NINETEENTH JUDICIAL CIRCUIT OF VIRGINIA

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October 12, 2016

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Re: *Parsons Government Services, Inc. v. Bechtel National, Inc.*, CL-2015-6014

Dear Counsel:

This case is before the Court after a bench trial in June 2016, on Parsons Government Services, Inc.'s ("Parsons") complaint for (I) Breach of Contract, (II) Breach of the Implied Duty of Good Faith and Fair Dealing, and (III) Declaratory Judgment against Defendant Bechtel National, Inc. ("Bechtel"), and Bechtel's counterclaim for (I) Breach of Contract and/or (II) Unjust Enrichment, based upon the subcontract entered into between the parties on February 15, 2006. The trial raised three central questions:

OPINION LETTER

A. Whether the subcontract requires Bechtel to share one third (1/3) of *award* fees paid by the United States, or otherwise renegotiate its fee sharing provisions upon modification of the prime contract's fee structure?

B. Whether or not modifications in the prime contract, without comparable modifications in the subcontract, constitute a breach of the implied duty of good faith and fair dealing under Federal common law?

C. Whether or not overpayment for incentive fees, resulting in the withholding of award fees after modification of the prime contract's fee structure, creates a claim for unjust enrichment against those with whom incentive fees were shared?

After considering the pleadings and exhibits, testimony of witnesses, authorities, and oral arguments presented by Counsel, the Court finds that the failure to share award fees when the contract only provides for sharing incentive fees does not constitute a breach, and that modifications in the prime contract altering the fee structure do not constitute a violation of the implied duty of good faith and fair dealing under the Federal common law. Furthermore, given the Court's interpretation of the contract, there is no actual controversy regarding the incentive fees and completion bonuses, therefore the Court declines to grant relief on Parsons' Declaratory Judgment action. As a result, the Court finds in favor of Bechtel on all three counts of Parsons' complaint. Additionally, the Court finds that the overpayment of incentive fees, resulting in the *withholding of award fees*, does not establish a breach of contract claim against Parsons to recover shared incentive fees, and the Court accordingly finds in favor of Parsons on Bechtel's counterclaim.

I. BACKGROUND[1]

A. Factual Background

Parsons is a Nevada corporation which provides leading chemical demilitarization technology for the United States and other government customers abroad. Bechtel is also a Nevada corporation, and a major defense contractor to the United States.

As part of an ongoing initiative to eliminate chemical weapons, in 2002 the U.S. Army sought bids for the design, construction and operation of a chemical neutralization plant, the Pueblo Chemical Agent Destruction Pilot Plant ("PCAPP"). Bechtel won the bid in September of 2002. Ex. 2 of Def., p. 3, ¶ B-2(b).

On February 15, 2006, Bechtel executed a subcontracting agreement with Parsons, whose primary performance obligation was the design and installation of a state-of-the-art munitions washout system. The agreement included a fee-sharing provision, requiring Bechtel to share 1/3 of all incentive fees and/or completion bonuses. Ex. 12 of Def., p. 45, § C1(c). This same .

[1] In forming its opinion, the Court has reviewed all of the admitted exhibits and the transcripts of witnesses' testimony. The following recitation of facts is a summary of the pertinent facts. The Court has cited to several exhibits and deposition transcripts, but relied upon all of the evidence in its decision.

provision expressly stated that it was "exclusive of fixed fee, *award fee*, and/or combination of award and fixed fee that is authorized and released by the Government." *Id.* (emphasis added).

Several years after the commencement of the contract, the United States sought to modify the fee structure in the prime contract. Namely, the United States determined that it valued safety and environmental consciousness over efficiency, and wanted to replace the *incentive fee* structure with an *award fee* structure. Ex. 9 of Def., p. 1, § 1. This modification was finalized on October 1, 2013. There were no parallel negotiations and modifications with Parsons. Bechtel thereafter determined it was not obligated to share award fees under the subcontract's incentive fee sharing provisions. When it ceased sharing award fees after this modification, Parsons commenced the present action.

