any damages resulting from the delay itself, the board denied any monetary relief to Kap-Sum.

The decision illustrates the high bar contractors need to surmount before a board will find a federal agency materially breached its contract. Given the changes clause, boards may find governmental delays that may be sufficient grounds for anticipatory breach in the commercial space to be within the scope of the contract. Further, the disputes clause restricts a contractor's options in light of such delays, leaving the contractor effectively with no choice other than to perform and seek damages later.[3]

Here, the board found that Kap-Sum did not overcome the high bar to prove material breach. In the board's view, Kap-Sum denied itself the profits of the lease by failing to perform and denied itself compensation for the government's delay by not claiming those damages. Moreover, the GSA had continued to direct performance and acknowledge ongoing issues, and Kap-Sum had alleged no interference or evasion. The CBCA found that "[t]he completion and occupancy urged by the agency reflect the antithesis of repudiation. The lack of response to the lessor's specific questions did not interfere with or alter the lessor's ability or obligation to perform."[4]

Contractors should remember that both the changes and disputes clauses present in federal contracts drastically alter the rules customary for commercial leases. When confronted with what the contractor views as a change from the agreed-upon terms, or delay, the contractor should continue to perform as the contracting officer directs, so long as those directions are unequivocal, including any changes. Contractors may then later seek compensation for those changes and delays, though they must be careful not to execute any waiver of such claims.

While performing these changes, contractors should preserve their rights by (1) ensuring the changes are at the direction of the contracting officer, (2) fulfilling any requirements to notify the contracting officer that the contractor feels the work constitutes a change, and (3) safeguarding against giving any waiver of rights or claims to the government. Additionally, contractors must accurately account for the additional costs incurred by delays in the government's performance if the contractor wishes to seek reimbursement for those costs.

[1] Kap-Sum Properties LLC v. General Services Administration, CBCA 2544 at *15 (Oct. 31, 2013).
[2] The lease contained GSAR 552.270-14, a specific GSA lease clause, but the unilateral change rights granted are substantially identical to those in the broadly applicable change clauses at FAR 52.243, et seq.
[3] The lease contained the standard FAR disputes clause at FAR 52-233-1.
[4] Kap-Sum, supra, at *17.

Ronald Schechter and Amy Rifkind are partners and Stuart Turner is counsel in Arnold & Porter's Washington, D.C., office. Brandon Bodnar also contributed to this article.