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Differing site conditions claims take center stage in Federal Court

Federal Circuit Court reverses design build decision *Metcalf v. U.S.*, overriding the allowance of broad disclaimer language in government contracts, protecting contractors in differing site conditions claims.

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Disparate assessments of construction sites by the government and contractors have resulted in a long line of liabilities for contractors. Perpetuating the problem, has been the use of broad disclaimer language in government contracts—insulating the government from compensating contractors for unplanned labor affiliated with projects, and from being held accountable for providing incomplete or inaccurate information about sites.

A decision by the Federal Circuit Court in February, however, has seemingly leveled the playing field. It overturned a Claims Court decision that previously permitted the government—and in this case, the U.S. Navy—to shift the risks of unexpected site conditions to contractors, as well as take liberties

with “good faith and fair dealings” standards established by the courts.

In fact, *Metcalf Construction Co. v. United States* is being touted as one of the most important decisions to affect federal construction contractors

in 10 years. It restricts the government from barring differing site conditions claims with broad disclaimer language, and it maintains that the government is bound by a broad duty of good faith and fair dealing.

The importance of this decision cannot be overemphasized. It corrects several problems that have developed in government contracts in recent years. Also, it comes at a critical time, as the government seems to have adopted increasingly unfortunate and aggressive strategies to avoid paying reasonable contractor claims.

When differences arise

The *Metcalf* case is one such instance of a contractor being on the hook for costly site condition claims because of a one-sided contract. *Metcalf* was a design-build contractor who was awarded a contract to design and build housing units at a Marine base in Hawaii.

During the contract bid process, the Navy provided a soil report for the construction site, addressing its potential for soil swells, which can lead to cracks in concrete foundations and other damage. The report indicated the soil’s swelling potential was only slight. At the same time, the Navy indicated the report was intended “for preliminary information only.”

The design build contract actually required the contractor to conduct its own independent soil investigation, referring to FAR 52.236-2, which addresses site conditions that differ from those disclosed in a contract.

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As required, Metcalf enlisted a geotechnical firm to further investigate the soil. That firm determined the soil's swelling potential was far greater than had been indicated in the government-commissioned report, and it recommended a different design and construction to accommodate this soil condition.

Metcalf promptly notified the Navy of the differing condition and the alternative design that would be necessary. However, the Navy insisted Metcalf follow the construction requirements set out

in the original contract, despite Metcalf's evidence that this would be inappropriate considering the actual soil conditions.

The Navy's refusal to act upon the new soil information delayed the project for almost one year, until Metcalf decided the cost of waiting for the suggested design changes to be approved had become too high.

Despite the risk of going forward without a contract modification, Metcalf proceeded with the project—modifying the design by over-excavating the soil and replacing it with non-expansive fill, as suggested by the geotechnical firm.

Months later, the Navy realized the modifications were in fact necessary, yet it "denied that there was any material difference between the pre-bid and post-award soil assessments and thus concluded that no additional compensation was warranted," per the trial brief. However, Metcalf's claim for the expansive-soil problems was over \$4.8 million.

From construction site to courtroom

Metcalf estimated the final cost of construction to be roughly \$76 million, but the Navy only paid \$50 million, spurring Metcalf into action. Metcalf filed a claim with the Navy's contracting officer, and he issued an adverse decision. Metcalf then filed suit in the Court of Federal Claims.

The Navy countersued for liquidated damages.

The claims court found Metcalf was not entitled to damages for the differing site condition; however, they found that the Navy violated the contract by failing to investigate the expansiveness of the soil in a timely manner.

The claims court also held that the Navy failed to issue a proper notice to proceed until months later than contractually required. This delay was deemed by the trial court to be a contract breach that rendered Metcalf unable to work for a period of time, but did not excuse Metcalf for all delays.

The court awarded Metcalf about \$300,000 on the notice-to-proceed breach, and awarded the Navy about \$2.6 million in liquidated damages because Metcalf failed to complete the project by the agreed-upon completion date.

In reaching that decision, the trial court rejected Metcalf's argument that the two delay-causing breaches by the government nullified any liquidated damages based on late delivery. It also rejected Metcalf's argument that the government breached its duty to act toward the contractor with good faith and fair dealing.

"Good" and "fair"

In its appellate decision vacating and remanding the trial court decision, the Federal Circuit addressed the trial court's application of good faith and fair dealing standards for the government.

Regarding the "duty of good faith and fair dealing" claim, the Federal Circuit explicitly rejected the trial court's holdings that such a "claim against the government can only be established by a showing that it 'specifically designed to reappropriate the benefits [that] the other party expected to obtain from the transaction, thereby abrogating the government's obligations under the contract.'"

