

**Government Contract Default
Terminations**
May 4, 2010
Public Contracts Section

Framework for Terminations for Default

- Government's contractual right to completely or partially terminate a contract because of actual or anticipated failure of the contractor to perform its obligations.
- FAR 52.249-10. Procedures FAR subpart 49.4.

General Grounds for Terminations for Default FAR 52.249.-10

- Failure to complete work in stated time;
- Failure to make adequate progress and endangering timely completion; or
- Breach of "other provisions" of the contract.

If the Termination is Wrongful

- If the contractor can establish (or otherwise determine) that it was not in default or the failure to perform was excusable, *i.e.*, arose out of cause beyond contractor's control and no negligence on the part of the contractor, the termination for default becomes one of convenience. [Not such a great remedy: no profits. Think quantum meruit.]

Procedure

- When default is being considered, Government decides which type of action to take (default, no cost cancellation, convenience) only after review by contracting officer, technical personnel and counsel.
- Generally, issues a notice to cure or show cause and gives 10 days (or longer) to cure the failure.
- FAR 52.249-8/FAR 49.402-3/49.607(b) [form].

Procedure

- If contractor is an SBA firm, the notice to cure also goes to the contractor's office of small business specialist and SBA Regional office nearest the contractor.
- If termination appears imminent, the surety is also notified.

Limitations

- Acceptance of work bars termination of all work and reprourement of accepted work.
- Substantial completion generally gives the contractor the right to correct.
- Basic test for substantial completion is whether the product is capable of being occupied or used by the Government for its intended purpose.

Considerations by the Contracting Officer FAR 49.402-3

- Applicable laws and regulations.
- The specific failures and excuses for the failures.
- The availability of the supplies/services from other sources.
- The urgency of the need for the supplies/services versus alternative contractor.

Considerations by the Contracting Officer FAR 49.402-3

- The degree of essentiality of the contractor in the Government acquisition program and the effect of a termination for default upon the contractor on other contracts.
- The effect of termination for default on the ability of contractor to liquidate loans, progress payments or advance payments.
- Any other pertinent facts and circumstances.

Considerations by the Contracting Officer FAR 49.402-3

- The FAR factors do not limit the contracting officer and he/she can move beyond the factors to focus on the totality of the circumstances. *Jamco Constructors VABCA 3271, 94-1, par. 26405.*
- *I.e.*, concurrent delays, remaining work left and time required to perform.

Procedure for Issuing Notice of Termination FAR 49.402-3(g)

- The notice of termination for default shall state the following:
 - Contract number and date;
 - Acts or omissions constituting the default;
 - Contractor's right to proceed further under the contract (or a specified portion) is fully terminated;
 - Supplies or services terminated may be purchased against the contractor's account and contractor may be held liable for excess costs.

Procedure for Issuing Notice of Termination FAR 49.402-3(g)

- Contracting officer has determined failure to perform is not excusable, that the notice of termination constitutes such a decision, and that the contractor has a right to appeal under the disputes clause; and
- That the Government reserves all rights and remedies provided by law or contract, in addition to charging excess costs.

Procedure in Lieu of Default Termination FAR 49.402-4

- Permit the contractor, the surety or the guarantor, to continue performance under a revised delivery schedule.
- Permit the contractor to continue performance of the contract by means of a subcontract or other business arrangement with a third party provided the Government's rights are protected.
- Execute a no-cost termination settlement.

Reconsideration of Default Termination FAR 49.102(d)

- A terminated contract "may be reinstated by mutual agreement where the contracting officer determines that such reinstatement is advantageous to the Government."
- GAO has stated that the contracting officer has inherent authority to reinstate the contract in part or in whole.

Effect of Termination for Default FAR 9.406-2(b)(1)

- Government not liable for contractor's costs on undelivered work and is entitled to repayment of advance progress payments applicable to undelivered work.
- Government has the right, but not the duty, to appropriate the contractor's material, inventory, construction plant and equipment at the site, with the price to be negotiated.

Effect of Termination of Default

- The contractor is liable for excess costs of reprocurement or completion.
- The contractor is liable for actual or liquidated damages.
- The contractor may be subject to debarment. FAR 9.406-2(b)(1).

Effect of Termination of Default: Examples of Reprocurement Costs FAR 52.249-10 (Construction Contracts)

- Price adjustments in the work or materials being incorporated into the work.
- Time period includes costs incurred during the entire reprocurement period, including option years, as long as the original contractor had agreed to perform for that duration.
- Administrative costs for reprocurement.

