Focus ¶ 92

FEATURE COMMENT: The Most Important Government Contract Disputes Cases Of 2015

In 2015, unlike in some other years, the U.S. Court of Appeals for the Federal Circuit, the Court of Federal Claims and the boards of contract appeals rendered no decisions that will have a monumental impact on the law of Government contracts disputes. Nonetheless, there are several important decisions that address contract interpretation, the parsing of separate claims for jurisdiction, the Government's right to audit the contractor's books and records in litigation, and the parties' obligations to preserve, search for and produce responsive documents in discovery. This Feature Comment analyzes four cases issued in 2015 and provides insights on how they impact the assertion and resolution of Government contract disputes.

Reliance on Dictionary Definitions for Contract Interpretation (Reliable Contracting Grp., LLC v. Dep't of Veterans Affairs, 779 F. 3d 1329 (Fed. Cir. 2015), on remand, 15-1 BCA ¶ 36114; 57 GC ¶ 95)—In a case involving contract interpretation, the Federal Circuit relied on a dictionary definition to resolve an ambiguous term rather than giving effect to the parties' view of the contract requirements before a dispute arose.

Reliable Contracting Group agreed to design and construct a utility plant and electrical distribution system at the Department of Veterans Affairs Medical Center (VAMC) in Miami, Fla. The contract required Reliable to, among other things, furnish and install three "new" back-up emergency generators, stating as follows: "All equipment, material, and articles incorporated into the work covered by this contract shall be new and of the most suitable grade for the purposes intended."

Reliable subcontracted with Fisk Electric Co. to supply the generators, and Fisk utilized its electrical supplier, DTE Energy Technologies Inc., for that purpose. Two of the three generators were delivered to VAMC in late June 2004. After inspecting the generators, the VA's senior resident engineer (SRE) notified Reliable of his concern that the generators delivered were not "new" as required by the contract. Specifically, the SRE noted that the generators showed a lot of wear and tear, including field burns to enlarge mounting holes. The SRE asked Reliable a simple question: "Are they new and will you certify them as such?"

In correspondence, Fisk characterized the generators as in "bad condition," while Reliable said that the generators were "unacceptable by anyone's standards." Reliable advised the SRE that "representatives of Fisk have assured us that they were as surprised as anyone" at the condition of the generators, and that it had directed that the "non-conforming" generators be removed. After some investigation, Reliable and Fisk advised the SRE that the generators had been previously purchased, but never placed in service. The SRE maintained that previous ownership made them used and not new.

The generators were removed on July 1, 2004 and sent to a manufacturer-authorized service representative for analysis. Shortly thereafter, at the behest of Fisk and DTE, Reliable forwarded a proposal to the SRE that the generators be tested, evaluated and "pre-commissioned," and then returned to the site because they were (in DTE's view) "unused and warrantable." The SRE disagreed with the proposal, again citing the contract language requiring "new" equipment. As of July 2004, neither Reliable nor Fisk had made any representation to the VA that the generators were new.

Almost three years later, Reliable submitted to the VA contracting officer a certified claim in the amount of $1.1 million on behalf of Fisk for the additional costs to replace the generators. After
a deemed denial, Reliable appealed to the Civilian Board of Contract Appeals. The CBCA addressed the contract interpretation issue as follows:

To resolve the issue of contract interpretation, we must first look to the plain language of the contract. See Foley Co. v. United States, 11 F.3d 1032, 1034 (Fed. Cir. 1993). The intention of the parties is gleaned from the contract’s clauses interpreted as a whole, giving meaning to all provisions wherever possible. An interpretation which gives a reasonable meaning to all parts of an instrument will be preferred to one which leaves a portion of it useless, inexplicable, inoperative, void, insignificant, meaningless or superfluous; nor should any provision be construed as being in conflict with another unless no other reasonable interpretation is possible. Hol-Gar Mfg. Corp. v. United States, 351 F.2d 972, 979 (Ct. Cl. 1965).

We need not go beyond the four corners of this contract to decide the merits of the dispute before us. Id. at 976.

Reliable Contracting Grp., LLC v. Dep’t of Veterans Affairs, CBCA 3048, 14-1 BCA ¶ 35475. As such, the CBCA referred to the contract requirement that equipment be “new and of the most suitable grade for the purpose intended.” The CBCA noted that another contract provision required that the generators be tested at the factory, with the VA having the option to witness the tests. In denying Reliable’s claim, the CBCA held that the generators, which had been in storage for four years, could not be factory tested and did not meet the requirement of “new.” The Board also noted that Reliable and Fisk had been unwilling to certify them as “new,” which was probative of their condition.

