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Contract Administration

Session Two BEST PRACTICES, TERMINATIONS AND CLOSEOUT

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- Author of eight books including *The 100 Worst Government Mistakes in Government Contracting*,; *The 100 Worst Mistakes in Government Contracting* (with Jason D. Morgan), and *Elements of Government Contracting*.
- Published articles include “10 Big Mistakes in Government Contract Bidding,” “10 Big Mistakes in Government Contract Administration,” “Incorrect Government Advice – Whom Should You Heed” and “The Ten Big Mistakes Made by Small Businesses and New Government Contractors.”
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Agenda

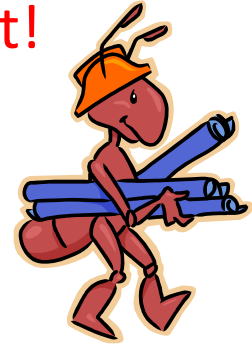
- Best Practices in Contract Administration
- Termination for Convenience
- Termination for Default
- Contract Closeout

Best Practice – Work Together

- Both contractor and Government are susceptible to making contract administration mistakes.
- Although Government and contractor have different goals, this is not a zero-sum game: everyone benefits when contract administration is done correctly.
- So . . . try to create a “virtuous cycle.”

Best Practice – Document!

- FIRST RULE OF GOVERNMENT CONTRACTING: It's not enough to do what is required – **one must document it!**
 - Contractor: For auditors
 - Government: For inspectors general, or protests
- Memories fade and people change jobs.
 - Good documentation makes disputes less likely - and less costly.
- Document and reconcile as tasks are performed; don't wait until contract is complete.
- Contract closeout should begin at award – planning, tracking, and above all, maintaining documentation!
- Document important communications in writing.
(Contractor: CO may forget, deny, or be unavailable.)
- Document contract modifications in advance – or ratify.



Best Practice: Know the SOW

- CO and Program Office: Understand contract SOW (which may differ from what you wrote in initial acquisition plan).
- Contractor: Be sensitive to differences between what your (program) customer expects and what contract actually requires.
- Avoid (or recognize) constructive changes - watch for requests for extra work (especially in fixed-price contracts) or other constructive changes.
- Contractor: Give prompt notice of constructive changes. Let Government decide whether you should do extra work. A dispute is easier to resolve before money is spent.
- Contractor: If you choose to do extra work voluntarily in order to exceed your customers' expectation, do so with your eyes wide open.

CAUTION

Best Practice – Don't Let the Grizzly Bears Sleep



- Be proactive. Problems will surface. Act accordingly..
 - Contractor: Communicate with CO early and often.
 - CO: Don't be standoffish.
 - Face-to-face meetings may be more effective than email changes or telephone tag.
- Avoid common traps:
 - “I don't want to tell my manager. (There goes my bonus.)”
 - “What my CO doesn't know won't hurt me.”
 - “No lawyers – they'll just get me into trouble.”
 - “This Cure Notice is just a shot over the bow. The contracting officer just wants to send me a message – he doesn't really mean it.”
 - “It's better to ask forgiveness afterwards than permission beforehand.”

Best Practice – Don't Let the Grizzly Bears Sleep!

AND THE MOST COMMON AVOIDANCE TECHNIQUE OF ALL:

- “Maybe the problem will go away and I won't have to address it.” (And maybe the pig will fly.)



Best Practice: Contractors, Choose your Battles

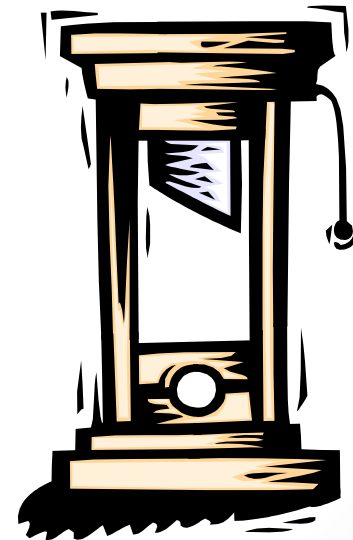
- Not every issue should become a “federal case.” Sometimes it’s best to pull your punches.
- Hardball negotiations may poison relationship. People have long memories.
- Why take position that will antagonize other side, if you know you will eventually have to give it up?
- Unlike commercial litigation, government contracting disputes/protests/litigation are conducted between parties that want to continue to do business with each other.
- Contractor: If you follow the contracting officer’s direction you can protect your legal and contractual rights, with less risk.
- If you don’t – even if you’re right, you’re wrong!

