COVID-19: Preparing for Its Effects on Government Contracts

Briefing Call Takeaways

Overview

In the wake of COVID-19, government contractors face challenges around business continuity, namely restrictions on who can enter facilities, delays in approval processes, and shelter in place directives preventing employees from working and suppliers from fulfilling obligations. We've provided the below takeaways to help contractors address these issues and more during these uncertain times.

Stafford Act and Emergency Order

- The federal government has limited authority to issue quarantine orders or to control the extent to which businesses can stay open in public health emergencies. However, it can restrict movement across state lines for those actually infected by the virus. State governments, on the other hand, have broader general police powers to issue shelter-in-place orders, limit gatherings, and shut down non-essential businesses.
  - As a result, federal guidance is explicitly advisory. The controlling factor is the extent to which state and local orders allow businesses or certain operations to stay in function. Federal guidance does not overcome state and local orders unless there is a direct conflict between a state or local order and a mandatory federal order, in which case the federal order would be preemptive.
  - There are procedural steps to obtain confirmation by states that companies are critical infrastructure and should maintain operations. Companies that have been explicitly referenced in Sectors covered by Department of Defense (DoD)/Department of Homeland Security (DHS) guidance or considered critical infrastructure have used such determinations to argue that they are "essential" businesses for state and local orders. It is important to review carefully the specific wording of state and local orders because they vary by state.
- The Emergency Order issued under the National Emergency Act for COVID-19 unlocked federal assistance for states under the Stafford Act. The Stafford Act, the declaration of a national emergency, and other state disaster declarations (*e.g.*, NY, WA, and CA), do not impose any direct restrictions or prohibitive effect on businesses.
  - The Stafford Act flow of aid is from the Federal Emergency Management Agency (FEMA) to state and local governments. Companies manufacturing products most relevant to combatting the crisis may have opportunities under FEMA grants to state and local governments. Thus, there may be opportunities for contractors at federal, state, and local levels, such as augmentation of testing resources, delivery of

medicine or food supplies, and establishment of public health hotlines. We can help clients with such procurements.

See our related blog post: State of Emergency: COVID-19, the Stafford Act, and What It All Means for Contractors.

Defense Production Act (DPA)

Overview

- DPA confers authority on the executive branch to shape national defense preparedness and to take appropriate steps to maintain and enhance the domestic industrial base. National defense is broadly defined, but encompasses military and energy related activities, efforts to support systems, and assets vital to national security, including economic security and public health and safety. It also covers emergency preparedness conducted under the Stafford Act and includes any activity measures designed or undertaken to prepare for emergency or used to minimize effects of emergency on civilian population.
- Title 1: Prioritization and Allocation
  - Prioritization may apply a rating to a U.S. government contract with individuals or organizations, which will prioritize government contracts over any competing obligation. Contractors will be granted immunity from civil actions if there are delays in filling commercial orders as a result of responding to rated orders.
  - Allocation (where there is most concern and interest), if invoked, allows the government to allocate materials, services, and facilities in any manner deemed necessary to promote the national defense. That allocation of materials can include technical information or services that are ancillary to the use of the materials (a concern for intellectual property (IP) and trade secrets). Authority to allocate services is broad and will include any effort needed for or incidental to the development, production, processing, delivery, or use of an industrial resource or critical technology item.
    - Government has not used this authority since 1989 (Cold War), but has threatened to do so in certain circumstances to bring parties to the table and use as leverage in contracting negotiations.
    - If the federal government determines that a business is essential but it is shut down under a state order, an invocation of the DPA, by the President or an allocation directive by the Secretary of Health and Human Services (HHS), for those businesses to stay open would likely preempt state action and be upheld as an appropriate use of the DPA.
- Title 3: Expansion of Productive Capacity and Supply
  - The DPA includes loan guarantees and direct loans to reduce current or projected shortfalls of industrial resources, but is limited by funding provided under the DPA. The Act also gives authority to domestically reproduced items. The government can issue purchase commitments, as well as equipment purchases and installations. In addition, the president can create, maintain, protect, expand, or restore the domestic industrial base that are essential for national defense as defined in the Act.