Reliable appealed the decision to the Federal Circuit. The Federal Circuit rejected both parties’ arguments as to the proper interpretation of the contract term “new.” First, the Federal Circuit found that the contract provision requiring factory testing was not determinative because there was no requirement that the testing be done before shipment from the factory. Second, the Federal Circuit rejected Reliable’s argument that “unused” equates to “new” because dictionaries do not define “new” as simply being the opposite of “used.”

The Federal Circuit deemed the term “new” to be ambiguous because it was not defined in the contract and there is no single plain meaning of the word. As such, the Federal Circuit turned to the dictionary definition of “new,” finding that the term “new” as used in the contract requires a “fresh condition,” and that “[f]resh in this connection applies to what is new and still retaining a first liveliness, energy, virginal quality, and so on.” According to the Federal Circuit, “new” and “fresh” do not, however, mean that the generators were required to be entirely free of cosmetic defects, since there was no evidence that the contract intended to define “new” to exclude damage such as paint scratches or light and easily fixable rusting. As there was conflicting evidence about the extent of the damage to the generators at issue, the Federal Circuit reversed and remanded to the CBCA to determine whether the damage was significant enough to render the generators not “new.”

Judge Newman dissented on the ground that whatever may be the applicability of the standard articulated by the majority to other facts, “the absence of ‘freshness’ of these begrimed, four-year-old, ‘inaequivocally stored,’ previously owned generators was not plausibly disputed.” She noted that no error in fact or law had been shown in the CBCA’s determination that the generators were not new, on any reasonable standard of newness. Judge Newman concluded,

The panel majority further errs in ruling that the correct interpretation of “new” in government contracts or under the FAR includes previously owned and damaged equipment if the damage “can be fully and easily cured.” Old and damaged equipment does not become new if the damage can be cured. There was no obligation, in law or equity, for the VA to determine whether these admittedly “nonconforming” generators could be cleaned up and refurbished.

On remand, the CBCA found that there was very little evidence of the actual condition of the generators, or the extent of the refurbishing and repair needed. So the CBCA could not determine whether the damage was significant enough to render the generators not “new” under the Federal Circuit’s definition. To resolve this dilemma, the CBCA relied on extrinsic evidence of the parties’ contemporaneous view that the generators did not meet the contract requirements—language in correspondence reflecting agreement that the generators were nonconforming, and the fact that Reliable (and its subcontractor, Fisk) did not stand by the generators as “new,” nor would they certify them as such.

The CBCA noted that if an ambiguity in contract language is presented for resolution, a tribunal’s primary objective is to discern and effectuate the mutual
understanding of the parties. As evidence of contemporaneous beliefs about contractual meaning is probative, the behavior of both Reliable and Fisk during the period when the condition of the generators was being considered indicates that they did not deem the units to be “new” within the meaning of the contract. On the record before it, the CBCA could not assess whether the generators were not used, in fresh condition and free of damage other than cosmetic damage. However, as the parties did not contemporaneously hold that belief themselves, the CBCA was precluded from finding that the generators were “new,” and the appeal was, at last, denied.

Key Lessons from Reliable: If contract language is unambiguous, it is to be given its “plain and ordinary” meaning, and the court may not look to extrinsic evidence to interpret it. TEG-Paradigm Envtl., Inc. v. U.S., 465 F.3d 1329, 1338 (Fed. Cir. 2006); 48 GC ¶ 385. Even though a contract term may initially appear to be unambiguous, when read in context, it may become apparent that there is no single plain meaning that can be given effect. Where contract language is susceptible to more than one reasonable interpretation, it is ambiguous, and the court may then consider extrinsic evidence to resolve the ambiguity. Id. at 1339.

The parties’ own construction of an ambiguous written instrument is important when determining its meaning. Daewoo Eng’g & Constr. Co., Ltd. v. U.S., 557 F.3d 1332, 1337 at fn. 3 (Fed. Cir. 2009); 51 GC ¶ 84. Thus, what is meant by an ambiguous term can be resolved by interpreting it according to the parties’ understanding of the requirement as evidenced by their conduct before a dispute arose. Had the Federal Circuit followed this aid in contract interpretation, it would have found that the parties’ contemporaneous correspondence showed that the parties were in agreement in July 2004 that the generators provided by DTE were not “new.”

