ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Lan-Cay, Inc.	)	ASBCA No. 56140
	)	
Under Contract No. DAAE20-03-D-0170	)	

APPEARANCE FOR THE APPELLANT: Cynthia Malyszek, Esq.
Malyszek & Malyszek
Westlake Village, CA

APPEARANCES FOR THE GOVERNMENT: Raymond M. Saunders, Esq.
Army Chief Trial Attorney
Robert T. Wu, Esq.
Trial Attorney

OPINION BY ADMINISTRATIVE JUDGE WILSON

This appeal was taken in response to the contracting officer's notice of termination for default for failure to deliver the contracted Blank Firing Attachments (BFAs) for the M2, .50 caliber machine gun, by the scheduled delivery date, as well as, the failure to perform higher-level contract quality requirements, and the failure to make progress. Appellant maintains the termination was improper alleging government failure to make progress payments, government-caused delays due to defective specifications, improper audits and overzealous inspection, and hindering performance through heightened inspection criteria. The Board has jurisdiction of the appeal under the Contract Disputes Act (CDA), 41 U.S.C. § 7105(e)(1)(A). The parties elected to submit the appeal on the record pursuant to Board Rule 11. The record consists of the government's Rule 4 file (tabs 1-123), the government's first, second, and third supplemental Rule 4 files (tabs 136-207, G1-G14, and G15-G23, respectively), appellant's supplemental Rule 4 file (tabs 124-135)[1] and appellant's Rule 11 file (tabs A1-A34), the parties' briefs and reply briefs.[2] At issue is the propriety of the termination. As the government has met its burden of

[1] By letter dated 24 April 2008, the government objected to appellant's Rule 4 supplement at tabs 127-29, 132-33 and 135. By Board Order of 30 April 2008, the documents were constructively removed with no evidentiary ruling made at that time. As appellant failed to offer any argument for their inclusion in the record, the documents are excluded.

[2] As each document tabbed has a discrete number, all of the government's filings shall be referred to as "R4" with the appropriate tab. Appellant's filings shall be cited to as: "App. supp. R4" together with the appropriate tab.

demonstrating the termination was proper, and appellant has failed to provide sufficient proof that the default was excusable, we deny the appeal.

FINDINGS OF FACT

1. On 21 August 2003, the Army, specifically TACOM-Rock Island (the government), awarded Contract No. DAAE20-03-D-0170 to Lan-Cay, Inc. (appellant). The five-year indefinite-delivery, indefinite-quantity (IDIQ) contract was for the production of the M2 Blank Firing Attachment (BFA). (R4, tab 1 at 1-3) The BFA, designated as the M19 BFA, clamps onto the M2 .50 caliber machine gun and allows the user to fire blank ammunition in support of new operator training on the weapon (R4, tab 50 at 2, tab 164 at 1, tab G1 at 2).

2. Issued concurrently with the award was Delivery Order No. 0001 (DO No. 0001) for 1,500 firing attachments, NSN: 1005-01-091-7510, at a unit price of $269.79 each for a total price of $404,685.00 (R4, tab 3 at 2, tab 4 at 1-3). The First Article Test Report (FATR) was due on 17 November 2003, with staggered delivery of the production quantities beginning on 15 April 2004 and ending with a final delivery installment on 22 November 2004 (R4, tab 4 at 3-4). The government issued two more delivery orders totaling 2,700 units to be delivered between 22 November 2004 and 22 December 2005 (R4, tabs 12, 28). The delivery schedule for DO No. 0001 was modified three times with the final modification, dated 31 October 2006, requiring the contractor to begin delivery by 15 January 2007 (R4, tabs 47, 67, 89). DO Nos. 0002 (R4, tabs 48, 90) and 0003 (R4, tabs 49, 91) were each modified twice, the final time on 2 November 2006 (R4, tabs 90, 91). The contractor sought the extension in each modification (R4, tabs 43, 66, 88). By the time of termination on 29 March 2007, over three and a half years following contract award, we find that no production quantities had been delivered under the contract (R4, tab 119 at 2).

3. The contract incorporated numerous standard Federal Acquisition Regulation (FAR) clauses by reference including: 52.233-1, DISPUTES (JUL 2002); 52.243-1, CHANGES–FIXED-PRICE (AUG 1987); and 52.249-8, DEFAULT (FIXED-PRICE SUPPLY AND SERVICE) (APR 1984) (R4, tab 2 at 25). Provided in full text, the contract included FAR 52.232-16, PROGRESS PAYMENTS (APR 2003) (R4, tab 2 at 27-31). Of relevance to this appeal, the Progress Payments clause, as quoted from the FAR, provides, in pertinent part, as follows:

> The Government will make progress payments to the Contractor when requested as work progresses, but not more frequently than monthly, in amounts of $2,500 or more

approved by the Contracting Officer, under the following conditions:

....

(c) *Reduction or suspension.* The Contracting Officer may reduce or suspend progress payments, increase the rate of liquidation, or take a combination of these actions, after finding on substantial evidence any of the following conditions:

(1) The Contractor failed to comply with any material requirement of this contract (which includes paragraphs (f) and (g) below).

(2) Performance of this contract is endangered by the Contractor's (i) failure to make progress or (ii) unsatisfactory financial condition.

(3) Inventory allocated to this contract substantially exceeds reasonable requirements.

(4) The Contractor is delinquent in payment of the costs of performing this contract in the ordinary course of business.

(5) The unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of this contract.

