28th Annual Ounce of Prevention Seminar

Welcome

Predicting the Future:
Federal Contracting in an Election Year

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CONTRACT CLAIMS AND DISPUTES RESOLUTION

Budget Implosion

and Contract Fallout

Chris Haile

Bob Wagman

Grant Book

Mounting Pressure on Procurement

- Budgetary pressures may lead to program changes, increased scrutiny, and aggressive contract administration
- Reduced quantities and extended schedules
- Delayed and decreased funding
- Resistance to compensation for changes
- De-scopes
- Terminations

Terminations for Default

- Expect Terminations for Default to Increase
- Grounds for Default Termination
- Material Breach vs. Default Termination
- Termination Process
- Protecting Your Interests
- Appeals and Conversion to Termination for Convenience

Grounds for Default Termination
Recent Examples

- Repudiation
  - *Free & Ben, Inc.*, ASBCA 56129 (Mar. 22. 2011)
  - *D&M Grading, Inc.*, CBCA 2625 (Apr. 24, 2012)
- Violation of Regulation or Contract Provision
  - *Laura K. McNew,* PSBCA 6286 (Apr. 23, 2012)
- Failure to Deliver on Time
  - *Matrix Research, Inc.*, ASBCA 56430 (June 22, 2011)
  - BUT, if Government waives delivery date and does not set a new date, can't terminate for default
    - *Environmental Safety Consultants,* ASBCA 51722 (Sep. 28, 2011)
- Defective or Deficient Product
  - *Lan-Cay, Inc.*, ASBCA 56140 (Jan. 23, 2012)

Material Breach vs. Default Termination

5860 Chicago Ridge, LLC v. United States, Ct. Fed. Cl., Nos. 07-680 and 09-576 (Apr. 27, 2012)

- Government may terminate a contract for default ***based on specific terms of the contract***, even if the failure giving rise to that default is not a "material breach" under common law
- If the default clause more generally states that termination may occur based upon the failure to perform "other provisions" of the contract, then those other provisions violated must be material

Material Breach vs. Default Termination

5860 Chicago Ridge, LLC v. United States
Ct. Fed. Cl., Nos. 07-680 and 09-576 (Apr. 27, 2012

- Two-stage process for examining termination:
  - First, was default proper under clauses in the contract providing for specific events of default.
    - If so, default liability established.
  - Second, did the contractor's failure to perform constitute a material breach, so as to excuse defendant's abandonment of the contract under a generic "other provisions" default clause or under common law.

Process – Cure Notice

- Termination for Default may be improper if written cure notice not issued or termination based on ground not stated in cure notice
- Cure Period = 10 days
- Cure Notice not required if performance schedule has expired or fewer than 10 days
  - Also not required if futile (*e.g.*, Repudiation)
- Company must cure or give "adequate assurance"
- Government must fully evaluate the response

Process – Show Cause & Termination Notices

- Show Cause
  - Encouraged, but not mandatory
  - No required response period
  - Issuance after due date does not impact government's right to terminate for default
- Termination Notice
  - Grounds for default, liability for excess reprocurement costs, right to appeal
  - Government failure to formally comply with FAR requirements not fatal unless contractor prejudiced

Protecting Your Interests:
Building a Record

- Before Notice:
  - Be alert to customer dissatisfaction
  - Diligently address perceived or actual performance issues
  - Fully document delay and performance issues
  - Consider getting legal involved early
- After Cure Notice
  - Timely complete response
  - Provide proof deficiency is cured or give “adequate assurance” of performance

Appeals and Conversion to Termination for Convenience

- "Appeal" to Contracting Officer
  - Can reinstate if doing so would be advantageous to the government
- Court of Federal Claims or Boards of Contract Appeals

Prime-Subcontractor Disputes

Priority One Servs., Inc. v. W&T Travel Servs., LLC
D.D.C. No. 10-1873 (Aug. 23, 2011)

- State contract law may be applied to material breach issues
- Subcontract allowed prime contractor to terminate for convenience only if it was terminated for convenience
- Incorporating the contract by reference does not confer on private parties the exact same rights the government has with respect to the prime contractor
- Tailor subcontracts to include any clauses and exact terms the parties want to be included

Termination for Default

- Is pretext relevant?
  - *Slesinger v. United States* (Ct. Cl. 1968)
  - *Darwin Constr. Co. v. United States* (Fed. Cir. 1987)
  - A-12 Decisions
  - Good faith / bad faith standard

Termination for Convenience – Fixed-Price Contracts

- T/C essentially converts FFP to cost-reimbursement contract
- Contractor entitled to recover
  - Allowable costs of performing terminated work;
  - Reasonable profit on work performed (subject to loss adjustment);
  - Additional costs caused by T/C; and
  - Settlement expenses
- Allowability based on FAR Part 31 cost principles, BUT contractor should be compensated fairly

Termination for Convenience – Cost-Reimbursement Contracts

- Recovery of costs incurred in performance
- Continuing costs
- Settlement costs
- Percentage of the fee equal to the percentage of completion of work contemplated under the contract (excluding subcontract effort included in subcontractors' termination proposals), less previous payments for fee