As Judge Newman’s dissent notes, the Federal Circuit unquestionably had before it enough evidence of the parties’ pre-dispute view that the generators were nonconforming, and could have sustained the CBCA’s decision on this basis, without resorting to dictionary definitions. And, in this case, the dictionary definition of “new” used by the Federal Circuit raised additional issues regarding the condition of the generators.

Even though the parties may take pains to define critical terms in a contract, it is impossible to predict which terms will ultimately be at issue. Invariably, disputes will arise regarding the parties’ intentions as to a contract term. Once a contract term is determined to be ambiguous, the parties’ conduct before a dispute arises may be given great weight in interpretation, or, as shown by Reliable, the court or board may rely on a dictionary definition that creates additional issues for resolution.

Necessary Elements of a Separate Claim (K-Con Bldg. Sys., Inc. v. U.S., 778 F.3d 1000 (Fed. Cir. 2015); 57 GC ¶ 64)—The Federal Circuit’s decision in K-Con Bldg. Sys. addresses a series of thorny jurisdictional issues pertaining to the assertion and litigation of contract claims. Additionally, the decision is noteworthy because it makes clear that, absent extenuating circumstances, contractors are required to comply with the written notice requirements set forth in the applicable contract Changes clause.

K-Con Building Systems Inc. entered into a contract with the Government to construct a building in Port Huron, Mich., for $582,641. The project was to be completed by Nov. 20, 2004, and K-Con agreed to pay $589 in liquidated damages for each day of delay. Substantial completion of the building was not accomplished until May 23, 2005. As such, the Government withheld from K-Con payment of $109,554—an amount the Government claimed represented 186 days of liquidated damages. K-Con did not challenge the liquidated damages assessment at this time.

On July 28, 2005, K-Con sent the CO a letter requesting remission of the liquidated damages. K-Con claimed that the “liquidated damages [constituted] an impermissible penalty,” and the Government had “failed to issue extensions to the completion date as a result of changes to the contract.” K-Con provided no details regarding the basis for its allegation that it was entitled to schedule extensions. The CO denied K-Con’s request for remission of the liquidated damages, and K-Con filed suit in the COFC.

On Dec. 15, 2006, while the litigation was pending before the COFC, K-Con sent the CO a second letter in which it provided details about the Government-caused contract changes and asked for a new remedy ($196,126.38 for additional work necessitated by the changes), as well as an extension of the contract completion date. The CO denied this claim, and K-Con amended its complaint to add the factual allegations and requested remedy set forth in the second claim letter.

The COFC held that the liquidated damages clause in the contract was enforceable and that K-Con did not comply with the written notice precondition.
to invoke the contract clause governing changes. Additionally, the COFC held that K-Con’s claim for an extension of the contract completion date should be dismissed for lack of jurisdiction.

K-Con appealed the COFC’s decision to the Federal Circuit. In its decision, the Federal Circuit first addressed a series of jurisdictional issues. In particular, the Government argued that there was no final decision on K-Con’s contract-changes claim before litigation on that claim commenced, “because K-Con sent its second letter [to the CO] after filing its original complaint, which the Government said already contained the contract-changes claim.”

The Federal Circuit rejected the Government’s argument in this regard, stating that it “disagree[d] with the premise that the second letter’s contract-changes claim was already in litigation when K-Con sent that letter.” The Federal Circuit noted that, “[t]he original complaint does complain about contract changes and included some factual assertions shared by the contract-changes claim presented in the second letter.” However, the Federal Circuit determined that “[t]he remedy requested in the two documents is categorically different,” and “[t]hat is enough to make the requests different claims.” Thus, the Federal Circuit held that the CO’s rejection of the contract-changes claim in K-Con’s second letter was an authorized final decision sufficient to establish jurisdiction in the COFC.

Next, the Federal Circuit held that the COFC properly found that it did not have jurisdiction over K-Con’s time extension claim asserted in the second claim letter. The Federal Circuit held that, at base, the time extension claim was “a request for remission of liquidated damages on the ground that the [Government] failed to issue time extensions for additional work added to the contract.” Because K-Con “squarely” placed that claim in litigation through its original complaint, K-Con was required to present that claim adequately in its first claim letter, and not in the second letter, which was submitted after litigation was commenced.

