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A Twice-Told Tale: The Strangely Repeated Story of "Bad Faith" in Government Contracts

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"Men are often more bribed by their loyalties and ambitions than by money."
Justice Jackson, dissenting in United States v. Wunderlich[1]

Raising the Curtain

It has been oft told in recent years how the principal forums for government contracts disputes, the U.S. Court of Federal Claims ("CFC") and the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"), have frequently misapplied the contracts law of good faith duties.[2] While the Supreme Court, for well over a century, has repeatedly advised those courts and their predecessors to treat the federal government as it would a private citizen when it is in a contractual relationship and to apply the common law of contracts when interpreting government contracts,[3] those admonitions often have been

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[1] 342 U.S. 98, 103 (1951) (Jackson, J., dissenting).

[2] *See, e.g.*, Stuart B. Nibley & Jade Totman, *Let the Government Contract: The Sovereign Has the Right, and Good Reason, to Shed Its Sovereignty When It Contracts*, 42 Pub. Cont. L.J. 1, 7 (2012); Ralph C. Nash, Jr., *Postscript: Breach of the Duty of Good Faith and Fair Dealing*, 24 Nash & Cibinic Rep. ¶ 22 (May 2010); Frederick W. Claybrook, Jr., *Good Faith in the Termination and Formation of Federal Contracts*, 56 Md. L. Rev. 555 (1997).

[3] *See*, *e.g.*, Mobil Oil Exploration & Producing S.E., Inc. v. United States, 530 U.S. 604, 614, 622, 624 (2000) (applying and relying extensively for general common-law principles on the *Restatement (Second) of Contracts*); United States v. Winstar Corp., 518 U.S. 839, 863, 869–70, 887, 895–96, 904, 907–08 (1996) (plurality opinion); *Winstar Corp.*, 518 U.S. at 911–12 (Breyer, J., concurring); Clearfield Trust Co. v. United States, 318 U.S. 363, 369 (1943); Lynch v. United States, 292 U.S. 571, 579 (1934); Sinking-Fund Cases, 99 U.S. 700, 719 (1879) ("The United States are as much bound by their contracts as are individuals."); United States v. Bostwick, 94 U.S. 53, 66 (1876) ("The United States, when they contract with their citizens, are controlled by the same laws that govern the citizen in that behalf."); Cooke v. United States, 91 U.S. 389, 398 (1875) (ruling that, when the federal government "enters the domain of commerce, it submits itself to the same laws that govern individuals there").

honored by them in the breach.[4] In the area of good faith duties, this has more than a little irony—indeed, irony with teeth—in that, as the Armed Services Board of Contract Appeals has recognized, "because of its size, power, and potential ability to manipulate the market place, the Government may have obligations of fairness beyond those of the ordinary citizen."[5]

This is not a new concept. In the 1874 case of *Corliss Steam-Engine Co. v. United States*,[6] the newly constituted U.S. Court of Claims pronounced that the federal government must deal with its contractors "in the strictest fairness and justice."[7] This would imply, if anything, that the Government is held strictly accountable to act in good faith and shown no special leniency when contracting with private parties.[8] In case law over the last few decades, however, that rule often seems to have been turned upside down.[9]

The common law, as reflected in § 205 of the *Restatement (Second) of Contracts*, recognizes that good faith duties of cooperation adhere in every contract: "Every contract imposes upon each party a duty of good faith and

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[4] *See, e.g.*, Steven L. Schooner & Pamela J. Kovacs, *Affirmatively Inefficient Jurisprudence?: Confusing Contractors' Rights to Raise Affirmative Defenses with Sovereign Immunity*, 21 Fed. Cir. B.J., 685, 686 (2012) (criticizing the Federal Circuit not applying normal contractual principles to allow contractors to raise affirmative defenses); Richard C. Johnson, *Beyond Judicial Activism: Federal Circuit Decisions Legislating New Contract Requirements*, 42 Pub. Cont. L.J. 69 (2012) (criticizing, inter alia, the Federal Circuit deviating from the common law with respect to estoppel, use of experts, and affirmative defenses); W. Stanfield Johnson, *The Federal Circuit's Great Dissenter and Her "National Policy of Fairness to Contractors*," 40 Pub. Cont. L.J. 275 (2011) (utilizing dissents written by Judge Newman to demonstrate that "the Federal Circuit has inappropriately moved the balance of its government contract jurisprudence toward protecting the sovereign"); Frederick W. Claybrook, Jr., *It's Patent That "Plain Meaning" Dictionary Definitions Shouldn't Dictate: What* Phillips *Portends for Contract Interpretation*, 16 Fed. Cir. B.J., 91 (2006) (observing that the Federal Circuit deviates from the common law as stated in the *Restatement (Second) of Contracts* when interpreting contracts); Daniel P. Graham, *Departing from* Hadley*: Recovering Lost Profits on Collateral Undertakings in Suits Against the Government*, 35 Pub. Cont. L.J. 43 (2005) (criticizing the Federal Circuit for deviating from the common law with respect to the articles subject); W. Stanfield Johnson, *Mixed Nuts and Other Humdrum Disputes: Holding the Government Accountable Under the Law of Contracts Between Private Individuals*, 32 Pub. Cont. L.J., 677 (2003) [hereinafter *Mixed Nuts*] (analyzing several Federal Circuit decisions that deviate from the common law of contracting).

[5] R & R Enters., 89-2 B.C.A. (CCH) ¶ 21,708 at 109,148 (Mar. 24, 1989).

[6] 10 Ct. Cl. 494 (1874), *aff'd*, 91 U.S. 321 (1875).

[7] *Id.* at 502; s*ee also* S&E Contractors, Inc. v. United States, 406 U.S. 1, 10 (1972) ("A citizen has a right to expect fair dealing from his government.").

[8] *Corliss Steam-Engine Co.*, 10 Ct. Cl. at 502.

[9] *See supra* note 2.

fair dealing . . . ."[10] Under the common law, the breach of such duties is not presumed, but must be proven, like every other breach, by a preponderance of the evidence.[11] If a party breaches its good faith duties to cooperate and not to hinder the performance of the other party, the breaching party, in common law contractual parlance, acts in "bad faith."[12] The *Restatement* makes this clear in frequently quoted comment *d* to § 205, which defines "Good Faith Performance" by giving examples of *bad faith* contractual actions:

> A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasions of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.[13]

Thus, under the common law, establishing that the party with whom you contracted acted in *bad faith* only requires you to show, by a preponderance, that the other party did not honor its duties of good faith and fair dealing.[14]

Like with every other contractual breach, motive is not an element of the cause of action.[15] Although, if a breach is willful, it makes proof of the breach easier and plays into the calculus for damages (requiring presumptions against

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[10] Restatement (Second) of Contracts § 205 (1981) [hereinafter Restatement]; *see also* U.C.C. § 1-203 ("Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance or enforcement."); § 1-201(19) (defining *good faith* as "honesty in fact in the conduct or transaction concerned"). *See generally* E. Allen Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. Chi. L. Rev. 666, 666 (1962); Robert S. Summers, "*Good Faith*" *and General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195, 196 (1968).

[11] Steven J. Burton & Eric G. Andersen, Contractual Good Faith: Formation, Performance, Breach, Enforcement 107 (1995) [hereinafter Burton & Andersen]. Judge Wolski in Tecom, Inc. v. United States, 66 Fed. Cl. 736, 758 (2005), traces this principle back as far as Justice Story's words in Bank of the United States v. Dandridge, 25 U.S. (12 Wheat.) 64, 69–70 (1827) ("[T]he law . . . presumes that every man, in his private and official character, does his duty, until the contrary is proved."); *see also Tecom, Inc.,* 66 Fed. Cl. at 760–61 (citing Supreme Court cases as early as 1836 applying a presumption of regularity and good faith action in wholly private contexts).

[12] Burton & Andersen, *supra* note 11, at 36–37; Summers, *supra* note 10, at 217.

[13] Restatement § 205 cmt. d.

[14] *Id.*; Burton & Andersen, *supra* note 11, at §§ 3.1–.4; *see also* U.S. Ecology, Inc. v. Neb., 358 F.3d 528, 547–48 (8th Cir. 2004) (applying federal law for an interstate compact and relying on Restatement § 205, equating breach of good-faith duties with bad faith).

[15] Burton & Andersen, *supra* note 11, at 75.

the breaching party to be applied with a heavier hand[16] and even cutting off the breaching party's right to prove an offset to the innocent party's damages in the appropriate case[17]), it is not necessary to prove animus to recover for breach of good faith duties, which, again, is equivalent in the common law to acting in contractual bad faith.[18]

When it comes to applying the law of good faith duties to government contracts, the CFC and Federal Circuit are schizophrenic. They give lip service to the firmly established common law,[19] and sometimes apply it in accordance with the *Restatement*.[20] But they also sometimes layer on additional elements

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[16] According to the Restatement:

> Doubts are generally resolved against the party in breach. A party who has, by his breach, forced the injured party to seek compensation in damages should not be allowed to profit from his breach where it is established that a significant loss has occurred. A court may take into account all the circumstances of the breach, including willfulness, in deciding whether to require a lesser degree of certainty, giving greater discretion to the trier of the facts.

Restatement § 352 cmt. a; *cf.* 28 U.S.C. § 2412(d)(1)(D) (2012) (equating willful violation of law with bad faith).

[17] *See* LaSalle Talman Fed. Sav. Bank, N.A. v. United States, 317 F.3d 1363, 1372 (Fed. Cir. 2003). In *LaSalle Talman*, the Federal Circuit noted that the willfulness of a breach or other equitable circumstances might cause a court to disallow proof of an offset to breach damages. *Id*. As an example, the court cites the Sixth Circuit's decision in Great Lakes Transmission Co. v. Grayco Constructors, Inc., 506 F.2d 498 (6th Cir. 1974), in which the court refused to permit proof of an offset because the breaching party acted negligently. *Id*. at 504; *see also* United Protective Workers of Am., Local No. 2 v. Ford Motor Co., 223 F.2d 49, 54 (7th Cir. 1955) (allowing only compensatory damages when no bad faith or misconduct, but innocent breach).

[18] Restatement § 205 cmt. d. An analogous application of this is found in the law of recovery against losing plaintiffs in civil rights cases under fee-shifting statutes. The Supreme Court in Christianburg Garment Co. v. EEOC, 434 U.S. 412 (1978), held that, to recover fees, the winning defendant must show *objective* bad faith measured by the plaintiff's action being "frivolous, unreasonable, or without foundation, even though not brought in subjective bad faith," but proof of *subjective* bad faith makes an award all the more appropriate. *Id*. at 421–22.

[19] *See, e.g.*, Medlin Constr. Grp., Ltd. v. Harvey, 449 F.3d 1195, 1200 (Fed. Cir. 2006) ("The general rules of contract interpretation apply to contracts to which the government is a party."); Maxima Corp. v. United States, 847 F.2d 1549, 1556 (Fed. Cir. 1988) ("The need for mutual fair dealing is no less required in contracts to which the government is a party, than in any other commercial arrangement.").

