EXPANDING YOUR HORIZONS: NOT EVERYTHING IS IN THE FAR

Everything you need to know is not in the FAR - Contract principles and court decisions that shape contracting policy.

TODAY'S TOPIC (CMBOK 1.2) "CONTRACT MANAGEMENT PRINCIPLES"

Contract Principles originate in:

- Legal Principles (including Common Law)
  - Federal Acquisition Law
  - Uniform Commercial Code
  - Restatement of the Law (Second) Contracts
  - State and Local Law
- Custom and Usage
  - Principles
- Precedent and Decisions
  - Doctrine

Legal Principle

"… a well settled Rule of Law … an undisputed legal proposition that is clear and does not need to be proved" [1]

1. http://legal-dictionary.thefreedictionary.com/principle

Basic Contract Principles

- Contracts are legally binding
- Contract provisions are enforceable by law
  - "… contracts arise out of an exchange of promises, in which each promise constitutes, in Oliver Wendell Holmes's words, "reciprocal conventional inducement" for the other" (Holmes 1881: 293–94)".
  - "…contract is distinct from both tort and fiduciary law in that contract involves essentially *chosen obligations*"
  - "..(a) contract obligation is not fault-based but rather strict liability"

1. Markovits, Daniel, "Theories of the Common Law of Contracts", The Stanford Encyclopedia of Philosophy (Fall 2015 Edition), Edward N. Zalta (ed.), URL = <http://plato.stanford.edu/archives/fall2015/entries/contracts-theories/>

Contracting Doctrine

"A rule or principle or the law established through the repeated application of legal precedents."

G.L. Christian and Associates v. United States

375 U.S. 954, 84 S.Ct. 444, 11 L. Ed.2d 314 (1963)

a.k.a. “The Christian Doctrine”

G.L. Christian and Associates v. U.S.

- Army Corps of Engineers signed contract with G.L. Christian and Associates to construct military family housing units.
- Contract value of 32.9 Million
- Subsequently the installation (Ft. Polk, LA) was deactivated and the Army terminated the contract
- G.L. Christian and associates termination claim included anticipatory profits
- Owing to the absence of the standard "Termination for Convenience" clause in their contract G.L. Christian asserted that the Army's cancellation of the project constituted a "Breach of Contract" and therefore common-law damages (including anticipatory profits) applied.

G.L. Christian and Associates v. U.S.

- "…. The right to recover for anticipated profits arises, however, only if the termination of the contract by the Government is wrongful and constitutes a breach. If the Government has reserved the right to terminate a contract for its convenience and then does so, there is no breach and normally there can be no recovery for the profits that would have been made if the Government had not exercised its reserved right.[1]"

1. Davis Sewing Machine Co. of Delaware v. United States, 60 Ct. Cl. 201, 217 (1925), affirmed 273 U.S. 324, 47 S. Ct. 352, 71 L. Ed. 662 (1927); College Point Boat Corp. v. United States, 267 U.S. 12, 45 S. Ct. 199, 69 L. Ed. 490 (1925); De Laval Steam Turbine Co. v. United States, 284 U.S. 61, 73, 52 S. Ct. 78, 76 L. Ed. 168 (1931).

G.L. Christian and Associates v. U.S.

- "We are not, and should not be, slow to find the standard termination article incorporated, as a matter of law, into plaintiff's contract if the Regulations can fairly be read as permitting that interpretation. The termination clause limits profit to work actually done, and prohibits the recovery of anticipated but unearned profits. *That limitation is a deeply ingrained strand of public procurement policy*. … to provide for the cancellation of defense contracts when they are no longer needed, as well as for the reimbursement of costs actually incurred before cancellation, plus a reasonable profit on that work — but not to allow anticipated profits."

