

BEWARE OF GOVERNMENT “BEST EFFORTS” ON OPTIONS

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A previous blog, “The Government Controls the Options,” makes clear that contractors cannot demand that the Government exercise an option in the contract, and that the Government has the sole right to exercise or not exercise the option. Two recent cases demonstrate that the contractor will also lose a claim where the government fails to exercise an option, even though both contracts required the government to make “best efforts to obtain funds” for the options.

In *Mach I AREP Carlyle Center LLC*, ASBCA No. 59821, June 1, 2016, Mach I entered into a lease with the Corps of Engineers for office space in the Northern Virginia suburbs of Washington, DC. The lease contained a base year, and nine separate option years, and the Corps was obligated “to use its best efforts to obtain and maintain all necessary appropriations and related approvals in connection with [the options in]this lease.” In 2011, DOD funding was subject to automatic cuts known as “sequestration,” and in early 2014, the Corps notified Mach I that it was terminating the lease. During option year 3 of the lease, the Corps made no request for funds for the lease, presumably because it had already notified Mach I of the intent to end the lease.

Mach I contended that the lease required “automatic renewal” if funds were available, and the Corps had an obligation to use its best efforts to obtain those funds. The Board disagreed, noting that the Anti-Deficiency Act precluded any “automatic renewal,” and the Anti Deficiency Act could not be evaded by the inclusion of a “best efforts” clause. In *Leiter v. United States*, 271 US 204 (1926), the Supreme Court stated that even if the lease involves a term of year, if it is entered into under an appropriation available for but one fiscal year, the lease is binding on the Government only in that year. For subsequent options, not only must an appropriation be made, but the duly appointed officers (contracting officer) must affirmatively continue the lease.

The court rejected the idea that the breach of the “best efforts” clause was separate and independent from the failure to exercise the option. “Even if the government had fully complied with the best efforts clause here and had also been successful in obtaining the necessary appropriation, *it still possessed an effective veto at the point of option renewal which could not be challenged as a breach of contract...*” (emphasis added). The court concluded that by law, no lease can compel the Corps of Engineers to exercise option years that were not yet funded at the time the lease was entered. Mach I received nothing.

In *Northrop Grumman Computing Sys., Inc. v. United States*, Fed. Cir., May 24, 2016, 2016 WL 3004862, the Federal Circuit held that even if the government fails to make its best efforts to obtain funds for an unexercised option, if the contractor suffers no financial harm, it will obtain no recovery. In 2001, the US Immigrations and Customs Enforcement (“ICE”) awarded Northrop a delivery order to supply network monitoring software produced by Oakley Networks, with a base year and three options years. The delivery order required that ICE use its best efforts to secure funding for the option years. Without notice to the Government, Northrop assigned all payments to ESCgov, another contractor, and ESCgov paid the total amount of the three year contract, including \$191,571, which covered Northrop’s anticipated profit under the delivery

order. The Government was never notified of this assignment under the Assignment of Claims Act.

ICE decided not to exercise the first option year because it did not secure funding, and ICE never exercised any of the option years. Northrop alleged that ICE had breached the contract by failing to use its best efforts to secure funding. The Appeals court held that in order to recover on a breach of contract claim, a plaintiff must prove damages—that *it has been harmed*. A plaintiff fails to meet this burden if it proves damages to a third party, but not to itself.

The facts showed that Northrop's financial position was exactly what it expected it to be if all options had been exercised—a profit of \$191,571. Northrop had suffered no harm because of the non-exercise of the options, and could obtain no payment on its claim. This is another example of the way the government can control the options process.

Contractors should realize that a “best efforts” clause included in a contract will have no effect on the government's discretion to exercise or not exercise an option. And further, that the contractor must show *its own damages* if the options are not exercised, in order to stand any small chance of recovery.