

Government Contracts Blog

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Federal Circuit Grounds The "Flying Dorito"

In *McDonnell Douglas Corp. v. United States*, Civil Action No. 2007-5111-5113 (Fed. Cir. June 2, 2009), the Federal Circuit, after more than a decade of A-12 litigation, upheld a termination for default, finding that the Government was justifiably insecure about the contract's timely completion. The Court's opinion articulates the sustainable rationale for a default termination when there is no firm contract end date or set delivery schedule.

Background

McDonnell Douglas Corp. (now Boeing Co.) and General Dynamics entered into a firm-fixed price contract with the Navy in 1988 to engineer the A-12 Avenger – often referred to as the "Flying Dorito" because of its triangular shape. Originally, the contractors were to test and develop eight prototypes, with the first aircraft to be delivered in June 1990 and the remaining seven to be delivered monthly thereafter. Shortly after the contract's inception, delays and design issues caused the contractors to miss their first flight date, ultimately causing the Navy to unilaterally modify the aircraft delivery dates. As problems continued to mount, Dick Cheney, the then-Secretary of Defense, directed the Navy to show cause why the A-12 program should not be terminated. The Navy then issued a cure notice to the contractors, stating that the contractors failed to meet the specification requirements and the schedule for delivery. The contractors admitted that they could not meet the delivery schedule, but denied they were in default because the delivery schedules were invalid and told the Government that, in exchange for restructuring, they would absorb a \$1.5 billion fixed loss and waive their claims for equitable adjustment. The Navy then terminated the contract for default and demanded the return of \$1.35 billion in unliquidated progress payments.

a. Contractors' Claim: Round 1

In 1991, the contractors filed an action at the United States Court of Federal Claims ("COFC") for equitable adjustment, to convert the termination for default to a termination for convenience, and to deny the Government's demand for return of progress payments. The Court initially ruled that the Government's default termination was invalid because the contracting officer failed to

exercise "reasoned discretion" in that Secretary Cheney's actions effectively forced the Navy to terminate the A-12 contract for default.

b. The Navy's Appeal: Round 2

On appeal, the Federal Circuit reversed and remanded, holding that because the default termination was related to the contractors' performance, it was within the discretion of the Government.

c. Contractors' Claim: Round 3

After a six week trial, the COFC ruled in favor of the Government, sustaining the termination for default, based solely on the contractors' failure to meet the first flight date.

d. Contractors' Appeal: Round 4

On appeal, the Federal Circuit held that the Government cannot justify a default termination based solely on a contractor's expressed concerns about meeting a schedule milestone or specification requirements. Rather, citing *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759 (Fed. Cir. 1987), the Federal Circuit held that the Government must establish by a preponderance of the evidence a "reasonable belief on the part of the contracting officer that there was no reasonable likelihood that the contractor could perform the entire contract effort within the time remaining for contract performance." It remanded the case to the COFC.

e. Contractors' Claim: Round 5

On remand, the COFC noted that the facts of the case did not neatly coincide with those of *Lisbon Contractors* in that there was no established and enforceable contract completion date and the Contracting Officer had not undertaken the traditional *Lisbon Contractors* analysis in advance of the termination. Nonetheless, the COFC concluded that the overall evidence of record supported a conclusion that the Government was justified in terminating the contract for "failure to make progress."

f. Contractors' Appeal: Round 6

On appeal, the contractors argued that the Federal Circuit should apply its standard for termination for default literally and hold that the absence of a contract completion date *per se* precluded the Government from ever justifiably terminating a contract for failure to make progress. The Federal Circuit's response was unambiguous (at least doctrinally) – “We cannot adopt such a broad categorical rule.” The Court explained that contrary to the contractors' argument, the *Lisbon Contractors* test only "requires the contracting officer's reasonable belief that there was no reasonable likelihood of timely completion.