It also rejected the trial court's finding that "incompetence and/or the failure to cooperate or accommodate a contractor's request do not trigger the duty of good faith and fair dealing, unless the government 'specifically targeted' action to obtain the 'benefit of the contract' or where government actions were 'undertaken for the purpose of delaying or hampering performance of the contract.'"

The trial court had come to those conclusions based upon its interpretation of *Precision Pine & Timber Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010). However, the Federal Circuit concluded, "The trial court misread *Precision Pine*, which does not impose a specific-targeting requirement applicable across the board or in this case." The court went on to say, "neither *Precision Pine* nor other authority supports the trial court's holding that specific targeting is required generally or in the present context ..."

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The government argued that the almost impossibly high legal standard established by the claims court was correct because the precedent relied upon by Precision Pine held the duty "cannot expand a party's contractual duties beyond those in the express contract or create duties inconsistent with the contract's provisions." In rejecting that argument, the Federal Circuit stated:

"As we have already explained, all that the quoted language means is that the implied duty of good faith and fair dealing depends on the parties' bargain in the particular contract at issue... The government suggests a more constraining view when it argues, for example, that there was no breach of the implied duty because, 'Metcalf cannot identify a contract provision that the Navy's inspection process violated...' That goes too far: a breach of the implied duty of good faith and fair dealing does not require a violation of an express provision in the contract."

Difference in conditions

Along with the "duty of good faith and fair dealing" claim, the Federal Circuit also addressed the trial court's interpretation of the case's contract provisions pertaining to differing site conditions and conducting site inspections.

The trial court interpreted the pre-bid site representations and related RFP provisions to be nullified by Metcalf's investigative responsibilities during performance, concluding, "the Contract required Metcalf to conduct an independent soil analysis [and so] Metcalf was on notice that it could not rely on the 'information only' report."

The trial court said Metcalf was entitled to rely on the government soils report only "for bidding purposes," but not in performing the project. Similarly, with respect to the chlordane contaminant, the

trial court found that because Metcalf could assess the soil after its contract award, it could not rely on the representations that remediation was not required since Metcalf "was on notice to seek more information."

In rejecting the trial court reasoning, the Federal Circuit stated:

"The Court thus treated the contract as placing on Metcalf the risk and costs of dealing with newly discovered conditions different from those stated

by the government before the contract became binding... These rulings about an important allocation of risk were based on a misinterpretation of the contract. Nothing in the contract's general requirements that Metcalf check the site as part of designing and building the housing units, after the contract was entered into, expressly or impliedly warned Metcalf that it could not rely on, and that instead it bore the risk of error in, the government's affirmative representations about the soil conditions.

To the contrary, the government made those representations in the RFP and in pre-bid questions-and-answers for bidders' use in estimating costs and therefore in submitting bids that, if accepted would create a binding contract. The natural meaning for the representations 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."

The Federal Circuit went on to explain that the Differing Site Conditions clause of the contract exists precisely to take some of the gamble on subsurface conditions out of bidding instead of requiring the contractors to submit high prices to insure against the risk. The court explains:

"For that reason, even requirements for pre-bid inspection by the contractor have been interpreted cautiously regarding conditions that are hard to identify accurately before work begins, so that 'the duty to make an inspection of the site does not negate the changed conditions clause by putting the contractor at peril to discover hidden subsurface conditions or those beyond the limits of an inspection appropriate to the time available.'" (citing *Foster v. U.S.* and *Hollerbach v. U.S.*)

And finally, of great importance for future federal contractors asserting differing site conditions claims, the Federal Circuit reiterates the government cannot avoid contractor reliance on data and reports provided by the government merely by including broad disclaimers of liability for differing site conditions in the contract. The court stated:

"The conclusion is not changed by the statement in a revised RFP that the expansive-soil report was 'for preliminary information only...' That statement merely signals that the information might change (it is 'preliminary'). It does not say that Metcalf bears the risk if the preliminary information turns out to be inaccurate. We do not think that the language can fairly be taken to shift that risk to Metcalf, especially when read together with the other government pronouncements, much less when read against

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the longstanding background presumption against finding broad disclaimers of liability for changed conditions.” United Contractors v. United States, 368 F.2d, 585, 598 (Ct.Cl. 1966).”

Narrow language, broader appeal in design-build community

For these reasons, the court vacated and remanded the case for further review and decision by the claims court. The government’s misinterpretation of the law pertaining to its duty of good faith and

fair dealing has been most unfortunate, and it seems the court seized on the opportunity of this case to right what had become a serious wrong.

In the context of design-build contracts, the government has been adding insult to injury by insisting that a design-builder, by virtue of having to do further site investigation and final design after contract award, is assuming all the

risk of the site and cannot rely upon initial subsurface information and reports provided by the government. This decision lays that false argument to rest.

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