

Understand The Law Before You Contract

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Are you confident that you understand the laws applicable to the government contracts you enter? Contracting without being adequately informed about the law is certainly a gamble that could end up costing the unwary contractor in the long run.

Even if the law is ultimately favorable to your position, you could be found to have waived certain rights or breach of contract claims you may have otherwise had by knowingly entering a contract that is not in accordance with applicable laws or regulations. If you think you can take solace in the reasoning that you cannot possibly be expected to understand the law as well as the government entity with whom you contract, think again. Contractors simply cannot afford to enter contracts without knowing the law first.

Understanding the law entails much more than merely familiarizing yourself with well-publicized groundbreaking cases, it means being informed about and understanding all the cases, statutes and regulations applicable to your industry. Furthermore, even absent actual knowledge of the law, knowledge of the law may be imputed to a contractor for the purposes of determining waiver of contract claims. Simply stated, ignorance of the law is no defense. Furthermore, government contractors cannot assume that government contracts will be in conformance with the most current applicable laws and regulations. It is the contractor's responsibility to assert its rights and challenge illegal or unauthorized contract provisions BEFORE entering a contract.

A Paradigm Case

The United States Court of Federal Claims has recently reminded all government contractors of the importance of understanding the laws applicable to their work and the sometimes-harsh effects of the equitable doctrine of waiver. *Hermes Consolidated, Inc. v. United States*, No. 02-1460 C, 2003 WL 22495861 (Fed. Cl. Nov. 3, 2003) (though this case specifically deals with a government contractor, its holdings may also be applied to private contractors as well.) The *Hermes* case was an action for breach of contract which arose out of nine separate contracts for the sale of jet fuel between the plaintiff, *Hermes Consolidated, Inc.*, d/b/a Wyoming Refining Company (Wyoming, and the United States military, acting through the Defense Energy Supply Center (DESC). Between 1988 and 1994, Wyoming entered the contracts to supply the government with jet fuel for military purposes. Each of the contracts contained an Economic Price Adjustment (EPA) clause which tied the price of the contracts to the fluctuating average prices published monthly by the Department of Energy.

In 1992, however, in the seminal *MAPCO* case, the United States Court of Federal Claims held that a virtually identical EPA clause violated the Federal Acquisition Regulations (FAR). *MAPCO Alaska Petroleum, Inc., v. United States*, 27 Fed. Cl. 405 (1992). Now, more than a decade after *MAPCO* and at least 14 years after the first contracts were entered, Wyoming asserted its breach of contract claims based on the DESC inclusions of these illegal EPA clauses in its contracts with Wyoming. The DESC, armed with the venerable equitable doctrine of waiver and a string of binding federal cases, argued that by knowingly entering the contracts and by voluntarily performing under the contracts for such an extended period of time, Wyoming waived any breach of contract claims it may have otherwise had. In response, Wyoming, similarly armed with valid federal precedent, argued that, notwithstanding its voluntary performance, the DESC, acting as the arm of the federal government, should not be allowed to profit from contracts it drafted that violated known federal regulations.

After characterizing this split of authority as only apparent and not factual, the Court of Federal Claims held that Wyoming had in fact waived its breach of contract claim and was required to perform under the contracts notwithstanding the illegal EPA clauses. (The appeal period has yet to expire, but no appeals are notified to date.)

Two Lines of Waiver Cases

The Court of Federal Claims, when deciding *Hermes*, considered two separate lines of federal precedent with regard to waiver. The DESC asserted the line of cases that support the standard notion of the equitable doctrine of waiver; a

contractor is precluded from challenging the validity of a contract under an unlawful regulation or other illegality where the contractor fails to raise the problem prior to execution or litigation. *Hermes II*, 2003 WL 22495861, at *2 (citing *American Telephone and Telegraph Co. v. United States*, 307 F.3d 1374 (Fed Cir. 2002); *Whittaker Elec. Sys. v. Dalton*, 124 F.3d 1443 (Fed. Cir. 1997); *E. Walters & Co., Inc. v. United States*, 576 F.2d 362 (Ct. Cl. 1978)).

Waiver is generally understood as the intentional relinquishment or abandonment of a known right or privilege. E.g., *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938). Because knowledge of the law is normally presumed under common law, the DESC argued that Wyoming knowingly abandoned any possible breach of contract claims by initially entering the contracts when it knew, or should have known, that they contained illegal EPA provisions and by subsequently continuing to perform for a substantial period of time before challenging the provisions.

