

IN THE UNITED STATES COURT OF FEDERAL CLAIMS

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HAMILTON SECURITIES ADVISORY		)	
SERVICES, INC.		)	
		)	
	Plaintiff,	)	CASE NO. 98-169C
		)	(Judge Horn)
v.		)	
		)	
UNITED STATES OF AMERICA,		)	
		)	
	Defendant.	)	
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**PLAINTIFF'S BRIEF IN SUPPORT OF  
ITS MOTION IN LIMINE**

Plaintiff, Hamilton Securities Advisory Services, Inc. ("Hamilton"), by its undersigned counsel respectfully submits the following Brief in support of its Motion in Limine. For the reasons set forth herein, the Court should grant the Motion.

**STATEMENT OF THE ISSUES PRESENTED**

1. Whether the Inspection of Services Clause provides a price adjustment for defects in services rendered by Hamilton?
2. Whether the Inspection of Services Clause is HUD's exclusive remedy because it affords complete relief in the form of a price adjustment?
3. Whether HUD's tort claim is barred by the Economic Loss Rule?

**STATEMENT OF THE CASE**

This case arises out of HUD's failure to pay Hamilton \$1,505,256 for work Hamilton performed in August, September and October 1997. HUD has

acknowledged that Hamilton is entitled to the claimed amount, but it has withheld payment based solely on an alleged right of setoff premised on a counterclaim in the amount of “at least \$3.8 million” against Hamilton. HUD’s counterclaim alleges counts of breach of contract and negligence based on a discrepancy in the running of a computer model designed to identify the most advantageous set of bids in sales of HUD-held mortgages. HUD received over \$1 Billion in two particular sales – the West of Mississippi and North Central sales – but claims it would have received \$3.8 million more in those two sales had the computer model discrepancy not existed.

As shown below, HUD has no entitlement to recover either under a breach of contract or tort theory, because Hamilton’s contracts contain a remedy granting provision covering the precise contingency presented here. The Inspection of Services Clause allows an equitable adjustment in price in the event the contractor renders defective services. The adjustment is based on the price of the defective services, and not on damage to the Government. The availability of such a contractual remedy prevents HUD from working a total forfeiture on Hamilton or recovering damages under either a breach of contract or tort theory.

In addition, HUD’s tort claim is barred by the economic loss rule, which bars litigants from recovering for economic losses suffered as a result of a breach of duties assumed only by contract. The courts refuse to intrude into the parties’ allocation of risk, as set forth in their contract, by superimposing tort-based liability on them. The parties are left to their agreed contractual remedy, which, in this case, is solely an adjustment of price pursuant to the Inspection of Services Clause.

## STATEMENT OF FACTS

In the mid-1990s, the Federal Housing Administration (AFHA@), headed by HUD's Assistant Secretary - Federal Housing Commissioner, Nicolas Retsinas, established a program in which it sold, by sealed-bid auction, mortgages held by HUD. **Joint Stipulation of Facts (“Stipulation”) 1.** In support of that program, HUD awarded Hamilton the two contracts at issue here: Contract No. DU100C000018161 (the A18161 Contract@) and Contract No. DU100C000018505 (the A18505 Contract@). **Stipulation 2.** Under those contracts, Hamilton was to provide, among other things, financial advisory support services necessary to sell or refinance HUD-held mortgages, and to conduct auction sales of groups of HUD-held mortgages. **Stipulation 3.**

Hamilton rendered services with respect to two auctions at issue in this case: the West of Mississippi Sale,@ conducted in September 1995 under the 18161 Contract, and the ANorth Central Sale,@ conducted in August 1996 under the 18505 Contract. **Stipulation 5.**

### The West of Mississippi Sale

The contracts were indefinite-quantity contracts, under which services were to be secured through the issuance of task orders. **Stipulation 4.** In March 1995, HUD issued Task Order 7 (effective March 29, 1995) to the 18161 Contract, which encompassed work on the West of Mississippi Sale. **Stipulation 6.** Task Order 7 had a period of performance of six months and, as modified, established a fixed

fee in an amount not-to-exceed \$1,765,631. **Stipulations 7 and 8.** Hamilton performed work under Task Order 7 during the period March through October 1995. **Stipulation 9.**

Task Order 7 stated that Hamilton was required to perform the following specific tasks relating to the West of Mississippi Sale:

- § The Financial Advisor shall oversee the design of the due diligence process, according to the Design created for the Southeast non-performing sale.
- X The Financial Advisor shall recommend alternative methods for structuring the mortgage sale and pricing options to maximize loan sale proceeds to HUD.
- § The Financial Advisor shall prepare advertisements and other materials for the pre-marketing of the loans to potential purchasers of multifamily mortgages.
- X The Financial Advisor shall design the auction process and prepare auction announcements containing data on mortgages offered for sale and the loan sale structure. The package should explain the procedures for bidding and should contain the necessary documentation required of purchasers, including any representations and warranties that HUD will make to purchasers.
- § Working with HUD and the contractor for legal counsel, the Financial Advisor shall review and oversee the design of the legal documents required, including the Loan Purchase Agreement.
- X The Financial Advisor shall prepare copies of loan documents for the purchase by potential bidders, including the preparation of the bid packages and all necessary due diligence materials.
- X The Financial Advisor shall manage and implement all phases of the bidding and auction process with responsibility for providing the necessary equipment, services, and supplies and managing the necessary personnel.
- The Financial Advisor will oversee the closings for the loan sales, including the contractor for legal counsel hired to handle such closings. It is

anticipated that the contractor for due diligence and legal counsel will notify mortgagors and taxing authorities regarding the change in mortgage ownership and change in billing address with oversight from the Financial Advisor.

