IN A FIXED PRICE CONTRACT, THE CONTRACTOR GENERALLY ASSUMES THE RISK OF HIGHER COSTS

By Richard D. Lieberman, Consultant and Retired Attorney

Many contractors do not fully understand the implications of a "firm-fixed-price" contract. Agility Defense and Government Services, Inc. (formerly Taos Industries, Inc.) learned the hard way. *Agility Def. & Gov't Svcs.*, 115 Fed. Cl. 247 (2014).

Agility had a firm-fixed-price indefinite quantity contract to deliver Soviet-style weapons in support of the Army's security assistance mission in Afghanistan. In December 2007, the Army issued a $1.3 million fixed price delivery order for 225 SPG-9 recoilless guns (a Soviet anti-tank gun). The guns were to be delivered by April 7, 2008. Agility sought to obtain the guns from both a Hungarian and a Bulgarian company, but both governments refused to release the weapons. Agility did not deliver as required, and still hadn't delivered by two years later, in April 2010. At that time, the Army and Agility signed a bilateral modification agreeing Agility would not meet the contract delivery date, but instead would provide 20,000 YAK-B links as consideration for late delivery. The delivery date of the SPG-9s was "to be determined." No guns were delivered during the next year, and in March 2011, the parties signed another modification setting firm delivery dates dependent upon the Army—but making no change in the contract price.

Agility finally delivered the 225 SPG-9s on December 24, 2011, but requested an equitable adjustment of $1.4 million because it had "incurred significant additional costs as a result of actions/non-actions by foreign sovereign governments outside of its control." Agility filed a certified claim when its equitable adjustment was denied, and the claim was also denied, giving rise to the appeal to the court.

Before explaining what the court did, it is worthwhile to review the types of contracts recognized by the Federal Acquisition Regulation ("FAR"). There are five principal types of contracts. Each is outline in the FAR and summarized below:

> FAR 16.202 **Firm-Fixed-Price Contracts**
> A firm-fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss. It provides maximum incentive for the contractor to control costs and perform effectively and imposes a minimum administrative burden upon the contracting parties.
>
> FAR 16.301 **Cost-Reimbursement Contracts**
> Cost-reimbursement types of contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract. These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without the approval of the contracting officer.
>
> FAR 16.401 **Incentive Contracts**
> Incentive contracts … are appropriate when a firm-fixed-price contract is not appropriate and the required supplies or services can be acquired at lower costs and, in certain instances, with improved delivery or technical performance, by relating the amount of profit or fee payable under

Copyright 2014 Richard D. Lieberman.
This article does not provide legal advice as to any particular transaction

the contract to the contractor's performance. [Used primarily for cost-reimbursement contracts, but may be used for fixed-price contracts].

16.500, 16.501 **Indefinite Delivery Contracts**
Delivery-order (task-order) contract means a contract for supplies (services) that does not procure or specify a firm quantity of supplies (services) (other than a minimum or maximum quantity) and that provides for the issuance of orders for the delivery of supplies (performance of tasks) during the period of the contract. There are three types of indefinite-delivery contracts: definite-quantity contracts, requirements contracts, and indefinite quantity contracts [also known as indefinite delivery, indefinite quantity, or "IDIQ"].

FAR 16.601 **Time-and-materials contracts**
A time-and-materials contract provides for acquiring supplies or services on the basis of-- (1) Direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and (2) Actual cost for materials.

It is clear that Agility's contract was firm-fixed-price, based on FAR 16.201, cited by the Court, which noted that "this contract places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss." Holding fast to the principle of firm fixed price, the court rejected Agility's assertions that

(1) the Army had made a constructive change. However, the court rejected this because there had been no change in the products to be delivered, so no constructive change—the modification did not change products, it added a new product as consideration;

(2) Army required delivery of more expensive goods by a government change. The court rejected this theory because there had been no change in specifications of the SPG-9s;

(3) Agility's failure to deliver was on time was excused by the doctrine of impossibility. The court rejected this because Agility had clearly assumed the normal risk when it voluntarily entered into a firm-fixed price contract, thus there was no impossibility. The court said that "because fixed price contracts do not contain a method for varying the price of the contract in even unforeseen circumstances, they assigned the risk to the contractor that the actual cost of performance will be higher than the price of the contract."*Allegheny Teledyne Inc v. United States,* 316 F. 3d 1366, 1376 n 7 (Fed. Cir. 2003). Agility had assumed the risk, and now could not avoid the consequences.

TIP: The FAR, which is cited above, is very clear about the implications of different types of contracts. If you receive a firm-fixed-price contract, you assume *both* the risk that your suppliers will increase their prices and your profits will decline, as well as the risk that suppliers might decrease their prices, and you will have an increased profit. That is why you must price this type of contract so carefully.

Until 1976, the United States, had a provision in law for recapturing "excess profits" under the Renegotiation Act of 1951. This Act expired in 1976, and has not been revived, so if your fixed price contract results in a windfall profit (for example, if your suppliers significantly reduce their prices), the Government cannot "recapture" the "excess profits." But, if you lose money on a fixed priced contract, you cannot get an equitable adjustment or claim for suppliers whose prices change and impact your final price.

Copyright 2014 Richard D. Lieberman.
This article does not provide legal advice as to any particular transaction

(Note: The Renegotiation Act of 1951, 50 U.S.C. App. 1211-1233, which was enacted shortly after the close of World War II and at the height of the Korean conflict, recited that Congress had made available "extensive funds" for the execution of the national defense program and that "sound execution" of the program required "the elimination of excessive profits from contracts made with the United States, and from related subcontracts." The act set up a Renegotiation Board that operated primarily (but not exclusively) by informal negotiation with the contractor to eliminate excessive profits. Contractors filed financial statements with the Board, which then could made a determination of excessive profits.)

Copyright 2014 Richard D. Lieberman.
This article does not provide legal advice as to any particular transaction