- For carrying out provisions of Title 3, DPA establishes a fund generally valued at $750 million, which does not expire. Budget authority for direct loan and guarantees in Title 3 would have to be included in an Appropriations Act passed by congress. Any industrial base project under Title 3 that will cost more than $50 million typically has to be passed by an act of congress, but can be waived in the case of emergency. Also, there are no wage price controls permitted under the DPA. Therefore, the president cannot use the DPA to control wages or to set prices, unless there is a joint resolution of Congress.

Insights on Application

- In response to the scarcity of critical public health and medical items at local and regional centers, on March 18 President Trump issued an Executive Order (EO) to prioritize and allocate resources to respond to the crisis. To date, the President and HHS have stopped short of issuing orders under the authorities enumerated in Title 1 to respond to local and regional centers and, instead, are relying on the response of the market by threatening to leverage the authorities under the DPA.
- Though HHS has authority under the DPA, the Trump Administration designated FEMA as the lead agency for pandemic response. FEMA is also supported by senior military and civilian officers from DoD to design and oversee logistics of production supply operations.
- In the coming days and weeks we will witness the give-and-take between the executive branch and Congress on whether and under what circumstances the authorities under the DPA should be used to prioritize the production and acquisition of needed medical products.
  - Minority Leader Chuck Schumer has urged President to make more immediate use of authorities, namely priority provisions, under Title 1.
  - On March 23 and 24, House Democrats introduced the Medical Supply Chain Emergency Act, sponsored by Congressman Tim Ryan and Congresswoman Elissa Slotkin, seeking to compel President Trump to use DPA authorities to issue purchase orders for N95 masks.

See our related blog posts:

- A Coronavirus Contractor's Guide to the Defense Production Act
- The Defense Production Act and the Coronavirus Executive Order: Key Considerations

PREP Act

- Under the PREP Act, the Secretary is authorized to provide covered individuals and entities with nearly complete protection from suit and liability under federal or state law for any losses related to the administration or use of specifically identified countermeasures after determining that a disease, condition, or other threat constitutes a present or credible risk of a future or present public health emergency. The Secretary has issued a declaration under the PREP Act for COVID-19 which:
  - provides immunity for any loss by use of a countermeasure in response to a disease, condition, or threat; and

- provides immunity for manufacturers, distributors, state and local program planners, health professionals and anyone else prescribing, administering, or dispensing these covered countermeasures.

- When applicable, the PREP Act protects those individuals and entities from liabilities for death, physical, mental or emotional injury, illness, disability, as well as fears of such outcomes, in addition to loss of or damage to property and business production losses. This is a broad immunity available for cases brought in the United States; it does not have extraterritorial effect, so there is no immunity for cases brought abroad.
- The current declaration requires that the activities involving the covered countermeasure must be related to a government agreement or be authorized by a federal, state, or local health authority. This is a very important link.
- Covered countermeasures include drugs or biological products or devices that are used either in an approved way or unapproved way pursuant to an Emergency Use Authorization (EUA). Investigational New Drug application (IND) can also be used to provide for protection.
    - A significant issue is the expansion of the definition of covered countermeasures to include medical devices that are not regulated as medical devices by the Food and Drug Administration (FDA). For example, N95 respirators are not regulated by the FDA and are not generally issued or allowed to be used pursuant to EUA. However, the emergency declaration and statutory mention in Families First legislation identifies them, making clear that respirators for purposes of use of this emergency are covered even though they are regulated by the Occupational Safety and Health Administration (OSHA).
    - There are remaining questions as to whether other products (*e.g.*, face masks, face shields, and other products that may be manufactured) can be pigeonholed into an expanded counter measure to provide protection.

See our related blog post: A Coronavirus Contractor's Guide to the PREP Act.