**Stipulation 11.** It described nine deliverables Hamilton was required to provide, one of which was “[o]n the day of the auction, the Financial Advisor shall conduct all phases of the auction with responsibility for the personnel, equipment, services and supplies.” **Stipulation 12.**

Hamilton retained Bell Laboratories/ Lucent Technologies, Inc. (ALucent@) and instructed Lucent to use an “Optimization Model.” **Stipulation 18.** The Optimization Model was a computer model that was to evaluate the optimum combination of bids for HUD to accept in any particular auction of HUD-held mortgages. **Stipulation 17.** Hamilton paid Lucent \$20,000 to run the Optimization Model for the West of Mississippi Sale. **Plaintiff’s Separate Statement of Facts As To Which There Is No Genuine Dispute, ¶ 2.**

Lucent ran the Optimization Model on September 20-21, 1995, and HUD awarded mortgages based upon the reported bid results. **Stipulations 20, 23-25.**

HUD received revenues of \$385,196,928 from the West of Mississippi Sale.

**Stipulation 29.** HUD paid Hamilton the fee specified in Task Order 7 (as amended), \$1,765,631, for all services Hamilton performed relating to the West of Mississippi Sale. **Stipulation 28.**

### **The North Central Sale**

On April 25, 1996, HUD issued to Hamilton Task Order Number 1 under the

18505 Contract. **Stipulation 30.** Under Task Order 1, Hamilton was the “Crosscutting Advisor, and a different firm, Cushman & Wakefield, was the “Financial Advisor.” **Stipulation 32.** “Crosscutting” issues were issues and services that cut across transactions and Departmental disciplines and were best handled on a coordinated basis by one entity. **Stipulation 31.** Task Order 1 provided that Hamilton was to be paid a fee not to exceed \$20,842,000, payable in monthly installments of \$868,417. **Stipulation 33.**

Task Order 1 provided for Hamilton to provide services to HUD in the following areas:

- \$ Credit reform
- \$ Overall Project Management
- \$ Asset Sales Design
- \$ Due Diligence
- \$ Marketing the Transaction
- \$ Bid Date Review, Sale Approval and Post Auction Review
- \$ Post Closing Support
- \$ Data Review and Website Development and Maintenance
- \$ Budget and Budget Planning
- \$ Business Process Engineering; and
- \$ Staff Development.

**Stipulation 36.**

During the period of April 26 through September 25, 1996, Hamilton performed a multitude of tasks for HUD, including performing various tasks with respect to HUD=s Single Family Sale No. 3; providing general support for various HUD activities; advising on Credit Reform, Portfolio Reengineering and Portfolio Strategy issues, and participating in other HUD efforts. **Plaintiff’s Separate Fact Statement ¶ 7.**

Hamilton also worked on various aspects of the North Central Sale during the same period of time. **Stipulation 39.** As described in contemporaneous work summaries, Hamilton’s work on the North Central Sale included attending weekly sales meetings at HUD; briefing the financial advisor on optimization and credit reform; advising contractors on due diligence issues; creating maps of properties involved in the sale; reviewing executive summaries prepared by the financial advisor; monitoring information relating to the sale, and participating in post auction reviews. **Plaintiff’s Separate Fact Statement ¶ 6.**

Among other things, the “Bid Date Review” Specific Task section included a requirement to “[p]rovide and run an optimization model” on sales designated by HUD. **Stipulations 37 and 38.** HUD assigned Hamilton to provide and run the Optimization Model for the North Central sale. **Stipulation 42.** Hamilton retained Lucent to run the Optimization Model for Hamilton, and it paid Lucent \$59,000 for

such work. **Stipulation 43 and Plaintiff's Separate Fact Statement ¶ 8.** Lucent ran the Optimization Model on September 20-21, 1995, and HUD awarded the mortgages based upon the bid results. **Stipulations 45-47.** HUD received revenues of \$621,674,221 from the sale. **Stipulation 50.** Hamilton invoiced HUD, and HUD paid Hamilton, \$868,417 for all the services Hamilton performed from July 26 through August 25, 1996. **Stipulation 49.**

### **The Floor Discrepancy**

The Optimization Model used on the West of Mississippi and North Central Sales incorporated a "floor" feature, which meant that a bidder could condition its bid on the bidder's being awarded a certain volume (the floor amount) of mortgages, or none at all. **Stipulations 13, 16 and 40.** The bid instructions for both auctions stated that bidders should express their bid floors in terms of the unpaid principal balance ("UPB") of the mortgages bid upon. **Stipulations 15 and 40.**

In late October 1996, Hamilton realized there might have been a discrepancy in the way the bid floor was calculated in the West of Mississippi and North Central Sales. **Stipulation 51.** Hamilton conducted an investigation and determined that, on the two sales, the Optimization Model expressed the bid floor in terms of minimum revenue; i.e., the price offered by the bidder. **Stipulation 52.** As a result, in each of the two sales,

the Optimization Model identified as winning bids one or more bids that should not have been accepted and excluded one or more bids that should have been accepted. **Stipulation 54.**

In December 1996, Hamilton took corrective action for the future and disclosed the discrepancy to HUD Assistant Secretary Nicolas Retsinas and the Comptroller of the Federal Housing Administration, Kathryn Rock. **Stipulation 56.** Hamilton's December 20, 1996 Report on this matter states that use of the UPB floor in running the optimization model in the West of Mississippi Sale and the North Central Sale "would have generated increased proceeds" of \$3,883,551, consisting of additional proceeds of \$2,372,307 in the West of Mississippi Sale and additional proceeds of \$1,511,244 in the North Central Sale.<sup>1/</sup> **Stipulation 55.** It also states that this amount is less than 4/10ths of one percent of the proceeds generated in the two sales. **Stipulation 55.**

### **Performance and Payment After Disclosure**

Hamilton continued to perform services under the 18505 Contract through the end of 1996 and for most of 1997. **Stipulation 57.** HUD paid Hamilton for all invoices submitted before September 27, 1996. **Stipulation 58.** On October 17, 1997, the contracting officer issued a letter terminating the 18505 Contract for the convenience of the Government. **Stipulation 59.**

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<sup>1</sup> The quoted statement was based on construing all factors (e.g., all winning bidders actually going to closing on the two sales) favorably to HUD. **Plaintiff's Separate Fact Statement ¶ 11.**