Best Practice: CO's, Exercise Independent Judgment

- Contracting Officers are “allowed wide latitude to exercise business judgment.”
- Independent judgment should be exercised when making discretionary decisions.
 - Directing changes and reviewing requests for equitable adjustment
 - Deciding CDA claims and terminations
- Role of DCAA (or IG) is advisory.
 - CO's are often reluctant to decide against DCAA recommendations.
- Your mandate is to “safeguard the interests of the United States in its contractual relationships” and to “ensure that contractors receive impartial, fair, and equitable treatment.” (FAR 1.602-2). DCAA is not your client. The United States of America (including the contractor!) is your client.



TERMINATION FOR CONVENIENCE (T4C) FAR Part 49



Termination for Convenience (“T4C”)

- The Clause: “The Government may terminate performance of work under this contract in whole, or . . . in part if the Contracting Officer determines that it is in the Government’s interest.” FAR 52.249-2(a)
- **Government has right to terminate without cause.**
- **Contractor may recover costs and reasonable profit, but not anticipated future profits.**
- Purpose: Wars end, Congress stops funding programs, circumstances or technology change. (Would you want your tax dollars wasted?)
- **T4C Clause = unique aspect of government contracts – not in most commercial contracts.**

The “Christian Doctrine”

- Christian Doctrine: Even if it’s not in your contract, if it reflects a “major government principle” it will be read into your contract.
- CO does not have authority to waive requirement.
- **Required** under Christian: E.g., Termination for convenience, Changes, Buy American Act, and Bonds (in construction)
- **Not required** under Christian: E.g., Variation in estimated quantities, Contractor patent rights

“Should I T4C?”

- **Contracting Officer should T4C ONLY when it is in the Government’s best interest.**
 - Note: T4C extinguishes funding (which must be deobligated), so other funds must be used for subsequent procurement.
- Contracting Officer should not T4C if:
 - No-Cost termination is possible (FAR 49.109-4).
 - Contract balance is less than \$5,000.
 - Contractor is in default (but is it worth going through default process?)

T4C: Limits on exercise

- The Contracting Officer has broad discretion, but . . .
- Torncello: Termination for convenience is not permitted if done in bad faith:
 - Malice [but overcoming presumption that government operates in good faith requires “well nigh irrefragable” evidence of bad faith]
 - If at time of award government did not intend to honor contract, i.e., it intended immediately to terminate portion of contract. [Test: was there post-award change in circumstances that motivated termination?]
- If termination for convenience is invalid, contractor may be able to recover damages/lost profits.

What Does the CO Do?

- CO provides the contractor with written notice:
 - Contract is being terminated for convenience
 - Effective date of termination
 - Extent of termination (if partial)
 - Any special instructions



What Must the Contractor Do?

- Contractor must stop work!
 - Notify subcontractors. (Is it in your subcontract? It should be!!!)
 - Mitigate termination costs
 - Reassignments or severance?
 - Dispose of inventory, work in progress
- T4C settlement proposal (within one year of notice)
 - Audited and negotiated
 - Final settlement modification
 - Convert to claim if not settled (with right to appeal to Board of Contract Appeals or Court of Federal Claims)



Termination Settlements

- Contractor is entitled to recover:
 - Contract price for work performed and accepted (including profit)
 - Costs incurred to point of termination, plus reasonable profit thereon, unless it is a “loss contract.”
 - Wind down costs (e.g., severance payments, unrecoverable lease costs)
 - Settlement expenses (including legal and accounting)
 - **Not lost profits!**
 - FAR Part 31 cost principles are not strictly applied - “fair and reasonable” compensation is a business judgment.

