Navigating Default Terminations on Federal Projects: Best Practices for Avoiding Default and Overturning Erroneous Termination Decisions

Nicholas T. Solosky and Diana Lyn Curtis McGraw | Fox Rothschild LLP

Terminations for default are an extreme remedy that contractors should seek to avoid if at all possible. Full stop, period, end of sentence.[1]

It may seem like an oversimplification (and it is), but contractors – particularly federal contractors performing work for the government – should always look for ways to complete the contract scope of work and avoid default terminations. The Federal Acquisition Regulation (FAR) offers several ways for contractors to resolve performance disputes with the government. Most notably, FAR 52.243-1 (Changes) opens the door to recover additional time and/or costs based on government-caused project impacts. The availability of these remedies become (at a minimum) more complicated post-termination.

The same is true for private construction contracts and subcontracts where the government is not a party. All parties to a construction contract – be it the government, owner, contractor or subcontractor – must approach terminations with caution and an appreciation for the likelihood of follow-on litigation.

It is a classic case of advice that is easy to give but more challenging to execute in the heat of battle. Neither side begins a project contemplating a default termination, but unfortunately many contracts and subcontracts do end that way. In this article, we tackle the best practices for dealing with default terminations in two ways:

- First, we examine some of the major root causes of default terminations and when and why they most commonly occur.
- Following that, we examine practical strategies that contractors, subcontractors and owners can utilize to avoid default terminations – or at least mitigate the effects.

Terminations often end with no winners – only losers. By providing this analysis, and in particular discussing proactive steps to avoid default terminations, we hope to offer a road map to all parties centered on avoiding negative outcomes and living to fight another day.

The Consequences for Federal Contractors (i.e., Reasons To Avoid Government Termination)

Before diving into the analysis, it is important to establish why it is so critical for a government contractor to avoid a default termination. A default termination by the government is almost always a "bet-the-company" situation. Along with the potential financial consequences discussed below, the looming concern for a terminated contractor is the adverse effect on the ability to obtain future contracts from the government.

The government procurement process relies heavily on past performance information, and in nearly all cases, requires the contracting officer to issue a decision regarding the contractor's responsibility to perform the work.[2] Having a default termination in your company's file is a giant, flashing red flag.[3] Put another way, default termination on one contract can severely jeopardize a contractor's chances of winning future awards, thus rendering it nearly impossible to dig out of the financial hole created by the default. It is circular and leads down a dark path.

[1]J.D. Hedin Constr. Co. v. U.S., 408 F.2d 424 (Ct. Cl. 1969) ("A default termination is a drastic sanction . . . which should be imposed (or sustained) only for good grounds and on solid evidence").
[2]See FAR 9.104.
[3]M. Eradl Kamisli Co Ltd., Comp. Gen. B-403909.2 (upholding the agency's responsibility determination based on the contractor's negative past performance history, including a default termination).

Navigating Default Terminations on Federal Projects: Best Practices for Avoiding Default and Overturning Erroneous Termination Decisions

Nicholas T. Solosky and Diana Lyn Curtis McGraw | Fox Rothschild LLP

And speaking of the financial hole created by a default termination, a contractor faced with a termination can find itself dealing with excess costs associated with reprocurement or completion, as well as actual or liquidated damages and even debarment.[4] In this regard, holding a performance bond offers little relief to the contractor. While the government may compel the surety to step in to tender a completion contractor and pay the difference between the balance of the defaulted prime contract amount and the amount of the completion contract, that merely shifts the contractor's obligation under the bond's indemnification provision. In other words, rather than owing the money to the government, you are now indebted to the surety.

The same basic framework holds true for private contracts and subcontracts in terms of the potentially steep financial consequences of a termination. And while not subject to the same federal contract repository, terminations have a way of haunting a contractor's reputation, making it harder to obtain work or negotiate favorable terms.

Again, the results of default termination are potentially and even likely catastrophic. Rather than focus on the outcome, we want to focus on best practices for avoidance and mitigation before the nightmare scenario becomes a reality.

Underlying Causes of Terminations

Most default termination scenarios fall into one of three buckets:

- Failure to deliver the product or complete the work in the time provided by the contract;
- Failure to make progress or advance the work, thus endangering timely completion; and
- Breach of other material contract provisions or requirements.[5]

The shades of gray among these causes falls largely to the variety of federal contracts. FAR 52.249 includes numerous variations for termination of different types contracting vehicles. For example, FAR 52.249-8 deals with fixed-price supply and service contracts. The language authorizes the contracting officer to terminate the contract when the contractor fails to deliver or perform – often a black and white situation.

