

# RETROACTIVE LEGISLATION AND REGULATIONS AND FEDERAL GOVERNMENT CONTRACTS

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## I. INTRODUCTION

Does, *or should*, the federal government have the *right* to avoid its existing contractual obligations by passing a law or adopting a regulation? My premise is that it should not, and it is my opinion that it does not. As any contracting party, the government has the *power* to withhold its own performance or to prevent its contractors from performing. But, absent contract terms or common law contract principles permitting it to avoid liability, it should be liable for damages if it exercises that power. The only exceptions should be actions taken under the "war powers" and those instances where the government is excused under the "sovereign acts" defense. When that defense is found to be appropriate, the contractor should be entitled to recover just compensation under the Takings Clause.

The tension between the federal government's powers of taxation and regulation and its role as a contractor has long been recognized. Alexander Hamilton, the constitutional government's first contracting officer, opined that the government should act as a "moral agent" when it enters into a contract:

When a government enters into a contract with an individual, it deposes, as to the matter of the contract, its constitutional authority, and exchanges the character of legislator for that of a moral agent with same rights and obligations as an individual. Its promises may be justly considered as excepted out of its powers to legislate, unless in aid of them. It is in theory impossible to reconcile the idea of a promise which obliges, with the power to make a law which can vary the effect of it.<sup>1</sup>

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1. 3 THE WORKS OF ALEXANDER HAMILTON 518 (John C. Hamilton ed., 1812)

Nevertheless, whether based on theoretical concepts of sovereignty or presumed practical considerations, the government has often attempted to avoid liability based upon retroactive statutes or regulations. For many years these attempts, some successful, were based upon what has been called the "sovereign acts" defense.<sup>2</sup> In addition, what is termed the "unmistakability doctrine" has been advanced to support avoidance of contractual obligations through retroactive application of statutes or regulations.<sup>3</sup> In *United States v. Winstar Corp.*<sup>4</sup> the Supreme Court addressed both of these concepts. However, because of the absence of a clear majority on the issues involved, the decision is open to a number of interpretations.

It is my view that support for either of the doctrines must be based upon valid underlying policy concerns and not on theoretical concepts of sovereignty. Thus, this Article will first address the underlying policy considerations which have been advanced in support of retroactive application. It will then discuss the unmistakability and the sovereign acts defenses. Next will be a discussion of the few cases which have dealt with these issues since *Winstar*. This will be followed by a consideration of the multitudinous types of contracts which the government uses to advance the public good and an identification of some examples of retroactive statutes and regulations.

## II. THE PUBLIC INTEREST

In advocating retroactive voiding of contractual liability, the government has argued that the prospect of paying large amounts of damages or otherwise being held in breach of a contract may deter lawmakers and regulators from taking action which is considered to be in the public interest.<sup>5</sup> This proposi-

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(quoting Letter from Alexander Hamilton to the House of Representatives (Jan. 14, 1790)).

2. *Horowitz v. United States*, 267 U.S. 458, 461 (1925).

3. *Bowen v. Public Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52 (1986).

4. 518 U.S. 839 (1996).

5. Joshua I. Schwartz, *Liability for Sovereign Acts: Congruence and Exceptionalism in Public Contract Law*, 64 GEO. WASH. L. REV. 633, 643 (1993).

tion has also been advanced by several commentators.<sup>6</sup> The short answer to this contention is: That is the way it should be. A cost/benefit analysis should be part of every legislative or regulatory act, and neither Congress nor regulators should be able to promulgate rules without making a determination that the benefits outweigh the costs. Surely, our government is not founded on the principle that the public interest is served by permitting Congress or regulators to run roughshod over the rights of its citizens, especially those who have taken the risk of dealing with it on a contractual basis. The proposition that some higher public interest supports the avoidance of contractual obligations was rejected in the eloquent words of Learned Hand:

