

Changes, Terminations, and Claims

J. Clark Pendergrass

Lanier Ford Shaver & Payne P.C.

2101 West Clinton Ave., Suite 102

Huntsville, AL 35805

256-535-1100

jcp@LanierFord.com

www.LanierFord.com

Copyright 2012



Agenda

- Changes and Requests for Equitable Adjustment (REA)
- Terminations for Convenience (T4C) and Default (T4D)
- Claims

Changes and REAs: Overview

- Changes Clause required in all government contracts (*Christian doctrine*).
- Changes Clause gives government unilateral right to order changes in the contract work during the course of performance (exception for commercial items contracts).
- Can change drawings, design, specifications, place of delivery, etc.
- Purposes of Changes Clause
 - To provide operating flexibility by giving the government the unilateral right to order changes in the work to accommodate advances in technology and changes in the government's needs and requirements
 - To provide the contractor a means of proposing changes to the work, thereby facilitating more efficient performance and improving the quality of contract end products
 - To furnish procurement authority to the CO to order additional work within the general scope of the contract without using the procedures required for a new procurement or utilizing new funds
 - To provide the legal means by which the contractor may process claims against the government

Changes and REAs: *Christian Doctrine*

- Mandatory contract clause that expresses a significant tenet of public policy is considered to be included in the contract by operation of law, regardless of whether CO expressly incorporates by reference or sets out in contract.

Changes and REAs

- Types of Changes

- Express Changes (formal order under Changes Clause)
- Constructive Changes



Express Changes

- Express Changes under Changes Clauses
 - CO issues a Change Order or Modification
 - Done through SF 30
- Five Basic Types of Changes Clauses
 1. Fixed-Price Supply or Service Contracts (FAR 52.243-1)
 - Alternates I through V
 2. Cost-Reimbursement Contracts (FAR 52.243-2)
 - Alternates I through V
 3. T&M/Labor-Hours Contracts (FAR 52.243-3)
 4. Fixed-Price Construction Contracts (FAR 52.243-4)
 5. Commercial Items (FAR 52.212-4)—not unilateral; changes may be made only by agreement of both parties

Express Changes

- Common Features of Changes Clauses
 - Alternative versions; must check to see which particular version is stated in contract or incorporated by reference in contract
 - Contain procedures for the CO to order changes
 - Describe the types of changes that may be made
 - Provide for equitable adjustment if the change increases or decreases the cost and/or time of performance
 - Additive Change: contractor entitled to an increase in price if change results in an increase in contractor's cost
 - Deductive Change: government entitled to a reduction in price if change decreases the contractor's cost
 - Contractor has a duty to proceed with work even if there is a dispute regarding the amount of the equitable adjustment

Express Changes

- Requirements under Changes Clauses
 - Change is permitted only within the general scope of the contract. Cannot be a “cardinal change,” i.e., one beyond the scope of the contract.
 - Change must be one of the types described in the particular Changes Clause.
 - Only CO acting within scope of his/her authority has the power to issue change order or modification.

Constructive Changes

■ Constructive Changes

- A constructive change is any conduct by a CO or other government representative authorized to order changes that is not a formal change order, but has the consequence of requiring the contractor—by informal order or by the government's fault—to perform work beyond the original contract documents, thereby entitling the contractor to an equitable adjustment.
- The constructive change doctrine applies even though a formal change order has not been issued by the government.

Constructive Changes

- A constructive change entails two basic components:
 - (1) Change component; and
 - (2) Order or fault component.
- Change Component—describes work outside the scope of the contract
- Order/Fault Component—describes the reason that the contractor performed the work

Constructive Changes

- There are five types of constructive changes:
 - (1) Disputes over contract interpretation during performance;
 - (2) Government interference or failure to cooperate;
 - (3) Defective specifications;
 - (4) Misrepresentation and nondisclosure of superior knowledge;
and
 - (5) Acceleration.
- Two most common constructive changes:
 - (1) Defective specifications and
 - (2) Misrepresentation.