Cardinal Change Doctrine

" …. to provide a remedy for contractors who are directed by the government to perform work which is not within the general scope of the contract"[1]

1. *Edward R. Marden Corp. v. United States, 194 Ct.Cl. 799, 808, 442 F.2d 364, 369 (1971)*

Cardinal Changes - Defined

- "… one which fundamentally alters the contractual undertaking of the contractor."[2]
- The basic standard, therefore, is whether the directed change comprises "essentially the same work as the parties bargained for when the contract was awarded."[3]
- " …..cannot be redressed within the contract by an equitable adjustment to the contract price"[1].

1. *Allied Materials & Equipment Co.. Inc. v. United States, 569 F.2d 562, 215 Ct.Cl. 406 (1978)*
2. *2. Marden, 194 Ct.Cl. at 808; Air-A-Plane Corp. v. United States, 187 Ct.Cl. 269, 275-76, 408 F.2d 1030, 1033 (1969)*
3. *Araaona Construction Co. v. United States, 165 Ct.Cl. 382, 391 (1964)*

Third-Party Protests

- Changes that result in additional work (i.e., increasing the contract value) may be protested by interested third parties.
- At issue is whether the proposed change constitutes a cardinal change to the work, which should be separately competed.
  - "In weighing [whether a modification is beyond the scope of the competition], we look to whether there is a material difference between the modified contract and the prime contract that was originally competed. . . . In determining the materiality of a modification, we consider factors such as the extent of any changes in the type of work, performance period and costs between the contract as awarded and as modified."[1]
  - "We also consider whether the solicitation for the original contract adequately advised offerors of the potential for the type of changes during the course of the contract that in fact occurred…"[1]
  - "… or whether the modification is of a nature which potential offerors would reasonably have anticipated under the changes clause."[1]

1. *Neil R. Gross & Co.*, 69 Comp. Gen. 247 (B-237434), 90-1 CPD ¶212

Cost and Disruption

- Even if the nature of the work is within the general scope of the contract, a change may be still be cardinal if:
  - the cost of the added work as compared to the original contract value is excessive.
  - the amount of effort the contractor is required to perform is significantly changed.

Other Factors

- Defective Specifications
  - "Most defective specification claims have been treated as changes within the scope of the contract, and it has been stated that the impact of the defects would have to be 'profound' in order to justify ruling that the changes were outside the scope of the contract."[1]
  - However, "a change incorporating extensive redesign resulting from a defective specification is beyond the scope of the contract and therefore constitutes a cardinal change".[2]

1. *Cannon Structures, Inc.*, AGBCA 90-207-1, 93-3 BCA ¶26,059
2. *Luria Bros. & Co. v. United States*, 177 Ct.Cl. 676, 369 F.2d 701 (1966)

Why Cardinal Changes are Prohibited

- Are a material breach to the contract.
- Represent work that should be separately acquired by another procurement action.
- Adding work via a cardinal change restricts competition and is prohibited by FAR Part 6 and the Competition in Contracting Act.

Constructive Change

The theory of constructive change

Constructive Changes

- A constructive change occurs when
  - The contract work is actually changed but
  - The procedures of the changes clause have not been followed.
- The theory of constructive change was needed to address issues of implied contract or breach of contract within the limits of the Tucker Act – thus avoiding civil breach of contract.
  - "Arising under the contract"
  - Remedy granting Clause
- In essence, the theory allows for an equitable adjustment of contract value in lieu of contract damages. "Assuming that the evidence adduced is sufficient to establish entitlement we would find entitlement under the contract and not outside of it".[1]
- The Contracts Disputes Act broadened the the waiver of sovereign immunity granted by the Tucker Act ("Arising under or related to the contract") thus obviating the need for the theory. "Constructive changes" are now addressed as claims under the "Disputes Act"

1. See *Johnson & Son Erectors*, ASBCA 24564, 81-1 BCA ¶15,082, *aff'd*, 231 Ct. Cl. 753, *cert. denied*, 459 U.S. 971 (1982)

Types of Constructive Changes

A Constructive change can be any of these types of changes and more.