(6) The Contractor is realizing less profit than that reflected in the establishment of any alternate liquidation rate in paragraph (b) above, and that rate is less than the progress payment rate stated in subparagraph (a)(1) above.

....

(f) *Control of costs and property.* The Contractor shall maintain an accounting system and controls adequate for the proper administration of this clause.

> (g) *Reports and access to records.* The Contractor shall promptly furnish reports, certificates, financial statements, and other pertinent information reasonably requested by the Contracting Officer for the administration of this clause. Also, the Contractor shall give the Government reasonable opportunity to examine and verify the Contractor's books, records, and accounts.
>
> ....
>
> (m) Progress payments under indefinite—delivery contracts. The Contractor shall account for and submit progress payment requests under individual orders as if the order constituted a separate contract, unless otherwise specified in this contract.

During performance the parties were expected to comply and perform in accordance with various contract requirements concurrently. In an attempt to present an understanding of the events that occurred during performance, and the parties' respective actions relating to each of the pertinent contract clauses, we will discuss each relevant topic individually.

Higher-Level Contract Quality Requirement

4. Incorporated into the contract and of critical importance to the successful performance of the contact was FAR 52.246-11, HIGHER-LEVEL CONTRACT QUALITY REQUIREMENT (FEB 1999). This clause required that the contractor comply with a higher-level quality standard, either the International Organization for Standardization (ISO) 9001:2000 (tailored by excluding paragraph 7.3) or, ISO 9002. (R4, tab 2 at 15, tab G6 at 2) The ISO standard is a quality management system that requires implementation of procedures, record keeping, process analysis, and monitoring the quality of goods produced. The higher-level quality standard was required to make certain that the BFAs were produced in a controlled environment to ensure a consistent product that met contractual requirements. (R4, tab G1 at 4, tab G6 at 1-2)

5. Following award of the contract, during the post-award conference, it was recognized that the contractor had not made an ISO election as required in the solicitation, and it was not currently compliant with either of the ISO standards. From the time of the post-award conference, the government realized that Lan-Cay's lack of ISO compliance would impact the contractor's "ability to present material for acceptance and meet the contract delivery schedule." (R4, tab 5 at 3, tab G20 at 29)

6. By e-mail of 22 September 2003, Lan-Cay notified the government that it had hired personnel to work on the implementation of the ISO 9001:2000 standard and that the new employee would be receiving third-party instruction on the standard. In the same e-mail, the contractor requested two years to bring itself into compliance. (R4, tab 6) The employee hired to implement the ISO standard had no previous experience with ISO compliance (R4, tab G22 at 6, 9). In its 23 September 2003 response, the government pointed out that 1,500 items were scheduled to be delivered during the first year. Eventually, the government agreed to allow Lan-Cay one year to comply with the ISO terms of the contract (R4, tab 10). By letter dated 20 January 2005, the government informed Lan-Cay that a determination had been made, that Lan-Cay "has implemented a quality system which meets the existing contractual requirements." The same letter cautioned that DCMA would conduct subsequent audits to measure Lan-Cay's adherence to its Quality Policy and Procedures Manual. It does not appear that the government conducted an audit prior to this determination, but relied upon a third-party, Innovative Productivity Inc., who performed an ISO 9001 readiness audit. (App. supp. R4, tab 125)

7. On 26 April 2006, the government sent a team of quality and product assurance specialists to Lan-Cay "to conduct a cursory review of the contractors [sic] production methods, quality system and delivery status." The result of the inspection, with regard to the BFA contract, was that the government had concern "with the amount of scrapped product and recommended that Lancay [sic] implement an adequate incoming receiving inspection." (R4, tab 163) Following this inspection, a Mandatory Product Verification Inspection (PVI) was implemented; once Lan-Cay achieved successful completion of one production lot, this mandatory inspection could be reduced (R4, tab 164).

8. Also following the April inspection, it was decided that the government would conduct a Quality System Evaluation (QSE) Audit of Lan-Cay. This audit was conducted between the 26th and 29th of June 2006. (R4, tab 167) The audit results revealed that Lan-Cay had not "established, documented, implemented, maintained and continually improved a Quality Management System in accordance with the ISO 9001:2000 standard" (R4, tab 169 at 1).

9. In its 5 September 2006 response to the results of the audit, Lan-Cay did not dispute the QSE findings but instead addressed 47 issues identified, and confirmed remedial actions taken in response to the QSE audit findings (R4, tab 82). We find that appellant had not brought itself into compliance with the higher-level quality requirements of the contract prior to the date of contract termination.

<u>Phosphate Coating</u>

10. Another contract clause relevant to this appeal was a requirement for phosphate coating (R4, tab 2 at 10). The Contract Data Requirements List stated that

"PRIOR TO PRODUCTION, APPROVAL [OF THE PHOSPHATE COATING PRE-PRODUCTION PROCEDURE] THROUGH THE CONTRACTING OFFICER IS REQUIRED WITHIN 60 DAYS AFTER CONTRACT AWARD" (R4, tab 2 at 52, 54). Lan-Cay was reminded of this requirement during the post-award conference discussion of the first article test (FAT) (R4, tab 5 at 4). Following multiple attempts to comply with the contract's phosphate coating requirement, on 7 June 2005, more than 21 months following award, Lan-Cay's revised phosphate coating procedures were approved (R4, tabs 21, 29, 34-36, 38-40, G1 at 5). There is no evidence that the lengthy time needed by Lan-Cay to receive approval of its phosphate coating procedures was the result of government delays. On the contrary, Lan-Cay was remiss in resubmitting its phosphate coating procedures for over nine months during this period from 16 July 2004 to 27 April 2005, while the government solicited Lan-Cay for the resubmittal (R4, tabs 21, 29, 34-36, 38).