Changes and REAs

- Defective specifications:
 - When the government provides a contractor with defective specifications, the government is deemed to have breached the implied warranty that satisfactory contract performance will result from adherence to the specifications, and the contract is entitled to recover all the costs proximately flowing from the government's breach.
 - The compensable costs includes those attributable to any period of delay that results from the defective specifications.
 - Unlike some situations in which the government has a reasonable period of time to make changes before it becomes liable for delay, all delays due to defective specifications are per se unreasonable and hence compensable.
 - FAR 52.243-4 provides that in the case of defective specifications for which the government is responsible, the equitable adjustment shall include any increased costs reasonably incurred by the contractor in attempting to comply with the defective specifications.

Changes and REAs

- Misrepresentation:
 - Occurs when the government has misrepresented information regarding a contract term (such as a specification) or fails to disclose information it has a duty to disclose and the contractor has detrimentally relied upon the government's misrepresentation.
 - It is of no consequence that the misrepresentation may have been innocent or inadvertent, as long as it is material and the contractor suffers increased costs of performance as a result.
 - Absent detrimental reliance by the contractor or a failure to investigate sources that would have revealed the truth, the government is liable for damages attributable to misstatements of fact in the contract or specifications.
 - In order for a contractor to prevail on a claim of misrepresentation, the contractor must show that the government made a false representation of material fact that the contractor honestly (subjective) and reasonably (objective) relied upon to the contractor's detriment.
 - When an official of the contracting agency is not the CO, but has been sent by the CO for the express purpose of giving guidance in connection with the contract (e.g., TCO), the contractor is justified in relying upon the representative's statements.

Changes and REAs

- Equitable Adjustment: An equitable adjustment encompasses the quantitative difference between the reasonable cost of performance without the added, deleted or substituted work and the reasonable costs of performance with the addition, deletion or substitution.
- Burden of proving amount of equitable adjustment is on claimant.
- In order to prove the amount of equitable adjustment, it is not necessary that the amount be proven with absolute certainty or mathematical exactitude.

Changes and REAs

- Quantum of adjustment
 - Depends in part on the type of contract involved
 - Typically entitled to increased costs and reasonable profit on added work
 - Relatively small changes: usually use profit rate in the original contract
 - 10% profit regarded as norm
 - Actual costs should be provided when available
 - Requires contractor to segregate costs after receiving the Change Order
 - CO may order Change Order Accounting (FAR 43.205 and 52.23-6)
 - Contactor entitled to costs in preparing the REA; costs includes attorneys' fees (FAR 31.205-33)
 - Interest is not recoverable

Changes and REAs

- Three Methods of Calculating Quantum
 - (1) Actual costs;
 - (2) Total costs; and
 - (3) Jury verdict method

Changes and REAs

■ Actual Cost Method

- Preferred method
- Simply considers the actual cost data
- Actual costs more likely to be available where (i) formal change order has been issued; (ii) the contractor initiated accounting procedures to segregate costs related to the change; and (iii) the changed work has been completed.

Changes and REAs

■ Total Costs Method

- The monetary difference between the amount of costs anticipated in the bid price from the actual costs of performance plus profit.
- Assumes that (i) the costs in excess of original bid were caused by the changes; (ii) the contractor's original bid is a fair indication of what it would have cost to perform the work absent the changes; and (iii) all the extra costs incurred by the contractor are related to the changes.
- Used as a last resort, when difficulty exists in determining the nature or amount of the added work or no other way to compute damages is feasible.
- Contractor must prove the following:
 - The impracticability of proving its actual losses directly;
 - The reasonableness of its bid;
 - The reasonableness of its actual costs; and
 - Lack of responsibility for the added costs.

Changes and REAs

■ Jury Verdict Method

- Evidence is sufficient to enable the trier of fact (judge/court or jury) to make a fair and reasonable approximation, i.e., reasonable computation of damages
- Used less frequently
- Typically results in an equitable adjustment significantly less than amount requested by contractor

Changes and REAs

- Determining Unabsorbed Home-Office Overhead
 - Contractors can recover additional overhead for delays either on the theory that additional overhead costs are incurred when the contract period is extended or on the theory that the contractor has absorbed its share of overhead during the period when no work, or lesser amount than planned, has been performed
 - *Eichleay* formula—exclusive method of computing unabsorbed overhead

Changes and REAs

- *Eichleay* formula:

- Computes a daily amount of home office overhead which is a rough approximation of the amount contractor would have charged to the contract had there been no delay, and gives the contractor that amount of overhead for each day of delay that occurred during performance.
- Used primarily in construction contracts
- Three Requirements:
 - (1) There must have been a government caused delay of uncertain duration;
 - (2) The contractor must show that delay extended the original time for performance or that, even though the contract was finished within the required time, the contractor incurred additional costs because it planned to finish earlier; and
 - (3) The contractor must have been on stand-by and was unable to take on other work during the delay period.