[20] *E.g.*, Metcalf Constr. Co. v. United States, 742 F.3d 984, 991 (Fed. Cir. 2014) (rejecting argument that the implied duty of good faith must mirror an express duty set out in the contract); Centex Corp. v. United States, 395 F.3d 1283, 1304 (Fed. Cir. 2005) (citing and quoting Restatement § 205 with approval; however, also noting government's action

and burdens of proof for contractors complaining of government action or inaction. Starting with the proposition that government agents are presumed to act in good faith, they build an alternative construct on the theory that this presumption can only be overcome, and a "bad faith" breach proven, by a showing of intentional animus or malice by the agency against the contractor, and then only by "well nigh irrefragable proof," which the Federal Circuit has equated with a "clear and convincing" burden.[21] The U.S. Department of Justice ("DOJ") attorneys do their part to exploit this fissure between the common law and Federal Circuit law. Whenever a contractor pleads a violation of good faith duties, DOJ argues that the allegation is essentially that the government acted in bad faith, which (they argue) requires ironclad proof of intentional misconduct targeted at the contractor, which is almost always impossible to demonstrate.[22] For example, in *Croman Corp. v. United States*,[23] when the contractor had made an initial showing that the agency's justification for canceling certain parts of a contract was pretextual, DOJ argued this was the equivalent of saying the agency had acted in bad faith.[24] Instead of requiring the agency to come forward with rebuttal evidence, the Federal Circuit adopted DOJ's characterization and found the contractor's showing

was "specifically targeted"); Malone v. United States, 849 F.2d 1441, 1442–45 (Fed. Cir. 1988); *see also* Rumsfeld v. Applied Cos., 325 F.3d 1328, 1334 (Fed. Cir. 2003) (applying duty to estimate requirements in good faith, not negligently); B.R. Burke Corp. v. United States, 277 F.3d 1346, 1360 (Fed. Cir. 2002) (relying upon Restatement § 205 to hold that, by submitting for approval a work plan it had reason to know was inadequate, contractor violated his duty of good faith and fair dealing); Aviation Contractor Employees, Inc. v. United States, 945 F.2d 1568, 1572–73 (Fed. Cir. 1991) (observing that open terms are enforceable due to duty to negotiate in good faith); Pac. Far E. Lines v. United States, 394 F.2d 990, 990 (Ct. Cl. 1968). *See generally* Claybrook, *supra* note 4, at 101–03 n.75 (noting Federal Circuit's use of the *Restatement* in almost 150 decisions).

[21] *See* Am-Pro Protective Agency, Inc. v. United States, 281 F.3d 1234, 1239 (Fed. Cir. 2002). For a critique of *Am-Pro* as inconsistent with the common law, see *Mixed Nuts*, *supra* note 2, at 696–705.

[22] The task, however, has been accomplished on rare occasions. *E.g.*, The Libertatia Assocs., Inc. v. United States, 46 Fed. Cl. 702, 712 (2000). The Civilian Board of Contract Appeals has also rebuffed attempts by agency attorneys to require animus as an element of a breach of good-faith duties. *E.g.*, Sigma Servs., Inc. v. HUD, 12-2 B.C.A. (CCH) ¶ 35173 (Nov. 5, 2012) ("A claim that [the agency] breached the implied covenant of good faith does not require a showing of bad faith.") (citation omitted); Jane Mobley Assocs., Inc. v. GSA, 12-2 B.C.A. (CCH) ¶ 35178 (Nov. 14, 2012).

[23] 724 F.3d 1357 (Fed. Cir. 2013).

[24] *Id.* at 1364.

inadequate because it did not meet the standard of well-nigh irrefragable proof of subjective malice.[25]

Professors Steven Burton and Eric Andersen, leading authorities on the law of good faith, note that the large majority of common law courts hold to an *objective* standard of whether the party with discretion exercised it within the parties' reasonable expectations stemming from the promises made at contract formation.[26] Only "[a] few very weak common law authorities suggest that a party whose exercise of discretion is motivated by malice or other wrongful motives is in breach of contract for failing to perform in good faith."[27] While not canvassing federal government contracts law in their treatise, Professors Burton and Andersen remark that, under the common law, a party cannot be excused from an improper (i.e., "bad faith") exercise of discretion because the party had a "kind heart and an empty head"[28] and summarize as follows:

> On the question whether wrongful motives establish bad faith, our answer is clear and amply supported by the cases: wrongful reasons may establish bad faith, but an absence of wrongful reasons does not establish good faith. Wrongful reasons establish bad faith not because they are wrongful, but instead because they are outside the reasonable expectations of the parties. An absence of such reasons, however, does not suffice to establish good faith because bad faith may also consist of action for reasons that are disallowed by the contract even though not wrongful.[29]

For years, judges, academics, and other commentators, consistent with this quoted summary of the law, have criticized those government contracts cases requiring a showing of subjective bad faith to prove a breach of good faith duties.[30] Most notably, Judge Wolski, in the 2005 case of *Tecom, Inc. v. United States*,[31] with great erudition and tact, laid out a path between the fractured precedent of the circuit, with his main point being that, in the normal contract setting, a contractor does not have to prove animus to show a breach of the implied duties of good faith, cooperation, and not to hinder performance of the other party.[32] Professor Nash has ridiculed the Federal

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[25] *Id.* at 1364–65.

[26] Burton & Andersen, *supra* note 11, at 89–90.

[27] *Id.* at 75.

[28] *Id.* at 83 (internal quote marks omitted).

[29] *Id.* at 77–78; *see also id.* at 289–90.

[30] *E.g.*, Daniel E. Toomey et al., *Good Faith and Fair Dealing: The Well-Nigh Irrefragable Need for a New Standard in Public Contract Law*, 20 Pub. Cont. L.J. 87, 88, 124–25 (1990).

[31] 66 Fed. Cl. 736 (2005).

[32] *Id.* at 757–72. Judge Wolski concludes that a heightened burden applies only for fraud or quasi-criminal conduct and goes so far as holding that "when the government actions that are alleged are not formal, discretionary decisions, but instead the actions that might be taken by any party to a contract, the presumption of good faith has no application." *Id.* at 769. The Federal Circuit in Road & Highway Builders, *LLC* v. United States, 702 F.3d

Circuit's 2010 pronouncement in *Precision Pine & Timber, Inc. v. United States*[33] that breaches of good faith duties typically involve "bait-and-switch" situations and require "specifically targeted" action by the government,[34] when that is wholly inconsistent with over 100 years of government contracts precedent (not to mention the common law).[35] Moreover, as previously pointed out, the implied premise on which the Federal Circuit builds its animus edifice for breach of good faith duties is faulty;[36] that government agents are presumed to act in good faith does not distinguish federal contracts from private ones.[37] Under the common law, it is presumed that a private party accused of a good faith breach has acted in good faith, but that does not heighten the innocent party's burden of proof or require proof of willfulness.[38] If he breaches his duty of good faith, the guilty party has acted in bad faith, and the innocent party must only prove that by a preponderance of the evidence.[39] But, despite the

1365 (Fed. Cir. 2012), repudiated the *Tecom* analysis with respect to the presumption that a government official acts in good faith as inconsistent with its precedent. *Id.* at 1369. *Road & Highway Builders*, properly read, does not deal with contractual duties. *See infra* notes 196–203 and accompanying text.

[33] 596 F.3d 817 (Fed. Cir. 2010).

[34] *Id.* at 829.

[35] Nash, *supra* note 2, at 67–68; *see also Appeal of Raytheon Missile Sys.*, 13-1 B.C.A. (CCH) ¶ 35241 (Jan. 1, 2013) (noting that *Precision Pine* injected into government contracts cases which "have nothing to do with sovereign immunity" the concept of "specifically targeted action"). The Federal Circuit has subsequently restrictively read *Precision Pine* in *Metcalf Construction Co. v. United States*, ___. 742 F.3d 984, 991 (Fed. Cir. 2014).

[36] Claybrook, *supra* note 2, at 576–77; *see also Mixed Nuts*, *supra* note 2, at 698–705.

[37] *See supra* note 11.

[38] Burton & Andersen, *supra* note 11, at 107; *see also* Huna Totem Corp. v. United States, 35 Fed. Cl. 603, 613 (1996) ("there is a presumption that both parties have fulfilled their duties of good faith and fair dealing" (i.e., both the government and the private party)).

[39] Burton & Andersen, *supra* note 11, at 107. Moreover, under the common law, even animus and malice in a breach setting, when relevant, do not *require* proof of specific intent. While, under the common law, malice connotes willfulness, it does not require personal ill will, but merely intentional action for a wrongful purpose to gain some advantage at the other party's expense. *See* Bitterman v. Louisville & Nashville R.R. Co., 207 U.S. 205, 223 (1907) (stating that personal ill will is not required for malice in law, only wanton disregard of the rights of the other to gain personal advantage); Getschow v. Commonwealth Edison Co., 444 N.E.2d 579, 584 (Ill. App. Ct. 1982) ("It is also well settled that malice, when used in this context, does not require a showing of ill will, hostility or an intent to injure . . . ."), *aff'd in part and rev'd in part*, 459 N.E.2d 1332 (Ill. 1984) (internal quotation marks omitted); Coleman v. Whisnant, 35 S.E.2d 647, 656 (N.C. 1945) ("The word *malicious* used in referring to malicious interference with formation of a contract does not import ill will, but refers to an interference with design of injury to plaintiff or gaining some advantage at his expense.") (internal quotation marks omitted); s*ee also In re* Posta, 866 F. 2d 364, 367–68

efforts of judges, academics, and commentators, the confusion continues, as the CFC and the Federal Circuit sometimes lapse into equating allegations of breach of good faith contractual duties with the type of bad faith conduct that requires proof of malice aforethought by a standard greater than a preponderance, as in fraud cases, for example.[40]

The purpose of this article is not to expand on that critique, but to tell another tale, although it is largely the same one. It is the tale of the little phrase, "or so grossly erroneous as necessarily to imply bad faith." This phrase, though normally ignored, appears in both the Contract Disputes Act of 1984 ("CDA")[41] and the Wunderlich Act,[42] from which the CDA authors carried it

(10th Cir. 1989) (stating that malicious intent under the Bankruptcy Code may be proven by either direct evidence with specific intent to injure or, "[m]ore commonly, . . . by evidence that the debtor had knowledge of the creditor's rights and . . . proceeded to take action in violation of those rights"); Ballentine's Law Dictionary 768 (3d ed. 1969) (defining malice as an "improper motive, not necessarily a positive malignity; a willful disregard of the rights of another, whether in accomplishing an unlawful purpose or a lawful purpose by an unlawful means"); Black's Law Dictionary 956–57 (6th ed. 1990) ("Malice in law is not necessarily personal hate or ill will, but it is that state of mind which is reckless of law and of the legal rights of the citizen.")