Delay

- The standard Excusable Delay Clause (the "Clause") allows you to obtain schedule relief (i.e., an extension) in the event of a delay caused by circumstances beyond the contractor's control to avoid a termination or a breach claim. The Clause does not allow contractors to recover costs associated with that scheduled delay.
    - The Clause lists a number of examples of excusable delays, including acts of the government in either its contractual or sovereign capacity, epidemic, and quarantine. Federal Acquisition Regulation (FAR) 52.249-14(a). The causes of delay listed in the Clause are not intended to be exclusive. A contractor also can rely on other events that are beyond its control and occur without its fault or negligence as a ground for excusable delay. However, the courts and boards of contract appeals typically take a more restrictive view of such contentions not listed in the Clause. For COVID-19, tying to the epidemic or quarantines are helpful since they are explicitly enumerated in the Clause.
- The mere occurrence of an event that qualifies as an excusable delay does not automatically entitle the contractor to an extension of time. The contractor must establish that (a) the event that caused the delay was unforeseeable, beyond the contractor's

control, and without its fault or negligence (and of its subcontractors); (b) the delay prevented timely completion of the contract; and (c) the contractor took reasonable precautions to avoid foreseeable causes of delay and to minimize their effect.

  - **Leading case**: Ace Electronics Associates out of the Armed Services Board of Contract Appeals (ASBCA) [1967 WL 3981] where the Board acknowledged epidemics as an example of excusable delay but explained that they are not per se excusable events. The board provided examples of proof needed to establish and proof to collect and maintain as documentation to qualify as excusable delay. Key takeaway is that companies should document how the epidemic may be impacting its performance to establish excusable delay and compensation for delays.

- The excusable delay provision does not excuse delays based on the fault or negligence of subcontractors. Ordinarily, a prime is liable for its subcontractors' delays. However, if the delay is beyond the control of both the prime and any tier of subcontractor and without the fault or negligence of either, it would be excused UNLESS: (1) the subcontracted supplies or services were available from other sources; or (2) the Contracting Officer (CO) had directed the prime to purchase services or supplies from another subcontractor and the prime ignored the direction.
- To seek relief, contractors need to notify the CO promptly about the delay and provide as much detail as possible to justify the request. Contractors should focus on how the "particulars" of a quarantine such as social distancing, and/or sick employees may have caused the delay. *Philips Nat'l, Inc.*, ASBCA No. 53241, 04-1 BCA ¶ 32567 (requiring "particulars"). The delay must affect "completion" of the "overall" contract or delivery deadlines—in other words, immaterial or minor delays do not count. See *Sauer, Inc. v. Danzig*, 224 F.3d 1340, 1345 (Fed. Cir. 2000).
- Potential Traps
  - Trap 1: Not documenting what happened, and how it affected the contractor.
  - Trap 2: Cause must be "beyond the control" of the contractor.
  - Trap 3: Some clauses contain stricter notice requirements than others. Know which applies to specific contracts.

See our related blog post: "Excuse Me, My Performance Has been Interrupted" – How Excusable Delay Provisions in the FAR May Help Federal Contractors Affected by the Coronavirus.

Affirmative Recovery

- **Key:** Read your contract. Understand your contractual rights. Your contract is likely to contain FAR clauses that provide potential bases for recovery. As a general matter, a best practice is having open communication with the CO.
  - On 3/21, the Office of Management and Budget (OMB) issued a memo providing guidance on managing contract performance issues in the wake of the COVID-19 pandemic. It includes helpful language: "Agencies are encouraged to be as flexible as possible in finding solutions."
- Circumstances in which contractors may be entitled to contract-price adjustment as a result of Coronavirus-related impacts
  - Stop Work Clause (FAR 52.242-15)

- The Stop Work Clause provides the most straightforward path to recovering compensation for increased costs. It also provides for scheduled adjustments.
- The CO can issue a stop work order that pauses the work for a defined period of time, which is subject to an adjustment, and can be extended or shortened. The contractor has to immediately go pencils down and cease incurring costs. However, the clause states that where a Stop Work Order has been issued, the CO "shall make an equitable adjustment" if the work stoppage results in increased costs and the contractor timely asserts that right.
  - Caveat 1: The CO has to issue a formal Stop Work Order, which is a matter within his/her discretion.
  - Caveat 2: Generally, any costs that you claim would have to be reasonable, allowable, and allocable, in accordance with FAR Part 31.