With respect to the merits of the appeal, the Federal Circuit held that the contract’s liquidated-damages clause was enforceable because the liquidated-damages amount in the contract was reasonable. Second, the Federal Circuit agreed with the Government that K-Con’s changes claim was precluded because K-Con had not provided written notice to the CO as required by the Changes clause in the contract.

The Federal Circuit held that K-Con, by submitting its changes claim more than two years after the changes were ordered, did not comply with the 20-day written notice requirement in the contract’s Changes clause. And K-Con proffered no evidence that the Government was aware that K-Con considered the work requests to be contract changes, so there were no extenuating circumstances that would weigh against strict enforcement of the contractual notice provision. Thus, the Federal Circuit upheld the COFC’s denial of K-Con’s contract-changes claim.

**Key Lessons from K-Con:** The Federal Circuit’s decision in K-Con makes clear that, once a contractor asserts a claim in litigation, the CO has no authority to rule on it, even if the claim is not properly in litigation because of a procedural misstep by the contractor. Under 28 USCA § 516, the Department of Justice gains exclusive authority to act in the pending litigation, and that exclusive authority divests the CO of his authority to act on and issue a final decision on the claim.

However, a CO retains authority to consider new claims, and a contractor may amend the complaint to add such new, denied claims, so long as they are separate claims—meaning that the new claims either request different remedies (whether monetary or non-mandatory), or assert grounds that are materially different from each other factually or legally (e.g., breach of contract for not constructing a building on time versus breach of contract for constructing the building with the wrong materials). To avoid jurisdictional wrangling and a possible ruling that a claim asserted in litigation lacks a jurisdictional predicate, contractors should not assert claims in a piecemeal fashion, and they should be mindful when drafting a complaint to include only those claims that have been presented to the CO for decision. And, as a final take-away, K-Con confirms that contractual notice requirements may be enforced unless extenuating circumstances are present.

**The Government’s Right to Audit in Litigation** (Kepa Servs., Inc. v. Dep’t. of Veterans Affairs, CBCA 2727 et al., 15-1 BCA ¶ 35942)—In a case involving an audit sought by the VA inspector general, the CBCA addressed the scope of the Government’s audit rights and held that the VA IG was required to request financial information through legal counsel and comply with the Board’s discovery rules in conducting the audit.

*Kepa* involved a fixed-price contract related to work associated with gravesite expansion and cem-
ety development. After Kepa Services Inc. filed eight appeals of 24 separate claims, the VA CO contacted the IG and asked it to initiate an audit of Kepa’s claims. Shortly thereafter, the VA IG issued three letters—one to Kepa, one to a subcontractor that had claims in the consolidated appeals, and one to a third-tier subcontractor—requesting information related to the quantum requested so that the VA IG could determine the reasonableness, allocability and allowability of the amounts claimed before the Board. Both Kepa and its subcontractors immediately objected to the scope of the audit requests and insisted that any information requested or submitted must be exchanged through legal counsel for the parties.

The VA argued that the IG is entitled to conduct audits in the manner it wishes, and without the involvement of counsel, under the authority of three distinct sources: (1) the Inspector General Act of 1978 (IG Act), 5 USCA app. 3 §§ 1–13 (2012); (2) the Audit and Records-Negotiation clause in the contract, 48 CFR § 52.215-2(c); and (3) the CBCA’s general discovery rules.

The CBCA first addressed the VA IG’s authority under the IG Act. Although the main purpose of the IG Act is to ensure that the IG has the power to ferret out fraud, waste and abuse in federally funded programs, that power is not unlimited and must be exercised through Congress’ grant of a broad, but challengeable, subpoena power to each IG. Because the VA IG had not issued subpoenas, but instead had issued administrative audit letters, Kepa and its subcontractors were not required by the IG Act to comply with the IG’s requests.

Next, the CBCA addressed the VA’s assertion that Kepa was compelled to participate in the audit under the authority of 48 CFR § 52.215-2(c), the Audit and Records-Negotiation clause contained in Kepa’s VA contract. This clause provides that if a contractor was required to submit certified cost or pricing data in connection with any pricing action related to the contract, the CO has the right to examine and audit all of the contractor’s records related to the pricing proposal. Because Kepa was not required to submit cost or pricing data, the clause did not give the VA a contractual right to audit Kepa’s books and records.