Termination Settlements in Other Types of Contracts

- Cost Contracts – indirect costs and fee may be adjusted
 - Commercial Items contracts - Contractor is entitled to recover:
 - Percentage of price (based on percentage of completion)
 - Settlement costs
- (FAR 52.212-4(I))



T4C Scenario

- January 2011: DLA awards construction contract to JR and Company. Tom Tightwad is Contracting Officer.
- February – December 2011: JR runs into performance problems, including unexpected site conditions, strikes, faulty specifications and drawings, and employee attrition.
- During this period the Contracting Officer meets frequently with JR management.
 - At first the discussions are positive. Both parties are seeking ways to make the project a success.
 - Later, however, discussions turn adversarial, and JR starts filing claims for constructive changes. To Tom, JR appears to be more interested in protecting its bottom line than in making the project succeed. He asks JR's president, "do you want some cheese with that whine?"
 - Finally, the parties become exasperated and stop talking to each other. JR continues to perform on the contract, but Tom thinks they are "working to the rule."

T4C Scenario

- Finally, on March 17, 2012, Tom Tightwad summons JR management to a meeting, and tells them:

“I’m tired of your bellyaching. After putting up with you this past miserable year, I’ve concluded that you’re one of those contractors who gives our business a bad name. I probably should terminate you for default, but because it’s Saint Patrick’s Day and I’m Irish, I’ll be nice and terminate you for convenience.

- Two days later, the CO issues a written termination for convenience. JR and Company appeals.

What result?

- A) The T4C was valid, because the CO reasonably determined it was in the government’s best interests.
- B) The T4C was not valid because it was motivated by Tom Tightwad’s malice and bad faith.
- C) The CO erred in not terminating for default.
- D) What the heck does “irrefragable” mean, anyway?

T4C: Constructive Terminations

- Constructive termination for convenience:
 - Where government does not say it is terminating for convenience but takes action that effectively does so – e.g., by making performance impossible - court may treat contract as having been “constructively terminated for convenience.”

T4C: Partial Terminations

- Partial Termination for Convenience vs. Deductive Change:
 - Both involve reduction in contract requirements with accompanying reduction in price.
 - Deductive change reduces contract price by price of deleted work.
 - Partial termination for convenience allows contractor to reprice from bottom up (excluding deleted work).
 - Partial termination may, or may not, be better for contractor.

T4C: Best Practices

- Termination for convenience clause is not a mandatory flowdown!
 - Prime contractor omits clause at its peril.
 - Subcontractor may want to limit prime's right to terminate to instances where prime contract is terminated.
- Good recordkeeping is essential – only supported, auditable costs will be allowed.
- Contractor must show diligent compliance with the requirement to stop work and wind up subcontracts.
- Consider using accounting and legal assistance (costs can be included in settlement proposal).

TERMINATION FOR DEFAULT (T4D) FAR Part 49



Termination for Default ("T4D")

- Government may terminate contract when contractor is "in default."
- Not unique to government contracts – "Termination for cause" in contracts for commercial items or services



T4D: Grounds

- (52.249-8): “The Government may. . . by written notice of default to the contractor terminate this contract in whole or in part if the Contractor **fails to**—
 - **Deliver** the supplies or perform the services within the time specified. . .
 - **Make progress** so as to endanger performance of the contract. . .
 - **Perform** any of the other provisions of this contract”
 - **Proceed** (rather than proceeding and then filing constructive change claim).
- Contractor should proceed as directed, lest it provide “anticipatory repudiation” under common law.

T4D Discretionary

- A termination for default is a drastic sanction that should be imposed upon a contractor only for good cause and in the presence of solid evidence.
- Highly discretionary—the Government is never compelled to terminate for default.
- Government bears the burden of proving that a default termination was substantively justified.
 - T4D must be correct procedurally.
 - T4D must not be an abuse of discretion.

Alternatives to T4D

- FAR 49.402-4
 - Allow contractor to continue performance under extended schedule.
 - Allow contractor to continue to perform via subcontractor.
 - Execute deductive change (and meet requirements under a different contract).
 - Execute a no-cost termination for convenience settlement agreement.

T4D: Procedural Protections

Cure Notice

- Required if T4D before delivery date (*e.g.*: Failure to make progress or perform other contract provision)
- In writing
- Identify Contractor's problem/failure with "enough particularity" to inform the contractor as to what has placed it in danger of default.
- Minimum 10 day "grace period" for contractor to contest or cure failure.
- Flowdown: Prime contractors should give subs <10 days, to allow processing time.
- Not required if deadline for performance has passed or if contract has been repudiated.