[40] *See generally* Tecom, Inc. v. United States, 66 Fed. Cl. 736, 771 n.41, 757–73 (2005). Judge Wolski in *Tecom* criticizes, for example, *Boston Edison Co. v. United States,* 64 Fed. Cl. 167, 186 (2005), and *J. Cooper & Associates, Inc. v. United States*, 53 Fed. Cl. 8, 23 (2002), for applying a clear and convincing evidence standard. Another example of a heightened bad faith standard is with regard to a court exercising its authority to sanction by awarding attorneys fees due to bad faith litigation conduct. *See* Chambers v. NASCO, Inc., 501 U.S. 32, 47 (1991). Even though the courts often require an improper "bad faith" motive to impose such a sanction, the Federal Circuit and other circuits have emphasized that showing the requisite bad faith does not require proof of actual intent, but can be proven by conduct. *E.g.*, First Bank v. Hartford Underwriters Ins. Co., 307 F.3d 501, 522–25 (6th Cir. 2002) (holding that lack of merit to positions taken supported inference that claim was brought to harass and to force settlement of other claims); Fink v. Gomez, 239 F.3d 989, 992–94 (9th Cir. 2001) (holding that it is not necessary to prove subjective motivation, but can prove bad faith by evidence of improper purpose and reckless conduct); L.E.A. Dynatech, Inc. v. Allina, 49 F.3d 1527, 1531 (Fed. Cir. 1995) (inference of bad faith adequately supported by flip-flop of litigation positions).

[41] Pub. L. No. 95-563 § 10(b), 92 Stat. 2383, 2388 (codified as amended at 41 U.S.C. § 7107(b) (2012)).

[42] Pub. L. No. 83-356, 68 Stat. 81 (codified as amended at 41 U.S.C. §§ 321–22 (Supp. 2013)). The Wunderlich Act was temporarily repealed, with a savings clause, in the 2010 recodification of title 41, apparently based on the false assumption that the CDA was applicable to all types of government contracts. The House of Representatitves reenacted and recodified the Wunderlich Act in its 2013 technical amendments to the title 41 recodification, but the Senate has not acted on the measure as of August16, 2014.

forward. But it was first penned long before it was codified in the Wunderlich Act, and therein lies our tale.

Act One. The Supreme Court Saves an Important Government Contract by Conditioning a Discretionary Contractual Duty on Good Faith

It was the 1870s, the days of the Indian Wars, when the U.S. Army struggled to tame both tribes and territory. Fingers of track reached into the western expanse, but railroads did not yet crisscross the nation.[43]

Mr. Kihlberg was undoubtedly a hearty soul, such as those storied in the Old West. He was obviously a risk taker—he did business in the often uncivilized territories of the nation, and he was willing to contract with the Army. He agreed to transport

> military, Indian, and government stores and supplies from points on the Kansas Pacific Railway to posts, depots, and stations in portions of Kansas, Colorado, Texas, Indian Territory, and New Mexico, and to such other depots as might thereafter be designated within the States and Territories named, and transport such goods to various posts and depots,[44]

which the doughty Kihlberg did.

The dispute arose over the proper payment for his much needed, high risk work. The contract provided for payment to be calculated by a formula involving distance and poundage.[45] With respect to setting the distance, the contract read as follows:

> Transportation to be paid in all cases according to the distance from the place of departure to that of delivery, the distance to be ascertained and fixed by the chief quartermaster of the district of New Mexico, and in no case to exceed the distance by the usual and customary route.[46]

Now, undoubtedly, the maps they had to work with at that point did not have the accuracy of a Rand-McNally. But one can well understand Mr. Kihlberg's frustration when, after he took all the risk of transporting the goods to their destination, the New Mexico chief quartermaster set distances for the contract that were not by the "usual and customary route" and were even less than "by air line,"[47] which presumably meant "as the crow flies." Mr. Kihlberg took his

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[43] For a compelling history of the Comanche Wars, see S.C. Gwynne, The Empire of the Summer Moon (2010).

[44] Kihlberg v. United States, 97 U.S. 398, 398 (1879).

[45] *Id.* at 399–400.

[46] *Id.* at 400.

[47] *Id.*

beef to the Court of Claims, and, finding no solace there,[48] he pursued his case to the Supreme Court.

The first Justice Harlan, writing for a unanimous Court, ruled for the government.[49] He pointed out that the chief quartermaster had "discharged a duty imposed upon him by the mutual assent of the parties," "not simply to ascertain, but to fix, the distances which should govern in the supplement of the contractor's accounts for transportation."[50] Because the contract gave the chief quartermaster the duty to set the distances, the courts could not step in to do so "without doing violence to the plain words of the contract."[51] However, the Court's affirmance was not based on the supposition that a judicial officer could *never* question the finality of the government's decision in such a circumstance. The Court's ruling was based upon its factual determination that

> [t]he difference between [the chief quartermaster's] estimate of distances and the distances by air line, or by the road usually travelled, is not so material as to justify the inference that he did not exercise the authority given him with an honest purpose to carry out the real intention of the parties, as collected from their agreement.[52]

Justice Harlan summarized shortly afterwards in his one-paragraph resolution of this issue as follows:

> [I]n the absence of fraud or such gross mistake as would necessarily imply bad faith, or a failure to exercise an honest judgment, his action in the premises is conclusive upon the [contractor] as well as upon the government.[53]

Perhaps things were simpler for the Supreme Court in the days of the Wild, Wild West. In those days, the Supreme Court could write decisions, like that in *Kihlberg*, of only three pages and without citation to a single authority. So it leaves it somewhat to the imagination to uncover what the Supreme Court was really doing, both practically and in terms of contract theory, and how the facts and theory interacted. One would think that, if motivated only by contract theory, the Court would have struck down the contract for lack of certainty or for indefiniteness. (Of course, this was well before the introduction of the Uniform Commercial Code and *Restatement* and the greater flexibility for open-price terms.[54]) When one party has exclusive control of pricing, with no brake on that power, an agreement between private parties would generally not be enforceable.[55] However, the practicalities of the situation shine through

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[48] 13 Ct. Cl. 148 (1877), *aff'd*, 97 U.S. 398 (1878).

[49] *Kilhberg*, 97 U.S. 398.

[50] *Id.* at 401.

[51] *Id.*

[52] *Id.* at 401.

[53] *Id.* at 402.

[54] *See* U.C.C. § 2-305(4); Restatement §§ 34(1), 331 cmt. a, b.

[55] *See, e.g.*, Corthell v. Summit Thread Co., 167 A. 79 (Me. 1933). *See generally* 1 Arthur Linton Corbin, Corbin on Contracts § 98, at 438–39 (1963) [hereinafter Corbin on

in Justice Harlan's brief opinion. This was a contract with the government for desperately needed services critical to the national defense. In a flight of freewheeling dicta and speculation, Justice Harlan hypothesized,

> Indeed, it is not at all certain that the government would have given its assent to any contract which did not confer upon one of its officers the authority in question. If the contract had not provided distinctly, and in advance of any services performed under it, for the ascertainment of distances upon which transportation was to be paid, disputes might have constantly arisen between the contractor and the government, resulting in vexatious and expensive and, to the contractor oftentimes, ruinous litigation . . . [b]e this supposition as it may . . . .[56]

So how did the Supreme Court save this contract the Army desperately needed from lack of certainty and indefiniteness? Without saying so expressly, the Court imposed a duty of good faith on the exercise of the chief quartermaster's discretion to set the distances. Needless to say, the Court did this well before what is often credited as the first modern articulation of the implied duty of good faith, Justice Cardozo's celebrated, 1933 decision in *Kirke La Shelle Co. v. Paul Armstrong Co.*[57] But imposing a good faith restriction on the chief quartermaster's seemingly unbounded discretion to set distances (at least on the low side to the contractor's disadvantage) is exactly what the Supreme Court was doing.[58]

The Supreme Court in *Kihlberg* articulated that restriction in three parts: that duty could be breached (1) by outright fraud, or (2) by a judgment so off-kilter that it "would necessarily imply bad faith," or (3) by a "failure to exercise an honest judgment."[59] Anticipating issues to come, this three-part enunciation of the good faith duty incorporated regulation of both *intentional* malfeasance (i.e., "fraud") and *unintentional* malevolence that simply skewed the exercise of the duty such that a reasonable, objective person would not consider the discretionary exercise of the duty to be fair, honest, or reasoned, but biased and inconsistent with the justified expectations of the other party.

Contracts].

[56] *Kihlberg*, 97 U.S. at 401–02.

[57] 188 N.E. 163, 166 (N.Y. 1933). *See generally* Burton & Andersen, *supra* note 11, at 23–29.

[58] As Corbin explains, when one party has performed under an open-price term, the remedy is identical whether it is considered to be under the contract or, if the contract is not enforceable due to indefiniteness, under quasi-contract. Corbin on Contracts § 99, at 444–45. If the Supreme Court had found the contract to fail for indefiniteness, it would still likely have awarded a remedy for the part performed, but would not have been bound by the contract's price term granting discretion to the quartermaster to set the amount. *See* Clark v. United States, 95 U.S. 539, 542–43 (1877) (holding contractor entitled to recover in *quantum meruit* for performance under void contract).

[59] 97 U.S. at 402.

Such bias could be implied from the discretionary act itself.[60] It bears repeating, though, that in 1879 when the Supreme Court decided *Kihlberg* the doctrine of good faith duties was not commonly articulated as a limiting theory in contract law,[61] and so *Kihlberg* can rightfully be seen as a groundbreaking decision in the field. In that sense, it is no surprise that Justice Harlan cited no other precedent for his ruling for the unanimous Court.[62]

Act Two. The Supreme Court Applies the Rule to Other Contract Clauses

Over the rest of the Nineteenth Century, the Supreme Court applied the *Kihlberg* standard of "such gross mistake as would necessarily imply bad faith or failure to exercise honest judgment" in three other principal cases. In doing so, the Court expanded the standard's application to other contract clauses giving one party discretionary duties that bind the other, never requiring animus to show a breach of good faith when exercising those duties.

In the 1883 decision of *Sweeney v. United States*,[63] the contractor built a wall with materials that he had previously been told were unacceptable and, after completion, the government's engineer refused to certify the wall's acceptability.[64] The contract provided that payment was contingent on the government's "civil engineer, or other agent, [having] certified that it is in all respects as contracted for . . . ."[65] Applying the *Kihlberg* standard, the Court, in a unanimous opinion by Chief Justice Waite, noted that the engineer's determination was conclusive because the Court of Claims had found that "there was neither fraud, nor such gross mistake as would necessarily imply bad faith, nor any failure to exercise an honest judgment on the part of the

[60] *Id.*

[61] *See generally* Burton & Andersen, *supra* note 11, at 23–29.