Wyoming propounded another line of federal cases that carve out an exception to the common law doctrine of waiver for government contractors. These cases hold that when a contractor enters a contract with the government that contains a provision the government is unauthorized to make, the contractor cannot be bound by the doctrine of waiver.

When a contract clause drafted by the Government is inconsistent with law, whether the [contractor] inquired, protested, accepted or otherwise assumed any risks regarding the same is not controlling; the impropriety will not be allowed to stand. *MAPCO*, at 416; see also, *Beta Sys., Inc. v. United States*, 838 F.2d 1179, 1185-86 (Fed. Cir. 1988); *Chris Berg, Inc. v. United States*, 426 F.2d 314, 317 (Ct. Cl. 1970). These cases seem to place the burden on the government to ensure that its contracts are in accordance with governing laws and regulations, therefore, even if a contractor fails to challenge an illegal provision, the government will not be allowed to profit from the contractor's mistake. So how did the *Hermes* Court determine that the DESC should be allowed to profit from an illegal contract provision at the expense of Wyoming?

The Middle Ground

The *Hermes* Court explained the apparent contradiction between the aforementioned cases by utilizing the familiar equitable tool of balancing the equities. The Court acknowledged that the *Beta/Chris Berg* line of cases stands for the proposition that the government should not be allowed to profit because of its own illegalities. However, the Court also stated this should not, and cannot, mean that a contractor has carte blanche to behave in any [manner] it wishes. These cases are not a court-made contractor's functional equivalent of 007's license to kill. The Court clarified that it must balance the desire to prevent devious contractors from preying on the public treasury with the similar desire to prevent the government from profiting when contractors are bound to perform under illegal contract provisions. *Hermes I*, 58 Fed. Cl. at 19.

Two Main Distinguishing Factors

The *Hermes* decision advocates the rule that courts should consider two main factors when balancing the equities in similar cases: the sophistication (education, background and experience) of the contractor, and the amount of time between entering the contract and challenging its provisions.

First, courts will consider the sophistication of the contractor because waiver [of contract claims] may be established either through an express statement or by implication through a party's conduct inconsistent with an intent to assert a right. *Hermes II*, 2003 WL 22495861, at *6 (citing *Mooney v. City of New York*, 219 F.3d 123, 131 (2d Cir. 2000); *Dooley v. Weil*, 672 F.2d 1340, 1347 (11th Cir. 1982)). Basically, the more sophisticated the contractor, the more willing the court will be to imply that the contractor knew of any illegal provisions yet acquiesced to the clauses and waived any right to sue by willingly proceeding by the terms of the contract.

Generally, parties are presumed to know the law, and ignorance of the law is no excuse. *Id.* (other citations omitted). Another interesting aspect of the *Hermes* decision was the court's rejection of Wyoming's argument that knowledge of the law cannot be imputed before the law has been concretely established by at least an appellate level court decision. The *Hermes* Court clarified that Wyoming was presumed to know and understand governing laws and regulations, including applicable FAR provisions, at the time they were adopted. Any later judicial pronouncement simply explains,

but does not create, the operative effect. Id. at 6-8 (other citations omitted). Wyoming was presumed to have known the laws included in the FAR even before the MAPCO decision.

Second, courts will consider the amount of time that elapsed between when the parties contracted and when the contractor challenged the illegal provisions. The Hermes Court explained that the key factual distinction between Beta Sys., Inc., Chris Berg, and Whittaker, E. Walters & Co., AT&T V, as well as [Hermes], is that in the former cases the contractors either complained during contract formation or, at the very least, at an early stage in the history of the conflict. Id. at *2. The law will not allow a party to reap the benefits of a contract and years later refuse to perform when the contract is no longer economically beneficial. Id. at *8. In essence, the Hermes Court explained that contractors must challenge suspect illegal provisions before entering a contract, or at the least, as soon as the contractor learns of the illegality, in order to avoid the somewhat harsh and costly effects of the doctrine of waiver.

Understand the law before you contract. A prudent contractor, whether private or government, must consider the current laws and regulations applicable to its industry before entering a contract. The amount of time and money spent during the initial contracting phase will be paid back in dividends by not inadvertently waiving your contract claims.