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Metcalf revives the federal government's implied duty of good faith and fair dealing, which benefits not only government contractors, but likely also the federal government itself for less obvious reasons.

By **ERIC A. FRECHTEL**

The leading court in U.S. federal government contract jurisprudence has spoken: The government will be held accountable for unreasonable contract administration. To be sure, *Metcalf Construction Company, Inc. v. United States* resuscitates the government’s duty of good faith and fair dealing, which many feared dead and buried as a result of earlier decisions.¹

The U.S. Court of Appeals for the Federal Circuit (CAFC) made clear that unreasonable contract administration exposes the government to liability for breach of contract. *Metcalf* also clarifies that the government is responsible for a contractor’s additional costs incurred when site conditions differ from those indicated in the contract documents. For years to come, contractors will cite the *Metcalf* decision to bolster their position in disputes with project owners—public and private alike.

Contract Maladministration Leads to Crippling Cost Overrun

In October 2002, Metcalf Construction, a small business based in Hawaii, was awarded a \$48 million contract to design and build 212 housing units for the U.S. Navy on a Marine Corps base in Hawaii. The project went badly for its entire duration. Metcalf’s performance was impacted by unanticipated soil conditions and other issues that were exacerbated by the Navy’s failure to administer the contract fairly and according to its terms. By the time the Navy finally accepted the project as complete in March 2007, almost two full years after the original scheduled completion date, Metcalf had spent more than \$76 million. The Navy paid Metcalf only \$49 million.

After submitting a certified claim and exhausting administrative remedies, Metcalf filed a lawsuit in the U.S. Court of Federal Claims (CFC) to recover the bulk of its \$27 million cost overrun. In support of its position that the Navy was responsible for the additional costs, Metcalf presented evidence at trial of numerous examples of unreasonable decisions made by the Navy personnel administering the contract. Metcalf argued that such conduct amounted to breach of the duty of good faith and fair dealing—an implied duty written into all government contracts.

The CFC Concludes Metcalf Failed to Prove Breach

Ultimately, the CFC issued a decision in which it made various findings in Metcalf’s favor, including the following:

- The Navy failed to promptly investigate Metcalf’s contention that the “expansiveness” of the project soils constituted a “differing site condition,” entitling Metcalf to a 260-day time extension²;
- The Navy employed “hard-nosed” tactics by forcing Metcalf to withdraw and compromise claims and fire personnel in order to trigger the Navy’s release of earned progress payments and retainage³;
- The project was “plagued” by the Navy’s contracting officer’s “lack of knowledge and experience”⁴; and
- A “difficult and overzealous” Navy inspector performed his duties in a “retaliatory” manner.⁵

Yet despite these findings, the CFC denied Metcalf relief and actually awarded damages of \$2.4 million to the government for project delay.

Relying on the *Precision Pine* decision⁶ issued by the CAFC in 2010, the CFC said that Metcalf was required to show that the Navy “specifically designed to reappropriate the benefits” Metcalf expected from the contract and “specifically targeted” action to obtain the “benefit of the contract” or “for

the purpose of delaying or hampering” contract performance.⁷ The CFC concluded that Metcalf had failed to meet that standard.

The Federal Circuit Reverses the CFC’s Decision

Metcalf appealed the CFC’s decision to the CAFC. Principally, Metcalf argued that the “specifically designed/specifically targeted” standard applies only in a unique factual context in which acts of a separate government agency or authority, like new legislation or a court order in a separate case, impact the contract at issue. Metcalf insisted that in the more ordinary context presented in its case, in which the conduct of the government officials administering the contract forms the basis of the breach, courts are required to apply a “reasonableness” standard to the conduct in assessing the breach claim. Metcalf also argued that the CFC misinterpreted certain provisions of Metcalf’s contract.

The CAFC agreed with Metcalf, vacating both the CFC’s decision that Metcalf failed to establish liability and the CFC’s damage award in favor of the government, and directing the CFC to conduct further proceedings “using the correct standard.”⁸

Implied in Every Government Contract is a Mutual Duty of Good Faith and Fair Dealing

As an initial matter, the CAFC reaffirmed that every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement, and that failure to fulfill that duty constitutes a breach of contract. The court explained that the implied duty exists “because it is rarely possible to anticipate in contract language every possible action or omission by a party that undermines the bargain....”⁹ That said, the duty depends in large part on what the contract says, for “an act will not be found to violate the duty...if such a finding would be at odds with the terms of the original bargain, whether by altering the contract’s discernible allocation of risks and benefits or by conflicting with a contract provision.”¹⁰



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The Standard Adhered to in *Precision Pine* Applies Only in a Specific Context

Next, the court determined that the CFC “misread *Precision Pine*, which does not impose a specific-targeting requirement applicable across the board or in this case.”¹¹ The court distinguished *Precision Pine* in two ways. First, the contract in that case expressly permitted the conduct that formed the basis of the breach claim. The contractor contended that the agency’s suspension of its timber harvesting operations under the contract constituted breach of the implied duty of good faith and fair dealing. However, the suspension was based on an injunction issued by a court in another case, and the contract expressly permitted the government to suspend operations in order to “comply with a court order.”¹² Second, the conduct at issue in *Precision Pine* involved the contracting agency’s enforcement of, and compliance with, the injunction. The court explained that the “specific targeting” standard “protects against use of the implied contract duty to trench on the authority of

other government entities or on responsibilities imposed on the contracting agency independent of contracts.” The *Metcalf* case, however, “involves no such concern.”¹³

In short, the court concluded that the CFC’s decision was based on an “improperly”¹⁴ and “unduly narrow view of the duty of good faith and fair dealing.”¹⁵ *Metcalf*’s breach claim is governed, instead, by “the familiar broader standards [of ‘reasonableness’]”¹⁶ announced in other decisions.