The First Article Test

11. The contract contained clause Section E – Inspection and Acceptance, including subpart E-4, First Article Test (Contractor Testing) (Mar 2001) which provides in relevant part:

> a. The first article shall consist of:
>
> Three (3) each 9324931, Blank Firing Attachment to include all assemblies, subassemblies, and components which shall be examined and tested in accordance with contract requirements, the item specification(s), Quality Assurance Provisions (QAPs) and all drawings listed in the Technical Data Package.
>
> b. The first article shall be representative of items to be manufactured using the same processes and procedures and at the same facility as contract production. All parts and materials, including packaging and packing, shall be obtained from the same source of supply as will be used during regular production. All components, subassemblies, and assemblies in the first article sample shall have been produced by the Contractor (including subcontractors) using the technical data package applicable to this procurement.
>
> c. The first article shall be inspected and tested by the contractor for all requirements of the drawing(s), the QAPs, and specification(s) referenced thereon....

....

d. The Contractor shall provide to the Contracting Officer at least 15 calendar days advance notice of the scheduled date for fir[st] inspection and test of the first article. Those inspections which are of a destructive nature shall be performed upon additional samp[le] parts selected from the same lot(s) or batch(es) from which the first article was selected.

e. A First Article Test Report shall be compiled by the contractor documenting the results of all inspections and tests (includi[ng] supplier's and vendor's inspection records and certifications, when applicable). The First Article Test Report shall include actual inspection and test results to include all measurements, recorded test data, and certifications (if applicable) keyed to each drawing, specification and QAP requirement and identified by each individual QAP characteristic, drawing/specification characteristic and unlisted characteristic. Evidence of the QAR's [Quality Assurance Representative] verification will be provided. One copy of the First Article Test Report will be submitted through the Administrative Contracting Officer to the Contracting Officer with a copy furnished to AMSTA-AR-QAW-C.

f. Notwithstanding the provisions for waiver of first article, an additional first article sample or portion thereof, may be ordered by the Contracting Officer in writing when (i) a major change is made to the technical data, (ii) whenever there is a lapse in production for a period in excess of 90 days, or (iii) whenever a change occurs in place of performance, manufacturing process, material used, drawing, specification or source of supply. When conditions (i), (ii), or (iii) above occurs, the Contractor shall notify the Contracting Officer so that a determination can be made concerning the need for the additional first article sample or portion thereof and instructions provided concerning the submission, inspection, and notification of results. Costs of the additional first article testing resulting from any of the causes listed herein that were instituted by the contractor and not due to changes directed by the Government shall be borne by the Contractor.

(R4, tab 2 at 15-16)

12. On 3 January 2005, the contracting officer inquired from Lan-Cay as to the status of the FATR (R4, tab 32). Two months later, by email of 2 March 2005, Lan-Cay provided the government with its 15-day notice of the FAT to begin on 17 March 2005 (R4, tab 31). From the record, it is evident that the testing did not occur on 17 March due to issues Lan-Cay incurred gaining approval of its vendor's test facility (R4, tab 32).

13. By the end of March 2005, small cracks in the casted pieces of the First Article (FA) were discovered causing them to be rejected. At that time, the contractor estimated a 30-day delay to correct the problem while the government estimated more than a 60-day delay in the FAT. (R4, tab 145)

14. On 31 May 2005, the FAT was performed which resulted in the issuance of a "Written Corrective Action Request." The government required the contractor to provide a written corrective action report which was to include Certified Test Results by 30 June 2005, stating that multiple deficiencies were noted and that these discrepancies appeared to be systemic. (R4, tab 41)

15. The FATR was sent to the government on 30 June 2005 and received on 6 July 2005 (R4, tabs 44, 146 at 1). The government began its review of the test results shortly after receipt, but suspended the review on 20 July 2005 after realizing that "not all of the required inspection data and process certifications along with the related test reports were included in [Lan-Cay's] report." The government began its second review of the test results on 8 August 2005 with the report being rejected on 18 August 2005 due to missing inspection data and non-conforming characteristics. The government received Lan-Cay's third test report, its second resubmittal, on 14 November 2005, and reported its results on 16 November 2005 which included follow-up questions for Lan-Cay. On 21 November 2005, the government completed its review of the FATR and recommended approval to the contracting officer. (R4, tabs 51, G3 at 1-2, enclosures 1, 3, 5) We find the government's reviews of appellant's FATR submissions to have been done in a timely fashion and in accordance with contract requirements.

16. The FATR was originally due to be delivered to the government 90 days after award (R4, tab 2 at 8). However, Lan-Cay failed to meet this delivery date. Eventually, a modification was issued which extended the delivery date for the FATR until 30 September 2005 (R4, tab 47 at 3). Lan-Cay also failed to meet the revised delivery date. By far, the greatest amount of time lost during contract performance accrued while awaiting a satisfactory FATR from the contractor. While the FATR was originally due 90

days after award, it took Lan-Cay from the contract award on 21 August 2003, until 14 November 2005—more than two years—to meet this contract requirement.

