Department of Commerce
Office of General Counsel

CONTRACT LAW DIVISION

Office of the Assistant General Counsel for Finance and Litigation

Office of Finance & Litigation
Contract Law Division

A Lawyer's View of The Sovereign Acts Doctrine

July 30, 1997

The Sovereign Acts Doctrine: Avoiding Liability for Changes in the Law

by Fred Kopatich

Background

Generally, those charged with contract administration, working along with program officials, can ensure that the Government does not take actions which would cause a breach of contract, leading to liability for damages to a contractor. But sometimes "the best laid plans of mice and men" (and COs and COTRs) can go awry, not because of actions taken during contract administration, but by laws enacted by Congress, regulatory change or agency actions that may have the effect of changing the bargain agreed to between the parties, and increasing, sometimes dramatically, a contractor's costs.

Consider the following examples:

(1) A contractor begins construction of recreational facilities in a federal wilderness, but has to stop working when the Forest Service orders the closure of all roads in the area due to a fire hazard. The contractor asserts a claim for additional costs incurred because of the work stoppage.[1]

(2) A fixed price contract for construction of a federal office building is signed in 1972, during the imposition of wage and price controls, which, in this case, limited increases in the prices subcontractors could charge to the contractor during the life of the contract. In 1974, while construction was still on-going, the President lifted all price controls; subcontractors on the job, in turn, demanded steep increases in prices for materials. The contractor sought relief for the unanticipated rise in its costs.[2]

(3) In the 1950s, the U.S. Government, in order to spur development of nuclear power, entered into a number of fixed price contracts to provide uranium enrichment services to utility companies. Decades later, after the environmental consequences of uranium enrichment became known, Congress, as part of the Energy Policy Act of 1992, established a fund to clean up enrichment plants. Each year, those utilities that had purchased uranium enrichment from the Government were to provide $150 million towards the fund. The utilities argued that this assessment, in effect, constituted a retroactive increase in the fixed price they had agreed to in their earlier contracts.[3]

In each of these cases, a contractor and the Government entered into a contract under one set of mutually-agreed upon assumptions concerning the price or contract terms, and a subsequent action by the executive or legislative branches had the effect of changing those terms to the clear detriment of the contractor. In each case, however, the board of contract appeals or court, applying what has become known as the "sovereign acts" doctrine, found that the Government was not liable to the contractors for damages.

"Sovereign Acts" As a Shield Against Liability for Breach

The sovereign acts doctrine is a concept developed in the Court of Claims and articulated by the United States Supreme Court earlier in this century. The courts, in developing the doctrine, recognized that the federal Government has a dual nature—on the one hand it acts as a contractor which is bound by the contracts it enters into; on the other, it is a regulator whose enactments made for the public good may conflict with its contractual commitments. When the Government acts solely as a regulator, it cannot be held liable for any inadvertent breach of its contracts which may occur:

> [W]hatever acts the government may do, be they legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons...Though their sovereign acts performed for the general good may work injury to some private contractors, such parties gain nothing by having the United States as their defendant.[4]

The executive or legislative branches perform a "sovereign act" which immunizes the Government from its consequences on contracts it has entered into when the executive action or statute has a general purpose and is not targeted specifically at one or a class of contracts and its impact upon the affected contracts appears to be merely incidental and not intentional.[5]

In each of the cases described above, the Government successfully invoked the sovereign acts doctrine, as the executive or legislative actions which had the effect of abrogating previous contractual agreements were intended to address a situation generally related to the public welfare, and did not specifically target the contracts in question. For instance, closure of a forest during fire season, while having a direct effect on the contract for construction of recreational facilities, clearly had a more general intent. Similarly, the lifting of wage and price controls and imposition of an

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environmental cleanup fee on utilities were measures taken for the public welfare whose effect on individual contracts were merely incidental.

The Winstar Case

The most significant recent case regarding the sovereign acts doctrine, and one which is likely to have a huge financial impact on the taxpayers, is *Winstar Corporation v. U.S.*, __ U.S. ___, 116 S.Ct. 2432 (1996). *Winstar* arose from the savings and loan debacle of the 1980s and Congress' attempts to remedy it.