Cure Notice Scenario

- You received a contract for anesthesia services for a VA hospital. There was some tension between the parties during performance, and halfway through the contract period you receive the following cure notice:
 - “The number of hours you are performing is below the required number of hours. Fix the problem and refund the government the money for non-worked hours.”
- Because you completely disagree (you think your staffing meets the contract’s requirements), you fail to respond to the cure notice. Eleven days later you are terminated for default.

Cure Notice Scenario

- I. Can the contractor still challenge the default on the merits – i.e., argue that the bases for a T/D did not exist?
 - A) Yes, notwithstanding the failure to respond to the cure notice.
 - B) No – the failure to respond to the cure notice waives the contractor’s right to object.

- II. What happens if the contractor successfully challenges the T/D?
 - A) The contract is reinstated.
 - B) The contractor can claim lost profits.
 - C) The T/D is converted to a T/C.

Best Practice: Do you have a system for timely responding to cure notices?

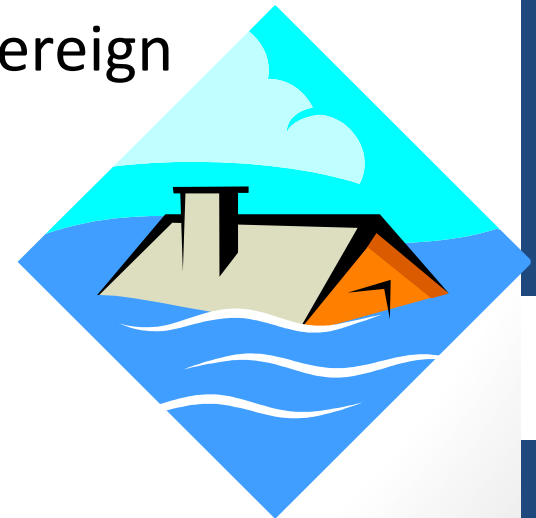
T4D: Procedural Protections

Show Cause Notice

- Optional, but required if practicable.
- In writing, reasonable time to respond.
- “Show reason why CO should not T4D.”
- Used when Contractor’s cure notice response was unsatisfactory and T4D justification is presumed (gives contractor opportunity to show that T4D is not best choice for government).
- Also used when T4D after delivery date or for anticipatory repudiation.
- Note: Cure Notice and Show Cause Notice not usual in commercial default provision!

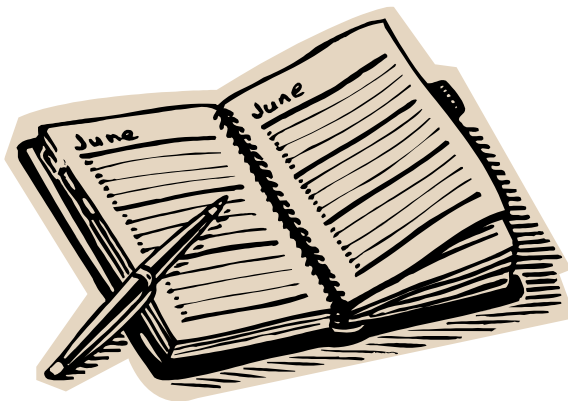
Contractor Defense : Excusable Delay

- Excusable Delay (remember last week's discussion?)
 - Beyond the control AND without the fault or negligence of contractor and any Sub or supplier. Everyone must be clean!
 - Claimed excuse must prevent performance.
 - Examples of excuses: fires, floods, sovereign acts, labor strikes



Contractor Defense: Waiver

- Waiver of schedule
 - Precludes termination - DeVito
 - Reasonable forbearance period
 - Detrimental reliance required by Contractor (Government led the Contractor on!)
 - Must reestablish “reasonable” delivery schedule.



Contractor Defense: Substantial Compliance

- Doctrine of Substantial Compliance (remember last week?)
 - Contractor must deliver on time.
 - Defect has to be minor.
 - Defect has to be readily correctible (and time not of the essence).
 - Contractor must reasonably believe that it performed with no defects.
- Contractor must still correct defect (unless CO accepts delivery, perhaps at reduced price).