- Disagreement between the parties over the contract requirements
- Orders of an Authorized Representative
- Defective specifications and government nondisclosure of information
- Acceleration
- Failure of the government to cooperate during performance

Improper Interpretation of Contract Requirements

- "Where as a result of the government's misinterpretation of contract provisions a contractor is required to perform more or different work, or to higher standards, not called for under its terms, the contractor is entitled to equitable adjustments pursuant to the changes article, including extensions of time."[1]
- General presumption that contractors do not voluntarily perform extra work.
- If government direction is absent, voluntary performance is frequently found.

1. *Inca Metal Products Corp.*, ASBCA Nos. 4239, 4243, 58-1 BCA ¶1719; *James A. Dunbar d.b.a. Dunbar Roofing Co.*, ASBCA No. 3559, 57-2 BCA ¶1487; *White Star Heating & Supply, Inc.*, ASBCA No. 2815; *Taag Designs, Inc.*, ASBCA No. 2371; *Fansteel Metallurgical Corp.*, ASBCA No. 1689, and cases collected

Orders of an Authorized Representative

- COR shall .. "Ensure that technical guidance given to the contractor addresses or clarifies only the Government's "intent"." [1]
- "the COR remains the official liaison for any technical communications with the contractor, including technical interpretations." [1]
- "Rejection of a method of performance selected or used by a contractor is clearly a constructive change if that method was permitted by the contract."[2]

1. DoD COR Handbook March 22, 2012
2. Contract Changes, Disputes and Terminations, Mastering the Fundamentals, Cibinic & Nash p37

Defective Specifications

- Effectively converts a government breach of its implied warranty of the specifications into a constructive change, thereby substituting the recovery of an equitable adjustment for breach of contract damages.[1]
- Impracticability Doctrine allows for an equitable adjustment compensating for the costs incurred in attempting to perform in accordance with defective specifications.
  - "*When defective or impossible specifications cause frustration and "wheel-spinning" and increase the time and cost of performance until the specifications are corrected or relaxed, this also gives rise to a constructive change.*"[2]
- The "order" component of the change is generally assumed as occurring when the contract was issued

1. *Hol-Gar Mfg. Corp. v. United States*, 175 Ct. Cl. 518, 360 F.2d 634 (1966)
2. *Consolidated Diesel Elec. Corp.*, ASBCA 10486, 67-2 BCA ¶6669

Acceleration

- An acceleration is a speeding up of the work in an attempt to complete performance earlier than otherwise anticipated.
- In almost all cases, such an order is found constructively where the government requires the contractor to speed up work to meet the current contract delivery schedule in the face of excusable delays.

Failure to Cooperate

- Government has an implied duty to cooperate and not hinder the contractor in the performance of its work.
- Relief is frequently granted without the need to prove an order for additional work was given.
  - Overzealous inspection
  - Failure to provide assistance
  - Inaction or silence
  - Unreasonable conduct
- Abuse of discretion

Applicability of Constructive Changes

- Constructive changes are not a one-way street.
- The government can seek a price reduction when the contractor realizes a reduced cost through the authorized or unauthorized actions of their officers or employees.[1]
- One theory used in support of this principle is that the government has the right to accept non-conforming work and therefore has the right to seek a reduced contract value for that work. [2]

1. *Varo, Inc.*, ASBCA 16087, 73-2 BCA ¶10,206, rev'd on other grounds, 212 Ct. Cl. 432, 548 F.2d 953 (1977)
2. *Farwell Co. v. United States*, 137 Ct. Cl. 832, 148 F. Supp. 947 (1957)

Doctrines of Substantial Compliance and Substantial Completion

…. An allowable defense against a default termination for failure to deliver or perform.

Substantial Compliance

- A summary default termination for failure to deliver may be prevented when supplies have been delivered on time and "substantially comply " with the contract requirements.[1]
- Seller must correct deficiencies within "reasonable time" or government right to terminate is revived.

1. *Radiation Tech., Inc. v. United States*, 177 Ct. Cl. 227, 366 F.2d 1003 (1966)

Substantial Compliance

- Must have been a “timely tender” (i.e., delivery of goods on time).
- There must be a “reasonable belief that goods conform” to the contract requirements.
- Defects must be minor in nature and easily correctable.
- No specific cure period defined but time must be “reasonable.”

