

WHY THE COVID-19 PANDEMIC IS NOT A “FREE PASS” FROM TERMINATION FOR DEFAULT

Jack Horan May 01, 2020

What an over 50-year-old ASBCA decision can teach us about contractual obligations and performance under the current environment caused by the global coronavirus pandemic.

In 1967, the Armed Services Board of Contract Appeals (ASBCA) issued a decision that is particularly relevant today, considering the widespread impacts to U.S. government contracts caused by the global COVID-19 pandemic.

Background and Pertinent Facts

Ace Electronics Associates was established sometime in 1952. One of the core tenets of the company was to provide work opportunities for those with physical and intellectual disabilities. In 1965, Ace was one of a limited number of companies that manufactured varying models of potentiometers.[1]

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potentiometers to the U.S. government and to the manufacturers and suppliers of radar countermeasures, computer systems, and ballistic missiles.

The Contract

On August 17, 1965, the Department of Defense (DOD) awarded a fixed-priced contract to Ace for the delivery of 160 potentiometers. At that time, Ace and the entire industry suffered from an inability to hire sufficient, qualified employees or trainees. Ace bid on the contract "on almost what you would call a cost basis"[2] ([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn2](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn2)) in order to "keep [its] people working." Ace "expected to break even" on the contract, but its main concern was to keep its "work force intact." Ace priced the 160 potentiometers at \$39 each for a total contract price of \$6,240.

The contract required first article testing on "three preproduction samples" that would not be included in the 160 production units. [3] ([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn3](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn3)) For these samples, one unit "was to be subjected to certain mechanical, electrical, and environmental requirements; another to certain shock and vibration requirements; and a third to certain rotational life [i.e., fungus] requirements." The testing had "to be performed at an approved commercial testing laboratory or at [Ace's] plant and to be witnessed by responsible government personnel."

The contract further required Ace to "prepare three copies of such test reports in accordance with specifications, certified to by both Ace and the cognizant procurement inspector," and to forward the reports to DOD. The contract prohibited Ace from fabricating or producing any production units prior to approval of the first article testing.

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The contract contained the customary "Termination for Default," "Termination for Convenience," and "Disputes" clauses found in government contracts at the time. As with current standard government contract Termination for Default clauses, the clause in Ace's contract gave DOD the right to terminate "the whole or any part" of the contract upon any unexcused failure to deliver the supplies at the time specified in the contract. Also, like current Termination for Default clauses, the clause specifically identified "epidemics" as an excusable cause for delay in performing the contract, entitling the contractor to an adjustment in the delivery schedule for the excusable delay. Further, a "First Article Approval" clause provided that failure to deliver the first article test reports by the agreed date would be deemed a failure to make timely delivery under the Termination for Default clause.

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Ace agreed to provide first article test reports within 90 days after award of the contract, and delivery of the entire production quantity within 60 days of DOD approval of the first article test reports. Thus, delivery of the first article test reports was due on or before November 18, 1965.

The Basis for the Dispute

Sometime after award, Ace suffered production delays beyond its control, which included "a flu epidemic that had 'passed through' its plant causing a 30% to 40% rate of absenteeism over a period of several weeks." November 18, 1965, passed without delivery of the first article test reports.

On November 29, 1965, DOD requested that Ace "suggest a firm and realistic delivery schedule that [Ace] was certain could be met..." On December 3, 1965, Ace informed DOD that "all first article testing was complete except for the fungus test then in progress at an outside laboratory, and that the test reports would be complete by December 28, 1965."

Ace had assigned one of its employees as a testing laboratory technician performing under the contract. However, this employee "came in prematurely one day and collected his pay check, early in January or in the last few days of the month of December," and

then, inexplicably, he fled both his family and his employment, and “neither his wife, the police, the FBI, [nor] any friends or acquaintances” were able to locate him. Unfortunately for Ace, this employee was directly responsible for the first article testing under the contract, and following his disappearance, Ace was unable to piece together the work he had completed to deliver the required reports.

On December 7, 1965, DOD sent Ace a “show cause” letter, requesting that Ace provide an explanation why DOD should not terminate for default.[4]

(file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn4) On December 13, 1965, Ace explained that first article testing “required a minimum of 52 days without regard to equipment breakdown, changeover time between tests, and equipment scheduling; and that fungus testing, which had to be performed at an outside laboratory, required scheduling in accordance with that laboratory’s prior commitments.” (Ace chose not to explain the issue caused by its technician’s mysterious disappearance, and did not describe any other difficulties caused by a flu epidemic either.) Ace concluded that based on a “realistic” evaluation of these factors, the first article test reports could be submitted during the week of January 4, 1966. However, January 1966 passed without Ace’s submission of the test reports or any other correspondence between Ace and DOD under the contract.

On February 18, 1966, DOD terminated the contract for default. Six days later, Ace sent the required three copies of the first article test reports to DOD. The reports submitted by Ace indicated that an approved commercial testing laboratory completed the 28-day testing in early January 1966 with the required observation by a DOD inspector, and the report was completed on January 11, 1966. The remainder of the required testing was conducted at its facility, witnessed by a DOD inspector, and was completed on February 7, 1966.

