The Implied Duty of Good Faith and Fair Dealing Lives!

One of the heralded benefits to an owner using the design-build project delivery system is the single point of responsibility. Consistent with the scope of work, the owner is able to shed itself of implied warranty liability for the accuracy of the plans and specifications for the project. However, if the owner wants a reasonable price for the project, there are limits to risk shifting. Even if the owner is able to shift significant risks to the design-build contractor, it must provide accurate information and it has the duty to act in good faith and fair dealing with the design-build contractor if the information it supplied is inaccurate.

The case of Metcalf Construction Co., Inc. v. United States, ___ F.3d ___, 2014 WL 519595 (Fed.Cir. 2014) illustrates the allocation of risks when the government provides information in an RFP for a design-build project regarding site conditions and the government’s duty to act in good faith when that information is inaccurate.

The Differing Site Conditions Claims

In Metcalf, the design-build contractor entered into a contract with the Navy for the design and construction of 212 new duplex housing units. The original contract price was $48,370,000 and the contract time was 835 days. By the time the Navy accepted the project, Metcalf had incurred costs in excess of $76,000,000 and the overall performance period encompassed 1,520 days. Metcalf sought an equitable adjustment for the differing site conditions relating to expansive soil conditions and remediation of high concentrations of Chlordane, which was found in the soil. Metcalf sued the Navy alleging that the Navy breached the contract by violating the implied duty of good faith and fair dealing for failing to pay Metcalf amounts incurred to address the differing site conditions.

Metcalf’s first claim concerned the soil. The Navy’s soil investigation report provided in the RFP incorrectly stated that the soil indicated a slight expansion potential. The RFP also stated that the information in the soil report was for “preliminary information only.” The RFP also required the design-build contractor to perform post-award site work including further independent soil investigation.

After performing its own soil investigation, Metcalf found the soil had moderate to high expansiveness. Metcalf submitted a claim for a differing site condition. The discussions between the Navy and Metcalf regarding the site conditions extended for nearly one year, which caused the construction to be delayed. Lacking a response from the Navy, Metcalf informed the Navy that it intended to move ahead with the foundation work in accordance with Metcalf’s approved design which required compacting the expansive soil to a rate of 90 percent. As reported in the Court of Federal Claim’s decision, the Navy, however, demanded that Metcalf follow the 95 percent compaction rate for non-expansive soil as listed in the specifications. Metcalf requested that the Navy issue a variance in response to its soil condition report but the Navy denied that request. Metcalf then warned the Navy that the 95 percent compaction rate would lead to defective work. See Metcalf Const. Co. v. United States, 102 Fed. Cl. 334, 351 (Fed. Cl. 2011). Metcalf proceeded on its own initiative without the Navy resolving the modification. Eventually,
the Navy denied the existence of a differing site condition. Metcalf claimed the expansive soil problems cost more than $4.8 million to remedy.

The second issue involved the remediation of Chlordane. The RFP informed bidders that Chlordane was present in the soil, but that no remediation was needed. The Navy directed Metcalf to perform tests for Chlordane on the soil stockpiles that resulted from the excavation of the expansive soil. Metcalf's test revealed unacceptable levels of Chlordane that required remediation. Although the Navy internally recognized that the presence of Chlordane was a potential problem, the Navy informed Metcalf that the discovery of the Chlordane was not a justification for a changed condition. Then the Navy commissioned the Navy Environmental Health Center (NECH) to conduct a risk assessment. After the NECH issued its report, the Navy changed the standard for measuring whether Chlordane contaminated soil required remediation. The Navy then issued a unilateral modification directing Metcalf to perform any required remediation.

The Court of Federal Claims denied Metcalf recovery on its site condition claim finding that Metcalf, as the design-builder, was contractually required to conduct an independent soil analysis and that Metcalf was on notice that the government's report was for information only. Also the court found that Metcalf knew about the expansiveness of the soil conditions in Hawaii because it was an established contractor in Hawaii with knowledge of the typical expansive soil conditions. With regard to the Chlordane remediation the court found that although the RFP stated that remediation was not necessary, the report advised the contractor to make an independent assessment. The court found Metcalf was on notice to seek more information.

**Federal Circuit Revises Ruling**

On appeal the United States Court of Appeals for the Federal Circuit determined whether the Court of Federal Claims ("COFC") applied the correct standard in determining whether the Navy breached the implied duty of good faith and fair dealing. It is basic contract law that every contract imposes on each party a duty of good faith and fair dealing in the performance and enforcement of the contract. Failure to fulfill that duty constitutes a breach of contract.

The Federal Circuit ruled that the COFC applied a very narrow view of the duty of good faith and fair dealing. The COFC heavily relied on Precision Pine & Timber, Inc. v. United States, 596 F.3d 817, 828 (Fed. Cir. 2010). In Precision Pine, the government was allowed to suspend a contractor's timberharvesting operations in order to comply with a court injunction prohibiting logging. The contractor accused the government of not acting in good faith because it unreasonably delayed carrying out the court order before harvesting might resume. The court found no breach because the challenged delays were not specifically targeted at the contracts and did not reappropriate any benefit guaranteed by the contracts.
In *Metcalf* the COFC erroneously held that *Precision Pine* stood for the proposition that a breach of the duty of good faith and fair dealing against the government can only be found by showing that the government specifically targeted the contracts and re-appropriated the benefits that the other party expected to obtain from the transaction.

The Federal Circuit disagreed and held that *Precision Pine* does not impose a specific-targeting requirement for finding a breach of the implied duty of good faith and fair dealing. The court stated that whether the Navy breached the duty of good faith and fair dealing as to the expansive soil and Chlordane problems has to be reconsidered under the broader standard articulated in other cases such as *Malone v. United States*, 849 F.2d 1441 (Fed. Cir. 1988) and *Centex Corp v. United States*, 395 F.3d 1283 (Fed. Cir. 2005). In addition, the Federal Circuit limited the reach of the post-award site investigation duty by concluding that such a duty did not place on Metcalf the risk that newly discovered conditions might differ from those described in the RFP.

**Design-Builders Breathe Easier**

The COFC decision was wrong. When the COFC issued its opinion the contracting world cried foul. Many believed that if the COFC decision was not reversed the basic concept of risk allocation in federal government contracting would be destroyed as the high standard applied by the COFC would have resulted in shifting all the risk to the contractor (whether performing under a design-build or design bid-build contract) even if the owner supplied the information.