Additionally, when the United States had paid Bechtel incentive fees, Bechtel shared those fees. Specifically in 2012, the United States provisionally paid Bechtel incentive fees totaling more than $6.5 million, which Bechtel appropriately shared with Parsons. The United States later determined, in April 2013, that several of those provisionally paid fees were actually unearned. The United States had retained the right to recoup any overpayment of incentive fees; however, rather than requiring Bechtel to pay-back the unearned incentive fees, the United States established an accounting set-off that credited those unearned incentive fees to future award fees under the modified contract. When Bechtel sought reimbursement from Parsons, Parsons refused. After Parsons brought this action, Bechtel counterclaimed to recover those unearned fees shared with Parsons.

B. Procedural Background

Parsons brought this action in May of 2015, for (I) Breach of Contract, (II) Breach of the Implied Duty of Good Faith and Fair Dealing and (III) Declaratory Judgment. Specifically, Parsons sought declarations that Bechtel breached the contract by failing to comply with or amend the subcontract to mirror the prime contract, and that Bechtel has a continuing obligation to pay completion bonuses. Bechtel answered, and then subsequently filed a counterclaim in January 2016, for (I) Breach of Contract, or alternatively (II) Unjust Enrichment, based upon an overpayment of incentive fees that had been shared and for which the United States sought recoupment. After extensive discovery, the case was heard at a five day bench trial in June 2016. Arguments were heard and evidence was presented before being taken under advisement.

I. STANDARD OF REVIEW

The subcontract expressly establishes that it is to be "construed and interpreted according to the federal common law of government contracts" and "[t]o the extent that federal common law...is not dispositive, the laws of the state of Colorado apply." Ex. 12 of Def., § A1-16. In Virginia, contractual choice of law provisions are valid and enforced. *Settlement Funding, LLC v. Neumann-Lillie*, 274 Va. 76, 80 (2007); *Paul Bus. Sys., Inc. v. Canon USA, Inc.*, 240 Va. 337, 342 (1990) (where "...parties to a contract have expressly declared that the agreement shall be construed as made with reference to the law of a particular jurisdiction, we will recognize such

agreement and enforce it."). Both Federal and Colorado law require courts to give effect to the plain and unambiguous terms of a contract. *Bell/Heery v. United States*, 739 F.3d 1324, 1331 (Fed. Cir. 2014); *USI Props. East, Inc. v. Simpson*, 938 P.2d 168, 173 (Colo. 1997).

In ruling on declaratory judgment actions, the Court is governed by statute: "In cases of *actual controversy*, circuit courts within the scope of their respective jurisdictions shall have power to make binding adjudications of right..." Va. Code § 8.01-184 (emphasis added).

II. ARGUMENTS

A. Plaintiff's Argument

Parsons argues that Bechtel breached the 2006 subcontract by either (1) failing to share fees earned under the existing fee sharing provision, or (2) failing to renegotiate and modify the subcontract in accordance with modifications to the prime contract. Specifically, Parsons argues the fee sharing provision should be constructed as requiring Bechtel to share all fees, free from potential diminution by the award of any other fee type. According to Parsons, the contract language sharing incentive fees to the exclusion of award and fixed fees "is designed to prevent Parsons' share of fees from being diminished by the award of any other fee-type as contemplated under the Subcontract and was not intended...to be used to eliminate all fees under the Subcontract." Compl. ¶ 58. Additionally, Parsons argues that language in the contract requiring "mutually agreeable terms for compensation, including pricing, cost, and fee structure,...will be negotiated for each task order" places a contractual duty on Bechtel to modify the Subcontract in conformity with changes in the prime contract fee structure. Compl. ¶ 59-60. Additionally, Parsons contends that Change Order 78, entered August 30, 2012, established the same by modifying the subcontract's compensation provisions. Ex. 15 of Def., § A10-2(h), C1(c).

