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OMB Should Clarify Plan To Pay Contractors' COVID-19 Costs

By **Robert Nichols, Andy Liu and David Bodenheimer** (May 8, 2020, 6:42 PM EDT)

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In Pernix Serka Joint Venture v. Department of State,[1] the Civilian Board of Contract Appeals recently sided with the government in refusing to pay contractor costs caused by the Ebola epidemic. This case, combined with the noncommittal positions taken by the U.S. Office of Management and Budget and various agencies, raises the risk that contractors and nongovernmental organizations, or NGOs, will be unable to recover costs related to the COVID-19 pandemic.

The government should make clear its intentions about paying for COVID-19 cost impacts so that contractors and NGOs can have certainty before they continue incurring these costs.

This article begins by presenting the holding in Pernix. It then describes how a lack of clear federal guidance on the recoverability of COVID-19 cost impacts is likely to undermine the contractor industrial base and unnecessarily lead to years of claims litigation.

Finally, the article ends with a call to the OMB to issue clear guidance to contractors and contracting agencies alike stating that COVID-19 cost impacts are presumptively recoverable, subject to clear limitations, and provides model language for such guidance.

CBCA Upholds Agency Refusal to Pay Ebola Costs

The Pernix case was decided April 22, but the costs at issue date back to the Ebola outbreak in Africa in 2014. The contractor had a firm, fixed-price contract with the U.S. Department of State to construct a rainwater capture and storage system in Sierra Leone. In 2014, while Pernix was working on the rainwater system, an Ebola virus outbreak spread to Sierra Leone.

Pernix, concerned about the safety of its personnel, asked the State Department for guidance on how to proceed. The agency, however, declined to provide any guidance as to whether Pernix should leave the job site.

After the World Health Organization declared the Ebola outbreak an international health emergency, and in the absence of government guidance to the contrary, Pernix unilaterally decided to shut the project down and evacuate the work site. Over the next few months, Pernix met with State Department representatives to discuss the ongoing Ebola crisis. Each time, the State Department told Pernix that the company was on its own and that the agency would not provide any additional guidance on whether Pernix should restart the project.

In March 2015, after it been off the job for several months, Pernix returned to the worksite. For the safety of its personnel, Pernix expanded its medical facilities on the site and hired a licensed paramedic.

A few months later, Pernix submitted requests for equitable adjustment, or REAs, to the State Department for (1) costs associated with the additional medical facilities, and (2) delays and additional work that Pernix had to perform as a result of the epidemic. The State Department either denied or took no action on the REAs.

Pernix then submitted certified claims for the Ebola-related costs. The State Department denied the claims, and Pernix appealed to the CBCA. The State Department moved for summary judgment on Pernix's appeal.

The board found that the agency acted properly in refusing to pay the Ebola-related costs. The board first observed that Pernix had a firm, fixed-price contract with the State Department. A contractor with a firm-fixed price contract assumes the risk of unexpected costs not attributed to the government. Pernix's firm, fixed-price contract obligated it to receive only the fixed price.

The contract's provision regarding excusable delays stated that Pernix would be allowed time, not money, for excusable delays. The contract defined excusable delays as, among other things, acts of God, epidemics and quarantine restrictions. As such, the CBCA held, Pernix was obligated to bear any additional costs of contract performance.

Still, Pernix asserted several theories in an attempt to shift the risk of increased costs to the government. First, Pernix alleged there had been a cardinal change. A cardinal change is a breach that occurs when the government makes such a drastic change to the contractor's work that the contractor is performing duties materially different from those in the original contract.

The CBCA, however, rejected the cardinal change theory, finding that the State Department never changed the description of work expected from Pernix. In fact, throughout, the agency had repeatedly stated that it would not direct Pernix on how to handle the epidemic.

Pernix also claimed the government was responsible under a constructive change theory. A constructive change occurs when a contractor performs work beyond the contract requirements.

Pernix argued that the demobilization and remobilization of personnel was a constructive change. But this argument failed because the government never specifically instructed Pernix to demobilize or remobilize.

Pernix also argued that there had been a constructive suspension of work. But the CBCA found that this theory relied on a different set of facts than the theories raised in the certified claim. Accordingly, the CBCA lacked jurisdiction to hear this theory.