Breach of the Duty Does Not Require a Violation of a Contract Term

The CAFC also considered the government’s argument, based on language in *Precision Pine*, that the implied duty of good faith and fair dealing “cannot expand a party’s contractual duties beyond those in the express contract or create duties inconsistent with the contract’s provisions.”¹⁷ The government maintained that *Metcalf* was required to identify provisions in the contract that the Navy violated.

The court rejected the government’s position. First, the quoted language from *Precision Pine* means only that the implied duty “depends on the parties’ bargain in the particular contract at issue.”¹⁸ In other words, as previously stated, the government will not be found to have breached the duty of good faith and fair dealing if the contract permits the conduct at issue or contains an allocation of risk in the event of such conduct. Second, the court announced an important (if obvious) concept: “[A] breach of the implied duty of good faith and fair dealing does not require a violation of an express provision in the contract.”¹⁹

The CFC Misinterpreted Contract Provisions

Finally, the CAFC reviewed *Metcalf*’s position that the CFC had misinterpreted certain provisions of the contract. The court explained that this inquiry was important because “any breach of [the implied duty of good faith and fair dealing] has to be connected, though it is not limited, to the bargain

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The U.S. Court of Appeals for the Federal Circuit (CAFC) made clear that

unreasonable contract administration exposes the government to liability for breach of contract.

struck in the contract”²⁰ and “[p]roper application of the implied-duty standard thus depends on a correct understanding of the contract.”²¹

Again, the CAFC agreed with Metcalf. Most notably, the court rejected the CFC’s determination that Metcalf assumed the risk and costs of differing site conditions because of contractual obligations to investigate the site during performance. Regarding the standard “Differing Site Conditions” clause incorporated into federal construction contracts, the court explained:

It exists precisely in order to “take at least some of the gamble on subsurface conditions out of bidding”: instead of requiring high prices that must insure against the risks inherent in unavoidably limited pre-bid knowledge, the provision allows the parties to deal with actual subsurface conditions once, when work begins, “more accurate” information about them can reasonably be uncovered.²²

The court held that the “natural meaning” of the Navy’s pre-bid representations concerning soil conditions “was that, while Metcalf would investigate conditions once the work began, it did not bear the risk of significant errors in the pre-contract assertions by the government about the subsurface site conditions.”²³

Metcalf Offers Authority Useful to Contractors on All Projects

Metcalf revives the federal government’s implied duty of good faith and fair dealing, which some feared had been read its last rites by *Precision Pine*. The CAFC clarified that the narrow (and apparently higher) standard adhered to in *Precision Pine* applies only when a contractor’s breach claim is based on the contracting agency’s effort to comply with the acts of another government authority. In the more ordinary and common breach case, the “reasonableness” standard governs the inquiry into whether the conduct at issue constitutes breach of the implied duty.

By clarifying the law in this area, the CAFC provided assurance to contractors that the government will be held accountable for unreasonable contract administration. The decision should also have a ripple effect beneficial to the government. Government accountability should bring back into the pool of government contractors those able firms formerly unwilling to perform government work deemed as being too risky.

Also, the decision should help control the government’s procurement costs because formerly vulnerable contractors looking to win contracts will be less inclined to inflate their bids with large contingencies meant to protect themselves against unreasonable contract administration. Consequently, the entire government contracting field should ultimately benefit from *Metcalf*.

Metcalf also reaffirms that the standard “Differing Site Conditions” clause allocates the risk of additional costs to the government and makes clear that pre-bid representations about subsurface conditions are not nullified by a contractor’s obligation to conduct a site investigation or by broad liability disclaimers—concepts equally applicable to contract disputes with public and private owners alike. **CM**

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Send comments about this article to cm@ncmahq.org.

ENDNOTES

1. See *Metcalf Constr. Co. v. United States*, 742 F.3d 984 (2014).
2. See *Metcalf Constr. Co. v. United States*, 102 Fed. Cl. 334, 354 (2011); and *Metcalf Constr. Co. v. United States*, 107 Fed. Cl. 786, 788 n.4 (2012).
3. See *Metcalf, ibid.*, at 365.
4. *Ibid.*, at 364.
5. *Ibid.*, at 361.
6. See *Precision Pine & Timber, Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010).
7. See *Metcalf*, note 2, at 346.
8. See *Metcalf*, note 1, at 987.
9. *Ibid.*, at 991.
10. *Ibid.*

11. *Ibid.*, at 993.
12. *Ibid.*, at 992.
13. *Ibid.*, at 993.
14. *Ibid.*, at 994.
15. *Ibid.*, at 993.
16. *Ibid.*, at 994.
17. *Ibid.*, at 993–994.
18. *Ibid.*, at 994.
19. *Ibid.*
20. *Ibid.*
21. *Ibid.*, at 995.
22. *Ibid.*, at 996.
23. *Ibid.*

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