Changes and REAs: *Eichleay* Formula

- $(\text{Contract billings} \div \text{Total billings for contract period}) \times \text{Total overhead for contract period} = \text{Overhead allocable to the contract}$
- $\text{Overhead allocable to the contract} \div \text{Days of performance} = \text{Daily contract overhead}$
- $\text{Daily contract overhead} \times \text{Days of delay} = \text{Amount recoverable}$

Changes and REAs

■ Procedure

- Usually must submit REA within 30 days of receipt of change order (express changes)
- Liberal rule for submission in case of constructive changes
- CO usually cannot consider REA after final payment
- REA must contain prescribed certification (10 U.S.C. § 2410(a); DFARS 243.204-70; DFARS 252.243-7002):

“I certify that the request is made in good faith, and that the supporting data are accurate and complete to the best of my knowledge and belief.”

Changes and REAs

Procedure (cont'd)

- Not an adversarial proceeding against government; negotiation with government
- Usually required to submit certified cost or pricing data in Table 15-2 format (FAR 15.408)
- Subject to being audited

Terminations: Overview

- The right of the government to terminate contracts is important for procurement flexibility and obtaining the maximum use of procurement funds.
- The government needs the ability to discontinue contracts that are made obsolete by technological or other advancements/developments OR that are no longer advantageous.
- Every contract must include a termination clause (*Christian doctrine*).
- In exchange for T4C right, government agrees to reimburse the contractor for all reasonable and allocable costs connected with contract performance. In addition, the contractor will normally be entitled to a reasonable profit on such costs.

Terminations

- Addressed in FAR Part 49
- Two Types:
 - For Convenience (T4C)
 - For Default (T4D)

Terminations for Convenience

- T4C is a government right to be exercised in the best interests of the government.
- Government has no duty to terminate for convenience to benefit the contractor.
- Can be either partial (part of contract) or complete (whole of contract).
- T4C is a major variation from most commercial or private contracts.
- T4C can arise as a result of written notice by government or by operation of law.

Terminations for Convenience

- T4C clauses are found in FAR Part 52.
- There are several contract clauses that are required to be included, in some form, in most government contracts—T4C is one of those.
- FAR 49.502 prescribes when T4C clauses are to be used.
- There are several variations of the clause, each designed for the specific contract type.

Terminations for Convenience

- Types of T4C Clauses:
 - Fixed-price Contracts
 - Short form T4C clause for contracts less than \$100,000 (FAR 52.249-1)
 - Long form T4C clause for contracts over \$100,000 (FAR 52.249-2)
 - Dismantling, Demolition or Removal Contracts (FAR 52.249-3)
 - Service Contracts (FAR 52.249-4)
 - Educational and Other Non-profit Institutions Contracts (FAR 52.249-5)
 - Cost-reimbursement Contracts (FAR 52.249-6)
 - Architect-Engineer Contracts (FAR 52.249-7)
 - Commercial Items Contracts (FAR 52.212-4)

Terminations for Convenience

- Decision to T4C will not be disturbed, unless contractor can show, by clear and convincing evidence, bad faith, meaning that:
 - Government acted with specific intent to harm the contractor; or
 - That the termination had no reasonable relationship to the government's interest.
- Examples where Courts/Boards have found bad faith:
 - Termination for purpose of performing contract with another source in order to obtain better price; and
 - To effectively debar the contractor without following proper procedures.