Furthermore, Parsons argues that Bechtel breached the implied covenant, inherent in all Federal contracts, of good faith and fair dealing by intentionally depriving Parsons of its reasonable expectations of the contract's fruits. Specifically, Parsons argues that the prime contract negotiations conducted between Bechtel and the United States to convert incentive fees to award fees was an intentional attempt to deprive Parsons of its contractual expectations. Moreover, the breach of this implied covenant is also evidenced by Bechtel's failure to inform Parsons of those prime contract modifications and refusal to modify the subcontract in conformity therewith.

Lastly, Parsons argues that these disputes entitle them to declarations that (1) the contract was breached in each of the aforementioned ways, and (2) that Bechtel has a continuing obligation to share completion bonuses under the same provision.

B. Defendant's Response

Bechtel argues that the subcontract's language is clear and unambiguous: Bechtel must share one third (1/3) of incentive fees, and has no obligation to share any award or fixed fees under the prime contract. The United States had the power to modify the fee structure of the prime contract, and it used that power to convert the incentive fees originally contemplated into award fees. Parsons simply has no claim to a share in those fees under the plain terms of the subcontract. There was no breach of contract, and hence Count I and Count III fail. Count III further fails with regard to the declaration on completion bonuses because they are not in dispute, and Virginia courts cannot issue declaratory judgments absent an actual controversy.

Secondly, Bechtel argues it did not breach any implied covenant of good faith and fair dealing, because Parsons assumed the risk of alterations in the prime contract's fee structure. Under Federal common law, the implied covenant of good faith and fair dealing does not authorize courts to re-write original obligations. When Parsons negotiated for incentive fees, to the exclusion of award and fixed fees, they assumed the risk of the prime contract no longer providing for incentive fees. Additionally, the same implied covenant also cannot be used to expand duties not incident to the original bargain. Nothing in the contract imposes an obligation on Bechtel to renegotiate terms of the subcontract in the event of prime contract modifications; to find such a duty would be to expand the duties Bechtel assumed under the original bargain.

Finally, Bechtel argues that it is entitled to reimbursement from Parsons for incentive fees that were shared, but which the United States determined were unearned and so seek recoupment. Bechtel argues that the United States withheld award fee payments as part of an accounting setoff to recoup overpayment under the prior incentive fee structure. In doing so, the United States effectively recovered the earlier incentive fees. Parsons breached the fee sharing provision by retaining its share, and/or was unjustly enriched.

III. ANALYSIS

A. Counts I and III: Clear and Unambiguous Contracts

Under both Federal and Colorado contract law, the Court must give effect to the plain and unambiguous terms of a contract. *Bell/Heery v. United States*, 739 F.3d 1324, 1331 (Fed. Cir. 2014); *USI Props. East, Inc. v. Simpson*, 938 P.2d 168, 173 (Colo. 1997). The terms of the subcontract between Parsons and Bechtel are plain and unambiguous. The contract states explicitly at § C1(c), "It is the intent of the Parties that SUBCONTRACTOR share of such fees be one third of the total *incentive* fees and/or completion bonus(es) exclusive of fixed fee, *award fee*, and/or combination of award and fixed fee that is authorized and released by the Government." Ex. 12 of Def., p. 45, § C1(c) (emphasis added). The language plainly only permits Parsons to share in incentive fees. Furthermore, nothing in subsequent change orders altered this structure, but only ensured continued compliance with the incentive fee sharing

provision until completion of the prime contract. Ex. 15 of Def., § A10-2(h), C1(c). The prime contract's fee structure was modified from incentive to award fees. Ex. 9 of Def., § 1. Thus, plain and unambiguous terms of both contracts now provide for award fees under the prime contract and only incentive fee sharing under the subcontract.

Furthermore, the Federal Acquisition Regulations make clear that award and incentive fees are distinct. *See* 48 C.F.R. § 16.401, *et seq.* Although an award fee *contract* is a type of *incentive contract* under § 16.401(e), incentive *fee* and award *fee* structures are treated separately, though under that larger umbrella of "incentive contracts." *Id.* at § 16.401(b-e). Incentive fees are defined as "predetermined" and "formula-type incentives on technical performance or delivery" where "increases in profit or fee are provided only for achievement that surpasses the targets." *Id.* at § 16.401(b). Conversely, the Regulations define award fee provisions as suitable when the work to be performed "is such that it is neither feasible *nor effective to devise predetermined objective incentive targets* applicable to cost, schedule, and technical performance" and where "[t]he likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance..." *Id.* at § 16.401(e)(1)(i-ii) (emphasis added). Accordingly, the two fee types are distinct and directed at different ends, incentivizing different performance goals.