Substantial Completion Doctrine

- Applied when contractor has substantially but not completely finished the work.
- Synonymously used with “substantial performance” for construction or services contracts.
- Defined as “performance in good faith and in compliance with the contract but falls short of complete performance due to minor and relatively unimportant deviations.”

Substantial Completion

- Doctrine prevents assessment of liquidated damages during a "reasonable time" to correct deficient performance.
- Contractor bears the burden of proof for the assertion of "substantial completion."
  - Daily performance reports, etc.
- Government still retains the right to terminate that portion of work not performed and accepted.

Test for Substantial Completion

- Is the product capable of being occupied (construction) or used by the government for its intended purpose?[1]
- Percentage complete is not an unequivocal test of completion.[2]

1. *Dimarco Corp.*, ASBCA 28529, 85-2 BCA ¶18,002
2. *Two State Constr. Co.*, DOTCAB 78-31, 81-1 BCA ¶15,149

Substantial Completion in Services Contracts

- Limited application of "substantial completion" defense
- Each failure to perform may be held as grounds for default termination.
- However, boards have held that number of instances may be "inconsequential" compared to the total number required (e.g., substantial completion).
- The presence of an inspections clause and the accompanying schedule of deductions in the contract has been held to be a mechanism short of default for dealing with omitted services.

Repudiation

…. "Sometimes it is better to remain silent and be thought a fool than to speak out and remove all doubt"[1]

1. Multiple attributions including Abraham Lincoln, Samuel Elliott, Mark Twain, and Confucius

Repudiation

- … (a) "definite and unequivocal manifestation of intention on the part of the repudiator that he will not render the promised performance when the time fixed for it in the contract arrives"[1].
  - Express Refusal to Perform
  - Failure to Give Adequate Assurances
- The crux of the doctrine is that a party to a contract need not wait until the other party fails to perform if, through their words or their deeds they communicate an unwillingness or inability to perform.

1. Corbin on Contracts § 973

Severin Doctrine

…. Sponsoring subcontractor claims

Sponsored Subcontractor Claims

- Subcontractor claims are limited by the Severin Doctrine[1] 🔑
  - A general (prime) contractor may not sue on behalf of its subcontractors…unless the contractor itself is liable to the subcontractor.
  - Subsequent rulings further limit the doctrine to breach of contract claims limiting recovery for
    - Differing site conditions
    - Suspension of work
    - Etc.
- If the subcontract's exculpatory clause does not completely free the contractor from liability, indirect sponsorship will be permitted.[2]
  - e.g., conditional release of claims

1. *Severin v. United States* Court of Claims 1943. 99 Ct. Cl. 435
2. *J.L. Simmons v. United States*, 304 F.2d 886 (Ct. Cl. 1962)

Constructive Debarment

Art-Metal V. Solomon

Art-Metal V. Soloman

- Legal Issue: Constructive Debarment
- Synopsis
  - Art-Metal was the Government's largest supplier of metal office furniture under 3 GSA contracts. Art-Metal's name came to light in a series of news articles relating to investigations of the GSA.
  - Art-Metal was awarded a Requirements Contract valued at 9.4 Million which was subsequently Terminated for Convenience. It also held an existing contract valued at 5 Million which was also Terminated for Convenience
  - Subsequently four additional awards were held in abeyance.

Art-Metal V. Soloman

- Art-Metal filed suit alleging the termination of their contracts and delay in awarding other contracts constituted a "constructive debarment" and that they had been denied due process.
- The Court found that defendants (GSA) have debarred Art Metal from contracting without proceeding in the manner prescribed by the law and their own regulations.
- Accordingly, a preliminary injunction will issue to enjoin further unlawful acts of debarment against Art Metal and to restrain defendants from perpetuating its prior unlawful acts of debarment.
- Defendants will therefore be required to reinstate the contract award wrongfully terminated and to allow Art Metal to bid, receive, and maintain contracts in the same manner and under the same standards applicable to other contractors, unless and until debarment or suspension proceedings are properly initiated, or until further order of this Court.