Specifically, the Court set forth the following rationale should be used when determining whether the Government's termination for default is justified where there is no delivery schedule, *i.e.*, no firm contract completion date:

- A court must conduct a factual inquiry on the events, actions, and communications leading to the default decision in ascertaining whether the contracting officer had a reasonable belief that there was no reasonable likelihood of timely completion.
- A factual inquiry should include the contractor's:
 - Failure to meet progress milestones – the Court noted that missed milestones are not sufficient, standing alone, to justify default but they do provide a context for understanding and evaluating the plaintiffs' continued problems;
 - Problems with subcontractors and suppliers;
 - Financial situation, including its ability to perform a contract at the specified contract price; and
 - Performance history.
- That it is proper for a trial court to allow a "cure notice" to serve the purpose of advising the contractor when the time for default has been reached "because the cure notice lets the contractor know that even if performance or delivery is not yet due, the contracting officer believes the contractor may not be making sufficient progress to complete the project on time."
- It follows that the burden is then on the contractor to advise the Government how it will complete the project on time, according to contract requirements.

The Federal Circuit applied these factors and determined that the evidence supported the termination. It affirmed the decision of the COFC and ordered the contractors to pay back more than \$2 billion to the Government, holding that the contractors' performance history and "dire" financial difficulty coupled with the fact that the contractors did not argue that their failure to make progress should be excused, demonstrated that the Contracting Officer was reasonably justified in feeling insecure about the contractors' rate of progress.

g. Rehearing: Round 7 on the Horizon?

Both Boeing and General Dynamics have issued press releases stating their belief that the default termination was not justified and that the companies will seek a re-hearing on the issues. Given the financial stakes, this is not surprising. It is somewhat incongruous that one can be found to have no reasonable likelihood of “*timely* completion,” when there is no enforceable completion date against which to assess the timeliness of future performance. The Federal Circuit would have been better advised to have jettisoned the *Lisbon Contractors* rule and eschewed what is obviously an attempt to shoehorn a square peg into a conceptual round hole. At bottom, what the Federal Circuit seems to have done is to hold that, in some cases, the likelihood of any successful performance on any schedule is so remote that the re-establishment by the Government of a reasonable delivery schedule to serve as the pretext for the termination would be a futile gesture that the law will not require. Indeed, the court cited with approval the COFC’s reliance on the Court of Claims 1976 decision in *Universal Fiberglass Corp. v. United States*, 537 F.2d 393, 397 (Ct. Cl. 1976):

In such circumstances, a unilateral delivery schedule prescribed by him would have been an exercise in futility, except for forensic purposes, should we be so foolish as to give the absence of such a schedule any legal significance or weight.

Having eliminated the need for any objective standard against which to judge the Government’s reasonable determination that “timely completion” was unlikely, the court held that the burden then shifted to the contractors to prove an affirmative defense of excusable delay or that performance was not in fact endangered. Because “[on] appeal, the contractors assert no affirmative defense” and because “[T]hey proffer no record evidence to show, without contract restructuring that they could have completed the contract *on any date*,” (emphasis added) the Federal Circuit sustained the termination.

Perhaps the most important principle for contractors to derive from this extended saga is that the absence of an enforceable contract completion date is not necessarily a condition precedent to a determination that they will not *timely* complete the contract. And while *Universal Fiberglass* has been on the books for years, the extension of its principles to the A-12 facts will come as news – and a caution – to many.

There are those who may take a more jaundiced view. Former GAO General Counsel, Paul Schnitzer, humorously suggested on more than one occasion that the value of a legal principle in a bid protest depended on the difference in price between the awardee and the protester and that no legal principle could ever be worth more than a \$60,000 difference in the offered prices. A joke, yes, but tendered perhaps with a certain grain of pragmatic reality, as many jokes often

are. So, some may be tempted to conclude that maybe, just maybe, the A-12 decision rests on a similar pragmatic reality, *i.e.*, that with more than a billion dollars in unliquidated progress payments at stake, a strict application of *Lisbon Contractors* would have been a little too rich for the Government's blood. Or, as many a first year law student has heard from the podium, "Bad facts make bad law."

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