The result is that the contractor did not recover the extra Ebola-related costs of performing the contract's scope of work. While we take issue with this holding, we anticipate that it will be relevant, and possibly predictive, for some COVID-19 claims. Given that every contractor (and the entire world) is being impacted by COVID-19, it would be better for the government to resolve in advance any ambiguities as to entitlement to reimbursement for these cost impacts.

Vague Federal Guidance on Paying COVID-19 Costs

Contractors and NGOs are suffering over the lack of clear legal guidelines regarding the recovery of cost impacts from COVID-19.

On March 18, the U.S. Army Corps of Engineers issued guidance specifically stating that possible closing of government installations due to COVID-19 would be "acts of the sovereign" that do not require stop-work orders.

We interpret this as shorthand for the idea that the government might assert force majeure as a rationale for not directing, and therefore not compensating contractors for, taking actions to deal with COVID-19.

We have worked with clients and industry associations to encourage the OMB to take a clear position, applicable to all agencies, that the federal government will presumptively pay COVID-19-related costs

incurred by contractors and NGOs, subject to audits for reasonableness.

We have drafted a sample memo for the OMB to issue describing the imperative of such action to maintain the contractor industrial base on which the government is so dependent. We believe enactment of the bipartisan Coronavirus Aid, Relief, and Economic Security, or CARES, Act of 2020, and the role the OMB has played in guiding critical federal procurement policy demonstrates support for this approach by Congress and the president.

The OMB instead has issued guidance that encourages agencies to be flexible with contractors related to COVID-19, but leaving it up to agencies to determine what costs to pay on a contract-by-contract basis.

Section 3610 of the CARES Act authorizes, but does not direct, contracting officers to reimburse contractors for the cost of providing paid leave to their employees and subcontractors who cannot work as a result of the COVID-19 crisis, in order to keep them in a ready state.

In our opinion, such authority was already inherent in the procurement statutes and regulations, so Section 3610 was not necessarily additive. Additionally, it expressly applies only to employees who work at a government-approved site that has been closed or subject to other restrictions.

This suggests that perhaps contracting officers cannot provide the same benefits for contractor personnel not working at government-approved sites. Overall, we find Section 3610 not to be particularly helpful for clarifying how contracting officers are to treat COVID-19-related costs incurred by contractors.

The U.S. Department of Defense arguably has been a leader among the agencies in issuing COVID-19 guidance to contractors. It recently issued a class deviation[3] as well as an FAQ document.[4]

They state that each contractor seeking reimbursement for COVID-19 cost impacts must describe how it has been affected by the COVID-19 pandemic, the actions the contractor has taken to continue performing work under the contract, the circumstances that made it necessary to grant employee leave, an explanation of why it was not feasible for employees to continue performance via telework or other remote work, and how the leave served to keep employees in a ready state.

Contractors also must support any claimed costs with appropriate documentation showing that they identified and segregated these costs in a way that will provide a sufficient audit trail.

The DOD's class deviation includes the new defense federal acquisition regulation supplement, or DFARS, clause 231.205-79, implementing CARES Act Section 3610. Where Section 3610 applies:

> Notwithstanding any contrary provisions of [federal acquisition regulation, or] FAR subparts 31.2, 31.3, 31.6, 31.7 and DFARS 231.2, 231.3, 231.6, and 231.7, costs of paid leave (including sick leave), are allowable at the appropriate rates under the contract for up to an average of 40 hours per week, and may be charged as direct charges, if appropriate, if incurred for the purpose of: (i) Keeping contractor employees and subcontractor employees in a ready state, including to protect the life and safety of Government and contractor personnel, notwithstanding the risks of the public health emergency declared on January 31, 2020, for COVID-19, or (ii) Protecting the life and safety of Government and contractor personnel against risks arising from the COVID-19 public health emergency.
>
> Costs covered by this section are limited to those that are incurred as a consequence of granting paid leave as a result of the COVID-19 national emergency and that would not be incurred in the normal course of the contractor's business. Costs of paid leave that would be incurred without regard to the existence of the COVID-19 national emergency Class Deviation 2020-O0013 CARES Act Section 3610 Implementation Page 6 of 6 remain subject to all other applicable provisions of FAR subparts 31.2, 31.3, 31.6, 31.7 and DFARS 231.2, 231.3, 231.6, and 231.7.

