Terminations for Convenience: HOW TO MAXIMIZE CONTRACTOR RECOVERY

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By
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RECOVERABLE COSTS – BASIC FORMULA

TRADITIONAL GOVERNMENT CONTRACTS
• Allowable cost + profit + settlement expense
• Subject to loss adjustment
  – Recovery = incurred costs X contract price/incurred costs + settlement expense

FAR PT 12 COMMERCIAL ITEM CONTRACTS
• % of price reflecting % of completion + reasonable charges resulting from T/C
• Loss adjustment implicit in Prong 1
### RECOVERABLE COSTS
FAR PT 12 COMMERCIAL ITEM CONTRACTS
ALLOWABLE COST SUMMARY

- **Prong 1 [price reflecting % of completion]** requires payment for:
  - *TriRad Technologies, Inc.*, ASBCA 58885, 15-1 BCA ¶ 35898
    - Completed items/work at contract price
    - Partially completed items/work based on % of physical completion

- **Prong 2 [reasonable charges resulting from T/C]**
  - *SWR, Inc.*, ASBCA 56708, 15-1 BCA ¶ 35832 states:
    The second prong . . . refers to the recovery of those charges incurred that "do not relate to work completed" but should be reimbursed to fairly compensate the contractor whose contract has been terminated.
  - At least coextensive with FAR 31.205-42
  - Other charges may also be recoverable
RECOVERABLE COSTS
TRADITIONAL GOVERNMENT CONTRACTS
FAR 49.201 FAIR COMPENSATION RULE

“(a) A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit. * * * *

(c) The amount of recordkeeping, reporting, and accounting should be kept to a minimum compatible with the reasonable protection of the public interest.”

  – Contractor developed improvements to communications system for purpose of obtaining government contract
  – T/C just after award. CO disallows development expense as unallowable pre-contract cost
  – Court holds disallowance improper if it would have deprived contractor of fair compensation

• [SWR, Inc. ASBCA 56708, 15-1 BCA ¶35,832]
  – Holds Fair Compensation Principle Applicable to Commercial Item Contracts]

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TRICKS OF THE TRADE –  
**MAXIMIZING CONTRACTOR RECOVERY**-  
**GENERAL STRATEGIES**

1. **DETERMINE IF REDUCTION A BREACH**

- Breach entitles contractor to anticipatory profits
- **Some Scenarios**
  - No Termination Clause in Subcontract
  - Failure to Order Guaranteed Minimum
  - Failure to Order Needs Under Requirements Contract

2. **CHARGE INDIRECT COSTS DIRECTLY**

- Direct charging necessary for “fair compensation”
- **Traditional Government Contracts**
  - No conflict with CAS 402
    - Not “like circumstances”
      - DCAA Audit Manual, ¶ 12-105c
- **FAR PT 12 CI Contracts**
  - CAS and Cost Principles Inapplicable
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
GENERAL STRATEGIES

3. SEEK FAIR COMPENSATION

- Claim cost if disallowance is unfair
- Provide explanation referencing FAR 49.201 fair compensation principle
- *Codex v US, supra.*

4. AVOID GOVERNMENT SECOND GUESSING

- Costs are often disallowed because auditor or CO would have acted differently
- Government may not substitute its judgment for that of the contractor
- Costs are allowable unless a clear abuse of discretion
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
GENERAL STRATEGIES

5. REJECT IMPRACTICAL PROOF REQUIREMENTS

Traditional Government Contracts
- Not Required to Have Documentation for Cost-Reimbursement Contract
- Liberal Approach to Proof of Costs
- Higher Burden of Proof for:
  - Settlement Expense
  - Costs Incurred After Termination

FAR PT 12 CI Contracts
- Cost Principles and CAS Inapplicable
- Proof from Regular Accounting System
- No Govt Audit Rights
- Higher Burden of Proof for:
  - Settlement Expense
  - Costs Incurred After Termination

6. CLAIM ALL ALLOWABLE COSTS

Traditional Government Contracts
- T/C converts fixed price contract to cost contract
- Contractor entitled to costs up to contract price
  - Contract price = award price + undefinitized equitable adjustments
- No need to show entitlement to equitable adjustments to recover up to contract price

FAR PT 12 CI Contracts
- T/C does not convert to cost contract
- Contract price does not limit prong 2 recovery
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
GENERAL STRATEGIES

7. AVOID LOSS ADJUSTMENTS

TRADITIONAL GOVERNMENT CONTRACTS
• Make government meet burden of proof
  – Must prove loss contract and the amount of loss
  – % of completion analysis is insufficient
  – Contractor is not required to provide EAC or ETC
    • DCAA Audit Manual ¶ 12-307a(3)
• Submit REAs to raise contract price

