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NEWSLETTER

Undefinitized Contract Actions: What Contractors Should Be Aware of Before Agreeing to Perform With Key Terms Undefined

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Undefinitized contract actions (UCAs) provide agencies with necessary agility to meet urgent needs, and contractors with an opportunity to lean forward and build customer confidence. But by their nature, UCAs are also prime candidates for later frustration. This article explores the potential pitfalls of UCA risks that could lead to future contract disputes. Each UCA arises in different circumstances, and so a smart risk in one case may be a bad bet in another. But no matter the circumstance, there are some issues every contractor should consider before entering into a UCA.

What are UCAs and why are they risky? UCAs are contracts where the contractor agrees to perform but the parties leave certain key terms undefined for future negotiations. UCAs are generally only awarded in pressing circumstances, where time simply does not permit parties to fully negotiate terms. Because they are merely an agreement to agree, UCAs expose contractors to significant risk if a final agreement proves unattainable. The high-pressure environment that made the UCA necessary in the first place may also cause the parties to move forward with sharply different ideas of how negotiations will or should proceed. And during those negotiations, the government maintains substantial negotiating leverage because it can unilaterally definitize the terms in the absence of an agreement.

What terms make sense for you to leave undefinitized? Agencies have significant discretion regarding what terms to leave for further

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negotiation, and leaving any term undefinitized presents its own risks. The most common term left open is price, but it is by no means the only one that can be. Other examples include minimum order quantities, schedule requirements, performance metrics, and cost/risk allocation, such as insurance or security requirements. But most commonly, UCAs arise where parties can agree on just about everything other than price/fee, with the government needing more time to determine that the contractor's price is fair and reasonable. And no matter the term, before committing to work the details out later, there are a few key questions that will help determine if it is a smart bet.

First, consider how far apart you are. This will be an obvious indicator on whether future negotiations can be productive enough that a UCA makes sense. Contracting officers should be able to provide a ballpark idea of where they are, or how much they think you should move. A failure to do so, or vague requests for more information without articulating precise concerns, are signs that you may be farther apart than you think and increases the potential for a unilateral definitization.

Second, make sure you can perform under a realistic, "worst case" unilateral definitization. While it may seem inconceivable that the government would want to definitize at less-than-cost, or leave you with a commercially untenable requirement, consider whether you are so far apart in your conception of what the performance entails that the contracting officer may deem many of your rationales behind your proposal (and, thus, the costs you incur) to be irrelevant for definitization purposes.

A third and related question is whether there should be a provisional term. For example, with an undefinitized price, agreeing to provisional rates can help with cashflow, and for better or worse, may "anchor" later negotiations. But contractors also are at risk of a government claim if the later-definitized rate is lower than the provisional one. Depending on which side of the provisional rates definitization seems likely to land, it may be wise to maintain adequate reserves to ensure sufficient working capital should the government attempt to collect an alleged overpayment–but doing so also means diverting money away from investing in your business on this or other contracts.

Is there a common understanding for the *basis* of the negotiation? UCAs are typically vague on what the negotiations will be based on, which can lead each party to assume different criteria will control and is a sure way for negotiations to break down.

The most common area for disagreement is whether a contract "price" will be negotiated based on the contractor's subsequent actual costs–a common government tactic that may betray the parties' up front pricing negotiations. Agencies can have "profit anxiety," or the belief that a high profit margin means they got a bad deal. So it is not uncommon, even in a commercial item environment, for the government to revert to a cost-plus mindset when negotiating price. And if the contracting office is one that has historically analyzed contracts through a FAR Part 31 lens, the risk is even higher that the parties will be talking past each other. It is counterintuitive, but government negotiators may be so reticent to pay a price that yields a high profit margin that an agency would rather pay an overall higher price with lower margins, than a lower price with higher margins earned through contractor ingenuity and efficiencies.

The best way to head this off is to reach an understanding up front and in writing on what factors the parties should consider during the negotiations, which can go a long way to avoiding an impasse down the road. Although it is rare to see, there is no reason why the UCA, or contemporaneous letter or email, cannot identify the criteria and relative weight that will guide negotiations. Identifying what costs, if any, will be considered, how they will be allocated and evaluated (and under what standards and by whom), and the importance of a price analysis of comparable services can help set guiderails that focus the negotiations and make them more productive.

Is there a common understanding for the *schedule* for negotiations? The UCA regulations contemplate generally bringing the definitization to conclusion fairly quickly, and each UCA must also include a definitization schedule. But agency heads have authority to waive the schedule if the services are necessary to for certain urgent operations, and in practice, it is not at all unheard of for a definitization schedule to push to the right. Before signing up for a UCA, contractors should consider whether they will be comfortable performing under the interim terms for longer than the definitization schedule would suggest. Contractors should also be ready for quick-turn agency requests, if agencies delay in providing feedback on contractor proposals, but nonetheless try to stick with the original schedule.

Contractors should also be mindful of the substantive impact an extended schedule can have on the definitization. As performance continues, initial risk to the contractor materializes into the actual cost of performance, and contracting officers are required to consider any such reduced risk when determining a reasonable profit. In practice, there is an undeniable temptation to effectively convert a fixed-price effort into a cost-plus one, where the risk to contractors is smaller but so is the reward.

One potential avenue to protect against that risk is to submit a qualifying proposal at the earliest date possible. A recent amendment to the UCA regulations requires agencies to consider the cost risk from the date that the proposal goes in, if definitization goes beyond the 180-day window, to avoid a "bait and switch" in contract type. But this is a relatively new requirement, and it is not clear how it will play out in practice. Agencies have not historically shown comfort in pricing risk, so it is unclear whether or how they will be able to do so after the fact when that risk has materialized (or not), at least in part, as actual cost.

Are you comfortable with the risk of unilateral definitization? No one agrees to a UCA with the expectation that negotiations will fail. But due to funding constraints, insurmountable differences of opinion, or other reasons, it happens–and contractors should be cognizant of the risks they are undertaking when agreeing to a UCA.

A unilateral definitization is not the final word, but it is the last word before things become costly and complicated. To challenge a unilateral definitization, contractors typically must proceed through the disputes process, ultimately raising the issue to federal court or a board of contracts appeals, both of which are lengthy, costly avenues. In the meantime, the contractor has a duty to continue performing at a unilaterally definitized price. Moreover, if the government is claiming an overpayment based on its definitization (not uncommon), agencies can claw back the putative overpayment by offsetting it against payments under the UCA, or even separate contracts. This means that even if you ultimately prevail on an appeal of the unilateral definitization, there may be significant financial strain during the years spent litigating, over and above attorney fees and other legal costs.

The best way to mitigate the risks of litigating a unilateral definitization is to avoid them in the first place. That means contractors should give careful consideration of the history of the players, including the agency, the contracting office, and the relevant personnel, as well as a sober assessment of the gap between the parties going into the negotiations and any external dynamics that may alter the analysis, before determining that the UCA is worth the risk of a unilateral definitization.

Conclusion. UCAs are both a vital tool for the agencies, and an opportunity for contractors to build trust and confidence in their government partners. But the very factors that make UCAs necessary also make them uniquely susceptible to disputes. Thinking critically and concretely in advance about the risks you are undertaking, and why, can go a long way toward heading off some very common post-execution bumps in the road before your options for dealing with those issues become increasingly limited.