[62] There is earlier precedent that could be cited as the progenitor of the good faith doctrine. Five years earlier, in the 1874 case of *Corliss Steam-Engine Co. v. United States*, 10 Ct. Cl. 494 (1874), *aff'd*, 91 U.S. 321 (1875), the newly constituted U.S. Court of Claims pronounced that the federal government must deal with its contractors "in the strictest fairness and justice." *Id.* at 502. The Court also recognized the government's implied duties "to do whatever is necessary for him to do to enable plaintiffs to comply with their promise or covenant." United States v. Speed, 75 U.S. 77, 84 (1869); *see also* United States v. Smith, 94 U.S. 213, 217 (1877) (finding implied duty not to interfere with contractor's performance); United States v. Bostwick, 94 U.S. 58, 65–66 (1877) (finding implied obligation in every lease that the lessor will not intentionally or negligently harm the property applicable to the government).

[63] 109 U.S. 618 (1883).

[64] *Id.* at 618.

[65] *Id.*

officer in making his inspections."[66] In this decision, there is no indication that the contractor was required to have proven intentional misconduct to meet the "gross mistake as would necessarily imply bad faith" standard.

Justice Harlan again wielded the pen for a unanimous Court in the 1885 decision of *Martinsburg & Potomac Railroad Co. v. March*.[67] Although the dispute was between private parties only, a contractor and a railroad, Justice Harlan applied the *Kihlberg* and *Sweeney* decisions to analyze the effect of contract clauses that gave the railroad's engineer final say in whether the work was satisfactory, clauses that used language strikingly similar to that construed in *Sweeney*.[68] Justice Harlan held that the contractor had not even stated a cause of action because the railroad's engineer had refused to issue a certificate of satisfaction when the contractor had not averred that the engineer "had been guilty of fraud, or had made such gross mistake in his estimates as necessarily implied bad faith, or had failed to exercise an honest judgment in discharging the duty imposed upon him."[69] Justice Harlan went on in dicta, however, to remark that the judge had improperly explained the applicable standard to the jury. The trial judge had instructed the jury to determine whether the engineer had acted with "fraud or intentional misconduct" or had committed a "gross mistake."[70] Justice Harlan instructed that this was insufficient, because the trial court should have further explained that "the mistake must have been so gross, or of such a nature, as necessarily implied bad faith upon the part of the engineer."[71] He explained that, from the contract's clauses, it must be "presumed" that the parties were aware of the possibility that the engineer might err or make common mistakes.[72] He then stated that, while the parties chose to risk such mistakes,

> the law presumes they did not intend to waive . . . that the engineer should, at all times, and in respect of every matter submitted to his determination, exercise an honest judgment, and commit no such mistakes as, under all the circumstances, would imply bad faith.[73]

Although the Court spoke in dicta, three points of relevance can be discerned from this latter passage in *Martinsburg*. First, the Court believed it was applying in government contracts cases (like *Kihlberg*) the same rule as applied in private disputes (like *Martinsburg*). Second, there is a distinction between, on the one hand, fraud or intentional misconduct and, on the other, gross

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[66] *Id.* at 620.

[67] 114 U.S. 549 (1885).

[68] *Compare id.* at 550–51, *with Sweeney*, 109 U.S. at 619.

[69] 114 U.S. at 553.

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.* at 554.

mistakes that would imply bad faith or lack of an honest effort or judgment. In other words, the party alleging breach of the exercise of a discretionary duty did *not* have to prove *intentional* misconduct, but only bias, *which could be shown from the very result of the exercise of discretion itself*. Third, this duty not to exercise discretion in bad faith was imposed on the parties as a matter of law. While not yet articulating it in terms of good faith duties[74] (Justice Cardozo's decision in *Kirke LaShelle Co.* was still almost a half-century in the future), the Court nevertheless implied that the contracting parties intended such a restraint on discretionary action by one party that could deprive the other party of the benefit of its bargain.[75]

In 1891, the Supreme Court, in *Chicago, Santa Fe & California Railroad Co. v. Price*,[76] again applied the *Kihlberg* rule in a contract between private parties.[77] In that case, the Court made a sharp distinction between intentional fraud and unintentional errors, thereby indicating that willful misconduct was *not* required under the *Kihlberg* standard.[78] However, the Court did not yet indicate a modern understanding of good faith duties, holding that "mere incompetency or mere negligence" does not equate to a mistake "so gross as to imply bad faith."[79]

Act Three. The Court of Claims and the Supreme Court Solidify That Bad Faith Does Not Require Intentional Misconduct

The Court of Claims read *Kihlberg*, *Sweeney*, and *Martinsburg* to apply a bad faith standard to limit government contracts clauses that on their face give absolute discretion to the government. The court understood the standard to allow it to police the performance of government agents such that a contractor could prevail *without* proving intentional wrongdoing. If the agent's exercise of discretion was so unreasonable or out of bounds that it implied a bias in favor of his government employer or demonstrated the lack of an honest

[74] It can reasonably be argued, however, that the Court's requirement articulated in *Kihlberg* that the exercise of discretion be an "honest judgment," Kihlberg v. United States, 97 U.S. 398, 402 (1879), is the linguistic equivalent of "in good faith."

[75] Justice Harlan in *Martinsburg* did not explicate what he perceived to be the difference between "gross mistake" and "such a gross mistake as necessarily implied bad faith." *Id.* at 553. The most obvious explanation, however, is that he faulted the trial court for not expressly instructing the jury that bad faith could be *implied*.

[76] 138 U.S. 185 (1891).

[77] *Id.* at 193.

[78] *Id.* at 195.

[79] *Id.*; *see also* Sheffield & Birmingham Coal, Iron & Ry. Co. v. Gordon, 151 U.S. 285, 292 (1894) (applying *Kihlberg*'s standard of "fraud or mistake" in context of private agreement).

(good faith) attempt to fulfill his contractual duty, the exercise of discretion was a breach, whether or not done with an intent to injure the contractor. Zeal to favor the government or a desire to protect the public fiscally did not excuse the irrationality; to the contrary, these natural motivations were some of the very reasons discretionary decisions of government agents needed to be policed in public contracts.

This was demonstrated in the 1912 case of *Ripley v. United States*.[80] *Ripley* involved building a jetty in a Texas harbor.[81] Like in contracts discussed in prior cases, this contract gave the government engineer the right to decide the acceptability of the contractor's performance, in this case when blocks could be put on top of the jetty's core base (and thereby provide workers more protection and reduce delays in the work) and whether the contractor was using the correctly sized blocks.[82] The Court of Claims found that the engineer's refusal to allow blocks to be added as requested by the contractor "was gross error and an act of bad faith on his part."[83] It made no similar finding with respect to the size of the blocks, but the Court of Claims granted the contractor relief on both aspects of the case.[84]

On appeal, Justice Lamar, for a unanimous Supreme Court, noted that, once again, the Court was dealing with a contract that vested final discretion in one party's agent to determine satisfactory performance by the other.[85] As to the size of the block, then, the Court reversed the Court of Claims because, in "the absence of fraud, or gross mistake implying fraud," the government's decision "was conclusive."[86]

This formulation of the *Kihlberg* test, on first glance, would seem to equate bad faith with fraud, requiring intentional misconduct. But the passage is dicta and, when read in context, is not retrenching on the *Kihlberg* rule. It is dicta because the Court of Claims did not find a gross mistake necessarily implying bad faith with respect to the issue of the size of the stone.[87] Thus, if the dicta were intended as a new test, it was not applied in *Ripley.* Moreover, Justice Lamar seemingly committed his own "gross mistake" by misquoting the Court's prior precedent. The "gross mistake implying *fraud*" formulation

[80] 45 Ct. Cl. 621 (1911), *aff'd as modified*, 223 U.S. 695 (1912); *see also* United States v. Gleason, 175 U.S. 588, 602, 607–08 (1900) (describing *Kihlberg* rule as involving either fraud or gross mistake or negligence).

[81] *See* 223 U.S. at 695–96.

[82] *Id.* at 696–97.

[83] *Id.* at 700.

[84] *See id.* at 496.

[85] 223 U.S. 695 (1912).

[86] *Id.* at 704.

[87] *Id.* at 492.

(instead of "implying *bad faith*") was repeated earlier in the opinion in the following curious passage related to the laying of the blocks:

> The contract provided that these blocks should be put in place when "in the judgment of the United States agent in charge" the core or mound had sufficiently consolidated. Until the agent determined that the core had settled, the contractor had no right to do this part of the work. No matter how long the delay or how great the damage, he was entitled to no relief unless it appeared that the refusal was the result of "fraud or of such gross mistake as would imply a fraud." *Martinsburg & P.R. Co. v. March*, 114 U.S. 549; *United States v. Mueller*, 113 U.S. 153.[88]

This formulation quoted by Justice Lamar, "fraud or of such gross mistake as would imply a *fraud*," does not appear in either the *Martinsburg* or *Mueller* decisions he cited. In fact, the *Mueller* decision does not even discuss the *Kihlberg* rule.

When *Ripley* is read in fuller context, it is also clear that Justice Lamar was not trying to scale back on the *Kihlberg* test, but to apply it. Indeed, language immediately following the passage quoted above appears to *expand* the test to explain that *capricious* and *unreasonable* action equates to a "gross mistake necessarily implying bad faith." The Supreme Court in this passage moved still closer to modern articulations of good faith duties:

> But the very extent of the power and the conclusive character of his decision raised a corresponding duty that the agent's judgment should be exercised not *capriciously* or fraudulently, but *reasonably and with due regard to the rights of both the contracting parties*. The finding by the court that the inspector's refusal was a gross mistake and an act of *bad faith* necessarily, therefore, leads to the conclusion that the contractor was entitled to recover the damages caused thereby.[89]

Taken together with the lack of any finding by the Court of Claims that the government inspector acted fraudulently, but that he acted only with a gross error of judgment implying bad faith, *Ripley* cannot reasonably be read to have cabined the agent's good faith duties to be only to refrain from fraud or other intentional misconduct. Indeed, four years later, in 1916, the Supreme Court upheld a decision of the Secretary of the Treasury, on appeal by a contractor, when the contract made that officer's decision final, because there was "no attempt to impugn [his] *good faith*."[90] In other words, the Supreme Court, almost a century ago, equated lack of good faith with contractual bad faith.[91]

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[88] *Id.* at 701 (citing Martinsburg & P. R. Co. v. March, 114 U.S. 549 (1885); United States v. Mueller, 113 U.S. 153 (1885)).

[89] *Id.* at 701–02 (emphasis added).

[90] Merrill-Ruckgaber Co. v. United States, 241 U.S. 387, 392–93 (1916) (emphasis added).

[91] *See also* United States v. Mason & Hanger Co., 260 U.S. 323, 326 (1922) (ironically stating that the *Kihlberg* standard extended "the rule between private parties to the government" when *Kihlberg* was a forerunner of the law of good faith duties).