Terminations for Convenience

- Written Notice—prescribed in FAR Subpart 49.6
 - Statement that contract is being terminated for convenience of the government
 - Effective date of termination
 - Extent of termination (if partial)
 - Special instructions, if any (such as work in progress, GFE, etc.)
 - Steps contractor should take to minimize impact of termination, especially on personnel
 - TCO responsible after issuance of notice of termination
- Contractor's Obligations (FAR 49.104)
 - Follow government instructions
 - Failure to do so leads to disallowance of costs

Terminations for Convenience

- Contractor's obligations (Cont'd)
 - Stop work immediately on terminated portion.
 - Terminate all affected subcontracts (FAR 49.108-2: "prime contractors should include a termination clause in their subcontracts for their own protection").
 - Immediately advise TCO regarding any special circumstances.
 - Continue performance of work not terminated.
 - Take all action necessary to protect and preserve government property.
 - Notify TCO of any legal action related to termination;
 - Settle subcontractor's claims (with approval if required by TCO).
 - Submit Settlement Proposal.
 - Dispose of termination inventory as directed by TCO.

Terminations for Convenience

- FAR requires that TCO negotiate a fair and prompt settlement with contractor
- Settlement is primarily by either (i) negotiated agreement; or (ii) determination by TCO.
- Settlement by Negotiation – Settlement Proposal
 - Must be submitted promptly, but no later than 1 year after effective date of termination (contained in Notice of Termination);
 - Must be supported by accounting data
 - Settlement proposal audited by the government
 - Negotiated agreement
 - Standard Forms for Settlement Proposals (FAR 49.602-1)
- Settlement by Determination by TCO
 - If parties cannot agree or settlement proposal not submitted timely, TCO issues a settlement by determination based on the applicable T4C clause and cost principles
 - Contractor may appeal TCO's final decision under the Disputes Clause

Terminations for Convenience

- Compensation Principles:
 - Recoverable costs under FAR 32.205-42
 - Settlement should fairly compensate contractor for completed work and preparations made for terminated portions and a reasonable allowance for profit on the completed work.
 - Contractor may receive costs of performance incurred up to time of termination, certain continuing costs, settlement expenses, plus
 - For fixed-price contracts, an allowance of profit
 - For cost-reimbursement contracts, contractor is entitled to a portion of the fee

Terminations for Convenience

- Compensation Principles (con't):
 - Profit
 - Amount based on numerous factors, including difficulty of work and level of performance
 - Not allowed if contractor would have suffered a loss
 - No profit allowed for unperformed work (that is, no anticipatory profits)
 - In fixed-price contracts, total settlement cannot exceed contract price (exclusive of settlement expenses)
 - No recovery for consequential damages

Terminations for Convenience

- Special Rules for Commercial Items Contracts
 - Contractor not required to comply with cost accounting standards or contract cost principles.
 - Government does not have right to audit contractor's records solely as a result of termination.
 - No time limit for submission of settlement proposal.
 - Final settlement is not restricted to the contract value.
 - No allowance for partial payments prior to final settlement.
 - No certification required on the proposal.

Terminations for Convenience

- Generally, a settlement proposal is not a claim because it is not a dispute, but submitted for purposes of negotiations.
- However, settlement proposal can become a claim for purposes of Contract Disputes Act:
 - Contractor requests a final decision and TCO does not accept settlement proposal;
 - Negotiations are at impasse, requiring TCO to issue final decision; or
 - TCO issues a final decision.

Terminations for Default: Overview

The Government's right to terminate for default has been consistently upheld if valid grounds for the default action exist at the time of the termination notice. For example, this right exists if delivery has already been missed or if the contractor has failed to comply with some material provision of the contract.

Terminations for Default

- Ends performance on a contract and subjects the contractor to possible liability.
- Could prevent contractor from getting a future contract.
- Contractors normally attempt to overturn termination for default.
- Under a default termination, the Government has burden of proving the validity of the basis for the default termination.

Terminations for Default

- The standard clause states that the “Government may” terminate a contract for default upon the occurrence of specified events.
- CO has discretion to terminate; CO may use T4C instead
- Practically speaking, the purpose of the permissive language is to allow for consideration of any number of various factors before issuing a default notice.