As savings and loan failures of the early 1980s began to tax the resources of the Federal Savings and Loan Insurance Corp. (FSLIC), the Federal Home Loan Bank Board devised a way to avoid liquidation of ailing S&Ls. If a solvent thrift was willing to take over an ailing one, it was allowed, through an agreement with the Board, to show the ailing thrift's liabilities as an intangible asset on its books, allowing it to meet its minimum required capital reserve requirements to operate. This device allowed many thrifts to avoid liquidation through merger. In 1989, however, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which, in part, reversed the agreements made earlier by disallowing the consideration of intangible assets towards minimum capital reserve requirements. The result was that many S&Ls that had taken advantage of the earlier rules to merge with ailing thrifts now found that because of the liabilities they had taken on, they would either have to go out of business themselves or, at a minimum, were in serious financial trouble.

What followed was dozens of lawsuits by thrifts affected by FIRREA, alleging that application of the statute would effectively breach the agreements made with regulators to take over ailing S&Ls, and in which the thrifts sought billions of dollars in damages. Eventually, the *Winstar* case reached the Supreme Court to sort out the legal issues involved. The decision itself is hardly an example of judicial clarity—while the Court majority ruled in favor of the thrifts, no more than four of the nine justices could agree on any of the legal issues, so the case has minimum precedential value.

Six justices found that the Government could not assert the sovereign acts doctrine as a defense to breach of contract. The plurality emphasized that whatever general purpose FIRREA may have had, it was written to specifically negate the agreements the thrifts had made with regulators in the early 1980s. Justice Souter stated that the sovereign acts defense was not available "when a substantial part of the impact of the Government's action rendering performance impossible falls on its own obligations."

As a legal matter, the *Winstar* case demonstrates that, while the Government can assert a sovereign acts defense to breach of contract caused by executive or legislative actions, the Supreme Court will independently and carefully scrutinize whether the Government's action had both a general purpose and effect, or if it was done to alter a previous contractual obligation of the Government. The practical effects of the *Winstar* ruling may be its most significant legacy, however. Currently pending before the Court of Federal Claims are 120 cases filed by thrifts adversely impacted by FIRREA. Trial must go forward in each case to apply the *Winstar* ruling to the individual contracts, each of which is unique.[6] Depending on the outcome of the individual cases, the Government's total liability for breach of contract could be from $10 billion to $30 billion or more.

Other Applications?

A final note: some commentators have suggested that the sovereign acts doctrine could be used to prevent any Government liability for the effects of a shutdown of federal operations caused by a lack of agreement on appropriations between the President and Congress, as occurred in 1995 and early 1996.[7] Although this has not yet been addressed in any board or court case, the Government could argue that the failure of Congress to pass, or the President to sign, end-of-year appropriations measures constitutes a general sovereign act of the Government, and contractors may not assert any claim for monetary damages that resulted from the ensuing shutdown of operations. Of course, we would rather not have to test this legal theory in the years ahead.

1 *Contractors Northwest, Inc.*, AGBCA No. 97-101-1, 97-1 BCA ¶ 28,847.

2 *Blake Construction Company, Inc.*, GSBCA No. 4118, 75-1 BCA ¶ 11,278.

3 *Yankee Atomic Electric Co. v. U.S.*, 1997 WL 225859 (Fed. Cir., May 6, 1997)

4 *Horowitz v. U.S.*, 267 U.S. 458, 45 S.Ct. 344 (1925)

5 *Winstar Corporation v. U.S.*. __ U.S. __, 116 S.Ct. 2432 (1996).

6 *Plaintiffs in All Winstar-related Cases*, 35 Fed.Cl. 707 (1996).

7 McGovern and Kunzi, *Government Shutdown Claims*, Contract Management, May 1996, at p. 5; *Legal Ramifications of the Government Shutdown*, The Government Contractor, November 22, 1995, at ¶ 587.