### **HUD=s Offset Claim**

On October 17, 1997, HUD separately issued an offset claim against Hamilton in the amount of ~~At least~~ of \$3,883,551, which the contracting officer stated "at a minimum, represents the monetary loss to HUD as a result of Hamilton's performance failure." **Stipulation 60.** HUD has withheld payment of two of Hamilton=s invoices totaling \$1,505,256 solely on the basis of its alleged offset claim. **Stipulation 61.** HUD has acknowledged that, were it not for whatever right HUD has to withhold funds for setoff or recoupment based upon HUD's claims against Hamilton, \$1,505,256 would otherwise be due Hamilton. **Stipulation 65.** HUD has refused to pay Hamilton=s certified claim for such amount, based upon the alleged breach and liability of Hamilton. **Stipulation 66.**

### **Applicable Contract Provisions**

The 18505 and 18161 Contracts both contained, among other things, the Inspection of Services ~~B~~ Fixed Price clause, (Federal Acquisition Regulation (~~A~~FAR~~@~~) 52.246-4 (February 1992)). **Plaintiff's Separate Fact Statement ¶ 15.**

The Inspection of Services clause provides as follows:

- (a) Definitions. "Services," as used in this clause, includes services performed, workmanship, and

material furnished or utilized in the performance of services.

- (b) The contractor shall provide and maintain an inspection system acceptable to the Government covering the services under this contract. Complete records of all inspection work performed by the Contractor shall be maintained and made available to the Government during contract performance and for as long afterwards as the contract requires.
- (c) The Government has the right to inspect and test all services called for by the contract, to the extent practicable at all times and places during the term of the contract. The Government shall perform inspections and tests in a manner that will not unduly delay the work.
- (d) If the Government performs inspections or tests on the premises of the Contractor or a subcontractor, the Contractor shall furnish, and shall require subcontractors to furnish, without additional charge, all reasonable facilities and assistance for the safe and convenient performance of these duties.
- (e) If any of the services do not conform with contract requirements, the Government may require the Contractor to perform the services again in conformance with contract requirements, at no increase in contract amount. When the defects in services cannot be corrected by reperformance, the Government may (1) require the Contractor to take necessary action to ensure that future performance conforms to contract requirements and (2) reduce the contract price to reflect the reduced value of the services performed.
- (f) If the Contractor fails to promptly perform the services again or to take the necessary action to ensure future performance in conformity with

contract requirements, the Government may (1) by contract or otherwise, perform the services and charge to the Contractor any cost incurred by the Government that is directly related to the performance of such service or (2) terminate the contract for default.

**FAR 52.246-4.**

**ARGUMENT**

HUD must pursue its claim as an equitable adjustment in contract price. It may not recover under a breach of contract theory, because the contract includes a remedy-granting clause covering the precise contingency presented here. HUD's tort claim is similarly barred by the economic loss rule.

**I. The Contract Provides A Remedy**

**A. Subparagraph (e) Governs Here.**

Subparagraph (e) of the Inspection of Services Clause provides a remedy for the precise situation presented in this case; that is, a failure to perform according to the contract requirements. It states that “[i]f any of the services do not conform with contract requirements” and the defects “cannot be corrected by reperformance”

the Government may (1) require the Contractor to take necessary action to ensure that future performance conforms to contract requirements and (2) reduce the contract price to reflect the reduced value of the services performed.

**FAR 52.246-4(e).**

**B. The Inspection of Services Clause Provides For Adjustment In Price, Not Damages.**

In order to make an equitable adjustment pursuant to the Inspection of Services clause, “the Government assumes the burden of proof both with respect to entitlement and the accuracy of the amounts deducted.” ***Exquisite Service Company***, ASBCA No. 21058, 77-2 BCA ¶ 12,799 at 62,288 (1977). As to the latter element, “[t]he Government must show that its method of calculating the deductions reasonably reflected the reduced value of the services performed.” ***Capital Services, Inc.***, ASBCA No. 40510, 91-1 BCA ¶ 23,310 at 116,908 (1990). However, the adjustment is to the price of the defective services and is not for damages to the Government. ***Nash & Cibinic, Administration of Contracts***, George Washington University (3d Ed. 1995) at 864.

Typically, the price reduction under the Inspection of Services clause reflects the pro rata price of the unacceptable services or the individual price of segregable tasks or subtasks. ***See Capital Services, Inc.***, 91-1 at 116,908 (“each deduction was properly proportionate to the defective work for that particular task, and for that task only”); ***A&W General Cleaning Contractors***, ASBCA Nos. 14809, 15010, 15148, 71-2 BCA ¶ 8994 at 41,797, 41,802 (1971) (deductions in custodial services contract were to be based on percentage allocation between satisfactory and unsatisfactory work); ***Teltara, Inc.***, ASBCA Nos. 42256, 44917, 94-1 BCA ¶ 26,485

at 131,829 (1993) (deductions calculated based on individual pricing of each segregable task).

It is clear that the Government has no right under the Inspection of Services clause to deny the contractor payment of all amounts under the contract when only some of the services performed were unacceptable. The Government must pay for the services that were performed acceptably. **Orlando Williams d/b/a Orlando Williams Janitorial Service**, ASBCA Nos. 26099, 26872, 84-1 BCA ¶ 16,983 at 84,602-03 (1983) (contract clauses “contemplate that the deductions be proportionate to the unperformed or deficient work and that the contractor be paid for satisfactory services”). As the Armed Services Board explained in rejecting an “all or nothing” approach:

More significantly, the Government’s intention to treat an entire divisible service as unsatisfactory because of defects found in a distinct subtask, without crediting the contractor for satisfactory performance of other subtasks, tends to deprive the standard mandatory Inspection of Services clause of most of its ordinary coverage and normal usage.

**Kee Service Company**, ASBCA No. 28966, 86-3 BCA ¶ 19,242 at 31,779 (1986).

**See also Wright’s Auto Repair, Inc.**, ASBCA Nos. 29138, 31372, 88-1 BCA ¶ 20,449 at 103,424 (1988) (agency’s failure to give contractor credit for satisfactory performance of three sub-tasks “contravenes the ordinary coverage of the standard Inspection of Services clause”).