On another hand, the most unique termination language is in FAR 52.249-10, which governs fixed-price construction contracts. Due to the variables unique to construction, the clause is broader and expands on the government's rights and remedies relative to taking over the work and recovering damages from the terminated contractor based on increased costs to complete the work:

> *If the Contractor refuses or fails to prosecute the work or any separable part, with the diligence that will insure its completion within the time specified in this contract including any extension, or fails to complete the work within this time, the Government may, by written notice to the Contractor, terminate the right to proceed with the work (or the separable part of the work) that has been delayed. In this event, the Government may take over the work and complete it by contract or otherwise, and may take possession of and use any materials, appliances*

[4]See, e.g., FAR 52.249-10 ("The Contractor and its sureties shall be liable for any damage to the Government resulting from the Contractor's refusal or failure to complete the work within the specified time, whether or not the Contractor's right to proceed with the work is terminated. This liability includes any increased costs incurred by the Government in completing the work"). See also FAR 9.406-2(b)(1) (discussing debarment as a potential outcome of termination).

[5]See FAR 52.249-8(a)(1).

> *and plant on the work site necessary for completing the work. The Contractor and its sureties shall be liable for any damage to the Government resulting from the Contractor's refusal or failure to complete the work within the specified time, whether or not the Contractor's right to proceed with the work is terminated. This liability includes any increased costs incurred by the Government in completing the- work.*

Rather than wait until the completion date to see if the contractor successfully performs the construction scope of work, the clause offers the government increased latitude. As detailed later in this article, the language specifying that the contractor must use proper "diligence that will insure completion within the time specified" allows the government to rely on a bit of crystal ball gazing as part of the termination decision.

Like the FAR clauses, the different scenarios leading to terminations exist on a continuum. There are cases in which a contractor suffers a financial or other kind of hardship that renders it simply unable to deliver. In those instances (that is, where a contractor falls down based on circumstances independent of the government), there is little that can be done legally to avoid termination. The situation fits squarely into the black and white situation contemplated by the FAR clause.

But what if – hypothetically – there were a sudden worldwide pandemic that disrupted the supply chain, thus rendering a contractor unable to deliver promised goods? It would be contrary to law and frankly irresponsible for the government to terminate in that scenario. The requirement to proceed with performance must be read in conjunction with the language of the FAR's default clause that excuses the failure to perform based on causes "beyond the control and without the fault or negligence of the contractor."[6] And, indeed, the government's reaction to the COVID pandemic was to avoid terminations and liberally grant time extensions.

The same is true with respect to complex construction projects that go off-schedule (as they often do). FAR 52.249-10 offers the government the ability to terminate based on schedule delays that threaten timely completion of the work, but also requires the government to assess its own role in those delays.

This article examines these gray areas and offers practical advice to contractors on how to avoid default terminations.

Strategies for Federal Contractors To Avoid Default Terminations

The baseline principle underlying the FAR's default termination framework is the contractor's duty to proceed. The Contract Disputes Act of 1978 (CDA) codifies the availability of contractor rights and remedies against the government, but it also includes express language compelling the contractor to proceed with the work, even in the face of material disputes with the agency:

> *The Contractor shall proceed diligently with the performance of this contract, pending final resolution of any request for relief, claim, appeal or action arising under the contract, and comply with any decision of the Contracting Officer.*[7]

This language prevents a contractor from "taking its ball and going home" (as it were) in the face of a dispute with the government. A claim for increased costs or additional

[6]See E.L. Cournand & Co., ASBCA 2955 (1960).
[7]FAR 52.233-1 (Disputes).

time due to government caused impacts is not a basis or leverage to stop performing. The contractor must continue to perform (barring exceptional circumstances discussed below) and resolve any disputes with the government later.

That said, the duty to proceed is not the same as a directive from the government to suffer in silence, which leads us to Strategy No. 1:

Strategy No. 1: Providing Noisy Notice

In terms of best practices for government contractors, providing notice through formal written communication with the government is top of the list. In the termination world, it is particularly critical.

The FAR requires contractors to provide timely notice for a variety of government-caused impacts, typically within a set number of days. For example, FAR 52.243-1 (Changes) provides:

> *The Contractor must assert its right to an adjustment under this clause within 30 days from the date of receipt of the written order. However, if the Contracting Officer decides that the facts justify it, the Contracting Officer may receive and act upon a proposal submitted before final payment of the contract.*

In the event of looming default, contractors must go beyond mere notice to what we call "noisy notice." That is, advising the government in writing of not just the impact, but the government's responsibility for the impact and the extent to which it endangers contract performance. A well-documented record is key.