And that is the way that the Court of Claims consistently understood the law in the first half of the Twentieth Century. For example, in *Levering & Garrigues Co. v. United States*,[92] a construction contractor sued for delay damages.[93] The contract specified that the agency's appeals board held final decision-making authority on such matters.[94] The board granted the suit in part, but also assessed liquidated damages against the contractor for twenty-three days of delay.[95] Before the Court of Claims, the government recited the restrictive formulation of Justice Lamar's dicta in *Ripley,* arguing that such final decisions could not be set aside unless they were "fraudulent or so grossly erroneous that *fraud* will be implied."[96] The Court of Claims rejected that reading of *Ripley*, citing *Ripley* instead to strike down the assessment of liquidated damages for the twenty-three day delay because it was "so *arbitrary* and grossly erroneous as to constitute *bad faith*."[97] The Court of Claims made no findings that the government decision makers had acted with animus or intent to injure the contractor. The court based its conclusions of bad faith strictly upon the facts that (a) there was no evidence in the record to support the attribution of the delay to the contractor and (b) there was no evidence supporting the board's disallowance of the contractor's proven costs.[98] In other words, by 1931, arbitrary and capricious conduct and decisions that were unreasonable or not based on substantial evidence were equated with bad faith acts.[99]

Approximately a decade later, in *Penker Construction Co. v. United States*,[100] the Court of Claims reiterated its power to set aside the agency's "final decision" under a disputes clause if it was "arbitrary, capricious, or so grossly erroneous as to imply bad faith."[101] This test was met in that case in part because the

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[92] 71 Ct. Cl. 739 (1931).

[93] *Id.* at 756.

[94] *Id.* at 757.

[95] *Id.* at 755–56.

[96] *Id.* (emphasis added).

[97] *Id.* at 756–57 (emphasis added).

[98] *Id.* at 754.

[99] *See, e.g.*, Carstens Packing Co. v. United States, 52 Ct. Cl. 430, 434–35 (1917) (equating *Kihlberg* rule with unreasonable action); Mundy v. United States, 35 Ct. Cl. 265, 287 (1900) (equating rule with "the exercise of capricious and wanton power"); *see also* Moore v. United States, 46 Ct. Cl. 139, 172–74 (1910) (finding government liable when agent's direction caused contractor loss "which the exercise of ordinary care and skill should have foreseen").

[100] 96 Ct. Cl. 1 (1942).

[101] *Id.* at 36. The discussion above does not purport to be exhaustive of all Court of Claims cases applying the *Kihlberg* rule. *See also, e.g.*, Mitchell Canneries, Inc. v. United States, 77 F. Supp. 498, 502 (Ct. Cl. 1948) (holding that "findings of fact of a contracting officer are binding upon both the Government and the contractor if there is no fraud, gross mistake or

agency's decision was not supported by substantial evidence.[102] Two years later, in 1944, the court in *Needles v. United States*[103] required proof by the contractor "by the greater weight of the credible evidence of record"[104] (i.e., by a preponderance of the evidence), and rejected the need to show actual bias or animus, finding that arbitrary acts demonstrate lack of requisite good faith, or bad faith, "by the use of an objective standard."[105] Similarly, in *Penner Installation Corp. v. United States*,[106] the Court of Claims in 1950 rejected the idea that the "so grossly erroneous as to imply bad faith" standard required proof of animus against the contractor, repeating that the test was satisfied when there was evidence of evident partiality towards the government by its agent, which could be demonstrated by the substance of the decisions themselves.[107]

This consistent reading by the Court of Claims of the "bad faith" standard—equating it with arbitrary, unreasonable, or capricious action and decisions not based on substantial evidence—not only was consistent with the text and rulings of the relevant Supreme Court cases;[108] it was also consistent with the contemporaneous reiteration by the Supreme Court that, when the government steps into the market place, it steps "off its pedestal" as sovereign and its conduct is dictated by the rules applicable to private citizens.[109] During this period, the "rules applicable to private citizens" were marked by the maturation of the common law of good faith duties being applied to the exercise of discretion of a contractual power given to one of the parties.[110] Moreover, Congress in 1946, with the passage of the Administrative Procedure Act ("APA"), adopted

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arbitrariness"); McShain Co., Inc. v. United States, 83 Ct. Cl. 405, 409 (1936); S. Shipyard Corp. v. United States, 76 Ct. Cl. 468, 480 (1932).

[102] *Penker Constr. Co.*, 96 Ct. Cl. at 36–39.

[103] 101 Ct. Cl. 535 (1944).

[104] *Id.* at 593.

[105] *Id.* at 602–05.

[106] 89 F. Supp. 545, 548 (Ct. Cl. 1950), *aff'd by equally divided court*, 340 U.S. 898 (1950).

[107] *Id.*; *see also* Crowley v. United States, 105 Ct. Cl. 97, 114 (1945) (holding that a clearly erroneous contract interpretation by government agent could "imply bad faith," even if it were "not intentional").

[108] In United States v. Blair, 321 U.S. 730 (1944), the Supreme Court also impliedly recognized that the *Kihlberg* standard could be met with less than intentional wrongdoing. In that case, the contracting officer's conduct was alleged to be biased, but the Court found that, even if the contracting officer's conduct "was so flagrantly unreasonable or so grossly erroneous as to imply bad faith," that same bias would not be imputed to the appeal board specified in the contracts disputes clause, and so the appeal procedure had to be followed. *Id.* at 736.

[109] Lynch v. United States, 292 U.S. 571, 579 (1934).

[110] *See generally* Burton & Andersen, *supra* note 11, ch. 2.

the "arbitrary and capricious" review standard for agency action.[111] Congress in that act also embraced the "substantial evidence" and "abuse of discretion" tests under which agency action could be reviewed and set aside.[112]

By mid-century, then, it seemed clearly settled that the *Kihlberg* standard for reviewing the government's exercise of contract discretion was *not* limited to fraud and intentional wrongdoing. Instead "such gross mistake as would necessarily imply bad faith" was basically equated with what became the APA's standards of "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" or "unsupported by substantial evidence."[113] Fraud, of course, was still forbidden, but fraud by a government agent acting on behalf of his employer is not as great a danger as it is with respect to a private party acting on his own behalf. Nevertheless, government agents are just as prone to abusing their discretion in gross, arbitrary, capricious, and abusive ways as are private citizens. They are just as prone to wear unintended blinders or to have their vision clouded by overzealous attachment to the interests of their employer or by hopes of personal advancement.[114] Indeed, such biases are all the easier to rationalize in government contracts, when the ultimate intent may be to save the government money or to benefit the troops—noble

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[111] 5 U.S.C. § 706 (2012) (originally enacted as Act of June 11, 1946, ch. 324, § 10(e), 60 Stat. 243).

[112] *Id.* The progenitors of the APA's substantial evidence standard are found in the Wagner Act, 29 U.S.C. § 160(e) (originally enacted as Act of July 5, 1935, ch. 372, § 10(e), 49 Stat. 449, 454), which was amended in 1947 by the Taft-Hartley Act to change the review standard from "[t]he findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive," which some courts held required affirmance if there was any supporting evidence. *See, e.g.*, NLRB v. Nevada Consol. Cooper Corp., 316 U.S. 105, 106–07 (1942) (holding that the NLRB's findings would be conclusive "if supported by evidence"). Congress adopted the latter standard in the APA in 1946. *See generally* Universal Camera Corp. v. NLRB, 340 U.S. 474, 487–88 (1951).

[113] § 706(2)(A), (E).

[114] The Court of Claims put it this way in *Penner Installation Corp. v. United States*:

> To ask the contracting officer to act impartially when he must decide a dispute between the contractor and his employer is, indeed, putting upon him a burden difficult to bear. And yet the contract requires him to do so.
>
> So, if in any case we say that the contracting officer has not acted in good faith, we mean only that he has not in good faith discharged his duties as an impartial, unbiased judge. We do not at all mean to impugn his fidelity to his employer. Indeed, it is this fidelity to his employer that makes it so difficult for him to act impartially.

89 F. Supp. 545, 548 (Ct. Cl. 1950), *aff'd*, 340 U.S. 898 (1950).

goals in the abstract, but not when they are used to divest contractors of their justified contractual expectations.[115]

Act Four. The *Wunderlich* Majority's Backsliding Generates an Immediate Backlash

Given the progressive acceptance of good faith duties in contracts in the common law and Congress's expansion of the corresponding judicial review of other agency action, the continued broadening of the "bad faith" finality exception first articulated in *Kihlberg* to include arbitrary and capricious conduct and failure of agency boards to act on the basis of substantial evidence was entirely predictable. The Court of Claims in its 1951 decision in *Wunderlich v. United States*[116] continued that trend, finding that the department head's resolution of a dispute arising under the contract was not entitled to finality because it was "arbitrary," "capricious," and "grossly erroneous."[117] The Court of Claims issued no less than 111 pages of fact-finding on approximately forty claims, each and every one of which had been denied *en toto* by the Secretary of the Interior, whose decision on questions of fact per the contract was to be "final and conclusive."[118] The court found the secretary's decisions in some respects to be devoid of evidentiary support—and, thus, to be so grossly erroneous as to necessarily imply bad faith—and granted judgment in those instances for the contractor.[119]

It came as a thunderbolt out of nowhere, then, when the Supreme Court reversed the Court of Claims in *Wunderlich.* Justice Minton, for a divided Court, in one short paragraph took the *Kihlberg* standard—"in the absence of fraud or such gross mistake as would necessarily imply bad faith, or a failure to exercise an honest judgment"[120]—to a place it had never been, ruling that it required a showing of *intentional dishonesty*:

> In *Ripley v. United States*, 223 U.S. 695, 704, gross mistake implying bad faith is equated to "fraud." Despite the fact that other words such as "negligence," "incompetence," "capriciousness," and "arbitrary" have been used in the course of the opinions, this Court has consistently upheld the finality of the department head's decision unless

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[115] *E.g.*, SUFI Network Servs., Inc. v. United States, 108 Fed. Cl. 287, 295 (2012), *aff'd in part, rev'd in part, vacated in part, and remanded*, No. 2013-5039, 2013-5040, 2014 WL 2210851 (Fed. Cir. May 29, 2014) (finding the ASBCA acted with obvious bias in favor of the government when setting damages despite multiple, willful breaches by the Air Force to assist troops in obtaining free phone calls by circumventing the contracted-for system).

[116] 117 Ct. Cl. 92, *rev'd*, 342 U.S. 98 (1951).

[117] *See, e.g.*, *id.* at 177, 219.

[118] *Id.* at 96–206.

[119] *See id.* at 207–20.

[120] United States v. Wunderlich, 342 U.S. 98, 99 (1951) (quoting *Kihlberg*, 97 U.S. at 402).