Indeed, one Board has stated that a services contract would be “unconscionable” and unenforceable, if it were to allow a complete deduction for work done just because some work was not done properly. **Northern Virginia Service Corporation**, GSBCA No. 7477, 85-1 BCA ¶ 17,815 at 89,044, 89,050 (1984). **See also Clarkies, Inc.**, ASBCA No. 22784, 81-2 BCA ¶ 15,313 at 75,832 (1981) (an “all or nothing” deduction is “an unfair and unreasonable payment penalty to impose on the appellant”).

Yet, the Government’s breach claim for \$3.8 million effectively is such an improper all or nothing deduction. It constitutes a complete forfeiture (and more) of all amounts HUD paid Hamilton for work performed on the WOM and NOC sales. HUD paid Hamilton \$1,765,631 on the WOM sale for a vast array of financial advisory services that Hamilton performed over the course of six months. **See Stipulations 11 and 12.** With the exception of the running of the Optimization Model, Hamilton performed all of the services satisfactorily, and HUD has never alleged otherwise. Notwithstanding Hamilton’s satisfactory performance of virtually all the work under that task order, HUD has asserted a claim for \$2,372,307 – over \$500,000 more than Hamilton was paid for all services it rendered.

Similarly, HUD seeks a deduction of \$1,511,244 on the NOC sale, which again is more than the total value of all services rendered with respect to the North Central Sale. Yet, again, Hamilton satisfactorily performed a wide variety of services

relating to the North Central Sale. **See Stipulation 39; Plaintiff's Separate Fact Statement ¶ 6.** It also performed a multitude of services that were wholly unrelated to the North Central Sale and which instead fell under other "Specific Task" categories. **See Plaintiff's Separate Fact Statement ¶ 7.** HUD's deduction is an order of magnitude greater than the \$59,000 cost of running the Optimization Model on the North Central Sale.

HUD has made no claim under the Inspection of Services Clause, relying instead solely on its breach and negligence theories. Even if, however, HUD were to claim an adjustment under the Inspection of Services Clause, it would not be entitled to a price reduction in excess of the costs associated with the running of the Optimization Model for the two sales. As shown above, those costs amount to no more than \$79,000 in all. **Plaintiff's Separate Fact Statement ¶¶ 2 and 8.** This figure represents the theoretical upper limit of any permissible deduction under the Inspection of Services Clause, because HUD actually derived great value from the running of the Optimization Model. Consequently, the Government cannot, as an alternative to its breach and negligence claims, justify its withholding of \$3.8 million based upon the Inspection of Services Clause.

**C. Subparagraph (f) Is Inapplicable.**

Subparagraph (f) of the Inspection of Services clause is inapplicable in the circumstances presented here. That subparagraph applies only in two

circumstances: (1) where the contractor fails promptly to perform the services again, or (2) where the contractor fails to take corrective action for the future. **FAR 52.246-4(f)**.

The first condition under which subparagraph (f) may be invoked does not exist here, because HUD never required Hamilton to perform the contract services again. As a matter of practical reality, the defects in the services could not be corrected by re-performance, because the mortgages at issue had already been sold. Such a contingency, however, is expressly contemplated by subparagraph (e) of the Inspection of Services Clause. The second condition allowing the Government to invoke subparagraph (f) does not exist because Hamilton did take corrective action for the future. **Stipulation 56**.

**D. The Government Did Not Elect To Proceed Under Subparagraph (f)**

Even if it were assumed for sake of argument that subparagraph (f) were applicable here – which it is not – it would afford the Government no relief, because the Government has not elected either of the remedies provided by that subparagraph. Subparagraph (f) allows the Government to elect one of the two remedies specifically enumerated. The Government may either (1) have the services performed and “charge to the Contractor any cost incurred by the Government that is directly related to the performance of such service,” or (2) terminate the contract for default. **FAR 52.246-4(f)**. The first of these remedies gives the Government the

right to recover costs paid to the replacement contractor. ***Kordick and Son, Inc. v. United States***, 12 Cl.Ct. 662, 670 (1987). The second, by sweeping in the default termination remedy, permits the Government to recover excess re-procurement costs as well as “any other rights and remedies provided by law.” ***FAR 52.249-8(b) and (h)***.

The Government did not elect either of the remedies specified in subparagraph (f). It did not re-perform the services, and, because re-performance was impracticable, subparagraph (e) expressly governs. HUD also did not elect the remedy of default, but rather elected to terminate the contract for the convenience of the Government. Having elected to terminate the contract for convenience, the Government cannot now convert it to a default termination to try to take advantage of the remedies provided by the default clause. ***A.M. Kinney, Inc.*** GSBCA No. 9329-TD, 89-2 BCA ¶ 21,717 at 109,203 (1989) (Board denied government counterclaim for excess re-procurement costs pursuant to the Default Clause, holding that the Government “cannot proceed in this appeal as if it had terminated the contract for default, when in fact it did not do so”).

## II. Price Adjustment Is The Sole Remedy Available Under The Contract

HUD's remedies in this case are limited to those set forth in the contract. Here, the contract provides for an equitable adjustment of contract price for defective services when the services cannot be re-performed. Because the contract contains this remedy-granting clause, the Government is limited to pursuing its remedies under that clause, and it may not seek to recover under a breach of contract or tort theory.      **A.      The Rule Is Well Established.**

The Court of Federal Claims has succinctly stated the principle governing here as follows:

contingencies contemplated by various contract clauses are remediable under those clauses of the contract, not as a breach of the contract.

***Triax-Pacific v. Stone***, 958 F.2d 351, 354 (Fed.Cir. 1992). ***See also Johnson & Sons Erectors Co. v. United States***, 231 Ct.Cl. 753, 759, ***cert. denied***, 459 U.S. 971 (1982) ("a claim remediable under a contract clause is not a breach and cannot be remediable as a breach"); ***Edward R. Marden Corp. v. United States***, 442 F.2d 364, 369, 194 Ct.Cl. 799 (Ct. Cl. 1971) ("[w]here a plaintiff, in a Government contract case, states a claim which is fully redressable under the contract, the plaintiff cannot be permitted to maintain a separate claim for breach which is merely a recharacterization of the claim which is redressable under the contract").