17. By e-mail dated 28 November 2005, Lan-Cay notified the government that its investment casting contractor, Precision Casting of Tennessee, had filed for bankruptcy, resulting in a possible change of vendors to Dafco in Louisville, Kentucky. In the same e-mail, Lan-Cay requested a 90-day extension of the delivery schedule (R4, tab 61). On 7 December 2005, Lan-Cay revised its request to a 120-day extension to accommodate the time necessary to obtain approval of samples from the new vendor (R4, tab 64).

18. The government responded by e-mail of 15 December 2005. In its response, the government reminded the contractor that in accordance with contract requirements, the change in a casting vendor required FAs be produced for approval, the government also solicited new dates to meet the FA and production quantities requirement. (R4, tab 65) Eventually, contract Modification No. 02, issued 20 December 2005, incorporated these extensions with delivery of 200 units to begin on 30 May 2006 for which Lan-Cay offered consideration of $300 (R4, tab 67).

19. Subsequently on 31 January 2006, Lan-Cay notified the government that it would be returning to its original investment casting vendor, who was only reorganizing under Chapter 11 and was still available for production work (R4, tab 68). We find that the extension of time granted in contract Modification No. 02, while within the discretion of the contracting officer, was not in response to an excusable delay. The contract's Default clause, FAR 52.249-8(c), (d), does not excuse the prime contractor for delays caused by the bankruptcy of its subcontractor, which we find to have been recognized by the contractor in its offer of consideration to the government for the extension.

Acceptance Inspection Equipment Approval

20. Provided in full text, the contract included TACOM-RI 52.246-4531, ACCEPTANCE INSPECTION EQUIPMENT (AIE) (MAR 2001) (R4, tab 2 at 16-17). Of relevance to this appeal, the AIE clause provides as follows:

> (a) The contractor shall use a calibration system with traceability to a national or international standard for the AIE used on this contract.
>
> (b) The contractor shall provide all AIE (except for any AIE listed as available in Section H or Appendix I) necessary to assure conformance of material to the contract requirements.

(c) AIE shall be available for use on the First Article (FA) submission, if FA is required, or prior to use for acceptance of production material on this contract.

(d) Contractor furnished AIE shall be made (i) to the AIE designs specified in Section C, or (ii) to any other design provided the contractor's proposed AIE design is approved by the Government. Contractor's proposed AIE design for inspection of characteristics listed as "Critical, Special or Major" shall be submitted to the Government for review and approval as directed on the Contract Data Requirements List, DD Form 1423. Government approval of AIE design shall not be considered to modify the contract requirements.

(e) When the contractor submits it's [sic] proposed AIE on commercial off the shelf equipment, the contractor shall include the manufacturer's name and model number, and sufficient information to show capability of the proposed AIE to perform the inspection required. When submitting proposed AIE design documentation on commercial computer controlled test and measuring equipment include information on (1) test program listing (2) flowcharts showing accept and reject limits and computer generated test stimuli (3) calibration program listing (4) sample of the printout of an actual test and calibration (5) test plan to verify accuracy of inspection and correctness of accept or reject decision (6) identification of the equipment by model name and number.

(f) Resubmission of the contractor's proposed AIE design for Government approval on a follow on Government contract is not required, provided the inspection characteristic parameters specified in the technical data package and the previously Government approved AIE designs have not changed. In this situation, the contractor shall provide written correspondence in the place of the AIE designs that indicates the prior Government approval and states that no changes have occurred.

(g) The Government reserves the right to disapprove, at any time during the performance of this contract, any AIE that is not accomplishing its intended use in verifying an inspection or test characteristic.

> (h) If the contractor changes the design after the initial approval, the modified design must be submitted for approval prior to use.

21. The minutes of the 8 September 2003, post-award conference stated that "Lan-Cay to submit acceptance inspection equipment (AIE) designs for critical and major characteristics prior to FAT" (R4, tab 5 at 4). However, the record shows that Lan-Cay submitted its list of inspection and test equipment sometime between 10 July and 16 August 2006, even though FAT was conducted on 31 May 2005 (R4, tabs 41, 78, G4 at 1). The record contains evidence that the AIE eventually submitted and approved was the same equipment used in the FAT (R4, tab G21 at 153). The contracting officer stated that to assist Lan-Cay in meeting their production schedule, she permitted Lan-Cay to receive AIE approval prior to initiation of production in lieu of FA; however, it was discovered during the government's 25-26 April 2006 plant visit, that Lan-Cay had not submitted its AIE for approval. She further stated that when Lan-Cay did submit its AIE package, it was incomplete. (R4, tab G-1 at 6, tab G-21 at 153) Lan-Cay received conditional AIE approval on 26 September 2006; complete approval was conditioned upon the government receiving the first lot acceptance inspection report (R4, tabs 85, 178 at 11, tab G4 at 1). While it took Lan-Cay from 8 September 2003 until July 2006 to submit its initial AIE submission—34 months, the length of time between Lan-Cay's initial AIE submission and final government approval of the AIE was less than two months.

<u>Lan-Cay's Requests for Deviation (RFD)</u>

22. The contract allows the contractor to submit engineering change proposals and value engineering change proposals as follows:

> 52.248-4502 CONFIGURATION MANAGEMENT DOCUMENTATION (JUL/2001) TACOM RI
>
> The contractor may submit Engineering Change Proposals (ECPs), Value Engineering change Proposals (VECPs)...including Notice of Revisions (NORs), and Request for Deviations (RFDs), for the documents in the Technical Data Package (TDP)....
>
> Contractor ECPs/VECPs shall describe and justify all proposed changes and shall included [sic] NORs completely defining the change to be made[.] Contractors may also submit RFD[s], which define a

> temporary departure from the Technical Data package or other baseline documentation under Government control. The contractor shall not deliver any units incorporating any change/deviation to Government documentation until notified by the Government that the change/deviation has been approved and the change/deviation has been incorporated in the contract.

