

ISSUE: CAN THE GOVERNMENT RECOVER CONSEQUENTIAL DAMAGES FOR CONTRACTORS' FAILURE TO PERFORM UNDER FEDERAL FIXED PRICED OR COST-REIMBURSABLE INSPECTION OF SERVICES PROVISIONS?

ANSWER: YES, ACCORDING TO THE U.S. COURT OF FEDERAL CLAIMS IN HAMILTON SECURITIES ADVISORY SERVICES, INC. V. UNITED STATES, 46 FED. CL. 164, MAR, 15, 2000; NO. 98-169C.

FACTS: Hamilton was awarded a contract to provide financial advisory support services to the U.S. Department of Housing and Urban Development (HUD). As part of this contract Hamilton was to recommend "alternative methods for structuring the mortgage sale and pricing options to maximize loan sale proceeds to HUD". Id., at 166. To support this requirement, Hamilton's subcontractor ran a computer program to help the optimize the combination of bids. Unfortunately, the "optimization model" made a slight error in calculations, resulting in HUD receiving less than the maximized loan sale proceeds.

Hamilton's contract was ultimately terminated for convenience, and the government had not paid the final invoice amount to Hamilton. Instead HUD's PCO issued a demand letter for the amount of losses the Government suffered due to Hamilton's errors. Hamilton filed a claim for the unpaid invoice amount. The Government counter-claimed under two theories: 1) Hamilton breached its contract resulting in damages, and 2) Hamilton made negligent misrepresentations relating to the group of bids that would yield the maximum sales proceeds.¹

The issue before the court was whether the Inspection of Services Clause - Fixed price (February 1992) provides the exclusive remedy and only possible source of damages for the parties. The court found that it did not, and permitted the Government to pursue consequential damages.

Central to this decision was a determination as to whether the claim "arose under" the contract or whether the claim was "related to" the contract. A claim arises under a contract when the contract terms themselves provide for complete definable relief for the specific claim alleged. If the contract specifically provides for relief, then the claim is not a claim for breach of contract. Therefore, breach of contract damages are not allowable.

The court here found that the Inspection of Services clause did not provide complete relief, intend to be the exclusive remedy, for the damages suffered by the Government. The court found two types of damages suffered: 1) the reduced value of the services

¹ The court dismissed the Government's tort counterclaim under the "economic loss" rule. This rule basically states that "a plaintiff who suffers only pecuniary injury as a result of another cannot recover those losses in tort. Instead, the claimant is limited to recovery under the law of contract." Id., p176; Apollo Grp., Inc v. Avnet, Inc, 58 F.3d 477, 479 (9th Cir. 1995).

performed by Hamilton, and 2) the consequential shortfall in proceeds from the mortgage auctions.

The first category could be addressed by the inspection clause, wherein the Government could "reduce the contract price to reflect the reduced value of the services performed" (FAR 52.246-4 (February 1992)). This means that the Government could recover under the clause the contractor's cost of running the "optimization" program, but couldn't recover the consequential loss of mortgage proceeds.

Because the clause provided for no remedy for the consequential losses, and because there was no language in the contract indicating that the Inspection of Services remedies were intended to be exclusive, the court found the government entitled to damages for breach.

The damages allowed were stated as those damages which "should place the injured party in as good a position as he or she would have been had the breaching party fully performed."

Here the court looked to the "expectancy damages" sought by the Government (HUD's expected revenue). The court stated "expectancy damages, including lost profits, are recoverable, so long as they are either actually foreseen or reasonably foreseeable, are caused by the breach of the promisor, and are proved with reasonable certainty."

APPLICATION TO COST REIMBURSEABLE CONTRACTS: While this case focused on the Inspection of Services clause for a fixed priced contract, it would seem that the court's reasoning would apply equally well on a cost reimbursable contract. The language of the Inspection of Services - Cost Reimbursement clause (FAR 52.246-5) is similarly limited to addressing the loss of value of the services rendered rather than consequential or expectancy damages.

The clause states:

"(d) If any of the services performed do not conform with contract requirements, the Government may require the Contractor to perform the services again in conformity with contract requirements, for no additional fee. When the defects in services cannot be corrected by reperformance, the Government may--

- (1) Require the Contractor to take necessary action to ensure that future performance conforms to contract requirements; and
- (2) Reduce any fee payable under the contract to reflect the reduced value of the services performed.

(e) If the Contractor fails to promptly perform the services again or take the action necessary to ensure future performance in conformity with contract requirements, the Government may--

- (1) By contract or otherwise, perform the services and reduce any fee payable by an amount that is equitable under the circumstances; or
- (2) Terminate the contract for default."

None of this language indicates intent to limit other damages or that this clause be the exclusive remedy for failure to perform.

Accordingly, we should consider claims for consequential damages against contractors our who fail to perform (and possibly set them off as was done in the Hamilton case). Likewise, we should consider the potential for such claims against us should we not meet our duties under contract.

POC is Mr. David C. DeFrieze, Attorney-Advisor, U.S. Army Operations Support Command (OSC) (PROV), DSN 793-8424, e-mail: defriezed@osc.army.mil.