FAR PT 12 COMMERCIAL ITEM CONTRACTS
• Submit REAs to raise contract price

8. DON’T LET GOVT LIMIT PROFIT TO THAT BID

• Profit bid a factor of competitive forces
• FAR 15.404-4(b) Favors Structured Approach
  – Early work often entitled to higher profit
    because:
    • More difficult
    • Greater risk
• Estimate at completion (“EAC”) can be used to show what profit would have been if contract was completed
TRICKS OF THE TRADE – MAXIMIZING CONTRACTOR RECOVERY - GENERAL STRATEGIES

9. REQUEST PARTIAL PAYMENT

TRADITIONAL GOVERNMENT CONTRACTS
• With interim or final settlement proposal
• Consider asking TCO to submit on a total cost basis even if settlement proposal submitted on inventory basis
• Amounts
  – 100% for items completed or to be completed
  – 100% for subcontractor settlements and partial payments
  – 90% of other allowable costs

FAR PT 12 COMMERCIAL ITEM CONTRACTS
• No partial payment provision in FAR PT 12
• Request under FAR 12.210 “Contract financing”

10. SCHEDULE ALL INVENTORY

Traditional Government Contracts
• Plant Clearance Officer (“PCO”) is authorized representative of contracting officer
• If contracting officer or PCO accepts inventory the Government bought it

FAR PT 12 CI Contracts
• No requirement to turn over inventory
• CO may request as condition of paying inventory costs
• If contracting officer or PCO accepts inventory the Government likely bought it
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
GENERAL STRATEGIES
11. SUBMIT A TIMELY PROPOSAL

TRADITIONAL GOVERNMENT CONTRACTS
• Time limits
  – Prime Contracts
    • 1 year from effective date of termination
    • Partial T/C – 90 days to submit equitable adjustment on nonterminated work
  – Subcontracts
    • See subcontract
• Missed deadline = no judicial review

FAR PT 12 COMMERCIAL ITEM CONTRACTS
• No time limit in regulations or CI clause
• Could be time barred by
  – Laches
  – 6 year statute of limitations on submitting claims to CO

12. OBTAIN PROFESSIONAL HELP

• Arcane legal and accounting issues
• Expertise necessary to maximize recovery
• Professional fees recoverable as settlement expense
TRICKS OF THE TRADE – MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS

1. NONCONFORMING WORK

Traditional Government Contracts

• Claim cost of defective or nonconforming work
• T/C converts fixed-price contract to cost contract
  – Includes cost for defective or nonconforming work
• Limitation
  – Willful misconduct or gross negligence
• FAR provisions on damaged inventory are inapplicable
  – FAR 49.204 AND 52.249-2, ¶ (G)

FAR PT 12 CI Contracts

• Not compensable under prong 1
• Claim under prong 2 as a reasonable charge resulting from termination
• T/C does not convert to cost contract

2. CONTRACTOR CAUSE DELAYS

• Worsham Construction Co., ASBCA 25907, 85-2 BCA ¶ 18016
  – “Even assuming ... delayed performance was caused in part by [the contractor], under the [termination for convenience clause] clause the contractor is entitled to recover all allowable costs.”

- Nicon, Inc., 331 F.3d 878 (Fed. Cir. 2003)
  - “If the contractor itself played a role in the delay or if the delay was ... Beyond the government's control, then there is no entitlement to damages for unabsorbed overhead ...”
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS

3. PRECONTRACT COSTS

Traditional Government Contracts

- Rules
  - Precontract costs FAR 31.205-32
    • Allowable “when such incurrence is necessary to comply with proposed delivery schedule”
  - Fair compensation rule – FAR 49.201(a)
    • Depends on extent of performance prior to T/C

- Use “Fair Compensation” Principle to Recover Precontract Costs

FAR PT 12 CI Contracts

- Cost principles inapplicable
- Claim under prong 2 as a reasonable charge resulting from termination
- Invoke “fair compensation” principle if necessary

TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS

4. IDLE FACILITIES AND IDLE CAPACITY

Traditional Government Contracts

- Pertinent Provisions
  - FAR 31.205-17 “Idle Facilities and Idle Capacity and FAR 31.205-42(b) “Costs Continuing After Termination”
  - “maintenance, repair, housing, rent, and other related costs, e.g. property taxes, insurance and depreciation”

- Bogus DCAA Defenses
  - Period claimed > one year
  - Facilities not completely idle
  - Sales have increased
  - The facilities are not special tooling

FAR PT 12 CI Contracts

- Cost principles inapplicable
- Claim under prong 2 as a reasonable charge resulting from termination
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS
6. COMMON ITEMS

Traditional Government Contracts
• FAR 31.205(a)
• How to rebut disallowances
  – Demonstrate items cannot be retained at cost without a loss

FAR PT 12 CI Contracts
• Cost principles inapplicable
• Not reasonable to charge for items that can be retained at cost without a loss
• Demonstrate items cannot be retained at cost without a loss

TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS
7. FIRST ARTICLE COSTS

• FAR 52.209-3 "First Article Approval" clause
  – Contractor cannot recover costs for production units it T/C prior to first article exception
• Judically crafted exceptions
  – Minimum order quantities
  – Waiver
  – First Article subsequently approved
  – Costs also necessary for production articles
  – Long lead time materials necessary to meet delivery schedule - MAYBE
    • Switlik Parachute, ASBCA 18,024, 75-2 BCA ¶ 11434 - EXCEPTION
      – "...a contractor is not bound by this risk provision when it would be impossible to wait until first article approval before ordering production materials, and still to meet the delivery schedule."
    • Rex Systems, ASBCA 59,624, 16-1 BCA ¶ 36350 – NO EXCEPTION
      – "Although this long lead time concern could explain why Rex initially expected to make an early diode order...it does not provide us a basis for ignoring the plain terms of the contract when determining what compensation is owed to Rex for the termination."
• Recovery limited to “total contract price” – not first article price
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS

8. G&A ON SUBCONTRACTOR SETTLEMENTS

Traditional Government FAR PT 12 CI Contracts

Contracts

- Contractors entitled to G&A on subcontractor settlements
- **Don’t be misled by the forms**
- Cost principles inapplicable
- Claim under prong 2 as a reasonable charge resulting from termination

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TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC COSTS

8. G&A ON SUBCONTRACTOR SETTLEMENTS (cont.)

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TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-SPECIFIC COSTS

9. SETTLEMENT EXPENSE

Traditional Government FAR PT 12 CI Contracts

- Keep time sheets
- Indirect costs on settlement expense
  - Full burden on outside fees and in-house personnel normally charged direct
  - Reduced burden on in-house personnel normally charged indirect
- Keep time sheets
- Claim with G&A under prong 2 as a reasonable charge resulting from termination

10. INTEREST

- Reflectone> Ellet> Rex
- Include REAs in settlement proposal
- Certify and request final decision if Government delays or disputes costs
- Consider filing suit or threatening suit to obtain interest as part of a settlement
- Settlement expense and interest not always an either/or proposition
TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC CONTRACT TYPES – IDIQ CONTRACTS
1. “LET SLEEPING DOGS LIE”

- Government required to purchase the guaranteed minimum
- Failure to order a breach
  - Entitles contractor to anticipatory profits or in some cases the price of the items not purchased
- Contractor’s recovery limited by T/C clause if T/C during contract period
- Therefore, “let sleeping dogs lie”

TRICKS OF THE TRADE –
MAXIMIZING CONTRACTOR RECOVERY-
SPECIFIC CONTRACT TYPES – IDIQ CONTRACTS
2. SUBMIT REA FOR PARTIAL T/C IF MINIMUM NOT MET

- T/C clause
  - Entitles contractor to equitable adjustment increasing price of nonterminated portion of work
- Equitable adjustment
  - Computed by increasing price of nonterminated work by costs that would have been recovered in the prices of the terminated work.
- What if Minimum Quantity Satisfied?
  - Deval Corp., ASBCA No. 47132, 95-1 BCA ¶ 27,537
  - Partially terminated contractor entitled to equitable adjustment on nonterminated portion even if minimum quantity purchased if costs of nonterminated work increased
TRICKS OF THE TRADE – MAXIMIZING CONTRACTOR RECOVERY -
SPECIFIC CONTRACT TYPES – SERVICE CONTRACTS
BE SURE YOU HAVE THE RIGHT CLAUSE

• FAR 52.249-4 Short Form Service Contracts T/C clause
  – Limits recovery to price of services rendered
  – To be used only when CO reasonably determines no substantial preparation costs
• If short form improperly used it may be judicially replaced by standard clause.
  – *DWS, Inc.*, ASBCA 29742, 90-2 BCA ¶ 22,696

TRICKS OF THE TRADE – MAXIMIZING CONTRACTOR RECOVERY -
SPECIFIC CONTRACT TYPES – COST TYPE CONTRACTS

• Pertinent rules
  – Recovery is limited by the LOF clause
  – Limitation is waived where contractor is required to turn over *severable* termination inventory resulting from overrun
  – T/C may reopen prior cost agreements
• Fairness doctrine
  – Not in regulations but judicially applied
  – *Jacobs Eng’g Group, Inc. v. U.S.*, 434 F.3d 1378 (Fed. Cir. 2006)
• Strategy
  – Include all severable work in termination inventory
    • If Government accepts severable work, they bought it
  – Reopen prior cost agreements after T/C
  – Use same strategies as fixed price contract
TRICKS OF THE TRADE – MAXIMIZING CONTRACTOR RECOVERY –
FURTHER READING

- For a discussion of strategies for maximizing recovery see P. Seidman and D. Seidman, “Maximizing Termination for Convenience Settlements/Edition II – Part I, Briefing Papers 08-03 (Feb. 2008) and 08-05 (Apr. 2008)
  - PT I covers General Strategies
  - PT 2 covers Specific Costs and Contract Types
- For a discussion of evolving case law concerning commercial item terminations see -
- Available at www.seidmanlaw.com

THANK YOU

QUESTIONS:

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