(R4, tab 2 at 11) We find that under the contract, proposed changes are discretionary and the government's approval or disapproval of the change is not subject to a specific timeline.

23. During the first year of contract performance, and prior to making any RFDs, Lan-Cay reported to the government that it believed there were problems with the drawings for the BFA and requested clarification. Lan-Cay's initial notice to the government was by e-mail dated 7 October 2003 (R4, tab 8), with a follow-up e-mail of 22 October 2003 (R4, tab 11). At the time, Lan-Cay stated that the problems with the drawings "are all minor and can be resolved easily." However, the contractor requested the government clarify the problems before it proceeded with performance. (R4, tabs 11, A4) The problems were resolved in an ECP which was approved by the government on 9 February 2004 (R4, tab 30 at 6-11). By letter dated 12 February 2004, the government informed the contractor of the change and requested Lan-Cay either accept and acknowledge the change at no cost to the government and no change to the delivery schedule or inform the government of a firm cost proposal and delivery schedule. On 17 February 2004 Lan-Cay accepted and acknowledged the change at no cost to the government and no change to the delivery schedule. (R4, tabs 15, 30, G1 at 4-5)

24. During performance, Lan-Cay submitted two RFDs. The first was requested on 20 October 2006, to increase the boss diameter of a specific part, approved on 3 January 2007 (R4, tab 94 at 3). The second was made on 5 December 2006, to substitute the contract-specified .186-.002 (mm) wire with 3/16 (inch) wire, which was approved on 24 January 2007 (R4, tabs 92, 97). These RFDs were incorporated into the contract by Modification No. P00005 (R4, tab 98). We find that the RFDs were requested to make it easier for Lan-Cay to produce the BFAs (R4, tab G1, ¶ 13).

The Default Clause

25. The contract incorporated by reference FAR 52.249-8, DEFAULT (FIXED-PRICE SUPPLY AND SERVICE) (APR 1984) (R4, tab 2 at 25). In pertinent part, the April 1984 version of the Default clause provides as follows:

(a) (1) The Government may, subject to paragraphs (c) and (d) of this clause, by written notice of default to the Contractor, terminate this contract in whole or in part if the Contractor fails to–

(i) Deliver the supplies or to perform the services within the time specified in this contract or any extension;

(ii) Make progress, so as to endanger performance of this contract (but see subparagraph (a)(2) of this clause); or

(iii) Perform any of the other provisions of this contract (but see subparagraph (a)(2) of this clause).

(2) The Government's right to terminate this contract under subdivisions (a)(1)(ii) and (1)(iii) above, may be exercised if the Contractor does not cure such failure within 10 days (or more if authorized in writing by the Contracting Officer) after receipt of the notice from the Contracting Officer specifying the failure.

....

(c) Except for defaults of subcontractors at any tier, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Contractor. Examples of such causes include (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance the failure to perform must be beyond the control and without the fault or negligence of the Contractor.

....

(g) If, after termination, it is determined that the Contractor was not in default, or that the default was excusable, the rights and obligations of the parties shall be the same as if the termination had been issued for the convenience of the Government.

The First Show Cause Letter/Progress Payments

26. By letter dated 23 March 2006, ACO Lynn Ruehl informed appellant that its accounting system was considered "adequate to support progress payments for direct material costs only" (app. supp. R4, tab A28). The letter was silent as to the availability of progress payments based on appellant's compliance with the quality requirements of the contract. The government provided a declaration from ACO Ruehl which gives needed context to her previous statement. She declared that this rating was based on a DCAA Post Award Accounting System Review dated 20 March 2006. ACO Ruehl also indicated that she considered this review and a DCMA post award financial report rating Lan-Cay's financial risk rating as high and the financial rating as unsatisfactory, as "background information should Lan-Cay officially request progress payments." (R4, tab G5 at 2-3)

27. On 10 May 2006, ACO Ruehl visited appellant's facility to discuss contractual issues. ACO Ruehl further declared: "we all agreed that the issues of Acceptance Inspection Equipment (AIE) and material shortages must be resolved before DCMA would consider progress payments due to the need to balance risk to the government against enabling the contractor to perform" (*id.* at 2). The record also shows that in the June 2006 timeframe, the government informed Lan-Cay that it was unable to receive progress payments because of quality issues (R4, tab 77).

28. By letter dated 26 July 2006, the government issued Lan-Cay the first show cause letter under the contract. The government cited to the contractor's failure to perform in a timely manner under DO No. 0001. (R4, tab 76) By letter of 8 August 2006, Lan-Cay responded to the show cause letter. Lan-Cay explained that its failure to make progress was due to a compilation of factors which had multiplied into a situation where Lan-Cay was in a financial bind having to put some orders to vendors on hold. Specifically, Lan-Cay cited to the contract requirement to meet ISO 9000/2001 as costing large sums of money and causing delays while attempting to comply. Further, the contracting officer had told it this failure to comply with ISO 9000/2001 resulted in Lan-Cay's ineligibility for progress payments, which it needed to complete performance. (R4, tab 77) In its 24 August 2006 response, the government stated it was within the contracting officer's discretion to withhold progress payments if the contractor failed to comply with a material requirement of the contract, or performance was endangered by the contractor's failure to make progress. The letter further directed that progress payments would not be authorized until Lan-Cay had received approval of its AIE, which was currently defective, and made necessary corrections to its quality system. Lastly, the government gave the contractor 90 days to cure the conditions endangering performance. (R4, tab 79)