It was urged at the bar that this result might expose the United States to serious loss and impede it in the discharge of its governmental functions. This is, of course, an irrelevant consideration, when the purpose of the act is clear; but here it is out of place in any event. Whatever be the justification in policy of the sovereign's immunity, the first consideration ought to be this: That in the performance of its voluntary engagements with its citizens it should conform to the same standard of honorable conduct as it exacts of them touching their conduct with each other. Any policy which would exempt the United States from the scrupulous performance of its obligations is base and mean; it serves in the end to bring the United States into contempt, to prejudice it in its dealings when it enters into the common fields of human intercourse, and to arouse the indignation of honorable men. Congress by the Tucker Act meant to avoid such consequences.<sup>7</sup>

This rationale was also rejected in Justice Souter's opinion (joined by Justices Breyer, O'Connor and Stevens) in *Winstar*:

We recognize, of course, that while agreements to insure private parties against the costs of subsequent regulatory change do not directly impede the exercise of sovereign power, they may indirectly deter needed governmental regulation by raising its costs. But all regulations have their costs, and Congress itself expressed a willingness to bear the costs at issue here when it au-

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6. See Edward A. Fitzgerald, *Conoco Inc. v. United States: Sovereign Authority Undermined by Contractual Obligations on the Outer Shelf*, 27 PUB. CONT. L.J. 755, 796 (1998) and commentators cited therein.

7. *Heil v. United States*, 273 F. 729, 730 (S.D.N.Y. 1921).

thorized FSLIC to "guarantee [acquiring thrifts] against loss" that might occur as a result of a supervisory merger. 12 U.S.C. § 1729(f)(2) (1988 ed.) (repealed 1989). Just as we have long recognized that the Constitution "bar[s] Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole," *Dolan v. City of Tigard*, 512 U.S. 374, 384 (1994) (quoting *Armstrong v. United States*, 364 U.S. 40, 49 (1960)), so we must reject the suggestion that the Government may simply shift costs of legislation onto its contractual partners who are adversely affected by the change in the law, when the Government has assumed the risk of such change.<sup>8</sup>

Justice Breyer's concurring opinion adds:

To draw the line—i.e., to apply a more stringent rule of contract interpretation—based only on the amount of money at stake, and therefore (in the Government's terms) the degree to which future exercises of sovereign authority may be deterred, seems unsatisfactory. As the Government acknowledges, . . . this Court has previously rejected the argument that Congress has "the power to repudiate its own debts, which constitute 'property' to the lender, simply in order to save money."<sup>9</sup>

Neither Justice Scalia's concurring opinion (joined by Justices Kennedy and Thomas)<sup>10</sup> nor Chief Justice Rehnquist's dissent (joined by Justice Ginsburg)<sup>11</sup> take issue with this principle.

### III. PROTECTING THE FEDERAL FISC

The law of federal government contracting is replete with special rules designed to protect the public. Many of these rules have been fashioned by courts. Thus, the government is not bound by transactions which are not authorized by Congress, which vary from statutory requirements, or which have not been awarded pursuant to required procedures. Further, the government is bound only by the agreements of officials who have been delegated the authority to enter into contracts. In addition, man-

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8. *United States v. Winstar Corp.*, 518 U.S. 839, 883 (1996).

9. *Winstar*, 518 U.S. at 917.

10. *See id.* at 919 (citation omitted).

11. *See id.* at 924.

datory contract provisions will be read into contracts even though they were left out of the agreements by the parties.