The DiVito Doctrine

Joseph DiVito v. United States

Joseph DeVito v. United States

- Legal Issue: Termination after Waiver of Default; Timely Termination After Notice of Default; Time Is Of The Essence
- Synopsis
  - DeVito, as receiver for Seaview Electric Company sought recovery of $150,000 resulting from the default termination of a fixed-price supply contract awarded to Seaview by the U.S. Army Signal Corps, for Seaview's alleged failure to timely deliver certain wire-splicing kits.
  - Appealed to ASBCA and upheld.

Joseph DeVito v. United States

- Appealed to U.S. Court of Claims
- Basis of appeal was at the time of termination Seaview was not in default because
  - (a) termination occurred prior to the expiration of a reasonable time for performance which should have been granted after Seaview encountered excusable causes of delay, or
  - (b) the termination action was premature because it occurred prior to the passage of a reasonable time for performance after the Government had waived the established delivery schedule.

Joseph DeVito v. United States

- Prior to contract award Seaview was notified of errors in the specifications and drawings. This resulted in 200 changes to the specifications.
- Pre-production samples were timely submitted and approved by the Government
- Subsequently Seaview encountered five alleged causes of delay. The Government acknowledged one of the five (a steel strike) and extended the schedule via a bilateral modification
- Seaview subsequently encountered damage to its production facilities from a fire and received a second extension
- A key subcontractor abruptly shutdown and Seaview encountered additional delays.
- Seaview subsequently missed delivery of their first production lot but thereafter were able to make delivery of less than the 1835 units per month required. Actual production was on the order of 150 units per month
- The CO requested permission to Terminate for Default in November, 1960

Joseph DeVito v. United States

- The contract was terminated January 16, 1961
- Between the time when the termination decision was requested and the contract was actually terminated, the Government encouraged Seaview to continue production and expedite several small deliveries. Seaview interpreted these actions as a waiver of their default.
- Seaview contested the termination on the grounds of excusable delay under the Disputes clause of the contract
- Findings
  - During the 48 days it took the government to approve termination, Seaview was allowed to continue production and encouraged to accelerate its deliveries. Neither it nor the COR were aware of the pending termination. To its detriment it increased its workforce and took other actions to do so.

Joseph DeVito v. United States

- The court cited precedent … “Where the Government elects to permit a delinquent contractor to continue performance past a due date, it surrenders its alternative and inconsistent right under the Default clause to terminate, assuming the contractor has not abandoned performance and a reasonable time has expired for a termination notice to be given.” … “The election is sometimes express, but more often is to be inferred from the conduct of the non-defaulting party.”

Joseph DeVito v. United States

- The necessary elements of an election by the non-defaulting party to waive default in delivery under a contract are
  - (1) failure to terminate within a reasonable time after the default under circumstances indicating forbearance, and
  - (2) reliance by the contractor on the failure to terminate and continued performance by him under the contract, with the Government's knowledge and implied or express consent.
- Time is of the essence in any contract containing fixed dates for performance.
  - When a due date has passed and the contract has not been terminated for default within a reasonable time, the inference is created that time is no longer of the essence
  - The proper way thereafter for time to again become of the essence is for the Government to issue a notice under the Default clause setting a reasonable but specific time for performance on pain of default termination.

Government's Limited Right To Terminate for Convenience

Torncello v. United States

Vibra-Tech v. United States

Torncello v United States

- Legal Issue – Unlimited right to terminate for convenience
- Torncello (d.b.a. Soledad Enterprises) had a pest control contract with the Navy in San Diego, CA.
- The contract was a "requirements contract" in which the Navy was obligated to use only Soledad for these specific services
- The Navy diverted business for one particular service to another firm because that firm offered it at a much lower price
- The Navy defended its action based on the premise of "constructive termination for convenience"

Torncello v United States

- The court held that since this was a requirements contract the Navy's election not to use any of the services offered effectively made this an IDIQ with a minimum quantity of zero
- Such an action in essence provided no consideration to Soledad and therefore made the contract void
- The court held that were the Government permitted to use the logic thus advanced it would allow the Government to dishonor with impunity its contractual obligations

Torncello v United States

- The case limits the Government's ability to use Termination for Convenience in cases where no change in conditions has occurred.
- This decision also prevents the Government from "Termination for Exculpation"
- Ruling overturns (at least part of) the Colonial Metals decision.