Finally, the CBCA addressed the VA’s argument that the IG was entitled to conduct its audit pursuant to the CBCA’s discovery rules. CBCA Rule 13(b) provides that parties may obtain discovery regarding any matter, not privileged, that is relevant to the subject matter involved in the pending case, which the CBCA determined included an obligation to produce for inspection and audit records related to the incurred costs that formed the basis for Kepa’s claims. However, because the CBCA’s discovery rules were the VA’s only means of compelling Kepa’s participation in an audit, the CBCA ruled that the VA IG must conduct the audit, including contacting any employees, through requests to Kepa’s counsel, just as it would any other discovery.

Key Lessons from Kepa: The Government does not have an unfettered right to access a contractor’s books and records for purposes of conducting an audit. The audit right must emanate from a statute, regulation, or contract clause, or be authorized pursuant to discovery rules in litigation. However, as stated by the CBCA, once a contractor places its costs in issue through assertion of a monetary claim, it is in the contractor’s best interest to provide the financial data requested by the Government since, without adequate support, the contractor will not meet its burden of proving quantum.

Obligation to Monitor Document Discovery (New Orleans Reg’l Physician Hosp. Org., Inc. v. U.S., 122 Fed. Cl. 807 (2015); 57 GC ¶ 290)—In a case involving a $27 million claim for unilateral modifications to a managed care services contract, the COFC confirmed that counsel for party litigants have an obligation to take affirmative steps to monitor and supervise the search for and production of responsive documents in discovery.

After several years of discovery and several prior motions to compel, the COFC granted the plaintiff-contractor’s third motion to compel, finding that the Government’s discovery efforts had been inadequate from the outset of the litigation. To assess the Government’s compliance with its obligation to search for and produce responsive documents, the Court required the Government to submit the declarations of 23 current and former Government employees addressing the conduct of discovery. The declarations indicated that although plaintiff filed its complaint in August 2011, Government counsel did not put a formal litigation hold in place until February 2012, and, of the 23 document custodians who submitted declarations, only two expressed any knowledge of the litigation hold.

Moreover, while a few declarants began their search for responsive documents in 2012, most did not, and in 2013, Government counsel e-mailed nu-
merous custodians advising them of the need to conduct a thorough search for responsive electronic and hard copy documents. Government counsel included 12 categories of documents for which custodians were to search, and recommended eight search terms.

In early 2014, in the midst of ongoing discovery disputes, Government counsel represented to plaintiff’s counsel that 19 custodians had assisted with the search and had used 28 search terms to locate responsive electronic and hard copy documents. However, none of the declarants stated that they used the 28 search terms to identify responsive documents. Instead, to the extent the employees even remembered their efforts, the declarations showed great variation in the methods and keywords used to conduct the searches.

In criticizing the Government’s discovery efforts, the Court began by noting that a proper search for discoverable documents requires careful planning, oversight and monitoring by a party’s counsel. Counsel for a party must be able to explain to the court the rationale for the method chosen, demonstrate that it is appropriate for the task, and show that it was properly implemented.

Ultimately, the Court held that the Government had failed to put into place a systematic, reliable plan to find and produce all relevant documents due to little oversight by Government counsel over the Government employees’ search efforts. The declarations indicated that the custodians relied on an e-mail from Government counsel that listed document categories and recommended eight search terms to use in custodian searches. However, the decision regarding the exact search terms was left up to each individual, and none of the custodians used the 28 search terms that Government counsel represented had been used.

Moreover, the custodians were not required to keep any record of the search terms they used, nor did Government counsel exercise any meaningful oversight over individual search efforts. To remedy the Government’s discovery failures, the Court ordered Government counsel to collaborate with plaintiff’s counsel to identify relevant document custodians and establish a comprehensive search protocol.

Key Lessons from New Orleans Regional: Parties have an obligation to preserve relevant evidence and, in discovery, to search for and produce responsive documents. That obligation may not be satisfied if counsel fails to issue timely litigation holds and maintain control over the discovery process. Particularly where the harvesting of electronic documents (e.g., e-mails) is required, unless records are kept of the custodians whose records were searched and the particular search terms used, a party litigant might be unable to demonstrate that it has fully satisfied its discovery obligations.

Conclusion—The decisions described in this Feature Comment are among the most important Government contract claims decisions issued in 2015. These cases provide key lessons for interpreting contract requirements, establishing jurisdiction over claims, and conducting audits and document discovery in claims appeals.

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