Chief Justice Rehnquist's dissent suggests that the government needs the extra protection of avoiding unfavorable contracts entered into by authorized officials:

The short of the matter is that Justice Breyer and Justice Scalia cannot reach their desired result, any more than the principal opinion can, without changing the status of the Government to just another private party under the law of contracts. But 75 years ago Justice Holmes, speaking for the Court in *Rock Island, A. & L.R. Co. v. United States*, 254 U.S. 141, 143, . . . (1920), said that "[M]en must turn square corners when they deal with the Government." The statement was repeated in *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 385, . . . (1947). The wisdom of this principle arises, not from any ancient privileges of the sovereign, but from the necessity of protecting the federal fisc—and the taxpayers who foot the bills—from possible improvidence on the part of the countless Government officials who must be authorized to enter into contracts for the Government.<sup>12</sup>

There are several problems with this position. First, neither of the decisions cited are relevant to the issues involved in *Winstar*. Both dealt with *existing* statutes,<sup>13</sup> and *Rock Island* did not involve a contract.<sup>14</sup> Furthermore, *Federal Crop* applied one of the aforementioned rules—that the government is not bound by unauthorized officials.<sup>15</sup>

More importantly, this position fails to consider the principle announced by the Court in *Cooke v. United States*:<sup>16</sup>

Laches is not imputable to the government, in its character as sovereign, by those subject to its dominion. Still a government may suffer loss through the negligence of its officers. If it comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there. Thus, if it becomes the holder of a bill of exchange, it

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12. *Id.* at 937.

13. See *Rock Island Ark. & La. R.R. Co. v. United States*, 254 U.S. 141, 141 (1920); *Federal Crop Ins. Co. v. Merrill*, 332 U.S. 380, 381-82 (1947).

14. See *Rock Island*, 254 U.S. at 141 (explaining that the case arose out of a dispute between a taxpayer and the Internal Revenue Service).

15. See *Federal Crop*, 332 U.S. at 384-85.

16. 91 U.S. 389 (1875).

must use the same diligence to charge the drawers and indorsers that is required of individuals; and if it fails in this, its claim upon the parties is lost. Generally, in respect to all the commercial business of the government, if an officer specially charged with the performance of any duty, and authorized to represent the government in that behalf, neglects that duty, and loss ensues, the government must bear the consequences of his neglect.<sup>17</sup>

It would turn the concept of contract law upside down if the government were bound only by favorable transactions. As long as the official is authorized to make an agreement and the agreement conforms to the applicable statutes and regulations, the government should not be able to avoid liability because it was a poor bargain or turns out to be unfavorable.

#### IV. UNMISTAKABILITY

The problem with the unmistakability doctrine is that it is based on a faulty premise—that the government's sovereign powers can be waived. The *Winstar* plurality opinion recognizes this flaw, indicating that "if indeed it could be waived at all," the waiver must be done in "unmistakable terms."<sup>18</sup> But, the plurality opinion goes on to find that that does not mean that there must be an express and unmistakable agreement to pay damages if subsequent legislative or executive action makes it impossible for the government to perform its obligations. It would apply the doctrine only where the effect of the contract would bar the government from exercising sovereign powers. It would not be applicable where the contract merely shifted the risk of the subsequent action to the government:

The application of the doctrine will therefore differ according to the different kinds of obligations the Government may assume and the consequences of enforcing them. At one end of the wide spectrum are claims for enforcement of contractual obligations that could not be recognized without effectively limiting sovereign authority, such as a claim for rebate under an agreement for a tax exemption. Granting a rebate, like enjoining enforcement,

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17. *Cooke*, 91 U.S. at 398 (citations omitted).

18. *Winstar*, 518 U.S. at 878.

would simply block the exercise of the taxing power and the unmistakability doctrine would have to be satisfied. At the other end are contracts, say, to buy food for the army; no sovereign power is limited by the Government's promise to purchase and a claim for damages implies no such limitation. That is why no one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine. Between these extremes lies an enormous variety of contracts including those under which performance will require exercise (or not) of a power peculiar to the Government. So long as such a contract is reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of that power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it.<sup>19</sup>