Other Contractor Defenses

- No ground for termination existed.
- CO did not consider all relevant information or relied on erroneous information.
- CO failed to exercise independent discretion:
 - Consider alternative sources, revised schedule
 - Urgency, essentiality
- CO did not follow required procedure.
- Improper motive (Bad Faith)
 - Note: different from Torncello standard for T4C

T4D: Financial Consequences (Zero Sum)

- Contractor must return unliquidated progress payments, excess payments.
- Government is not liable for cost of work in process that is not accepted, but may elect to accept and pay lower price for defective goods.
- Contractor must pay the government excess cost of procurement (“cost to cover”) of same or similar items.
- (Alternative – liquidated damages provision)
- Cost reimbursement contracts have no cost consequences (because contractor was entitled to all allowable costs).



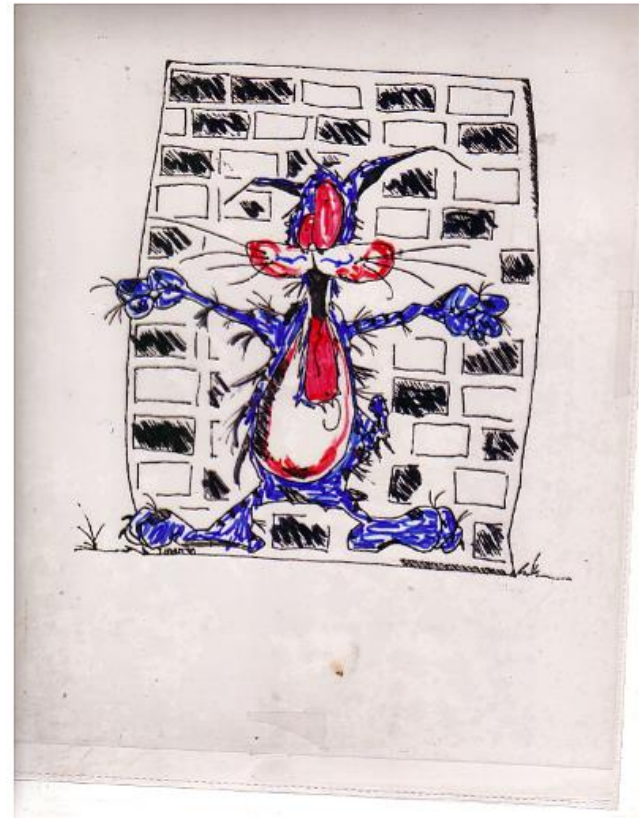
Excess Cost of Reprourement

- Government must reprocure similar items
 - “Similar in physical and mechanical characteristics as well as functional purpose”
 - Would the change in specifications fall within the scope of the Changes clause under the original contract?
- Competition: Very discretionary—evaluated in terms of the circumstances faced by the government at the time of reprourement.
 - Government has a duty to mitigate its excess costs, but . .
 - Government will frequently turn to the next higher bidder – i.e., your competitor!

Termination for Default: Non-financial Consequences

- Adverse responsibility determinations
- Negative Past Performance evaluations
- Possible suspension and debarment consideration

These consequences may be more significant than the financial costs.



Contractor Remedies

- Payment for accepted supplies and services, completed construction
- Can appeal CO T4D decision to Board of Contract Appeals or Court of Federal Claims
 - Can defer appeal of validity of T4D until reprocurement costs are assessed (Fulford doctrine)
 - Preserves judicial economy by eliminating need for protective appeals.

Government has burden to prove T4D was justified.

If Government meets burden, burden shifts to contractor to show that failure was excusable or government didn't follow rules for termination.

- If contractor prevails, T4D will be converted to T4C.
 - Faulty T4D is considered a “constructive termination for convenience,” since government had the right to T4C.

[Contractor will NOT get contract back!]

T4D: Best Practices

- T4D clause is not mandatory flowdown, but prime should include clause in subcontracts. (Termination for cause provision is standard in commercial contracts.)
- As always, good recordkeeping is essential.
- Cure Notice (or SC Notice) is WAKE UP CALL.
 - Focus team efforts, bring in resources as needed.
 - Don't keep your manager in the dark (“my customer just wants to send me a message”).

T4D: Best Practices

- Effects of T4D (vs. T4C) are asymmetrical
 - Monetary (reprocurement costs) is zero-sum. What contractor pays, government receives.
 - Other repercussions (past performance, responsibility determinations) harm contractor but do not benefit government.
 - This provides opportunities for contractor to trade dollars in return for no-cost T4C (or conversion to T4C).