> it was founded on fraud, alleged and proved. So fraud is in essence the exception. By fraud we mean conscious wrongdoing, an intention to cheat or be dishonest. The decision of the department head, absent fraudulent conduct, must stand under the plain meaning of the contract.[121]

The dissenting justices did not take the majority to task for its cribbed (and inaccurate) reading of *Ripley* and its related precedent. Instead, they focused on broader public policies. Justice Douglas, joined by Justice Reed, while acknowledging that the case "reveals only a minor facet of the age-long struggle," broadly observed, "Absolute discretion is a ruthless master. It is more destructive of freedom than any of man's other inventions."[122] He decried the new rule:

> It makes a tyrant out of every contracting officer. He is granted the power of a tyrant even though he is stubborn, perverse or captious. He is allowed the power of a tyrant though he is incompetent or negligent. He has the power of life and death over a private business even though his decision is grossly erroneous. Power granted is seldom neglected.[123]

Justice Douglas articulated his opinion that the *Kihlberg* rule should be affirmed as the Court of Claims had been interpreting it for years: "We should allow the Court of Claims, the agency close to these disputes, to reverse an official whose conduct is plainly out of bounds whether he is fraudulent, perverse, captious, incompetent, or just palpably wrong."[124]

Justice Jackson penned a separate dissent in *Wunderlich*. He began by noting that the Court of Claims, with its substantial experience, had concluded "that contracting officers and heads of departments sometimes are abusing the power of deciding their own lawsuits which these contract [disputes clause] provisions give to them."[125] He criticized the majority for essentially reading out of the *Kihlberg* standard its critical text, "or such gross mistakes as necessarily implied bad faith," text which the Court had recently reaffirmed.[126] Justice Jackson then spoke more theoretically, analogizing to fiduciary obligations and the standards of good faith and fair dealing:

> [O]ne who undertakes to act as a judge in his own case or, what amounts to the same thing, in the case of his own department, should be under some fiduciary obligation to the position which he assumes. He is not at liberty to make arbitrary or reckless use of his power, nor to disregard evidence, nor to shield his department from consequences of its own blunders at the expense of contractors. . . . [H]e who bargains to be made judge of his own cause assumes an implied obligation to do justice. This does not mean

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[121] *Id.* at 100.

[122] *Id.* at 101 (Douglas, J., dissenting).

[123] *Id.*

[124] *Id.* at 102.

[125] *Id.* (Jackson, J., dissenting).

[126] *Id.* (quoting United States v. Moorman, 338 U.S. 457, 461 (1950)).

> that every petty disagreement should be readjudged, but that the courts should hold the administrative officers to the old but vanishing standard of good faith and care.[127]

Justice Jackson argued that, if anything, this judge-made rule should be expanded, not contracted, and should definitely not be constricted to intentional misconduct:

> I think that we should adhere to the rule that where the decision of the contracting officer or department head shows "such gross mistake as necessarily to imply bad faith" there is a judicial remedy even if it has its origin in overzeal for the department, negligence of the deciding official, misrepresentations—however innocent—by subordinates, prejudice against the contractor, or other causes that fall short of actual corruption. Men are often more bribed by their loyalties and ambitions than by money.[128]

The majority decision in *Wunderlich* provoked immediate outrage.[129] Justice Minton in that decision had voiced the challenge, "[i]f the standard of fraud that we adhere to is too limited, that is a matter for Congress,"[130] and Congress quickly accepted it.[131] Within two years, representatives and senators had introduced no less than eight, complementary bills "to overcome the effect of the Supreme Court decision" in *Wunderlich*.[132] The House report on the bill as passed, which became known as the "Wunderlich Act," noted that representatives of both industry and government had all spoken in favor of the proposed legislation in public hearings.[133] The House report noted that the *Wunderlich* majority had overturned the prior existing law that decisions should be set aside if they were arbitrary, capricious, or so grossly erroneous as to necessarily imply bad faith.[134] The representatives quoted the Court of Claims in this regard, noting that court's observation that, before *Wunderlich*,

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[127] *Id.* at 103.

[128] *Id.*

[129] *See* S&E Contractors, Inc. v. United States, 406 U.S. 1, 25 (1972) (Brennan, J., dissenting) ("*Wunderlich*'s narrow definition of the fraud exception alarmed the Government as well as contractors, for, in practical effect, it meant that disputes decisions were virtually invulnerable to challenge.").

[130] *Wunderlich*, 342 U.S. at 100. Words of this type are not unusual for the Court to pen, but they are almost always related to the Court's interpretation of an act of Congress. That was not the context in *Wunderlich*. The *Kihlberg* rule was a judge-made rule which, presumably, the Court had greater authority to alter.

[131] *See generally* 406 U.S. at 47–58, 69–90 (Brennan, J., dissenting). Justice Brennan in his dissenting opinion in *S&E Contractors* gives an overview of the legislative reaction to the *Wunderlich* decision, although his focus was whether the government could challenge an adverse agency determination in the Court of Claims.

[132] H.R. Rep. No. 83-1380, at 2 (1954), *reprinted in* 1954 U.S.C.C.A.N. 2191, 2191–92. Six bills were introduced within two months of the *Wunderlich* decision. *See S&E Contractors*, 406 U.S. at 69 app. (Brennan, J., dissenting).

[133] H.R. Rep. No. 83-1380, at 7.

[134] *Id.* at 2–3.

it had equated *Kihlberg*'s "bad faith" standard with the failure to observe good faith duties:

> Until the time of the decision in that case [*Wunderlich*], this court had reviewed the contracting officer's decision when it was shown to be arbitrary, capricious, or so grossly erroneous as to imply bad faith, notwithstanding the parties had contracted that all matters of disputed fact might be decided by one of the parties to the contract. *Such a provision we had understood called for the highest good faith on the part of the interested party making the decision*.[135]

The House report then quoted approvingly from the dissenting opinions of both Justice Douglas and Justice Jackson and concluded that the *Wunderlich* decision was not "consonant with tradition that everyone should have his day in court and that contracts should be mutually enforceable."[136] The act restored "the standards of review based on arbitrariness and capriciousness," which the House report noted "have long been recognized as constituting a sufficient basis for judicial review of administrative decisions," (correctly) citing *Ripley* in support—an obvious slap at the *Wunderlich* majority's inaccurate reading of that case.[137] The House report then continued by noting that the act was also designed to overturn the effect of the Supreme Court's 1950 decision in *United States v. Moorman*[138] by outlawing any clause in a government contract that purports to make an agency official's decision final on a matter of law.[139]

In passing the Wunderlich Act[140] (more accurately, the "Anti-Wunderlich Act"), Congress expressly added the arbitrary and capricious factors for review, as well as the review standard from the APA that fact findings must be supported by substantial evidence and cannot be contrary to law.[141] The act read that an agency decision is final and conclusive "unless the same is fradulent [sic] or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by substantial evidence."[142] It also

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[135] *Id.* at 3 (quoting Palace Corp. v. United States, 124 Ct. Cl. 545, 549 (1953)) (emphasis added). This articulation of the standard suggests that the law of good faith duties must be applied strictly against those representing the federal government.

[136] *Id.* at 4.

[137] *Id.*

[138] 338 U.S. 457 (1950).

[139] H.R. Rep. No. 83-1380, at 5.

[140] Act of May 11, 1954, Pub. L. No. 83-356, 68 Stat. 81 (codified as amended at 41 U.S.C. §§ 321–22 (2006)).

[141] *Compare id.*, *with* 5 U.S.C. § 706 (2006). The Wunderlich Act did not expressly add the APA's "abuse of discretion" test, but that additional phraseology would not appear to add anything of substance to the test. *See* ICSD Corp. v. United States, 934 F.2d 313, 317 (Fed. Cir. 1991) (equating the Wunderlich Act standard, as replicated in the CDA, with "abuse of discretion").

[142] 41 U.S.C. § 321.

provided that no effect was to be given to any contract provision attempting to make an agency decision maker's findings of law conclusive.[143]

While the "capricious or arbitrary" language was expressly added to the *Kihlberg* formulation, in actuality Congress was simply adopting the gloss which the Supreme Court from the Nineteenth Century and the Court of Claims in the Twentieth Century had put on the "so grossly erroneous as necessarily to imply bad faith" standard.[144] In other words, an agency violated good faith duties inherent in exercising its decision-making authority if it acted arbitrarily or capriciously or outside the evidence when deciding a contract dispute.[145] Congress emphatically *rejected* the idea that bad faith only applied to intentional misconduct or animus against the contractor and expressly *adopted* the understanding that, by failing to act in consonance with good faith duties, a government agent acts in bad faith.[146]

This was driven home by the Court of Claims in *Hoel-Steffen Construction Co. v. United States*.[147] The court was there confronted with the refusal of the contracting officer to permit a substitution under an Approval of Subcontractors clause.[148] The court did not find that the contracting officer had any malicious intent, but it did find that he had misunderstood the legal and factual circumstances and that his denial was "arbitrary and capricious."[149] The court further explained that, under the Wunderlich Act, the appropriate exception to limit the contracting officer's discretion under the Approval of Subcontractors clause was "so grossly erroneous as necessarily to imply bad faith."[150] It concluded that the agency's refusal "fits into this language as into a glove . . . ,"[151] and expressly rejected the suggestion that bad faith in this context requires a showing of a specific intent to injure the contractor.[152]

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[143] *Id.* § 322.

[144] *See* 342 U.S. at 100; H.R. Rep. No. 83-1380, at 3 (quoting Palace Corp. v. United States, 124 Ct. Cl. 545, 549 (1953)).

[145] *Id.*

[146] H.R. Rep. No. 83-1380, at 3–4.

[147] 684 F.2d 843 (Ct. Cl. 1982).

[148] *Id.* at 844.

[149] *Id.* at 847–50.

[150] *Id.* at 852.