Justice Breyer would apply the ordinary rules of contract law and contract interpretation to determine whether the government entered into either an express or an implied-in-fact contractual agreement.<sup>20</sup> If so, then the rules of contract interpretation would determine whether the contractor or the government assumed the risks of subsequent government actions. In addition, he questioned whether "the 'unmistakability' language" in previous cases was "determinative of the outcome in those cases."<sup>21</sup> He also noted that in the previous cases "the language was directed at the claim that the sovereign had made a broad promise not to legislate, or otherwise to exercise its sovereign powers."<sup>22</sup>

Justice Scalia would hold that the unmistakability doctrine applies in all government contract cases. His view is that the normal rule of contract law that a party impliedly promises not to make its own performance impossible is not applicable to sovereign acts of the government:

When the contracting party is the government, however, it is simply *not* reasonable to presume an intent of that sort. To the contrary, it is reasonable to presume (*unless the opposite clearly appears*) that the sovereign does *not* promise that none of its

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19. *Id.* at 879 (citation omitted).

20. *See id.* at 911.

21. *Id.* at 914.

22. *Id.* at 916.

multifarious sovereign acts, needful for the public good, will incidentally disable it or the other party from performing one of the promised acts. The requirement of unmistakability embodies this reversal of the normal reasonable presumption. Governments do not ordinarily agree to curtail their sovereign or legislative powers, and contracts must be interpreted in a common-sense way against that background understanding.<sup>23</sup>

Once a promise is made, Justice Scalia would not require "a further promise not to go back on the promise."<sup>24</sup> Although the lower courts in *Winstar* rejected the application of the unmistakability doctrine, Scalia concludes that their findings were sufficient to satisfy his concept of the doctrine.<sup>25</sup> What his opinion leaves unexplained is the source of a contracting official's authority to make agreements (unmistakable) that the government will not exercise its sovereign powers.

The Chief Justice contends that the plurality opinion departs from existing law concerning the unmistakability doctrine. His primary concern is the absence of express language in the agreements providing for a remedy, should the law be changed:

But if there is a "serious contest" about the correctness of their interpretive positions, surely the unmistakability doctrine—a canon of construction—has a role to play in resolving that contest. And the principal opinion's reading of additional terms into the contract so that the contract contains an unstated, additional promise to insure the promisee against loss arising from the promised condition's nonoccurrence seems the very essence of a promise implied in law, which is not even actionable under the Tucker Act, rather than a promise implied in fact, which is.<sup>26</sup>

## V. THE SOVEREIGN ACTS DEFENSE

*Winstar* did little to change the sovereign acts defense. The plurality opinion rejects the government's argument that since the statutory change was a "public and general" act, it should

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23. *Winstar*, 518 U.S. at 920-21 (emphasis added).

24. *Id.* at 921.

25. *Id.*

26. *Id.* at 930 (citation omitted).



not be liable. It also rejects the concept that a regulation adopted for the "public good" would automatically qualify for the defense. In two sections of his opinion, not joined by Justice O'Connor (Parts IV-A and IV-B), Justice Souter focuses on the government's "self interest" in seeking "to shift the costs of meeting its legitimate public responsibilities to private parties."<sup>27</sup> In such cases, he would deny the defense on the ground that the government's contractual and sovereign characters are "fused together."<sup>28</sup> Thus, the greater the government's self-interest, the more suspect becomes the claim that its private contracting partners ought to bear the financial burden.

In Part IV-C, in which Justice O'Connor joined, Justice Souter's opinion holds that even if an act be "public and general,"<sup>29</sup> it would not qualify for the sovereign acts defense based on the standard established in *Horowitz v. United States*.<sup>30</sup> Instead, the government would have to show that the nonoccurrence of the subsequent government action was a basic assumption of the contract:

For a successful impossibility defense the Government would have to show that the nonoccurrence of regulatory amendment was a basic assumption of these contracts. The premise of this requirement is that the parties will have bargained with respect to any risks that are both within their contemplation and central to the substance of the contract; as Justice Traynor said, "[i]f [the risk] was foreseeable there should have been provision for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed." That inference is particularly compelling, where, as here, the contract provides for particular regulatory treatment (and, *a fortiori*, allocates the risk of regulatory change). Such an agreement reflects the inescapable recognition that regulated industries in the modern world do not live under the law of the Medes and the Persians, and the very fact that such a contract is made at all is at odds with any assumption of regulatory stasis. In this particular case, whether or not the reach of the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") reforms was [sic] anticipated by the

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27. *Id.* at 896.

