

WHEN DOES THE GOVERNMENT BREACH THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING?

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The Implied Covenant of Good Faith and Fair Dealing says that “every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.” Restatement (Second) of Contracts §205 (1981). The implied covenant prohibits subterfuges and evasions or interference with or failure to cooperate in the other party’s performance. The implied covenant is not the same as alleging that the government acted in “bad faith.” However, the implied covenant is “limited by the original bargain, preventing a party’s acts or omissions that, though not proscribed the contract expressly, that are inconsistent with the contract’s purpose and deprive the other party of the contemplated value.” *State of OH v. United States*, No. 20-288C (Fed. Cl. Oct. 7, 2022), quoting *Precision Pine & Timber, Inc. v. United States*, 596 F. 3d 817 (Fed. Cir. 210).

State of Ohio, and Ace Electronics Defense Sys., ASBCA No. 63224 (Oct. 5, 2022) are good examples of cases where breach of the implied covenant was considered and allowed (in *State of OH*) but not allowed in *Ace* based on specific promises in the contracts.

State of Ohio concerned a contract for dam construction between the State of Ohio and the U.S. Army Corps of Engineers (“Corps”). The contract stated that Ohio “shall pay 12.7 percent of the annual experienced joint-use operation and maintenance cost of the project” but did not define “joint use” or “operation and maintenance” (“O&M”). Ohio subcontracted with the City of Wilmington OH, and in that contract, Wilmington was to reimburse Ohio for all O&M costs under the State’s contract. When the Corps conducted an audit in response to Wilmington’s concerns about rising costs, the government billed the city an additional \$187,000. Ohio paid the requested amount under protest, but initiated this litigation.

In *State of Ohio*, the Court found problems with several of the Corps’ actions, but focusing only on Operation and Maintenance issue, the court held that the Government had breached the covenant in these respects:

- 1) The United States failed to sufficiently maintain cost records (the contract required the U.S. to make cost records available, and the records had to be clear and meaningful.) The United States failed to make records usable (even a park manager testified that purchasing records were “clear as mud.”)
- 2) The U.S. maintained arbitrary billing practices in its categorization of expenses. These were made without clear guidance being given to Corps employees who did the categorization.

Ace Electronics was primarily a fixed price contract for assemblies for cruise missiles. *Ace*’s claim and complaint was that it encountered higher prices from certain components that it purchased because of the COVID pandemic. However, *Ace* never identified any clause of the contract that would shift the risk of such costs to the government. *Ace*’s attempt to ground its complaint on Federal Acquisition Regulation (“FAR”) 16.203, 43.205 and 53.243-1 was insufficient because:

- 1) FAR 16.203 deals with fixed price contracts with economic price adjustments, but there was no price adjustment clause in this contract—it was firm fixed price.
- 2) FAR 43.205 provides instructions for inclusion of the Changes clause in contracts, and there was a changes clause in the contract (FAR 52.243-1)
- 3) The contract included FAR 52.243-1 Changes, Fixed Price, but Ace failed to include any allegation that written changes had been made by the government that caused Ace's alleged cost increases.
- 4) There was no showing that the government had demanded a constructive change—there was no work ordered beyond the contract requirements, and no one from the government had ordered any such work.

In *Ace*, (as in *State of OH*), the Board noted that a specific promise must be undermined for the implied duty to be violated, and that did not happen. There were no allegations that the government's refusal to relieve Ace from its firm-fixed price contract provisions undermined any specific promise or destroyed Ace's reasonable expectation regarding the fruits of the contract.

Takeaway: If you want to claim a violation of the covenant, be sure you can cite specific parts of a contract, and how the government's actions or failure of actions concerning them caused the issue in your claim.

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