Termination for Convenience – Commercial Item Contracts

- FAR Part 12.4 / 52.212-4(*l*)
- Payments to Contractor:
  - "percentage of the contract price reflecting the percentage of work performed prior to the notice of termination"
  - "Reasonable charges . . . that have resulted from the termination"
    - *Red River Holdings v. United States* (D. Md. 2011)
    - Does not require compliance with CAS or contract cost principles
    - Can be demonstrated using the contractor's "standard record keeping system"
    - FAR Part 49 provisions are only "guidance"
- Non-standard termination provisions

Termination for Convenience – Subcontract Relationships

- Promptly Notify subcontractors to Stop Work
  - Provide termination notices
  - Assure that scope of subcontractor termination is consistent with the prime contract termination

- In advance, consider: Flowdown of T4C provisions
  - Mirroring FAR
  - Beware of subcontract limitations / differences

Contractor Obligations Upon Receipt of Termination Notice

- Notify the TCO of any special circumstances that preclude the stoppage of work
- Continue performance of unterminated portion of the contract
  - Promptly submit REA for impact of termination on unterminated portion of the contract
- Settle outstanding liabilities in connection with termination
- Submit termination settlement proposal

Cost Recovery: Initial Costs

- Initial costs, both "starting loads" and preparation costs, are generally allowable
- Examples
  - Nonrecurring higher labor costs early in production if contractor can show positive learning (declining labor hours or costs) prior to the T/C
  - Initial plant rearrangement and alterations, management and personnel organization, and production planning
- May be recovered under T/C even if the same costs would not have been allowable as precontract costs, *e.g.,* planning costs incurred prior to start of performance. BUT, compare *OK's Cascade Co. V. United States* (Fed. Cir. 2012)

Limitations on Recovery – Loss Adjustment

- If the Contractor would have sustained a loss on the entire contract had it been completed, then:
  - No Profit
  - Reduce cost recovery using a loss adjustment / Loss Ratio

Limitations on Recovery – Loss Adjustment

- Defending against the loss adjustment
  - Documentation of changes
  - Documentation of government delays
  - Submission of REAs and Claims
  - Cost projections
  - Learning curves and efficiency

Other Limitations on Recovery

- May not exceed the total contract price
- Limitation of Costs Clause
- Limitation of Funds Clause
- Special termination liability provisions

Partial Terminations for Convenience

- Termination of part, but not all, of the work that has not been completed and accepted
- Contractor may seek an equitable adjustment for increased costs of continued work

Deductive Changes

- Alternative to a partial termination
- Based upon the “Changes” clause
- The contract price is reduced by the cost of the deleted work
- Reduction generally will include overhead and profit elements in addition to direct costs avoided

Deductive Change vs. Partial T4C

- No “bright line” rules for which must be used

- *Generally* a partial T4C will be more favorable where the contractor is in a loss position and a deductive change will be more favorable when the contractor is in a high-profit position

Claims Under Classified Contracts

- *Totten* Doctrine
- State Secrets Privilege
- Where are we after A-12?

Totten v. United States, 92 U.S. 105 (1876)

- Plaintiff claimed President Lincoln entered into a Civil War contract to spy on the Confederacy.
- Court held secret agreements could not be judicially enforced.
  - "It may be stated as a general principle, that public policy forbids the maintenance of any suit in a court of justice, the trial of which would inevitably lead to disclosure of matters which the law itself regards as confidential"

United States v. Reynolds, 345 U.S. 1 (1953)

- Three widows sued under Tort Claims Act related to an Air Force plane crash.
- Air Force objected to production of investigation report based on state secrets.
- Court drew distinction between civil and criminal case and held case could go forward without privileged information.

Tenent v. Doe, 544 U.S. 1 (2005)

- Cold War spies sued the DCI after CIA purportedly cut off promised financial assistance.
- Upheld "*Totten's* broader [than *Reynolds*] holding that lawsuits premised on alleged espionage agreements are altogether forbidden."
- "*Totten* precludes judicial review in cases such as respondents' where success depends upon the existence of their secret espionage relationship with the Government."

General Dynamics Corp. v. United States, _ U.S. _, 131 S.Ct. 1900 (2011)

- Plaintiffs raised a superior knowledge defense to the government's default termination.
- Inadvertent disclosures of classified information during discovery led the Air Force to assert state secrets privilege.
- COFC ruled that superior knowledge could not be litigated, and precluded defendants from raising defense. Federal Circuit affirmed.

General Dynamics (Cont.)

- Court held that *Totten/Tenent*, and not *Reynolds* controlled, because the case presented a public policy issue, not an evidentiary issue.
- "It seems unrealistic to separate, as the CFC did, the claim from the defense."
- Held that the superior knowledge was unadjudicable and "the parties will be left where the are." . . . "Rough, very rough, equity."

Dicta -- Enforceability

- "Both parties must have understood that state secrets would prevent courts from resolving many possible disputes under the A-12 agreement."
- "Both parties [ ]must have assumed the risk that state secrets would prevent the adjudication of claims of inadequate performance."
- The fact that the unenforceability did not exist at contract formation should not affect the remedy.

Impact on Future Contracts

- *Totten*-lite doctrine: "the nonjusticiability of one aspect of the case will not necessarily end the entire litigation."
- "[O]ur decision . . . renders the law more predictable and hence more subject to accommodation by contracting parties."
  - Manage the contract to anticipate unenforceability

Future Contract Claims

- Common-law, not statutory, opinion
  - Subject to further refinement

- COFC vs. BCA
  - A-12 decision focused on judicial enforcement
  - *Totten* "its agents in those [clandestine] services must look for their compensation to the contingent fund of the department employing them."