- Suspension of Work Clause (FAR 52.242-14) & Government Delay of Clause (FAR 52.242-17)
  - The Suspension of Work Clause typically applies to construction and engineering contracts and provides for an adjustment of the contract price in the event that the work is unreasonably delayed by an act or omission of the CO in administering the contract. This language has been interpreted by courts and boards to permit government contractors to recover additional costs in the event of either a directed suspension of work or constructive suspension. However, the contractor has to establish that the period of the delay was unreasonable.
  - The Government Delay Clause provides that the contractor can recover costs caused by the CO's act or omission of action within the time specified in the contract (or if no time is specified, within a reasonable time) or by some other unauthorized action. A company must demonstrate that the CO's action was unreasonable or unauthorized in order to recover under those clauses.
- Changes Clause (FAR 52.243-4)
  - The Changes Clause permits an adjustment to contract price and/or schedule when the government changes the work to be performed under the contract through a formal change order or a constructive change. Given our present circumstances, contractors should consider whether a change in the method or manner of contract performance constitutes a constructive change.
    - If the government direction increases the cost of performance, it is generally worth evaluating whether or not this could constitute a compensable change.
    - If a contract generates significant profit, it will be better served if the deletion is characterized as a deductive change. If a contract is in a loss position, it may be better for deleted work to be characterized as a partial termination.

- Obstacles to Recovery
  - Inadequate record keeping (refer to section above for more information).
    - Three Golden Rules to substantiate any REA or claim: (1) Document, (2) Document, and (3) Document. Make sure to document all of your costs.
  - Failure of imagination – Not thinking broadly or creatively enough about potential types of cost impacts. There are a number of damages theories that might entitle you

to adjustment if you think broadly about your categories of cost impact. A few common examples:

  - Constructive acceleration: Where the CO doesn't extend completion dates and you have to increase overtime work in order to meet the deadline.
  - Loss of efficiency: Where you have to perform work out of sequence and can demonstrate that you weren't as efficient as a result (using the "measured mile" approach or similar theory).
  - Idle facilities & equipment: Where you incur costs associated with renting and/or maintaining these facilities and equipment during the delay period.
  - Idle labor: Where workers remain on your payroll even when they are not permitted to work or access a work site.

- Sovereign Acts Doctrine – Affirmative defense that available to the government in certain circumstances. Distinguishes between the government's role as a sovereign and as a contractor, and provides that the government cannot be held liable as a contractor for acts it took in its sovereign capacity that prevent or obstruct contract performance. Where the Sovereign Acts doctrine applies, the contractor is only entitled to schedule relief; it is not able to recover costs.
  - How to Defeat Sovereign Acts Defense
    - If there is a concurrent sovereign in a contractual act, case law generally holds that the Sovereign Acts Defense will not apply. Therefore, the contractor still may recover costs as a result of the contract act, notwithstanding the corresponding sovereign act.
    - Even if there is a sovereign act, the doctrine only applies if that sovereign act renders impossible the government's performance of its obligations under the contract. This is a very high standard that the government bears the burden of meeting.
    - The government can contract to cover the costs of the changes implemented as a result of Coronavirus-related impact. If the government does so, that may entitle you to recovery notwithstanding the Sovereign Act Doctrine.

See our related blog post: Can I Recover the Added Costs of Work Caused by COVID-19?

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For more information on these and other legal issues relating to the pandemic, please see Covington's COVID-19 Legal and Business Toolkit.