28. *Winstar*, 518 U.S. at 897.

29. *Id.* at 840.

30. 267 U.S. 458 (1925).

parties, there is no doubt that some changes in the regulatory structure governing thrift capital reserves were both foreseeable and likely when these parties contracted with the Government, as even the Government agrees.<sup>31</sup>

Justice Scalia's opinion merely finds that the defense was not available since "Congress specifically set out to abrogate the *essential bargain* of the contracts at issue. . . ." <sup>32</sup>Chief Justice Rehnquist rejects the government's motive as a test for application of the doctrine and would instead base the determination on the impact of the action.<sup>33</sup>

## VI. CASES SINCE *WINSTAR*

The following are a representative sampling of the cases since *Winstar*, decided by the Court of Federal Claims and the Court of Appeals for the Federal Circuit, which bear on the retroactive statute and regulation issues.

### A. *Mortgage Prepayment Cases*

In *Adams v. United States*,<sup>34</sup> the Court of Federal Claims found the sovereign acts doctrine inapplicable but found that the unmistakability defense permitted Congress to retroactively deny plaintiffs their contractual right to exercise a prepayment option.<sup>35</sup> In *Cienega Gardens v. United States*,<sup>36</sup> the Court of Appeals for the Federal Circuit vacated judgments against the government on grounds that the plaintiff had no "privity of contract" with HUD relating to prepayment and therefore did not fall within Tucker Act<sup>37</sup> jurisdiction.<sup>38</sup>

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31. *Winstar*, 518 U.S. at 905-06 (citation omitted) (quoting *Lloyd v. Murphy*, 153 P.2d 57, 50 (1944)).

32. *Id.* at 924.

33. *Id.* at 933.

34. 42 Fed. Cl. 463 (1998).

35. *Adams*, 42 Fed. Cl. 463.

36. 162 F.3d 1123 (Fed. Cir. 1998), *reh'g denied, en banc suggestion declined*, Mar. 11, 1999.

37. 28 U.S.C. § 1491(a)(1) (1994).

38. *Scott*, 162 F.3d at 1136.

### B. Offshore Drilling Leases

In *Conoco Oil Inc. v. United States*<sup>39</sup> and *Marathon Oil Company v. United States*,<sup>40</sup> the Court of Federal Claims gave restitution to offshore drilling lessees, reversed on the grounds that a post-lease statute did not cause denial of permits.<sup>41</sup> The Court of Appeals did not decide whether the Secretary of Interior breached the contract by refusing to override the state's objections since "this issue is not before us on appeal."<sup>42</sup>

### C. Nuclear Fuel

The Court of Appeals reversed a Court of Federal Claims decision in *Yankee Atomic Electric Co. v. United States*<sup>43</sup> and held that the Energy Policy Act<sup>44</sup> was "a general exercise of Congress's taxing power" and was therefore a sovereign act.<sup>45</sup> It further found that the government's contract did not unmistakably surrender this sovereign power.<sup>46</sup>

### D. Timber Sales

In *Scott Timber Co. v. United States*,<sup>47</sup> the Court of Federal Claims found the sovereign acts defense unavailable even though the listing of an endangered species was a "sovereign act" because the government could not show that the non-occurrence of the listing was a basic assumption of the contract.<sup>48</sup>

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39. 35 Fed. Cl. 309 (1996).

40. 158 F.3d 1253 (Fed. Cir. 1998).