The reasons for following this principle are “highly important to the government as well as to the contractor,” because they permit the government to obtain the continued performance of the contract even when the government would otherwise be in breach of contract. ***Johnson & Sons Erectors***, 231 Ct.Cl. at 754.

The rule permits the Government itself to avoid liability under breach theories when a government delict is redressable under a contract provision. ***See Morrison-Knudsen v. United States***, 345 F.2d 833, 837, 170 Ct.Cl. 757 (1965) (“In a broad sense, every failure by the government to comply with its contractual obligations is a breach of contract . . . [b]ut we know this is not so”). The most prominent example of the advantage the Government derives from this principle is the protection it obtains from the termination for convenience clause, pursuant to which the Government’s liability and the contractor’s remedies are limited to those specifically enumerated in the clause and breach damages are barred. ***See William Green Constr. Co., Inc. v. United States***, 477 F.2d 930, 201 Ct.Cl. 616 (1973), ***cert. denied***, 417 U.S. 909 (1974).

**B. The Rule Barring Breach Claims Applies Here.**

The Courts have long and consistently held that claims remediable under the contract cannot be pursued as breach claims in the types of circumstances presented here. They have applied this rule whenever “complete relief is available under a specific provision of the contract;” that is, when the claim arises “under the contract.”

**See *Edward R. Marden Corp.***, 442 F.2d at 366-67. “A corollary principle is that, to the extent complete relief is not made available under a specific contract provision, a controversy is not subject to administrative determination” and may be pursued as a breach claim. ***Id.***, at 367.

As the Courts have used it in this context, the concept of “complete relief” simply means that “*some substantive contract provision authorizes the granting of a specific type of relief.*” **See *id.***, at 368, **quoting *Len Co. & Assoc. v. United States***, 385 F.2d 438, 181 Ct.Cl. 29 (1967) (emphasis in original). The Courts have also recognized that an equitable adjustment of the contract price constitutes the requisite “specific type of relief” to afford “complete relief” and, thus, preclude breach claims. ***Id.***, at 368 (“[w]e remain of the opinion that an adjustment provision is one which ‘authorizes the granting of a specific type of relief’”).

Here, the Inspection of Services Clause specifically provides for adjustment of the contract price: “the Government may . . . reduce the contract price to reflect the reduced value of the services performed.” ***FAR 52.246-4(e)***. Accordingly, it affords complete relief, and breach of contract and tort claims are barred by the availability of such a specific remedy.

**C. “Complete Relief” Means Price Adjustment.**

The Courts’ use of the term “complete relief” to mean price adjustment can readily be demonstrated by examining the historical development of the rule that

claims redressable under the contract must be remedied pursuant to the governing contract provision and not as breaches. This latter rule stems from the Government's own desire to provide administrative resolution of contract claims.

Prior to the enactment of the Contracts Disputes Act of 1978, the Boards of Contract Appeals had jurisdiction over disputes "arising under the contract" but not over those "relating to the contract." A controversy redressable by a specific contract provision was considered to arise "under the contract," while claims not redressable under specific contract adjustment provisions merely "related to the contract" and were thus considered to be "breach of contract claims." ***United States v. Utah Constr. & Mining Co.***, 384 U.S. 394, 404 n. 6, 86 S.Ct. 1545, 1551 n. 6, 16 L.Ed.2d 642 (1966). Because breach claims were beyond the jurisdiction of the Boards, they could be brought directly to the Court of Claims. The Court of Claims accordingly had to develop principles by which it could determine whether claims were redressable under the contract in order to determine the scope its own review of claims (i.e., de novo review of breach claims or Wunderlich Act review of claims arising under the contract). It was in this context that the Court adopted the "complete relief" formula, by which it meant that, if specific relief – a price adjustment – was available under the contract, the claim was one arising under the contract.

The Court of Claims explained the rationale for the "claims redressable" rule in ***Morrison-Knudsen Co.***, 345 F.2d at 837. In that case, the plaintiff initially

pursued a Board appeal of an equitable adjustment claim for costs arising out of the Government's changes to the contract work but was dissatisfied with its recovery from the Board. *Id.*, at 835. While acknowledging that "complete relief was available under the terms of the contract," the contractor then recast the claim as a breach claim in the Court of Claims. *Id.*, at 837. The Court of Claims rejected this attempt to convert a claim arising under the contract into a breach claim, explaining as follows:

In the broad sense, every failure by the government to comply with its contractual obligations is a breach of contract; this is the basis of our jurisdiction, 28 U.S.C. § 1491. In this context, a claim based on the inadequacy of an equitable adjustment would be a breach of contract. But we know this is not so. . . . Most government contracts, either by clauses contained therein or by regulation which form a part of the contract, prescribe specific remedies for certain breaches of the contract by the government. . . . Therefore, **where complete relief is available to the contractor under the provisions of the contract on a claim arising under the Disputes clause, the action is not one for such a breach of the contract that entitles either party to a de novo trial on the factual questions decided.**

*Id.* (citations and footnote omitted) (emphasis added).

Although the Court did not expressly define the term "complete relief," it is clear that it had in mind **only** the type of relief available from a board of contract appeals – that is, equitable adjustment of the contract price – and not breach damages. This latter point should be obvious, because Boards at that time had no

authority to award breach of contract damages, lost profits or consequential damages under any theory.

Stated another way, if the Court **had** used the term “complete relief” to mean breach damages, then no claim could ever have arisen “under the contract,” because the Boards could not have provided such relief. Such an illogical interpretation, however, would have rendered the *Morrison-Knudsen* holding an absurdity.

The Supreme Court specifically endorsed the *Morrison-Knudsen* holding in *Utah Constr. & Mining Co.*, 384 U.S. at 401-02, 86 S.Ct. at 1550. The Supreme Court stated as follows:

When a contract makes provision for equitable adjustment of particular claims, such claims may be regarded as converted from breach of contract claims to claims for relief under the contract.