On February 28, 1966, Ace asked DOD to reconsider its termination and to reinstate the contract. Ace claimed that its delay in submitting the reports was "due to unspecified production delays beyond its control, including specifically a flu epidemic that had 'passed through' its plant causing a 30% to 40% rate of absenteeism over a period of several weeks." Ace also stated that it could manufacture the production units "in a minimum of time."

On March 10, 1966, DOD responded that it could not reinstate a terminated contract, but that it would consider whether the default termination should be converted to a termination for convenience based on the "new evidence" Ace had submitted. DOD found that "as the flu epidemic was concerned, such an epidemic would not constitute excusable cause for delay if it occurred after 20 November 1965." Because Ace had not established the date of the epidemic and had provided no other evidence that its failure to submit the test reports before the due date "was due to causes beyond [its] control and without its fault or negligence," DOD would not convert the termination to one for convenience. DOD returned the test reports without evaluation or approval.

On March 16, 1966, Ace again requested reconsideration and reinstatement. On March 23, 1966, DOD again refused.

Ace timely appealed the termination for default to the ASBCA. The case is noted as *Ace Electronics Associates, Inc.*, ASBCA No. 11496, 67-2 BCA 6456 (July 18, 1967).

The Case—*Ace Electronics Associates, Inc.*

While the appeal was pending, Ace requested that DOD approve the test reports to establish Ace as a "qualified supplier" of potentiometers for future contracts "without the requirement for first article testing." On September 30, 1966, DOD approved the reports and deemed Ace qualified to manufacture potentiometers.

Ace's Arguments

In its appeal, Ace made two arguments that DOD improperly terminated the contract for default (which are *particularly* important to contractors active today during this unusual time of the COVID-19 pandemic):

- First, Ace argued that the flu epidemic that caused a 30% to 40% rate of absenteeism “over a period of several weeks” qualified as an excusable delay under the Termination for Default clause, entitling Ace to a schedule extension and making the government’s default termination improper.
- Second, Ace argued “that it was excusably delayed in the completion of its preproduction testing program on and after the end of December 1965, to 24 February 1966, by reason of the unforeseeable loss of a key and indispensable laboratory technician who had been in charge of preproduction testing under the terminated contract at Ace’s plant.”

The Board’s Analysis

The ASBCA noted that an “epidemic” was listed in the Default clause as one of several causes of excusable delay; however, that only took Ace part of the way. The Board also noted that “such enumeration [of ‘epidemic’ in the Default clause] does not make the occurrence of an epidemic an excusable cause [for delay] *per se*.”[5]

[file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn5](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_edn5)) To obtain relief, Ace had to prove not only that the epidemic occurred, but that the epidemic *delayed performance* of the defaulted contract:

Illness occasioned by the onset of a flu epidemic is in general an excusable cause for delay provided it can be shown that performance was in fact delayed by reason of such epidemic. It is incumbent upon [Ace] to establish not only the existence of an excusable cause for delay but also that such cause actually contributed materially to such delay as well as the actual extent of the delay so caused.... [Ace] has presented no evidence to show when the flu epidemic occurred or its precise duration, what

personnel were affected and the periods during which they were absent for that reason, whether such absences in fact caused delay in its preproduction testing program and if so the extent of such delay, and what efforts were made during such absences by the use of overtime or other measures to keep the work going. Since [Ace] has submitted no factual details in support of its contention that preproduction testing in connection with the terminated contract was delayed by such flu epidemic, relief on that basis must be denied for failure of proof.

In short, the flu epidemic may have occurred, but Ace did not prove that the epidemic *actually delayed performance*. The Board rejected Ace's argument of excusable delay based on the epidemic because of insufficient evidence.

Concerning the disappearance of Ace's technician, the Board noted that "the employment of sufficient qualified personnel to perform a contract, and to provide adequate supervision, is the contractor's responsibility," and a "failure to employ, retain, and adequately supervise such personnel [typically] is not beyond the control and without the fault or negligence of a contractor within the meaning of the Default clause." The Board recognized, however, that although "the unforeseen loss of an indispensable employee through illness, resignation, or disappearance does not relieve a contractor from the responsibility of carrying on its contract, under appropriate circumstances such loss may provide the basis for an appropriate extension of time for performance." Upon reviewing the circumstances of the technician's disappearance, the Board found that Ace had adequately established the following:

- The technician played a key role in the first article testing;
- The loss of the technician was not reasonably foreseeable;
- Ace could not have been reasonably expected "to assign other competent personnel to such preproduction testing in anticipation of such contingency" (i.e., the possible disappearance of the technician);
- Ace "made every reasonable effort to have the necessary re-testing performed as promptly as possible" after the technician's disappearance; and

- The technician's disappearance disrupted the portion of the testing program being conducted in Ace's facility.