[151] *Id.*

[152] *Compare* Haney v. United States, 676 F.2d 584 (1982), *with Hoel-Steffen Constr. Co.*, 684 F.2d at 851. The court distinguished situations in which there were allegations of bad faith in contract administration, citing *Haney*, 676 F.2d 584, and cases in which a statute confers finality on an administrative decision. *Hoel-Steffen Constr. Co.*, 684 F.2d at 851. The court also instructed that its decision in Knotts v. United States, 121 F. Supp. 630 (Ct. Cl. 1954), which, in a pay case, required a higher standard of proof for bad faith, the oft quoted "well nigh irrefragable proof," *id.* at 631, was misunderstood as requiring intentional wrong-

Denouement

Just ask O.J. Simpson: burdens of proof are a big deal. O.J. was not convicted of murdering his ex-wife and her new boyfriend when the jury had to find him guilty beyond a reasonable doubt,[153] but he was found responsible for their wrongful deaths when a later jury found it more likely than not that he had killed them.[154] Why the different burdens in O.J.'s two trials? The first was criminal; the latter, civil. The first threatened O.J. with loss of liberty; the latter, loss of money. In both trials, however, his innocence and good faith were assumed at the outset; it was up to the state (in the criminal trial) and then the families of the deceased (in the civil trial) to prove his guilt by the applicable standard. In the civil trial, the families also proved by a preponderance of the evidence that the killings were done with malice, justifying enhanced damages.[155]

Should the U.S. Government in its civil trials be held to a higher or a lower standard than O.J. Simpson in his civil trial? Is more or less at stake for the U.S. Government in a contracts case than O.J. had at stake in his wrongful death tort case? O.J. was subjected to obloquy by the civil verdicts; the United States suffers no such risk to its corporate being in a contract action. O.J. was wealthy, but the multi-million-dollar civil verdicts bankrupted him; contract damages will not bankrupt the U.S. Government. And should private citizens be held to the higher standard of conduct than their government? President Lincoln surely made this call correctly: "It is as much the duty of government to render prompt justice against itself in favor of citizens as it is to administer the same between private individuals." [156]

From the start, when the Supreme Court in *Kihlberg* recognized that good faith duties constrained discretionary contractual actions, it was not necessary

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doing as part of bad faith. The court noted that the standard of review was the *Kihlberg* "so grossly erroneous as to imply bad faith" standard and that the "irrefragable proof" found in *Knotts* "was wholly inferential and circumstantial. No one was found to admit he acted in bad faith." *Hoel-Steffen Constr. Co.*, 684 F.2d at 851. While noting the tensions in its precedent and attempting to minimize them, the court did not resolve them in a principled way. *See generally* Tecom, Inc. v. United States, 66 Fed. Cl. 736, 76469 (2005).

[153] *See* Christo Lassiter, *The O.J. Simpson Verdict: A Lesson in Black and White*, 1 Mich. J. Race & L. 69, 81, 110 (1996).

[154] *See* B. Drummond Ayers Jr., *Jury Decides Simpson Must Pay $25 Million in Punitive Award*, N.Y. Times (Feb. 11, 1997), http://www.nytimes.com/1997/02/11/us/jury-decides-simpson-must-pay-25-million-in-punitive-award.html?pagewanted=print.

[155] *See id.*

[156] Abraham Lincoln, *First Annual Message*, *in* 6 A Compilation of The Messages And Papers Of The Presidents, 1789-1897, at 51 (James D. Richardson ed., Wash. Gov't Prtg. Office 1897).

to show specific intent to harm to apply that brake.[157] In *Kihlberg*, for example, if the mileage fixed by the government agent had been half of any legitimate estimate, the Court undoubtedly would have found the quartermaster's exercise of his discretion to be "grossly erroneous" and, thus, made in "bad faith," even if innocently done.[158] "Bad faith" in this specific context would simply be the lack of a good faith effort to exercise his discretion in a way consistent with the purpose of the deal to estimate the mileage and not to do so in a way inconsistent with the justified expectations of the freight forwarder.[159]

The principle of *Kihlberg* and other early good faith cases was applied in disputes clause cases. The Court of Claims, as the good faith doctrine developed in the common law and disputes clauses calling for administrative resolutions of claims "arising under" the contract became commonplace, equated "so grossly erroneous as to imply bad faith" with arbitrary and capricious action and decisions not supported by substantial evidence of record.[160] That standard was adopted by Congress in the APA in 1946.[161] When, five years later, the Supreme Court in *Wunderlich* basically applied the Federal Arbitration Act review standard requiring fraud for decisions of independent arbitrators[162] instead of the APA standard for agency actions,[163] Congress promptly reinstated the "no specific intent" standard for contracts in which the federal government was a party.[164]

With this history, it is ironic that, over half a century later, the Federal Circuit still struggles with a consistent application of the modern law of good faith, contractual duties.[165] Half-measures are not what is needed to remedy the disconnect. Congress decreed an "about face" after the Supreme Court's

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[157] *See* Kihlberg v. United States, 97 U.S. 398, 401 (1879).

[158] *See id.* at 400–02.

[159] *See id.* at 402.

[160] *See supra* Part III.

[161] *See supra* notes 112–14 and accompanying text.

[162] *See* 9 U.S.C. § 10(a)–(b) (1946) (allowing vacating "[w]here the award was procured by corruption, fraud, or undue means" or "[w]here there was evident partiality or corruption in the arbitrators"). Congress passed the Federal Arbitration Act of 1925. Pub. L. No. 68-401, 43 Stat. 883 (codified as amended at 9 U.S.C. §§ 1–14 (1946)).

[163] *See* 5 U.S.C. § 706 (1946).

[164] *See supra* notes 141–47 and accompanying text.

[165] This is not to suggest that the Federal Circuit is the only jurisdiction to have inconsistent precedent in this area. *See, e.g.*, Terri J. Dobbins, *Losing Faith: Extracting the Implied Covenant of Good Faith from (Some) Contracts,* 84 Or. L. Rev. 227, 229 (2005) ("Despite decades of attempts to clarify the good-faith duty and its application in various contracts, almost all acknowledge that the cases in which courts have applied the duty of good faith are rife with inconsistencies and confusion, even within single jurisdictions."). As the *Kihlberg* history illustrates, this is to be expected as the common law develops.

majority misstep in *Wunderlich*.[166] But Congress is not realistically available to fix this current confusion. The Federal Circuit will need to heal itself by heeding the Supreme Court's admonitions for the last 100 years that, when the United States enters into contracts, it has no greater rights than those of a private party.[167] It should recall the words and example of its predecessor: "As always, the federal contract law we apply should take account of the best in modern decision and discussion."[168] This is the correct application of the Supreme Court's repeated instruction to apply the common law of contracts to government contracts.[169]

That common law lays out the following rules relating to contractual good faith duties:

> 1. Every contract has implied good faith duties that each party will cooperate with the other to achieve the purpose of the contract and that neither party is to exercise its discretion in a way to frustrate the other party obtaining the benefits of its bargain or to violate the other party's justified expectations.[170]
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> 2. The breach of good faith duties is, contractually, the same as acting in bad faith.[171]
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> 3. No specific intent, malice, or animus toward the other party need be shown to prove a breach of good faith duties (i.e., bad faith). It can be occasioned by neglect, stupidity, breach of law or other duty, or intent to advantage oneself, one's employer, or other third parties.[172]
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> 4. Breach of good faith duties, or bad faith, need only be proven by the same burden as every other contractual breach, by a preponderance.[173] Government agents, like private parties, are presumed to act in good faith until the opposite is shown. Government agents are not entitled to a greater presumption of propriety than private parties.[174]
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> 5. Willfulness, intentionality, animus, or malice is relevant in two senses, contractually. First, its presence is a strong (but not necessary) indicator of bad faith.[175] Second, its presence eases the degree of exactitude needed by the aggrieved party to prove

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[166] *See supra* notes 138–44 and accompanying text.

[167] *See supra* notes 1–8 and accompanying text. There are limited exceptions not applicable here. *See generally* Nibley & Totman, *supra* note 2.

[168] Padbloc Co. v. United States, 161 Ct. Cl. 369, 377 (1963); *see also* Nat'l Presto Indus., Inc. v. United States, 338 F.2d 99, 111 (Ct. Cl. 1964). Of course, as noted above, the Supreme Court in *Kihlberg* provided an early precursor of good-faith duties that anticipated the more explicit development of the common law by half a century. See *supra* notes 44–57 and accompanying text.

[169] *See supra* notes 9–42 and accompanying text.

[170] *See supra* notes 9–18 and accompanying text.

[171] *See supra* note 12 and accompanying text.

[172] *See supra* notes 22–42 and accompanying text.

[173] *See supra* note 11 and accompanying text.

[174] *See supra* notes 19–42 and accompanying text.

[175] *See supra* notes 28–30.

> damages for the breach or to bar the breaching party from proving an offset to the aggrieved party's proven damages.[176] This subjective bad faith, again, must only be proven by the wronged party by a preponderance.[177] To repeat, while subjective bad faith may reinforce the likelihood of a breach of good faith duties, in and of itself, it is not a breach, but becomes actionable when it is put to work by action or inaction that undermines specified obligations and/or rights in the contract.[178]

These rules are applicable to the field of government contracts from start to finish, from bid protest actions to terminations.[179] When colorable violations of good faith duties are alleged in bid protest actions, they should be viewed as a breach of the implied contract to give fair and honest consideration to an offer, a duty that arises under 28 U.S.C. § 1491(a),[180] as well as a breach of express duties in the Federal Arbitration Regulations ("FAR"),[181] also redressable under § 1491(b).[182] Similarly, unilateral discretionary actions by government officials during performance must continue to be bounded by

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[176] *See supra* notes 16–18 and accompanying text.

[177] *See id.*

[178] *See id.*

[179] *See infra* notes 182–85.

[180] 28 U.S.C. § 1491(a) (2012). *See generally* Claybrook, *supra* note 2, at 593–96.

[181] *See, e.g.*, 48 C.F.R. §§ 1.102(b)(3), 1.102–2(c) (2012). The CFC judges are in conflict as to whether these and similar FAR provisions are only hortatory or provide an independent ground of complaint. *Compare* Castle-Rose, Inc. v. United States, 99 Fed. Cl. 517, 532 (2011) (hortatory), *with* FFTF Restoration Co. v. United States, 86 Fed. Cl. 226, 237–40 (2009) (independent ground).

[182] 28 U.S.C. § 1491(b); *see* PGBA, LLC v. United States, 389 F.3d 1219, 1224 (Fed. Cir. 2004), *aff'g* 60 Fed. Cl. 196, 207; Banknote Corp. of Am. v. United States, 365 F.3d 1345, 1350 (Fed. Cir. 2003), *aff'g* 56 Fed. Cl. 377, 383; CW Gov't Travel, Inc. v. United States, 110 Fed. Cl. 462, 478–79 (2013). The CFC uniformly holds that discovery and evidence outside the administrative record is allowed to test allegations of bias, unfairness, and bad faith, but, applying Supreme Court precedent in *Citizens to Preserve Overton Park, Inc. v. Volpe,* 401 U.S. 402, 420 (1971), and Federal Circuit precedent in *Axiom Resource Management, Inc. v. United States*, 564 F.3d 1374 (Fed. Cir. 2009), the court initially requires a strong showing of a potential problem. *See, e.g.*, Linc Gov't Servs., LLC v. United States, 95 Fed. Cl. 155, 158 (2010); Madison Servs., Inc. v. United States, 92 Fed. Cl. 120, 129–31 (2010); L-3 Comm'ns Integrated Sys. L.P. v. United States, 91 Fed. Cl. 347, 354–56 (2010). While some cases, like *L-3*, acknowledge the showing for supplementation of the administrative record to prove bias in a bid protest action is less than the clear and convincing standard for the merits required by the Federal Circuit, if the showing is too "strong" or "substantial," the standard risks inconsistency with the *Wunderlich* experience and the modern development of the law. The allegation of animus is serious, but even if ultimately put to the heightened standard of proof on the merits, that should not prevent discovery based on a lesser showing of any plausibility, even if based on the alleged errors or inconsistencies of the challenged agency action itself.

good faith duties, such as decisions whether to accept a value engineering change proposal[183] or to grant an award fee.[184]

The Federal Circuit has put some good faith boundaries on the government's exercise of the termination for convenience clause, but it needs to give the topic a thorough reevaluation. The law supports that an agency abuses its discretion and violates good faith duties if it terminates and there were no changed circumstances.[185] Thus, if the government knew of a better contracting opportunity at the time it awarded a contract and then terminates to acquire the better deal, it breaches its good faith duties.[186] Presumably, the logic of this precedent is that there are no "changed circumstances" if the agency knew of the better deal *before* it contracted.