Providing this kind of written super-notice increases the odds of garnering government attention and intervention by the contracting officer (or even a level above the contracting officer). The goal is to either expedite resolution (thus eliminating any risk of default) or at least put the dispute firmly on the contracting officer's radar (in hopes of obtaining greater leeway before the contracting officer issues a show cause order invoking termination as a remedy).

Contractors facing a possible termination on a federal project should get an attorney involved early to navigate the process. While there may be no silver bullet for resolving these issues, having counsel's perspective on the situation will be helpful. Additionally, having proper citations in your notice letters will put the government on notice that your side understands the gravity of the situation and is proceeding accordingly.

Strategy No. 2: Making Actual Progress on the Job

While notice is important and an intelligent best practice to follow, there is often no better strategy to avoid termination than to progress the work.

The easiest example of how progressing the job insulates the contractor against default termination is substantial completion. Advancing the work to substantial completion precludes the government from invoking default termination as a remedy, even if there are minor or immaterial irregularities in the performance.[8] The substantial performance doctrine does not protect against defects in the work, but does protect a contractor that is able to perform the work in good faith compliance with the contract.

[8]Trident Indus. Prods. Corp., DOTCAB 2807 (1998) ("The default clause permitted [the government] to terminate the contract if [the contractor] failed to deliver the supplies called for. As long as the delivery was in 'substantial compliance' with the contract requirements, [the government could not properly terminate the contract for default").

Navigating Default Terminations on Federal Projects: Best Practices for Avoiding Default and Overturning Erroneous Termination Decisions

Nicholas T. Solosky and Diana Lyn Curtis McGraw | Fox Rothschild LLP

Even prior to substantial completion, there are benefits to continuing to progress the work to reduce the risk of termination. The best example comes under FAR 52.249-10 and the termination standard for construction projects. If a contractor falls behind on a construction project, the government can rely on the contracting officer's "justifiable insecurity" that the work will not be timely completed as a basis for termination. That is, the government can look at the contractor's lack of diligence up to that point and form the "reasonable belief" that it will not complete the work on time.[9]

From the contractor perspective, this metric for evaluating termination is a case of good news, bad news. Looking first at the negative, it means that termination is possible even where it is still theoretically possible to complete the work within the time allowed. The contractor cannot rely on simple mathematical percentages to save itself if there are multiple aspects or examples of poor performance.

On the flip side, having multiple factors to consider can also serve as a positive. A contractor that is behind schedule can show that it overcame early issues or otherwise increased or accelerated its efforts to complete the job. Contractors should also focus on submitting completion schedules, workplans and staffing information to demonstrate a real plan to the government. These demonstrations of due diligence and actual progress are often enough to stave off termination (which, again, is an extreme remedy that the government should not be eager to impose in the first place).

Strategy No. 3: Asserting Legal Defenses Against the Government

In some instances, the contractor is ready, willing and able to perform, but simply cannot do so for government-caused reasons outside its control. These are some of the most difficult termination scenarios to manage because they implicate legal disagreements between the contractor and the government about core contract issues.

For example, mirroring long-standing common law principles, the law of government contracts holds that a contractor is not required to continue performance in the face of an uncured material breach by the government.[10] This legal principle pre-dates the CDA, which narrows its application in favor of handling any alleged government breach in accordance with the CDA rather than by stopping performance.

Another defense that can excuse a contractor's duty to proceed arises where continued performance is a commercial impracticality or impossibility, as measured against the standard of a similarly situated contractor.[11] Contractors should be cautious about asserting a commercial impracticability defense solely based on a material increase in the price to complete the project. Case law on what constitutes a material price escalation is inconsistent, making it difficult to evaluate the outcome of a particular case.[12] When considering a commercial impracticability or impossibility defense,

[9]Lisbon Contractors, Inc. v. U.S., 828 F.2d 759 (Fed. Cir. 1987).

[10]See, e.g., Kiewit-Turner (JV) v. Dep't of Veterans Affairs, CBCA 3450 (2014) (finding that the contractor was entitled to stop performing where the agency breached the contract by failing to provide a design capable of being built within the contract price).