29. The parties continued to work through the technical issues and appellant was given conditional AIE approval on 26 September 2006 (R4, tab 86). Appellant submitted its first progress payment request (Progress Payment No. 1) in October 2006 (app. supp. R4, tab A29; R4, tab G5). After several resubmittals of Progress Payment Request No. 1 to the government during the months of November and December 2006, ACO Ruehl informed Lan-Cay, by letter dated 8 February 2007, that its submission was considered "inadequate for processing." This decision was based upon a DCAA Audit Report dated 31 January 2007. ACO Ruehl also informed appellant that its 16 January 2007 resubmittal of Progress Payment Request No. 1 was under review by DCAA. (R4, tab 108)

30. By letter dated 6 April 2007, ACO Ruehl notified Lan-Cay that DCAA concluded that appellant's "supporting records are inadequate and that the request for payment should not be processed" (R4, tab 118).

31. It is clear from the record that Lan-Cay did not have the contractually obligated quality system in place prior to contract termination (finding 9) and that appellant was unable to produce conforming goods. Thus, we find that based on Lan-Cay's failure to comply with material requirements of the contract, appellant was not eligible for progress payments.

Corrective Action Request (CAR) 06-06

32. Following a December 2006 inspection, the government sent Lan-Cay CAR No. 06-06, dated 19 December 2006. The CAR listed 20 nonconformities detected during the prior inspection, ten of which were identified as faults in major characteristics of the part to be supplied. The government suggested that the nonconformities may have been indicative of problems Lan-Cay may have been experiencing in their overall system. (R4, tab 93) Lan-Cay's 12 January 2007 CAR reply admitted some of the findings while contesting others, but the tone of the response noted its dissatisfaction with the government's inspector stating that the CAR amounted "to mostly unjust nit picking," speculating that they "will never be allowed to ship anything as long as [the inspector was] involved in the final inspections," and suggesting that perhaps the inspector had "personal gain in seeing [Lan-Cay] fail." (R4, tab 95) We find that the inspected products did not conform to the contract requirements.

The Second Show Cause Notice

33. By letter dated 24 January 2007, the contracting officer (CO) sent a second show cause notice to the contractor, this time for failure to perform in accordance with the delivery date of 15 January 2007, as prescribed in DO No. 0001. The notice gave Lan-Cay ten days to respond to the CO with an explanation of any excusable delays. (R4,

tab 96) By letter dated 6 February 2007, which was 22 days following the government's show cause letter—apparently overdue, Lan-Cay responded to the show cause notice giving examples of how the delays were government caused. The focus of the reply was on the length of time the government took in commencing and completing a December 2006 inspection and associated report, as well as the government's failure to make progress payments and the time consuming nature of repeated inspections and audits without timely government responses to these events. (R4, tab 107) By letter dated 8 February 2007, the government responded to the contractor's grievance over the lack of progress payments. The government noted that the direct material costs submitted by Lan-Cay included costs from various delivery orders associated with this contract. Further, according to a DCAA audit, DCAA was unable to extract information pertaining to DO No. 0001 from other invoices Lan-Cay submitted. Because of this, DCAA found that the request was inadequate and recommended rejecting the progress payment request. (R4, tab 108) DCAA again conducted an audit on 30 March 2007, and found appellant's second submission for progress payments to also be inadequate due to Lan-Cay's failure to submit costs according to individual delivery orders and utilize a billing system that ensured progress payments requests were prepared in accordance with the FAR (R4, tab 118). Other than the undisputed fact that the government was not making progress payments, which we find that the CO properly withheld, the conclusory allegations of Lan-Cay's 6 February 2007 response are not supported by corroborative evidence.

The Notice of Termination for Default

34. By letter dated 29 March 2007, the CO issued a notice of termination under the contract's default clause for all three delivery orders because of Lan-Cay's failure to meet scheduled delivery dates (R4, tab 117). The government confirmed the termination by letter dated 14 May 2007. The confirmation letter indicated that the CO had considered all of the FAR 49.402-3(f) termination factors and set out specific findings regarding the reasons for terminating the contract including: (1) the failure to perform and deliver supplies; (2) the failure to perform in accordance with the Quality Management System of ISO 9001:2000; and (3) Lan-Cay's failure to make progress on the contract and such failures were not shown to be beyond its control, or without the fault or negligence of the contractor. (R4, tab 119)

35. On 15 August 2007, appellant filed a timely notice of appeal. The appeal was docketed as ASBCA No. 56140.

Additional Facts

36. Appellant submitted affidavits wherein appellant maintains that the government's QAR was overzealous and at the root cause of delays (app. supp. R4, tab A32). We find that the specific details of the allegations put forward in the affidavits

are not supported by the record produced contemporaneously with contract performance. Even after the government's QAR was replaced, Lan-Cay found fault with the replacement for several reasons, including the purported fact that she was trained by the previous QAR (app. supp. R4, tabs A17, A26). Moreover, we find that these three affidavits consist of personal attacks, argument, hearsay and conjecture, and lack credibility.