Count III for Declaratory Judgment fails for the same reason with regard to several of the requested declarations. There was no breach of contract, and thus the declarations sought by Parsons to the same effect cannot be granted. *See Charlottesville Area Fitness Club Operator's Ass'n v. Albemarle Cnty. Bd. of Supervisors*, 285 Va. 87, 98-99 (2013). Finally, the Court will not make a declaration regarding the completion bonuses absent an actual justiciable controversy. *Id.*; *see also Martin v. Garner*, 286 Va. 76, 82-84 (2013). There are no completion bonuses in dispute, and Bechtel agrees it must pay them if and when they arise. As a result, there is no controversy.

B. Count II: Good Faith and Fair Dealing

There is an implied covenant of good faith and fair dealing incidental to every Federal contract which requires that each party "not...interfere with the other party's performance and not to act so as to destroy the reasonable expectations of the other party regarding the fruits of the contract." *Centex Corp. v. United States*, 395 F.3d 1283, 1304 (Fed. Cir. 2005). However, this duty is limited by the original contract's allocation of risk and scope of assigned duties. *See Metcalf Const. Co. Inc. v. United States,* 742 F.3d 984, 991 (Fed. Cir. 2014) ("The implied duty of good faith and fair dealing is limited by the original bargain..."); *Lakeshore Eng'g Servs. Inc. v. United States*, 748 F.3d 1341, 1349 (Fed. Cir. 2014); *Allen Eng'g Contractor Inc. v. United States*, 611 Fed. Appx. 701, 709 (Fed. Cir. 2015).

When determining a party's expectations of compensation, the risks assumed by that party under the original contract must be taken into consideration. *See Lakeshore*, 748 F.3d at 1349. In *Lakeshore*, the parties agreed to use the Universal Unit Price Book ("UUPB") to determine how payments should be adjusted to cover costs for materials. When it was discovered that the UUPB prices were too low and Lakeshore was bearing the costs of those inaccuracies, Lakeshore was still not entitled to a modification of compensation. *Id.* at 1343-45. There was no breach of good faith and fair dealing because in agreeing to use the UUPB, Lakeshore assumed the risk of inaccuracies. *Id.* at 1349.

Similarly, Parsons assumed the risk of a modification in the prime contract's fee structure. Although at the time the subcontract was formed the prime contract provided for incentive fees, it nevertheless expressly stated that Bechtel only share 1/3 of incentive fees to the *exclusion* of award and fixed fees. Parsons assumed the risk under the original subcontract that the prime contract fee structure would be modified to provide for award fees to the exclusion of incentive fees. Such a modification did occur, and the covenant of good faith and fair dealing does not alter that original allocation of risk.

Furthermore, the covenant of good faith and fair dealing under Federal contract law is limited by the scope of the duties originally imposed by the initial bargain. *Metcalf Const. Co. Inc. v. United States*, 742 F.3d 984, 991 (Fed. Cir. 2014) ("What is promised or disclaimed in a contract helps define what constitutes 'lack of diligence and interference with or failure to cooperate in the other party's performance.'"); *Bell/Heery*, 739 F.3d at 1331; *Allen*, 611 Fed. Appx. at 709. In *Allen*, a Naval contractor ("AEIC") was obligated to furnish bonds with an approved corporate surety. *Allen*, 611 Fed. Appx. at 704. However, AEIC's bonds later proved invalid, an error the Navy did not catch in its own procedures. When both parties were informed of the fraudulently posted bonds, AEIC was not able to secure valid bonds and thus the contracts were terminated. *Id.* Nevertheless, the Navy was not obligated to catch and notify AEIC of such mistakes, and to hold they had an obligation to do so in good faith and fair dealing would be an expansion of any original duties. *Id.* at 709.