[11]See, e.g., Ned C. Hardy, AGBCA 74-111 (1977) (recognizing that "[t]here are factual situations when, because of actions by the Government, proceeding with performance would have been futile or would have unnecessarily increased Appellant's cost of performance, would have been dangerous to life or property, or would have been a practical impossibility") (internal quotations omitted) (citations omitted).

[12]See, e.g., Contract Sales, Inc., ASBCA 56661 (2011) (holding that a contractor is not excused from performance merely due to increased price to perform); Commissioning Solutions Global, LLC, ASBCA 57429 (2013) (requiring a cost increase greater than 30% to justify a finding of impracticability of performance).

contractors should not be quick to walk off a job site. Ample communication and noisy notice once again are key.

A better strategy for contractors to pursue when dealing with a commercial impracticality or impossibility situation is to seek direction from the government in writing. There is ample case law holding that a contractor properly refrains from proceeding with a project where the government fails to adequately respond to a contractor's request for direction or clarification.[13]

Taken cumulatively, these strategies all amount to variations on a common theme. Federal contractors must take the duty to proceed seriously and advance the work in good faith to the maximum extent practicable. If government-caused issues negatively impact performance, diligent documentation and communication is a must, coupled with reserving the right to later pursue claims under the CDA. There are legitimate reasons that work can become impossible or impracticable to perform, but contractors must view the commercial impracticality or impossibility defense as a last resort to be asserted only if a request for direction or clarification is unsuccessful.

Terminations in the Context of Private Contracts and Subcontracts

Termination decisions are not exclusive to the relationship between the government and federal contractors, or even between private owners and contractors. Contractors (on both public and private jobs) must think about what will happen in the event that a subcontractor falls down on the job.

Focusing on the contractor/subcontractor relationship on federal projects, attention to detail means a great deal when it comes to termination. Prime contractors can and often must require subcontractors to comply with certain government terms by flowing down FAR clauses from the prime contract. Contractors that overreach by flowing down a FAR termination clause can inadvertently take on additional hurdles that they must clear before they can terminate a subcontractor. This delay could prove challenging in terms of the prime contractor's relationship with the government (or private owner) and could lead to a negative outcome in litigation with the subcontractor if not properly performed.

To be clear, FAR 52.249-10 (by way of example) itself does not include an express requirement that it be flowed down to subcontractors. Instead, prime contractors are free to negotiate independent terms governing default terminations, insert those terms in the subcontract and enforce the terms as needed.[14]

So what does a good termination for default clause include? Contractors should look for the following elements in a well-constructed termination clause:

- Establish contractor control over any subjective decision making related to what constitutes default;
- Include clear, plain language examples of what kind of action or inaction constitutes an instance of default (i.e., the subcontractor's failure or refusal to prosecute the work in a diligent, timely and workmanlike manner);
- Define clear terms for notice, opportunity to cure and authority to terminate;

[13]See, e.g., Industrial-Denver Co., ASBCA 13735 (1970) (finding lack of clear direction from the government justified contractor's failure to proceed).
[14]United States ex rel. Quality Trust, Inc. v. Cajun Constr., Inc., 486 F.Supp.2d 1255, 1263 (D. Kan. 2007).

- Be precise in identifying damages (actual value of work satisfactorily performed and any direct costs incurred due to such termination). Also consider including additional remedies like supplementing the subcontractors crew that can be utilized to avoid a complete termination.

Just like the best practice of providing notice to the government, prime contractors should provide notice to subcontractors early and often before exercising termination as a remedy. Contractors should not delay in providing notice of subcontractor performance failures, nor should contractors try to manage a subcontractor "off the record." In the event of a termination and subsequent dispute, a well-documented record is often essential to carrying the day.

The Final Word

It is well-established in the prevailing case law that a "default termination is a drastic sanction ... which should be imposed (or sustained) only for good grounds and on solid evidence."[15] Terminations at any level (government, owner, contractor or subcontractor) should never be arbitrary, punitive or retaliatory. All parties should think long and hard before exercising this nuclear option.

For federal contractors, the stakes are even higher. One termination can derail years or even decades of hard work and growth. Contractors need to fight to complete the work and avert termination. In the unfortunate event of an erroneous or unjust termination, contractors should be ready to fight like hell to overturn the decision at the Court of Federal Claims or Boards of Contract Appeals.

For more information, please contact:

Nicholas T. Solosky, Partner
nsolosky@foxrothschild.com
202.696.1460

Diana Lyn Curtis McGraw, Associate
dmcgraw@foxrothschild.com
202.794.1208

[15] J.D. Hedin Constr. Co., supra 408 F.2d 424.