37. The government rebutted allegations of overzealous inspection with evidence that government inspections were actually less stringent than required by government procedures; and in at least one case, the government customer reported an additional 56 discrepancies beyond those reported by the government inspector on the first articles (R4, tab G6 at 3, tab G17 at 1-2). As evidence that the technical data package was accurate, the government also offered testimony that one contract awarded prior to Lan-Cay's contract, and two contracts awarded following termination included the same technical data package as Lan-Cay's contract, and with the exception of one minor ECP, 9,500 BFAs were successfully produced and supplied to the government on these three contracts (R4, tab G1, ¶ 18, tab G15, ¶ 2b).

DECISION

Termination for default is a drastic sanction wherein the government bears the burden of proving, based on sound evidence and analysis, that the termination was justified. *Lisbon Contractors, Inc. v. United States,* 828 F.2d 759, 765-66 (Fed. Cir. 1987). If the government satisfies its burden of proving that the termination for default was justified, appellant must prove that its default was excusable in order to overturn the termination, *DCX, Inc. v. Perry,* 79 F.3d 132, 134 (Fed. Cir. 1996); or that the CO's default decision was arbitrary or capricious or an abuse of the CO's discretion. *Darwin Construction Co. v. United States,* 811 F.2d 593, 598 (Fed. Cir. 1987). Appellant makes five arguments which we will address individually.

Appellant's first contention is that the government improperly terminated the contract and has failed its burden of proof to show otherwise. We disagree. The government has gone to great lengths to show that it made every attempt to promote a successful contract from granting numerous extensions of time, to replacing the government's quality representative when pressed by the contractor (finding 32). However, by the time the contract was terminated, there is no dispute, the delivery date for DO No. 0001 had passed without the delivery of any BFAs; therefore the government has met its burden that the termination was properly within the terms of the default clause, FAR 52.249-8(a)(1)(i) (finding 25).

Lan-Cay argues that the government has not met its burden, contending that under 41 C.F.R. § 1-18.803-5(a)(3) the government had a "duty to undertake a study to determine whether [Lan-Cay] could complete the work within the required time, or determine how long it would take a follow-on contractor to do the work." (App. resp. br. at 3)

Initially, we address the fact that the cited regulation, 41 C.F.R. § 1-18.803-5(a)(3) (1984) is no longer in existence having been superseded by the Federal Acquisition Regulation (FAR) that went into effect on 1 April 1984. 41 C.F.R. Subtitle A, Editorial Note. However, we note that the regulation cited to by appellant applied exclusively to the termination of construction contracts, as it was titled, and is therefore irrelevant to our discussion. Nevertheless, with regard to supply contracts, the current regulation that appears to convey the nearest meaning to that advocated by appellant is found at FAR 49.402-3(f)(4) which advises that the contracting officer shall consider several factors in determining whether to terminate for default including: "[t]he urgency of the need for the supplies or services and the period of time required to obtain them from other sources, as compared with the time delivery could be obtained from the delinquent contractor." As we found above, the CO did, in fact, consider those factors. (*See* finding 34)

Lan-Cay also attempts to enlarge the government's burden of proof by claiming the government had a duty to show that Lan-Cay's failure to deliver was due to Lan-Cay's own fault. As we stated above, the government bears the burden of proving, based on sound evidence and analysis, that the termination was justified, once this burden is met, it is incumbent upon Lan-Cay to prove that its failure to deliver was excusable.

Appellant further contends that "the government failed to make any progress payments at all throughout the entirety of the contact in direct violation of the terms of the contract and without viable contract based reasons" (app. br. at 6).[3] The government counters that it properly withheld progress payments because Lan-Cay was not in compliance with two material terms of the contract, the Higher-Level Quality Requirement and the AIE clause (gov't br. at 66).

In order for the contractor to be excused for failure to perform as a result of the government's withholding of progress payments, the contractor must show that the government wrongfully refused to make progress payments. *Local Contractors, Inc.*, ASBCA No. 37108, 92-1 BCA ¶ 24,491, *recon. denied*, 92-1 BCA ¶ 24,693, *aff'd*, 988

[3] We note that appellant's 12th proposed finding of fact alleges that "Lan-Cay submitted a claim for damages to the contracting officer, based on breach of contract, defective specifications; Government caused delays, overzealous inspection and breach of the Governments [sic] duty not to hinder performance of the contract, and government breach due to the government's failure to make the contract required progress payments." However, there is no evidence to support this allegation, nor is such a claim before us in this appeal. (App. br. at 4)

F.2d 131 (Fed. Cir. 1993) (table) (contractor's failure to provide first articles not excused by the government's failure to make progress payments); *Meyer Labs, Inc.*, ASBCA No. 18989, 83-2 BCA ¶ 16,598 (suspension of progress payments for failure to make progress did not constitute wrongful action). Pursuant to the Progress Payments clause of the contract, the contracting officer may reduce or suspend progress payments if the contractor fails to comply with any material requirement of the contract and if contract performance is endangered by the contractor's failure to make progress or unsatisfactory financial condition.

The Progress Payments clause does not mandate payment. It is conditional. In *McDonald Welding & Machine Co.*, ASBCA No. 36284, 94-3 BCA ¶ 27,181, *aff'd*, 66 F.3d 347 (1995) (table), we upheld the government's right to withhold progress payments under an earlier version of the same clause on the basis the contractor's accounting system was not adequate and its unliquidated progress payments exceeded the fair value of the work remaining under the contract. Here, we found that Lan-Cay failed to meet the higher level contract requirements (finding 9) and did not deliver a conforming product in accord with the contract (findings 32, 33). Lan-Cay's failure to submit and receive approval of its AIE (finding 28) also strengthens the government's position. Under the circumstances in this appeal, we conclude that the ACO properly withheld progress payments upon her finding that Lan-Cay failed to comply with material requirements of the contract, and failed to correct the deficiencies.