Vibra-Tech Engineers, Inc. v. United States

- Legal Issue – Arbitrary and Capricious Termination for Convenience
- Vibra-Tech (VT) awarded a contract using a Best Value – Trade-off selection to provide vibration analysis equipment/services
  - Their technical proposal was evaluated at 856 out of 1000
  - Competitor was evaluated at 700 out of 1000
- Source selection authority overrode evaluation committee's recommendation and awarded to VT because it offered a technically superior solution albeit at a higher price.

Vibra-Tech Engineers, Inc. v. United States

- Fifteen months follow contract award the Government terminated VT's contract and subsequently awarded a replacement contract for the same requirements to the losing offeror.
- VT sued claiming the Termination for Convenience was arbitrary and caprecious

Vibra-Tech Engineers, Inc. v. United States

- Findings of the Court
  - The doctrine of termination for convenience enables the government, under certain circumstances, to terminate a contract that no longer is in the government's best interest. The courts, however, consistently have recognized limitations on the government's right to invoke this extraordinary doctrine.
  - "[T]he government may not use the standard termination for convenience clause to dishonor, with impunity, its contractual obligations.... We cannot condone termination based on knowledge of a lower cost when that knowledge preceded award of the contract." *Torncello v. United States,*
  - Since the competing packages being offered to the government were not of comparable price, cost or value, the government's own rules forbade its use of relative cost as a factor in choosing the successful proposal.
  - I find and conclude, therefore, that the government's decision to terminate Vibra-Tech's contract was arbitrary and capricious.

Aviation Technology, Inc. V. United States

Reestablishing Government Right to Terminate Following a Waiver

Aviation Technology, Inc. V. United States

- Legal Issue: Reestablishing Government Right to Terminate Following a Waiver
- Aviation Technology, Inc. (ATI) had an IDIQ contract from the U.S. Army for hydraulic pressure standards to be used as a calibration reference.
- The Army issued Delivery Order 1 for a First Article and 50 production units. The army subsequently issued DO 2 for an additional 60 units
- The Army then issued a modification extending the schedule by 30 days.

Aviation Technology, Inc. V. United States

- Following acceptance of ATI's Contractor Validation Plan delivery of the First Article was scheduled for April 15.
- On April 13 (or 14) ATI notified the Government that their (external) software developer had medical issues and the work would be brought in-house for completion but a delay would ensue.
- On May 20th the government issued a bilateral modification to extend the schedule to May 31st
- On May 24th ATI discovered a conflict in the SOW. ATI agreed to meet the additive requirement (by their interpretation) at no additional cost
- ATI also declined signing the modification (based on the above) and requested a either a further schedule extension to attend to the conflict or a stop work order within 24 hours.

Aviation Technology, Inc. V. United States

- The government subsequently issued a “Show Cause” notice because ATA had failed to meet the 31 May date in the (unsigned) bilateral modification.
- On 27 July the Contracting Officer terminated the contract for default.
- ATI appealed on the basis the Government had waived the original (15 April) delivery date and had not by either a bilateral or unilateral modification reestablished a reasonable date.

Aviation Technology, Inc. V. United States

- The decision held that the Government had rendered the original delivery date inoperative and had not either through a bilateral (method 1) or unilateral modification established a reasonable new due date (method 2) thereby reasserting its right to terminate for default.
- The Termination for Default was converted to a Termination for Convenience.

Conclusion

- Contract principles control or limit the actions permitted by the FAR
- These principles arise from legal decisions and the application of the law to specific circumstances or cases
- As Contract professionals, these principles form an important part of our knowledgebase.

Thanks for coming … Don Shannon

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