Likewise, nothing in the subcontract indicates that Bechtel had a duty to conform modifications of the prime contract to the contract with Parsons, nor to avoid modifications in the prime contract to ensure Parsons would have a continued share in fees paid. Bechtel's contractual duty with regard to compensation is clear: It must share 1/3 of incentive fees received, exclusive of award and fixed fees. There is nothing more. There is no further contractual duty, or any basis for a contractual duty, to ensure that there is always incentive fees included in the prime contract or to modify the fee sharing provisions to mirror the prime contract. This would be an inconsistent and ungrounded expansion of Bechtel's contractual duties.

Moreover, it was clear from the testimony of John B. Pierce presented at trial, that the United States made the decision to modify the fee structure. Transcript of Deposition of John Bradley Pierce, pp. 17-21 (May 10, 2016). Pierce stated that he was concerned the United States was "incentivizing the wrong thing" under the original fee structure, and that the highest priority

had to be "safety and environmental." *Id.* He states, "It was the wrong type of contract...and it led to the wrong type of decision-making." *Id.* It was then his "initiative;" on behalf of the United States, "that...[the United States] needed to put focus on the important aspects of the program." *Id. Pierce* suggested "working to transition over to an award fee contract basis for Pueblo..." *Id.* As a United States-initiated modification, there was no bad faith effort on the part of Bechtel to circumvent fee-sharing provisions and reduce Parsons' expected compensation. In sum, the evidence demonstrated that Parsons expected to receive compensation through sharing of incentive fees, and the United States modified the contract to eliminate such incentive fees.

C. Counterclaim: Breach of Contract and Unjust Enrichment

The United States recouped unearned incentive fees by setting off amounts due under the modified award fee structure; however, the plain and unambiguous language of the subcontract only pertains to incentive fees, not award fees. As a result, Bechtel cannot recover the incentive fees shared with Parsons simply because the United States withheld later award fee payments.

Although the United States' setoff of award fees *was* an accounting method to recover for the overpayment of incentive fees, this does not affect Parsons rights under the subcontract. Bechtel was paid incentive fees. It was required to share those, and it did so. If the United States had asked for direct reimbursement of those incentive fees, then perhaps Parsons would be required to return its share. However, the United States chose a different method of recoupment through withholding award fees. The withholding of award fees has no bearing on the subcontract and Parsons' right to a share in the incentive fees that *were* paid to Bechtel.

IV. CONCLUSION

For the foregoing reasons, the Court finds in favor of Bechtel National, Inc. as to Parsons three counts, and in favor of Parsons as to Bechtel's counterclaim, and dismisses the case with prejudice.[2]

Sincerely,

[redacted]

Daniel E. Ortiz
Circuit Court Judge

[2] For the reasons previously discussed on the record, which the Court incorporates here, the Court declines to award Bechtel attorney fees.

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

PARSONS GOVERNMENT SERVICES INC.,	)	
Plaintiff,	)	
v.	)	CL-2015-6014
BECHTEL NATIONAL, INC.	)	
Defendants.	)	

ORDER

THIS CASE came before the Court upon Plaintiff Parsons Government Services, Inc.'s action for Breach of Contract, Breach of the Implied Duty of Good Faith and Fair Dealing and Declaratory Judgment against Defendant Bechtel National, Inc., as well as Bechtel National Inc.'s counterclaim for Breach of Contract and Unjust Enrichment. For the reasons set forth in the Court's Opinion Letter; it is therefore,

ORDERED that the Court finds in favor of the Defendant on the complaint, and the Counter-Claim Defendant on the counterclaim. This case is dismissed with prejudice.

ENTERED this 12th day of October, 2016.

[redacted]

Judge Daniel E. Ortiz

ENDORSEMENT OF THIS ORDER BY COUNSEL OF RECORD FOR THE PARTIES IS WAIVED IN THE DISCRETION OF THE COURT PURSUANT TO RULE 1:13 OF THE SUPREME COURT OF VIRGINIA.