Liquidated Damages

FAR Subpart 11.5 as Guidance

- FAR 11.501 contains the general policy on the use of such clauses.
- Far 11.502 establishes some guidance for the rate of liquidated damages on construction contracts.
- 52.211-12 gives the standard liquidated damages clause for construction contracts.
- To avoid the liquidated damages provision, the burden is on the contractor to prove that the amount is an unenforceable penalty.
- **MOST CONTRACTS** now provide for the **CONCURRENT** assessment of liquidated damages and reprocurement costs.

Any Other Ascertainable Damages

- Contractor may be liable for any other ascertainable damages suffered by the Government.
 - Excess costs.
 - Common law damages to put the Government in the same position had the breach not occurred (additional on-site inspection services, additional testing costs, additional travel costs).

What the Government is Looking to Do to Protect Itself

- Government must be protected from overpayment, liens outstanding against the completed supplies or materials after the Government has paid for them.
- To accomplish that, the contracting officer may take the following steps:

What the Government is Looking to Do to Protect Itself

- Ascertain whether the payment bonds, if any, are adequate to satisfy all lienors' claims or whether it is feasible to obtain similar bonds.
- Require contractor to furnish appropriate lien releases.
- Withhold the amount due for the supplies or materials that the contracting officer determines is necessary to protect the Government's interest, but only if the other measures do not adequately assure the Government.
- Take other appropriate action considering the circumstances and the contractor's solvency.

What Contractual Rights are in Play?

- Who has contractual rights in a termination situation?
 - Surety?
 - Subcontractors?
 - Design Professionals?

Surety is most often encountered/questioned, so let us go there.

Surety in Play

- Miller Act Construction Case
- Generally sureties are exposed to cost overruns and potential remedial work and/or liquidated damages.
- Surety may also have defenses
 - Impairment of subrogation right (overpayment or improper releases).
 - Cardinal Change.
 - Faulty Design.
 - Contract Administration Default.

Surety Takeover Agreements on Government Contracts

- Since the surety is liable for damages resulting from the contractor's default, the surety has certain rights and interests in the completion of the contract work and application of any undisbursed funds.
- The contracting officer should normally allow the surety to complete the contract, unless the contracting officer believes that the persons or firms proposed by the surety are not competent or the proposal is not in the best interest of the Government.

Surety Takeover Agreements on Government Contracts

- There may be conflicting demands for contractor's assets, including unpaid prior earnings (retainages, progress payments). Thus, the surety may include a "takeover" agreement in its proposal, fixing the surety's rights to payment from those funds.

Surety Takeover Agreements on Government Contracts

- Usually, the contracting officer will enter into a takeover agreement with the surety (not effective until termination has occurred).
- Contracting officer may want surety, Government and defaulting contractor to resolve the defaulting contractor's residual rights.

Surety Takeover Agreements on Government Contracts

- Any takeover agreement requires the surety to complete the project and the Government to pay the surety's costs and expenses up to the balance of the contract price unpaid at the time of default subject to the following conditions:
 - Any unpaid earnings of the defaulting contractor must be subject to the debts due the Government by the contractor, except to the extent that the unpaid earnings are used to pay the surety its actual costs and expenses incurred in the completion of the work (offsets), but not including its payments and obligations under the bond.

Surety Takeover Agreements on Government Contracts

- The surety is bound by contract terms governing liquidated damages for delays in the completion of the work, unless the delays are excusable under the contract.
- If the contract proceeds have been assigned to a financing institution, the surety must not be paid from unpaid earnings, unless the assignees [bank] provides written consents.

Surety Takeover Agreements on Government Contracts

- The contracting officer must not pay the surety more than the amount it expended completing the work and discharging its liabilities under the defaulting contractor's payment bond.

If the Surety Does Not Take Over

- If the surety does not arrange completion of the contract, the contracting officer will normally arrange for completion by awarding a new contract based on the same plans and specifications.
- The new contract may be the result of sealed bidding or any other appropriate contracting method or procedure.
- The contracting officer is required to use reasonable diligence in obtaining the lowest price available.

If the Surety Does Not Takeover

- If the surety does not takeover, it is liable to the Government for the resultant damages.
- The contracting officer shall use retained percentages of progress payments and any due progress payments to liquidate the surety and/or contractor's debt to the Government.
- If the unpaid amounts are insufficient to cover the debt, the contracting officer shall take steps to recover the rest.

The Surety Has Interests

- The source of the surety's rights are the indemnity agreement with the principal.
- Surety may have equipment rights as well as some materials (were they pledged).
- Most surety agreements allow the surety to assume subcontracts.
- Is that provision actually binding? Check to make sure—assignment clauses are in place, otherwise it may be open season on new negotiations.

Wrap Up

- Termination for default is serious and it is essential to know how to defend against it or at least mitigate what may occur.
- Any questions?