Terminations for Default

■ Effect of Default

- Government not liable for contractor costs on undelivered work.
- Government may require contractor to assign title to completed, undelivered work.
- Contractor is paid contract price for delivered supplies.
- Contractor liable for the Government's cover costs (excess procurement costs).
- Negatively affects performance history (responsibility).

Terminations for Default

- Bases for default
 - Failure to deliver contract supplies or perform services on time;
 - Failure to make progress so as to endanger contract performance;
 - Failure to provide adequate assurance of performance
 - Anticipatory breach
 - Failure to comply with any terms or conditions
 - Cure notice required
 - Must be material provision

Terminations for Default

- Fixed Price Contracts—if termination is complete, the contractor is paid nothing—no cost, no profit.
- Cost Reimbursement Contracts—contractor is paid cost to date, but no fees.

Terminations for Default

■ Contractor Defenses

- Contractor may be able to avoid the termination for default if it can show:
 - Government delay/excusable delay;
 - Government waiver;
 - Failure to disclose vital information; or
 - Force majeure events

Terminations for Default

- Government Delays:
 - Unreasonable delays in approving contractor drawings, equipment, materials or subcontractors
 - Failure to accept or reject a “first-article” within a reasonable time
 - Improper and unreasonable government inspections
 - Formal or constructive suspensions of work
 - Defective specifications or drawings
 - Late or defective government furnished property
 - Failure to disclose vital information
 - Payment delays

Terminations for Default

- Government waiver:
 - Government waives right to T4D if:
 - Fails to terminate within a reasonable period of time after the contractor's default, and
 - Contractor continues to perform the contract in reliance on government's failure to terminate or failure to insist on strict adherence to the contract provision (such as delivery schedule).

Termination for Default

- Failure to disclose vital information
- Force majeure events (must be beyond the control and without fault or negligence of contractor); examples:
 - Acts of God or of the public enemy
 - Acts of the Government in either its sovereign or contractual capacity
 - Fires
 - Floods
 - Epidemics
 - Quarantine restrictions
 - Strikes
 - Freight embargoes
 - Unusually severe weather

Claims: Overview

- Claims governed by Contract Disputes Act, 41 U.S.C. §§ 7101 to 7109)
- Contract Disputes Act:
 - Establishes procedures and requirements for asserting and resolving claims.
 - Provides for the payment of interest on contractor claims.
 - Provides for certification of contractor claims.
 - Provides for civil penalties for contractor claims that are fraudulent or based on a misrepresentation of fact.

Claims

■ Definition of a Claim:

- A claim means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. (FAR 2.102)
- Is not a routine request for payment. There must be a dispute and must be certified, if necessary.

■ Accrual of a Claim:

- Accrual of a claim means the date when all events, that fix the alleged liability of either the government or the contractor and permit assertion of the claim, were known or should have been known. For liability to be fixed, some injury must have occurred. However, monetary damages need not have been incurred. (FAR 33.201)

Claims

■ Certification of Claims

- For any claim by a contractor in excess of \$100,000, the claim must have prescribed certification (FAR 33.207; 52.233-1):
 - “I certify that the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable; and that I am duly authorized to certify the claim on behalf of the contractor.”
 - If the certification is omitted or defective, then does not constitute a claim.

Claims

■ Contract Disputes Act: Procedure

- Presentation of a claim

- By the contractor to the CO
- By the CO on behalf of the government to the contractor
- CO has authority to decide all claims under CDA
- Six-year statute of limitations: a claim must be submitted to CO within 6 years after accrual (41 U.S.C. §7103; FAR 33.206)

Claims

- Alternative Dispute Resolution
 - Contractor can request ADR.
 - If CO rejects, must provide written explanation (FAR 33.214).



Claims

- CO issues final decision
 - For claims of \$100,000 or less, CO must issue a final decision within 60 days after receipt of claim, if contractor so requests, or within a reasonable period of time after receipt of claim if contractor does not make such a request.
 - For claims over \$100,000, CO must issue a final decision within 60 days after receipt of claim; provided, however, if CO determines that cannot issue a decision within 60 days, the CO must notify the contractor within the 60-day period of the time within which a final decision will be issued.
 - If CO fails to issue a final decision within either of the above required time periods, then claim is deemed denied by the CO.