T4D Scenario

- Let's revisit the March 17th meeting between JR and Company and Tom Tightwad, the Contracting Officer. This time Tom's in a foul mood. (Maybe he's not Irish?) Tom tells JR management:

“I am sick and tired of all your bellyaching. Your deliveries are late, so you owe the government \$800,000 for liquidated damages and other costs, and you've got the nerve to file a claim for \$1,000,000 for what you call 'constructive changes.' Bah, humbug. I'm going to terminate you for default. Put that in your pipe and smoke it. If you don't like it, tell it to the judge!”

T4D Scenario

Things look bleak. What can you do?

- A) Seek legal counsel. (This is obvious, so this answer doesn't get credit.)
- B) Try to persuade the CO to change his mind.
- C) Pursue your claim under the CDA and appeal the termination for default.
- D) Pursue your claim under the CDA and wait to see whether the CO assesses reprourement costs and, if he does, appeal.
- E) Offer to drop your claim and pay liquidated damages (and perhaps other consideration), if the CO will issue a T4C rather than a T4D.

CONTRACT CLOSEOUT



Contract Closeout

- Certification of completed work
- Return GFP, GFE
- Intellectual property – patents, tech data, copyrights
- **Indirect rates finalized** (or quick closeout procedures under FAR 42.708)
- Resolve or reserve any pending claims
- Final invoice
- Audits
- Release of claims and final payment
- Record retention requirements

Why Does Closeout Matter?

- Timely closeout saves dollars!
- **The agency**
 - Can de-obligate excess funds
 - Can identify needed new funds
 - Can reduce contract administration burden
 - Can ensure program requirements have been met
 - Can allow program shop to focus on future requirements
 - Can ensure that data rights have been preserved
- **The contractor**
 - Can ensure that it has received all money due
 - Can focus on future opportunities
 - Can reduce contract administration burden

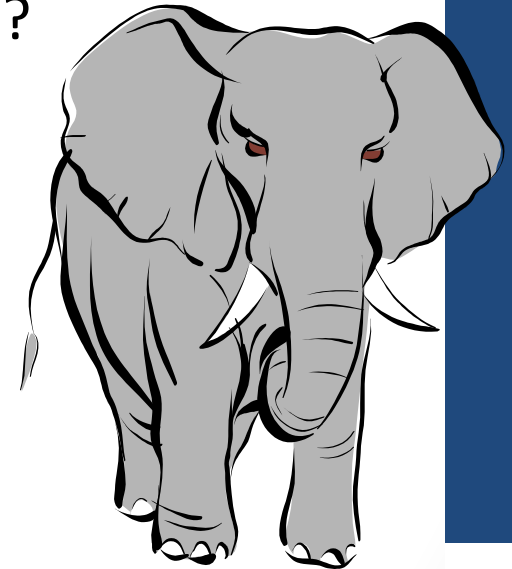
Indirect Rates

- Issue: Contractor cannot submit final voucher, and contract cannot be closed, until indirect rates are settled.
- Process (in theory):
 - Contractor submits “Incurred Cost Submission” within six months of end of contractor’s fiscal year.
 - DCAA evaluates direct and indirect costs, prepares audit report.
 - CO and contractor negotiate final rates.
 - Contractor submits completion voucher (within 120 days).



The Elephant in the Room

- What Really Happens:
 - Contractor submits incurred cost submission in April.
 - DCAA begins to audit submission in May.
 - But May of which year? Which decade?
- Can contractors work with ACO and DCAA to identify contracts and years where final indirect rates are needed to close contracts?
- FY2018 NDAA – requires DCAA to allocate resources and use private auditors to eliminate backlog by October 2020. DCAA claims it has (almost) done so.



DCMA Closeout Policy

“If all contract terms and conditions were met, then follow FAR 4.804-5, procedures for closing the contract.”

“When it becomes apparent that there will be a delay in the settlement of final indirect rates, it is recommended that the ACO utilize quick closeout where applicable.”

Closeout - Best Practices

- Closeout planning should begin at contract award. (“Pay me now or pay me later.”)
 - Determine what must be tracked.
 - Assign roles and responsibilities.
- Review status of funds, task orders, etc. along the way. Don’t wait until the contract ends.
- Keep good documentation, and keep it current.
- Don’t be adversarial – good contract administration and efficient closeout benefit both parties.
 - Ignored problems won’t fade away or improve with age – they will become obstacles at closeout.



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