The Decision

Although the Board did not explicitly conclude that the unforeseeable departure of the key technician provided Ace with an excusable delay, the Board *did* appear to conclude that Ace met all of the elements of excusable delay. Unlike the flu epidemic, Ace proved that the excusable event—the disappearance of the technician—*caused* the delay in performance.

Ace also argued that DOD had waived the first article delivery schedule by allowing Ace to continue performance without a default termination until February 18, 1966. DOD did not establish a reasonable delivery schedule after the waiver and, as a result, the Board found that the default termination was improper. The Board noted that “since a contract remains in force after a breach unless the non-defaulting party manifests an election to terminate it, upon a failure to perform on or before the contract due date, the government must within a reasonable time after such breach elect whether to terminate for such default or to permit continuance of performance.” DOD was entitled to “take sufficient time to determine what action [would] be in the best interest of the government”—which is known as a “period of forbearance”—“[when] the contracting officer may elect to terminate for default without the risk of waiving the original delivery schedule.”

The Board found that at some point after receipt of Ace's letter of December 13, 1965, and prior to Ace's receipt of the notice of default termination, dated February 18, 1966, “a reasonable period of ‘forbearance’ had expired” and that the government “induced [Ace] to continue with its preproduction testing program, thus manifested a willingness to permit continued performance, and thereby waived the requirement for their delivery in accordance with the original contract schedule.” Because the government did establish a reasonable revised delivery schedule after the waiver,

termination for default was improper, and should be converted to a termination for convenience. The Board directed DOD to pay Ace its termination costs under the Termination for Convenience clause.

Counsel Commentary

Despite being over 50 years old, as a seminal and rare case of a contractor claiming excusable delay based on an epidemic, the *Ace* case provides timely guidance for government contractors during the current COVID-19 pandemic. Most important, *Ace* demonstrates that a pandemic, in and of itself, does not *necessarily* establish an excusable delay—despite its explicit reference in Termination for Default clauses. In addition to the existence of the current pandemic, which would be easy to prove, a contractor seeking a schedule extension and to avoid a default termination will have to prove that the pandemic “actually contributed materially to such delay as well as the actual extent of the delay so caused.”

Thus, a contract manager should keep careful records of such things as—

- The specific employees affected by the pandemic;
- The dates of disruption;
- The contractor’s actions to continue performance and maintain the schedule;
- The nature of the disruption, such as the illness of key employees;
- The inability to hire substitute employees; or
- The disruption caused by transitioning from performance from an office or on-site to employees’ homes via telework.

Without a skillful contract manager taking reasonable action to continue performance and memorializing the disruption to performance that cannot be avoided, a contractor could suffer a termination for default. In short, the existence and widespread effect of the present COVID-19 pandemic is not a “free pass” from default.

The *Ace* case also provides some good news for present-day contractors. The Board in *Ace* recognized that even the unavailability of a single key employee could constitute an excusable delay if the contractor can demonstrate that it took reasonable steps to avoid the disruption caused by the absence. Thus, contractors should not have to show that the pandemic affected all, most, or some percentage of their operations—only that key employees responsible for performance of the contracts were materially unavailable.

Finally, the *Ace* case provides old (but still useful) examples of the contractor’s defense of waiver of the delivery failure and of the government’s forbearance period. Contracting officers must recognize that they may waive the government’s right to terminate if they allow contractors to continue performance after the missed delivery date beyond a reasonable period of forbearance. A contracting officer can take some time to determine whether termination is to the benefit of the government as part of reasonable forbearance, but an overly long period—two months in the *Ace* case—while the contractor continues performance will waive the right to terminate and requires the contracting officer to establish a revised, reasonable, delivery schedule. **CM**

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Endnotes

[1]
([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref1](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref1)) Editor’s Note: Potentiometers are a type of variable resistor that are predominantly used as control inputs to electronic circuits—e.g., volume controls for audio devices or dimmer switches on light fixtures.

[2]
([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref2](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref2)) All quotes in this article are to the Armed Services Board of Contract Appeals decision that forms the basis of this article (*Ace Electronics Associates, Inc.*, ASBCA No. 11496, 67-2 BCA 6456 (July 18, 1967)), unless otherwise noted.

[3]
([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref3](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref3)) First article testing often requires that the contractor test one or more of the first units produced and provide the test reports to the government for approval prior to the production of the remaining units. (See FAR 52.209-3, "First Article Approval–Contractor Testing.") The use of first article testing "ensures that the contractor can furnish a product that conforms to all contract requirements for acceptance," often when the contractor has no experience in manufacturing the items being purchased by the government. (See, generally, FAR 9.302.)

[4]
([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref4](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref4)) See FAR 49.402-3(e)(1), which recommends that the contracting officer send a contractor a notice to "call the contractor's attention to the contractual liabilities if the contract is terminated for default, and request the contractor to show cause why the contract should not be terminated for default."

[5]
([file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20\(003\).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref5](file:///C:/Users/amber.werner/AppData/Local/Temp/Temp1_0520%20Web%20Files%20(003).zip/0520%20Web%20Files/Word%20docs/Counsel%20Commentary.docx#_ednref5)) Emphasis added.

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