While this language is helpful for the narrow circumstances to which it applies, it is hardly the broad, sweeping commitment to pay COVID-19 costs that contractors need to feel comfortable continuing to incur those costs.

To the contrary, it suggests that the government may pay COVID-19 costs in only narrow circumstances. Other agencies have put out similar guidance suggesting their desire to keep contractor and NGO work forces intact, but making little or no commitments as to whether, when and how they will be reimbursed.

Call for Clarity

As we have previous stated, the federal government is providing hundreds of billions of dollars to small businesses through its Paycheck Protection Program. The vague guidance[5] around that program is coming back to bite the administration. Federal fraud investigators and qui tam lawyers are already circling that program.

The OMB can avoid these problems — and a years-long backlog of claims — by issuing a memorandum that sets clear standards and expectations around the rights and obligations for COVID-19 cost recovery for contractors, including recipients of federal procurement contracts and assistance awards, and their sub-awardees, during the COVID-19 public health emergency.

As stated, federal agencies already have numerous measures and tools available under various statutory authorities, and in the FAR[6] and in the uniform administrative requirements, cost principles, and audit requirements for federal awards.[7]

The OMB could issue a directive that unifies the approach of federal agencies in applying these available tools for maintaining cash flow to, and productivity from, contractors.

The OMB memorandum could stand on its own or, if necessary, facilitate issuance of class deviations from the FAR by the principal director of defense pricing and contracting (for DOD agencies), the Civilian Agency Acquisition Council (for civilian agencies), and the Office of Federal Financial Management.

Set out below is proposed text for such an OMB memorandum. Now is the opportunity for the OMB to act in this way to preserve its contractor industrial base by taking a clear position on cost recovery.

Draft OMB Memorandum

> Congress and the President, in enacting the bipartisan Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, have made clear their intent to save lives while preserving the continuity and capacity of the Federal government and private sector during the public health emergency declared on January 31, 2020 for
>
> COVID-19. The health and safety of all Americans necessitates quarantines and social distancing practices. At the same time, the Federal government must continue operations that meet the needs of our citizens.
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> Private-sector organizations play a vital role in supporting these Federal programs—from providing supplies in the battle against COVID-19 to food and logistics for the military, energy to operate facilities and transportation, defense equipment, cybersecurity and IT services, and basic administrative services.
>
> This Memorandum directs Federal agencies to implement specific measures to ensure the continuity of services and goods from the contractor industrial base (including for-profit and non-profit organizations) on which they depend. [OPTIONAL: It is anticipated that this Memorandum will be implemented through Class Deviations to the Federal Acquisition Regulation, Title 48 of the Code of Federal Regulation ("CFR"), and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, 2 CFR Part 200.]
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> Clear direction and guidance regarding contractor productivity and cost recovery during the COVID-19 health crisis are essential. Without such clarity, many contractors—particularly small businesses and non-profits—may be forced to lay off and furlough their work forces, which would diminish near-term agency performance and damage long-term Federal effectiveness. Reconstituting the contractor workforce is likely to be far more costly and difficult than retaining these resources (productively employed to the extent possible) during this health crisis. Clear direction about Federal expectations and commitments will give contractors the direction and confidence to keep their workforce intact and to take steps to maximize productivity to the extent practicable.
>
> Effective immediately, consistent with the intent of CARES Act and other existing

procurement and grant authorities, Federal agencies shall require their contractors:

1. to continue operations and performance, in accordance with their Federal awards, to the maximum extent practicable while maintaining quarantines and social distancing practices;

2. to evaluate and implement telework for contractor employees, wherever possible, as an important tool for enabling continued contract performance and maximizing contractor productivity[8];

3. to continue to maintain and pay their employees and contractors during the period of any disruptions or closures related to the COVID-19 public health emergency, to the extent required for the performance of current and new awards[9];

4. to provide paid leave to contractor employees who are not able to perform work at their normal place of work due to COVID-19 closures or restrictions and are not able to telework because their duties cannot be performed remotely[10];

5. to make such workforce payments at current levels of wages, salaries, benefits, and other compensation that such contractor paid the employees of such contractor on January 31, 2020;

6. to furlough employees only to the extent directed by agency stop work orders;

7. to grant paid leave or sick leave during this health crisis to the extent necessary;