Likewise, Lan-Cay's contention that the government was in violation of FAR 52.232-9, LIMITATION ON WITHHOLDING OF PAYMENTS, is also without merit. We note that FAR 52.232-9 was not included in the contract and is only a required clause when applicable in accordance with FAR 32.111(c)(2). However assuming, *arguendo*, the clause was included in the contract, it still would not be a barrier to the contracting officer withholding progress payments, as the clause refers to the "temporary withholding of amounts *otherwise payable to the Contractor...*" (emphasis added). Here, the contracting officer was not temporarily withholding amounts otherwise payable, the amounts were simply not payable under the terms of the Progress Payments clause as explained above.

Appellant's third argument is that the government caused delays in contract performance by supplying defective specifications, conducting two improper audits, and overzealous actions of the government's quality assurance representative.

With regard to the alleged defective specifications, we found by appellant's own admission that the defects to the original specifications were minor errors, easily correctable (finding 23). Likewise, the record also contains evidence that the specifications issued with the contract had been used successfully in one prior and two subsequent contracts (finding 37). Further, the two RFDs that were submitted by the contractor were discretionary and we believe that the amount of time spent by the government to approve the requests was reasonable (finding 24). Therefore, we hold that the specifications were not defective in such a way as to result in an appreciable delay in contract performance.

We find no support for appellant's allegation that the government performed two improper audits. As reported in the facts above, the government conducted both quality audits as well as financial audits. The quality audits were reasonably conducted after an on-site inspection raised concerns. (Findings 7, 8) The financial audits are a condition of the Progress Payments clause, found at FAR 52.232-16(g) (finding 3). Therefore, we hold that appellant has failed to support its allegation of improper audits; on the contrary, we conclude that the government had the right to conduct the aforementioned audits under the terms of the contract.

The final allegation of appellant's third argument is that the government's quality assurance representative was overzealous and committed intentional actions, presumably with the intention to delay performance. While the record contains affidavits to this effect, we found they lack credibility and consist of personal attacks (finding 36). We hold that the contemporaneous record produced during performance demonstrates that the root cause of Lan-Cay's failure to deliver, was its failure to comply with the exacting specifications required by the contract. The government's need for a BFA produced with exacting standards is evidenced by the contract's inclusion of the Higher-Level Contract Quality Requirement clause, to which Lan-Cay did not adhere. There is substantial evidence that during performance Lan-Cay did not contest the bulk of the results of government inspections, other than to call them unjust nit picking, on the contrary, the contractor addressed most of the government's noted defects by indicating they would correct the problem. While it may have appeared to appellant that the QAR was overzealous, the contract included exacting specifications to which the contractor agreed to comply, and an inspector demanding strict compliance with the contract requirements does not render an otherwise valid termination for default invalid. Accordingly, appellant's allegation is without merit.

The fourth argument advanced by appellant is that the government supplied appellant with defective specifications and appellant was burdened with the task of correcting the specifications at the contractor's time and expense. This argument presents the same theory as offered in appellant's third argument, which we held to be meritless as appellant had the opportunity to address this in the ECP; further, the RFDs were approved for the benefit of the contractor (finding 24).

The final argument advanced by appellant was that the government hindered performance with the actions and inactions of the quality control and quality assurance person. As we discussed above, other than appellant's affidavits which attempt to discredit the government's quality assurance representative with rumors of a derogatory nickname and lack of skill, the fact is that if Lan-Cay was complying with contract specifications and requirements, the time for demonstrating that they were performing in compliance with the contract, was during performance. However, the evidence is overwhelmingly to the contrary, particularly in light of the fact that even appellant has admitted that the cost of performing in compliance with the higher-level contract quality requirement had cost large sums of money and caused delays, which we found had the result of causing Lan-Cay to be ineligible for progress payments, further exacerbating the problem (findings 31, 32).

As part of its allegation that the government's quality representatives hindered performance by actions and inactions, is the sub-allegation that "[t]he Government improperly audited the appellant twice in order to find and make up a reason not to pay progress payments in violation of the terms of the contract" (app. br. at 2). We consider this allegation to be without merit. As we previously found, at least two contract clauses allow for government inspections, including the Progress Payments clause (finding 3) and the Higher-Level Contract Quality Requirement clause (finding 4). The fact that a considerable amount of time had passed since the contract award without any delivery would most certainly call into question the performance of the contractor, thereby justifying the need for an audit. The results of the audit disclose the basis for denying progress payments. For the contractor to claim that the government "made up" a reason to deny progress payments is simply without legitimacy.

CONCLUSION

We conclude that the termination was proper under the Default clause for failure to deliver within the time specified by the contract, including modifications. Accordingly, the appeal is denied.

Dated: 23 January 2012

OWEN C. WILSON
Administrative Judge
Armed Services Board
of Contract Appeals

(Signatures continued)

I concur

MARK N. STEMPLER
Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

I concur

EUNICE W. THOMAS
Administrative Judge
Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 56140, Appeal of Lan-Cay, Inc., rendered in conformance with the Board's Charter.

Dated:

CATHERINE A. STANTON
Recorder, Armed Services
Board of Contract Appeals