*Id.*, at 404 n. 6, 86 S.Ct. at 1551 n. 6.

The Supreme Court explained that these concepts had developed over a long period of time, dating at least to 1937, when the Court of Claims first held that the jurisdiction of the boards of contract appeals was “limited to claims for equitable adjustments, time extensions, or other remedies under specific contract provisions authorizing such relief” and did not encompass breach claims. *Id.* at 405, 86 S.Ct. at 1552. It further explained that government agencies had demonstrated their understanding of the significant advantages of limiting their own exposure to breach claims, under the Court of Claims precedents, by acting “to create alternative

administrative remedies for some breach of contract claims and to disestablish others by fashioning additional specific adjustment provisions contemplating relief under the contract in specified situations . . . .” *Id.*, at 413, 86 S.Ct. at 1555. The Supreme Court used the example of the adoption of the (then) new Suspension of Work clause, which permitted an equitable adjustment in contract price for delay, as an “illustration of the disestablishment of breach of contract claims through the fashioning of additional contract adjustment provisions . . . .” *Id.*, at 415-16, 86 S.Ct. at 1556-57. There was no suggestion that consequential damages had to be encompassed in order to convert breach claims to claims redressable under the contract.

The Court of Claims provided additional clarification in its subsequent decision in *Len Co. & Assoc.*, 385 F.2d at 442. There, the Court made clear that the term, “complete relief,” as both the Court of Claims and the Supreme Court had previously used it, encompassed only the concept of price adjustment, and not consequential damages. The Court stated as follows:

To the extent that complete relief is available under a specific provision – i.e., the claim is both cognizable under and adjustable by the terms of the contract – such as the currently standard “Changes”, “Changed Conditions”, or “**Inspection**” clauses, the controversy arises under the contract and is subject to initial administrative resolution as provided in the normal “Disputes” article.

*Id.*, at 442 (emphasis added). The contract at issue in that case included non-standard Changes, Changed Conditions and Inspection clauses that had been specially drafted for contracts issued under the Capehart Construction Act. Those special clauses failed to make the controversy – a claim for constructive change costs incurred due to improper inspection – redressable under the contract. *Id.* Thus, contrary to the Government’s argument that relief was limited to “an equitable adjustment in the contract price,” the contractor was permitted to pursue a breach claim. *Id.*, at 451.

The Court, however, contrasted the specially-drafted Inspection clause of the contract with the **standard** Inspection clause, which expressly provided for a price adjustment, stating as follows:

In contrast to the silence of this special provision, the standard “Inspection” clause for construction contracts, in use when the Capehart Act provision was drafted and incorporated in plaintiff’s contract, clearly and explicitly provided for an adjustment in contract price as well as an extension of time if required.

*Id.*, at 452 (footnote omitted). Thus, the Court equated the concept of “complete relief” with the availability of “an adjustment in contract price.” **See also *Edward R. Marden Corp.***, 442 F.2d at 366-67.

Finally, in ***William Green Constr. Co.***, 477 F.2d at 934-37, the Court of Claims specifically rejected the notion that the concept of “complete relief” embraces consequential damages. The plaintiff in that case alleged a breach claim for lost

anticipated profits and consequential damages (loss of net worth, etc.) resulting from the Government's wrongful termination of three of its contracts. The contractor asserted that its breach claim was not precluded by the convenience termination clause, but the Court limited the plaintiff to the specified remedies under the termination for convenience clause, explaining as follows:

But it is very plain under our decisions that the administrative remedy is the only one available to the contractor. Green does not retain a "breach" claim for an improper default, which can be brought in court and through which a supplemental award can be obtained. The exclusive remedy "under the contract" substitutes for the "breach" claim which would otherwise exist, and becomes the claimant's sole form of relief. The measure of recovery for a convenience-termination – costs incurred plus a reasonable profit on work performed – is an adequate replacement for the common-law cause of action.

*Id.* at 934.

The Court then specifically rejected the argument that, because the convenience termination clause did "not give full enough relief for the injuries suffered," the breach claim must be permitted. *Id.*, 477 F.2d at 936. The Court acknowledged that the convenience termination clause did not provide for anticipated profits or other remedies available under common law actions. It noted, however, that the exclusion of anticipated profits was a "settled policy which has long been accepted and enforced." *Id.* at 936. It concluded, therefore, that the "administrative

remedy is . . . a full and permissible substitute for the award of damages under the former 'breach' claim." *Id.* at 937.

Here, the Inspection of Services Clause provides a similar substitute for the award of breach damages. It expressly permits adjustment of the contract price. In addition, the Inspection of Services Clause itself provides the Government entitlement to recover common law damages in certain circumstances, because it allows the Government to terminate the contract for default pursuant to subparagraph (f) of the clause.<sup>2/</sup> The Default clause expressly states that "[t]he rights and remedies of the Government in this [default] clause are in addition to any other rights and remedies provided by law or under this contract." **FAR 52.249-8** (Fixed-Price Supply and Service) (April 1984). In other words, the Government had a contractual method of resorting to its common law breach and tort theories, but it declined to elect those remedies. Instead, it terminated the contract for convenience.

**D. HUD's Reliance on a Board Case Is Misplaced.**

The Government has relied on *PAE International*, ASBCA No. 45314, 98-1 BCA ¶ 29,347 at 145,916 (1997) to argue that the Inspection of Services Clause does not preclude its claim for breach of contract seeking consequential damages. The Government's reliance on that case is misplaced, however, because the Board's

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<sup>2</sup> As explained above, subparagraph (f) does not apply under the facts here, because the Government did not direct re-performance or terminate the contract for default.

reasoning was unsound and its holding was contrary to the Court of Claims precedents discussed above.

In the ***PAE International*** case, the Government sought breach damages arising out of the theft of fuel oil from the U.S. Embassy in Japan by employees of the contractor that monitored fuel usage by the Embassy. The Government asserted a breach claim for the value of the stolen oil, and the contractor asserted that the Inspection of Services Clause precluded the breach claim. Relying solely on the proposition that generally an injured party in a breach of contract action is entitled to recover for two types of losses: (1) loss in the value of the other party's performance, and (2) any other loss, including incidental and consequential damages, the Board concluded that "[c]omplete, as opposed to partial relief for breach of contract includes, therefore, recovery for both types of loss." ***Id.***, at 145,921. It then allowed the breach claim, because the Inspection of Services clause does not encompass relief for consequential damages.