41. See *Conoco*, 35 Fed. Cl. at 309.

42. *Marathon Oil*, 158 F.3d at 1260.

43. 112 F.3d 1569 (Fed. Cir. 1997), *reh'g denied, en banc suggestion declined*, Aug. 15, 1997.

44. 42 U.S.C. § 2296-2297 (1994).

45. *Yankee*, 112 F.3d at 1577.

46. *Id.*

47. 40 Fed. Cl. 492 (1998).

48. *Scott*, 40 Fed. Cl. at 494.

## VII. TYPES OF CONTRACTS AND RETROACTIVE STATUTES

There is no standard government contract. For many years the government has used contracts to obtain innumerable types of benefits for the public. In all of these contracts, the contractor furnishes consideration, either in the form of promises or the performance or non-performance of acts. The idea that the government should be granted a greater degree of latitude in determining whether to perform certain types of contracts is disingenuous. I am not certain what a "humdrum" contract is. Is it for procurement of computers? Missiles? Transportation of troops to Albania or Macedonia? Health services for the needy? Is it for the sale or lease of federal lands? Timber? Offshore drilling rights? What differentiates these various transactions from the point of view of the need of the government to escape financial liability if it decides what it once wanted and bargained for is no longer of value to it?

There are a number of examples of retroactive statutes and regulations which have not been the subject of decisions. These include § 808 of the Fiscal Year 1998 Department of Defense Authorization Act,<sup>49</sup> which makes certain executive compensation exceeding specified levels unallowable after January 1, 1998, without regard to the date of the contract.<sup>50</sup> Another example is the amendment to the Federal Acquisition Regulation ("FAR") dealing with unallowable costs of *qui tam* proceedings costs in cases in which the government does not intervene.<sup>51</sup> The FAR was issued as a "clarification," with the intention that the "clarified" would affect contracts already in existence.<sup>52</sup>

## VIII. SUMMARY

It is simply not possible to reconcile the various views expressed by the Justices in *Winstar*, and I submit, it is not worthwhile to attempt to do so. Despite the plurality's position, as far

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49. Pub. L. No. 105-85, 111 Stat. 1629, 1836 (1997).

50. *Id.*, 111 Stat. at 1838.

51. Federal Acquisition Regulation System, 48 C.F.R. § 31.205-47 (2000).

52. Federal Acquisition Circular 97-09, 63 Fed. Reg. 58,586, 58,602 (1998).

as the Court of Federal Claims is concerned, *it's only about money*. As far as that court is concerned, the only issue should be whether the government will be liable for damages or other remedies resulting from a statute or regulation causing extra costs to the contractor or preventing the government from performing. Neither the sovereign acts doctrine nor the concept of unmistakability is helpful in answering the question. They only serve to muddy the water and create confusion. If there is one point on which some semblance of agreement was reached in *Winstar*, it seems to be that the issue should be resolved through the process of contract interpretation. Thus, the question to be answered should be: Which party assumed the risk of subsequent legislation, regulations or other action by the government? Isn't *risk* what contract law is about?

In determining which party assumes the risk, the normal rules of contract interpretation should be applied. If the contract does not expressly address the matter, the rules for determining intent should be applied. Consideration of surrounding circumstances and other aids of determining intent will often provide the answer. If, however, two or more reasonable interpretations still exist, the matter should be determined using the rule of *contra proferentem*. This would place the risk on the government in most cases since it is most often the party that drafts the contract. This is as it should be. Most government contracts, regardless of type, are contracts of adhesion which leave little or no room for negotiation of terms. Thus, if the government wants the contractor to bear the risk of subsequent regulations or legislation, it should do so up front in clear and unmistakable language. This would give prospective contractors the options of refusing the contract on those terms and of including contingencies in its pricing or of bypassing the deal. If this increases the prices of government contracts or deprives the government of superior performers, so be it. Whatever the results, they would be far better than the disgraceful practice of waving the flag to escape from financial liability.