But why should there be any difference in result if the agency acted when it discovered the better deal *after* contracting? Some requirements contract cases suggest that it makes no difference,[187] and that is certainly the case under the common law. If a requirements buyer finds a better price during the contract term, he is not free to buy his requirements elsewhere.[188] The requirements seller priced his product on the assumption that he would supply all the needs, and so a diversion violates the justified expectations of the seller—no matter when the better market pricing is discovered or materializes.[189] Whether before or after contract award, a termination to acquire better pricing, whether partial or total, actual or constructive, would breach the buyer's good faith duties under the contract.[190] Nor is it necessary for there to be subjective animus to disqualify a termination action, in a requirements context or any other.[191] The focus must be on the justified expectations of the contractor under the contract and whether a termination violates them.[192] A contractor has a justified expectation that the termination clause will not be exercised unless there are changed circumstances.[193] This means that it may not be used just to

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[183] *See, e.g.*, M. Bianchi of Cal. v. Perry, 31 F.3d 1163 (Fed. Cir. 1994).

[184] *See, e.g.*, Burnside-Off Aviation Training Ctr. v. Dalton, 107 F.3d 854, 859–60 (Fed. Cir. 1997).

[185] *See* Salsbury Indus. v. United States, 905 F.2d 1518, 1521–22 (Fed. Cir. 1990); Maxima Corp. v. United States, 847 F.2d 1549, 1553, 1557 (Fed. Cir. 1988).

[186] *See* Krygoski Constr. Co. v. United States, 94 F.3d 1537, 1542 (Fed. Cir. 1996); Caldwell & Santmyer, Inc. v. Glickman, 55 F.3d 1578, 1581 (Fed. Cir. 1995).

[187] *E.g.*, Rumsfeld v. Applied Cos., 325 F.3d 1328, 1339 (Fed. Cir. 2003).

[188] *See id.*

[189] *See* Lockheed Martin Aircraft Ctr., 08-1 B.C.A. (CCH) ¶ 33,832 at 167,446 (Mar. 21, 2008).

[190] *See generally* Claybrook, *supra* note 2, at 569–82.

[191] *Id.*

[192] *Id.*

[193] *Id.*

get a better deal, no matter when discovered, or to recapture benefits already bargained away.[194]

Unfortunately, the Federal Circuit still often strays far from the proper path, as shown in *Precision Pine*[195] and in its late-2012 decision in *Road & Highway Builders, LLC v. United States*.[196] At issue in the latter case was the validity of a settlement agreement in which the Internal Revenue Service ("IRS") released tax liens on certain properties in exchange for $100,000, when the liens turned out to be worthless, but were not understood to be so at the time.[197] This agreement was not a procurement contract subject to the FAR, and both the CFC and the Federal Circuit analyzed the issue as whether IRS acted in "bad faith"—which it defined as with "specific intent to injure"—by clear and convincing evidence.[198] The taxpayer invoked Judge Wolski's analysis in *Tecom* that these heightened burdens of proof applied only when fraud or some other quasi-criminal wrongdoing was involved,[199] but the

[194] *Id.*

[195] Prior to the hopefully definitive limiting of the *Precision Pine* language by the Federal Circuit in *Metcalf Construction Co. v. United States*, 742 F.3d 984, 991 (Fed. Cir. 2014), other courts strove mightily to limit the unfortunate language in *Precision Pine* that on its face seemed to require a showing of intent to injure. *See* Precision Pine & Timber Inc. v. United States, 596 F.3d 817, 829 (Fed. Cir. 2010). The Federal Circuit majority in *Scott Timber Co. v. United States*, 692 F.3d 1365 (Fed. Cir. 2012), noted that a district court order preventing a contractor from obtaining the benefits of his contract gave rise to the "specific intent" language. *Id.* at 1375 n.4. The dissenting judge found the distinction specious and *Precision Pine* in conflict with earlier, controlling circuit precedent and called for its rejection en banc. *Id.* at 1380–82 (Wallach, J., dissenting); *see also* Centex Corp. v. United States, 395 F.3d 1283, 1309 (2005) (finding good faith and cooperation duties breached by congressional action); Struck Constr. Co. v. United States, 96 Ct. Cl. 186, 221 (1942) (holding, in oft quoted language, that the government's actions must be viewed in the aggregate to determine if it met its good faith duties). Some CFC judges limited *Precision Pine* to its facts of another government entity or third party being responsible for the interference with the contractor's justified expectations under the contract, rather than the contracting agency. *See* D'Andre Bros. LLC v. United States, 109 Fed. Cl. 243, 256 n.11 (2013); Fireman's Fund Ins. Co. v. United States, 92 Fed. Cl. 598, 675–77 (limiting *Precision Pine* to when "the Government's alleged wrongful conduct does not arise directly out of the contract; i.e., key to the alleged breach are actions involving another government actor or a third party").

[196] 702 F.3d 1365 (Fed. Cir. 2012).

[197] *Id.* at 1368.

[198] *Id.* at 1368–70, *aff'g* 102 Fed. Cl. 88 (2011) (internal quotation marks omitted) (citations omitted).

[199] *Id.* at 1369 (citing Tecom, Inc. v. United States, 66 Fed. Cl. 736 (2005)).

Federal Circuit rejected that limitation as inconsistent with its precedent, citing procurement cases.[200]

The issue in *Road & Highway Builders* was whether the agreement was void for lack of consideration because the lien turned out to be worthless.[201] The court properly recited the applicable common law, as reflected in the *Restatement*, that forbearance of a right (in that case, to tax) is valid, adequate consideration provided the forbearing party believes in good faith its right may fairly be determined to be valid.[202] But it then drove off the common-law highway by equating the *Restatement*'s "good faith belief" standard with an intent to injure the other party as set out (improperly) in some of its procurement cases. The common law requires neither proof of animus nor a heightened "clear and convincing" burden. Instead, to show lack of good faith in such a case, it is only necessary to show, by a preponderance, that one party knew it was getting something for nothing.[203] No specific intent to injure the other party need be shown.[204] Unfortunately, the Federal Circuit expanded its erroneous application of good faith law into this new territory, rather than limiting it and starting on the road back to the proper application of common-law principles.[205]

The term *bad faith* is used differently in different legal contexts. Sometimes it does, indeed, invoke concepts of intentional or grossly negligent behavior.[206] *Contractual* bad faith, however, is the equivalent of failing to act consistently with good faith duties. The standard for those duties is a constant—to act consistently with, and not to frustrate, the justified contractual expectations of the other party or "to reappropriate the benefits the other party expected to obtain from the transaction."[207] However, the application of that fixed

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[200] *Id.* (citing Savantage Fin. Servs., Inc. v. United States, 595 F.3d 1282, 1288 (Fed. Cir. 2010); Nova Express v. Potter, 277 Fed. Appx. 990, 993 (Fed. Cir. 2008); Galen Med. Assocs., Inc. v. United States, 369 F.3d 1324, 1335–37 (Fed. Cir. 2004)).

[201] *Id.* at 1368.

[202] *Id.* (citing Restatement § 74(1)).

[203] Restatement § 74 cmt. b, illus. 3 ("[T]he bargain is to be judged as it appeared to the parties at the time; if the claim was then doubtful, no inquiry is necessary as to their good faith.").

[204] *See id.*

[205] *See supra* note 157 and accompanying text.

[206] *E.g.*, Alyeska Pipeline Co. v. Wilderness Soc'y, 421 U.S. 240, 245, 247, 258–59 (1975) (holding that American Rule proscribes award of attorney's fees except for bad faith actions in litigation amounting to vexatious conduct and other exceptions); *see* 28 U.S.C. § 2412(b) (2012) (making government liable for attorney's fees and expenses to the same extent as a private party).

[207] Precision Pine & Timber Inc. v. United States, 596 F.3d 817, 829 (Fed. Cir. 2010); *see also* Metcalf Constr. Co. v. United States, 742 F.3d 984, 991–92 (Fed. Cir. 2014).

standard varies with the facts of the particular case. If the parties specifically delimit one party's duties, the other party has no justified expectation that the other party will exercise its discretion in his favor. And, sometimes, laws and regulations impose duties on the government that would not apply to private parties, most obviously in contract negotiation and formation.[208]

Conclusion

In *Kihlberg v. United States*, the Supreme Court in 1879 effectively ruled that the government's exercise of discretion under a federal contract is limited by good faith duties.[209] This rule, until 1951, continued to develop and expand along with the common law of good faith duties, requiring only an objective analysis in the context of the reasonable contractual expectations of the parties, not subjective animus or fraud.[210] When, in that year in *United States v. Wunderlich*, the Supreme Court tried to turn back the clock, misreading its own prior precedent in the process, Congress promptly overruled it.[211]

Unfortunately, this story is a twice-told tale, because the Federal Circuit has rolled back the clock by a century or more and has failed to apply the modern law of contractual good faith duties in multiple instances. That law does *not* require a showing of malice or intentional animus, but only action inconsistent with the reasonable expectations of the parties.[212] As elaborated in the *Restatement*, this breach of good faith duties is the equivalent of contractual bad faith.[213] This common law, consistent with more than a century of admonitions by the Supreme Court that the United States is generally subject to the same rights and responsibilities as private parties when it contracts, should be applied uniformly throughout the contracting process, from formation, during performance, to termination.

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[208] Another example is option exercise. A private party typically has no duty to act in any interest except its own in deciding whether or not to exercise an option, and so the other party has no justified expectations to enforce. However, the FAR imposes required considerations, 48 C.F.R. § 17.207 (2012), and so gives rise to justified expectations by the contractor. *See* Gov't Sys. Advisors, Inc. v. United States, 847 F.2d 811, 813 (Fed. Cir. 1988) (describing government's broad discretion whether to exercise an option); ALK Servs., Inc. v. Dep't of Veterans Affairs, 13-1 B.C.A. (CCH) ¶ 35,260 (Mar. 15, 2013) (reviewing option exercise for bad faith and arbitrary abuse of discretion).

[209] 97 U.S. 398, 402 (1879).

[210] *See supra* notes 15–29 and accompanying text.

[211] 342 U.S. 98, 100 (1951).

[212] *See supra* note 40 and accompanying text.

[213] *See supra* note 205 and accompanying text.