Claims

- If the final decision by CO is adverse to contractor, contractor may appeal the final decision either to
 - Applicable agency Board of Contract Appeals and must file appeal with 90 days from receipt of final decision or deemed denial, as case may be (41 U.S.C. § 7104);

OR

- U.S. Court of Federal Claims and must file appeal within 12 months from receipt of final decision or deemed denial, as case may be (41 U.S.C. § 7104).
- Final decision is required to include appeal rights language stating the above (FAR 33.211(a)(4)).

Claims

- Agency Board of Contract Appeals:
 - Armed Services Board
 - Civilian Board
 - Tennessee Valley Authority and
 - Postal Service Board



Claims

- Agency Board of Contracts Appeals have authority to:
 - Decide disputes under the contract
 - Modify, reform, or rescind contracts (mistake)
- Do not have authority to:
 - Decide Constitutional issues
 - Order specific performance or other injunctive relief
- Civilian Board of Contract Appeals
 - Decides cases from all civilian/executive agencies other than the U.S. Postal Service, TVA
- Armed Services Board of Contract Appeals
 - Decides cases from Department of Defense and military branches and subdivisions thereof

Claims

- If adverse decision to contractor in U.S. Court of Federal Claims:
 - May appeal to U.S. Court of Appeals for the Federal Circuit.
 - Must file appeal within 60 days (28 U.S.C. § 2107).
- If adverse decision to contractor in Agency Board of Contract Appeals:
 - May appeal to U.S. Court of Appeals for the Federal Circuit.
 - Must file appeal within 120 days (41 U.S.C. § 607).

Claims

- Can recover interest from date of submission of claim (FAR 33.208; 52.233-1(h)) until the date of payment of the claim (41 U.S.C. § 7109(a)(1)).
- Rate of interest:
 - The applicable interest rates are found at http://www.treasurydirect.gov/govt/rates/tcir/tcir_opdprmt2.htm
 - Current rate is 1.75% per annum, simple interest.

Claims

- Possible to recover attorneys' fees
 - Equal Access to Justice Act provides for award of attorneys' fees to certain statutorily defined small businesses who prevail on their appeals
 - An individual whose net worth did not exceed \$2M at the time the appeal was filed; OR
 - Any owner of an unincorporated business, or any partnership, corporation, association, unit of local government, or organization whose net worth did not exceed \$7M and which did not have more than 500 employees at the time the appeal was filed
 - For Agency Board of Contract Appeals—5 U.S.C. § 504
 - For U.S. Court of Federal Claims—28 U.S.C. § 2412(d)

Subcontractor Disputes

- Generally, subcontractor has no direct rights against the government (lack of privity).
- Subcontracts are generally private contracts subject to state law.
- Prime Sponsorship
 - Prime may bring claim on behalf of subcontractor OR
 - Subcontractor may bring claim in prime contractor's name with prime contractor's consent.
 - Does not require prime contractor's active participation.
 - Prime contractor does have to consent to any settlement.
 - Subcontractor should negotiate sponsorship terms in the subcontract.

Severin Doctrine

- Prime contractor cannot sue the government on behalf of its subcontractor, in the nature of a pass-through suit, for costs/damages incurred by the subcontractor, unless
 - the prime contractor is liable to subcontractor for such costs/damages or
 - has reimbursed subcontractor for such costs/damages.
- Examples where prime contractor is barred because not liable to subcontractor:
 - Released subcontractor (“iron-clad” release doctrine); be careful of lien waivers or
 - Subcontract contains exculpatory clause exonerating prime contractor of liability.
 - Government bears the burden of proving that prime contractor is not liable to subcontractor.

Severin Doctrine (con't)

- Does not apply where prime contractor's liability to subcontractor is contingent upon the prime contractor's recovery from the government ("as and when" clauses in subcontract).
- Government has the burden of proving that prime contractor is not liable to subcontractor.

Questions?

J. Clark Pendergrass

Lanier Ford Shaver & Payne P.C.

2101 West Clinton Ave., Suite 102

Huntsville, AL 35805

256-535-1100

jcp@LanierFord.com

www.LanierFord.com

Copyright 2012 J. Clark Pendergrass