The difficulty with the Board's conclusion is that it is wholly at odds with the holdings of ***Morrison-Knudsen, Utah Constr. & Mining Co., Len Co. & Assoc.***, and ***Edward R. Marden Corp.*** Indeed, the Court of Claims specifically rejected the concept advanced by the Board – that "complete relief" must include such damages as lost profits and consequential damages – in ***William Green Constr. Co.*** While this Court may give weight to the holdings of the Boards, when appropriate, it cannot

do so when the Board's holding would effectively overrule longstanding precedents of the Court of Claims.<sup>3/</sup>

In addition, the Board's interpretation of the term "complete relief" **cannot** have been the same one the Court of Claims had in mind for a very simple reason. Under the Board's interpretation of that term, **no claim would have been within the Board's jurisdiction** at the time the Court set forth the "complete relief" formula. The Boards simply had **no** authority then to award consequential damages under any theory. There would have been no clause that afforded "complete relief" as the ASBCA now wrongly interprets that term, and, thus, **all** claims could have been brought as breach claims. Plainly, such a result is ludicrous.

Moreover, even if it were assumed for the sake of argument that the Board's decision in *PAE International* could overrule the Court of Claims precedents – which it could not – it would still not govern the contracts at issue here.<sup>4/</sup> This is because

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3 The Board's holding also undercuts the policy implicit in the Court of Claims decision that use of administrative remedies is to be preferred. Under the Board's fallacious reasoning, contractors would be free to seek breach damages in a myriad of situations because most contract clauses do not afford breach remedies.

4 The Board's conclusion was wrong for several other reasons. First, contrary to the Board's conclusion, the Inspection of Services Clause does provide relief for incidental or consequential damages, but only if the Government elects to terminate the contract for default, which it did not do here. **See FAR 52.246-4(f) and 52.249-8(h)**. The Board's reliance on *General Electric Co.*, ASBCA No. 45936, 94-1 BCA ¶ 26,578 at 132,239 (1994) in holding that the Inspection of Services Clause is not an exclusive remedy also was misplaced. *General Electric* involved the Inspection of Supplies--Fixed Price Clause, FAR 52.246-2 (April 1984), which, unlike the Inspection of Services Clause, expressly reserves the Government's rights to resort to "other rights and remedies provided by law" whenever acceptance is not conclusive. As noted, the Inspection of Services Clause limits resort to such other remedies solely to instances where the contract is terminated for default. **Compare 52.246-2(l) with FAR 52.246-4.**

the contracts here were executed long before the *PAE International* decision was issued, when the governing Court of Claims precedent defined “complete relief” in the more limited sense of meaning “price adjustment.” The parties could not have intended their contract to incorporate a meaning of “complete relief” that had not ever been adopted by the Courts or Boards. *See Utah Constr. & Mining Co.*, 384 U.S. at 404, 86 S.Ct. at 1551 (“when the parties signed this contract in 1953, neither could have understood” contract provisions to have a meaning different from their settled interpretations) *Len Co. & Assoc.*, 385 F.2d at 447 (“There is no indication . . . that when these parties signed their contracts in 1958, less than three years after the general provisions for Capehart Act housing contracts were prepared, the Government or the contractor believed, or was led to believe” that different interpretations of their provisions would be adopted because neither the boards nor the Court of Claims considered such contracts until after the parties’ contract was made).

**E. The Inspection of Services Clause Did Not Shift the Risk of Economic Losses.**

The only type of losses HUD has claimed are economic losses resulting from the alleged breach, and it is clear that Hamilton did not assume the risk of economic losses in the event of defective services. HUD and Hamilton only bargained for and agreed to a limited remedy in the event of defective services. As provided in the Inspection of Services clause, they agreed that Hamilton would assume only the

limited risk of an equitable adjustment in contract price. HUD clearly did not bargain – or pay – for additional remedies. Had HUD desired to shift the risk of economic losses to Hamilton, it would have required the inclusion of provisions specifically allocating such risk to Hamilton. The bargain here was different, however.

It is significant that subparagraph (e) of the Inspection of Services clause contains no reservation of any other rights or remedies for defective services. The absence of a reservation of other remedies persuasively demonstrates that HUD did not intend to reserve any, because the Government knows how to reserve other remedies when it wants to do so. Indeed, HUD did so under the Default Clause, which applies through subparagraph (f) of the Inspection Clause. As another example, the Inspection of Supplies – Fixed Price clause expressly provides that the specified remedies of replacement or price adjustment are “in addition to any other rights and remedies provided by law.” **FAR 52.246-2(I)**. Such language is conspicuously absent from the Inspection of Services clause in Hamilton’s contracts. Similarly, HUD expressly shifted the risk of other types of losses to Hamilton but failed to shift to Hamilton the risk of economic losses. HUD included in Hamilton’s contracts the Limitation of Liability – Services Clause, **FAR 52.246-25** (April 1984), which expressly made Hamilton liable up to its insurance limits for personal or property damage resulting from Hamilton’s performance. Because HUD included language to shift such risks in other circumstances and failed to include language

shifting the risk for economic damages in the circumstances presented here, the contracts must be interpreted as excluding liability on Hamilton's part for economic damages.<sup>5f</sup> See ***Nicholson v. United States***, 29 Fed.Cl. 180, 196 (1993) (applying doctrine of *expressio unius est exclusio alterius*).