8. to identify where COVID-19 will impact the contractor's ability to meet the contract requirements to deliver goods and services and where meeting those requirements will require adjustments to the schedules, budgets, and financial ceilings of the contracts, and to submit appropriate requests for equitable adjustment as soon as practicable;

9. to submit requests for equitable adjustments to fixed-price agreements to address the financial impacts of COVID-19;

10. to calculate the impacts of COVID-19 on their provisional indirect rates and to reach agreement with their agencies on temporary adjustments to their indirect rate agreements;

11. to continue invoicing the Federal government under the applicable terms of their cost-type instruments;

12. to maintain records of these measures (including efforts and effectiveness of teleworking) and any impacts on productivity due to COVID-19, and provide access to such records, upon request, for audit[11]; and

13. to flow down these same measures to their subcontractors and suppliers.

Federal agencies also shall, to the maximum extent practicable:

1. continue administering Federal awards and awarding new instruments to maintain government programs and operations;

2. continue timely paying invoices for contractors that are performing productively, that are taking reasonable steps to continue performing productively, or that provide a reasonable explanation, in the discretion of the agency, for why COVID-19 is impeding or delaying performance;

3. consider all COVID-19 related costs to be allowable costs pursuant to FAR Part 31 and 2 CFR Subpart E;

4. use the authority under Section 3610 of the CARES Act to pay the costs of contractor employees and subcontractors that are unable to perform work due to COVID-19, without the need for equitable adjustments wherever possible;

5. modify contracts and grants to reimburseanypaid leave(up to 40 hours per week) thata contractor providesin orderto keep itsor its subcontractors' employeesin a"ready state," provided that theemployees(i)cannot perform workat their regular locationdue to facility closures or other restrictions, and(ii)cannot telework because their job duties cannot be performed remotely, and immediately pay invoices based on leave paid to covered employees;

6. provide equitable adjustments to fixed-price contracts to compensate the contractor for maintaining a "ready" workforce of covered employees;

7. promptly reach agreement with contractors on equitable adjustments to contract

schedules, budgets, and financial ceilings due to COVID-19 impacts, to ensure that the contractor can continue to meet the contract requirements to deliver goods and services;

8. promptly reach agreement with contractors on adjustments to provisional indirect rates agreements to ensure continuity of performance and capacity during the COVID-19 public health emergency;

9. apply these tools "without consideration" so that contractors does not need to concede something of value in exchange for the COVID-19 reimbursement;

10. utilize for such contractor payments the funds made available to an agency by the CARES Act or any other Act available to the agency;

11. utilize these tools equally to contracts, grants, cooperative agreements and task orders, delivery orders, other transactions, and other contractual agreements; and

12. apply a risk-based approach to commence audits of contractor records regarding COVID-19 impacts and workforce productivity to identify and minimize waste, fraud, and abuse during this public health emergency.

Nothing in this Memorandum is intended to shield contractors that misuse these measures from the government's standard remedies of default terminations, suspension and debarment, and civil and criminal penalties for fraud.

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[1] Pernix Serka Joint Venture v. Department of State, CBCA 5683.

[2] https://pubkgroup.com/pubk-webinar/covid19-cost-recovery-for-government-contractors/.

[3] https://www.acq.osd.mil/dpap/policy/policyvault/Class_Deviation_2020-O0013.pdf.

[4] https://www.acq.osd.mil/dpap/pacc/cc/docs/covid-19/FAQ_Implementation_Guidance_CARES_Act_Sec_3610_2020.04.24.pdf.

[5] https://www.forbes.com/sites/jasonbfreeman/2020/05/06/ppp-borrowers-and-false-certifications-last-call-for-sba-amnesty-under-safe-harbor/#2708ff193e99.

[6] Title 48 of the Code of Federal Regulations.

[7] 2 C.F.R. Part 200.

[8] This provision is based on M-20-18, the OMB Memorandum to the Heads of Executive Departments and Agencies, Subject: Managing Federal Contract Performance Issues Associated with the Novel Coronavirus (COVID-19), March 20, 2020.

[9] This provision applies tools described in Section 18006, Continued Payment to Employees, of the CARES Act and which are inherent in the Federal procurement and grants authorities.

[10] CARES Act Section 3610, Federal Contractor Authority.

[11] This provision applies tools described in Section 19010, Access to Information, of the CARES Act and which are inherent in the Federal procurement and grants authorities.