Finally, it is significant that the Government plainly knows how to shift the risk of economic losses to the contractor, when it desires to do so. The Government has various clauses employing specific language to shift the risk of loss to contractors when appropriate. For example, the Responsibility of the Architect-Engineer Contractor clause (April 1984) explicitly provides that "the Contractor shall be and remain liable to the Government in accordance with applicable law for all damages to the Government caused by the Contractor's negligent performance of any of the services furnished under this contract." **FAR 52.236-23**. In a similar vein, the Indemnification and Medical Liability Insurance clause (September 1989) provides that "[t]he Contractor shall be solely liable for and expressly agrees to indemnify the Government with respect to any liability producing acts or omissions by it or by its employees or agents." **FAR 52.237-7(a)**. There was no such shifting of liability for

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<sup>5f</sup>This analysis is consistent with the economic loss rule discussed below. In addition, although it is not a warranty provision, the Inspection of Services Clause has attributes similar to such provisions. It provides for assurances that services will be performed, or re-performed in accordance with contract requirements, and it provides a specific remedy in the event re-performance is impracticable. Because warranty provisions allow recovery after acceptance, the Government is limited to the remedies enumerated in a warranty clause and "may not obtain a warranty remedy not specifically mentioned in the warranty clause." ***Kordick and Son, Inc. v. United States***, 12 Cl.Ct. 662, 668 (1987). The same principle should apply to the Inspection of Services Clause to the extent such clause permits price adjustments subsequent to acceptance.

losses under Hamilton's contract. Consequently, the contracts must be interpreted as excluding liability on Hamilton's part for such losses.

Because the parties did not bargain for, or agree to, an allocation of risk to Hamilton of the economic consequences of defective performance of services, the Government may not impose such risk retroactively through the assertion of breach or negligence theories of recovery.

**F. HUD May Not Seek To Have Its Contract Re-Written.**

Both the Supreme Court and the Court of Claims have confirmed that "it is within the parties' power to select their own remedies." *Len Co. & Assoc.*, 385 F.2d at 441. The corollary to this principle is that this Court may not re-write the parties' contract simply because one of the parties becomes dissatisfied with the bargain it struck. *Id.*, at 444.

The Government's allegation of breach and tort counts reduces to an attempt to re-structure the contract to give HUD increased rights in the face of defective services. HUD could have sought such greater rights at the time it drafted Hamilton's contracts, but it failed to do so. Accordingly, the Government may not look to this Court to give it retroactively what the Government itself failed to obtain when the contract was executed. The Government must live with the bargain it struck.

### **III. The Tort Count Is Barred By the Economic Loss Rule and Not Contemplated by The Contract**

HUD has also dressed its breach claim in tort clothing, alleging that the defects in Hamilton's performance constituted negligence or negligent misrepresentation. This ploy fails because the tort count is barred by the economic loss rule.

The economic loss rule bars litigants from recovering in tort for purely economic losses; that is, where there is no personal injury or property damage.<sup>6</sup> **See, e.g., SFC Valve Corp. v. Wright Machine Corp.**, 883 F. Supp. 710, 713-714 (S.D. Fla. 1995). Its rationale is that tort law is not intended to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement. **Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.**, 374 S.E.2d 55, 58 (Va. 1988). A determination of losses in such cases necessitates an analysis of damages that were in the contemplation of the parties at the origination of the agreement, which is the particular province of contract law. **Id.**

The policy consideration underlying contract law is the protection of expectations bargained for, while in tort it is the protection of persons and property from losses resulting from injury. **Id.** In **East River Steamship Corp. v.**

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<sup>6</sup> The economic loss rule has been adopted by a majority of jurisdictions. **Potomac Plaza Terraces, Inc. v. QSC Products, Inc.**, 868 F. Supp. 346, 354 (D.D.C. 1994). The United States itself has resorted to the economic loss rule to avoid tort liability. **See Midwest Knitting Mills, Inc. v. United States**, 950 F.2d 1295, 1300 (7<sup>th</sup> Cir. 1991) (dismissing action against Small Business Administration based on negligence because the only loss was economic loss).

***Transamerica Delaval, Inc.***, 476 U.S. 858, 872-73, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986), the Supreme Court explained that contract law “is well suited to commercial controversies . . . because the parties may set the terms of their own agreements, . . . [and] restrict [their] liability, within limits by disclaiming warranties or limiting remedies.” ***Id.***, at 872-873. In such cases the Court sees “no reason to intrude into the parties’ allocation of risk” through resort to tort theories. ***Id.***, at 873.

The economic loss rule applies even where the contract provides no remedy for economic losses. ***See, e.g., SFC Valve Corp.***, 883 F. Supp. at 716. It has also specifically been applied to service contracts, particularly in a commercial context where the parties are capable of anticipating and allocating the risk of economic losses. ***See Employers Ins. of Wausau v. Suwannee River Spa Lines, Inc.***, 866 F.2d 752, 766 (5<sup>th</sup> Cir.), ***cert. denied***, 493 U.S. 820 (1989) (holding that creating an exception to the economic loss rule for professional services performed in process of producing a product would “effectively eviscerate the economic loss rule”).

The facts here fall squarely within the economic loss rule. The only losses HUD alleges are purely economic losses – there are no allegations of personal injury or property damage. HUD has alleged only that it was denied the expectations it bargained for – the identification of the bids that would yield optimum results. The duty that Hamilton allegedly breached was the duty set forth in the contract; that is, to run the optimization model using the UPB-based floor feature. The contract was

awarded in a commercial context, and the parties were both sophisticated entities capable of anticipating and allocating the risk of the type of losses alleged in the negligence count. As explained above, the United States had available to it contract clauses that would have shifted risk of economic losses to Hamilton, had HUD desired to use them. Under these circumstances, the economic loss rule bars the negligence and negligent misrepresentation count. There is “no reason to intrude into the parties’ allocation of risk.” *East River Steamship Corp.*, 476 U.S. at 873.

### **CONCLUSION**

For the reasons set forth above, the Inspection of Services Clause precludes HUD’s claims under breach and tort theories.

WHEREFORE, HAMILTON respectfully requests that the Court grant Hamilton’s Motion in Limine.

Hamilton respectfully requests oral argument on its Motion.

Respectfully submitted,

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**Certificate of Service**

The undersigned certifies he caused a copy of the foregoing Plaintiff's Brief in Support of Its Motion in Limine to be served on the following government counsel by hand on October 1, 1999:

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