

# Inspection, Acceptance, and Warranty: Fundamental Government Contracting Principles Take on Heightened Importance in Wake of Federal Budget Uncertainty

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The government's rights to inspect contractor-provided goods or services and to assert warranty claims against contractors in connection with defective goods or services have long provided the government with formidable quality assurance tools. And with sequestration and continuing federal budget woes, the government's inspection and warranty rights have taken on increased significance as the government attempts to stretch its budget and get more performance out of its existing contracts by advancing more aggressive contract interpretations and demanding strict performance where it has not in the past. In this context, the government finds prime opportunities to exercise its substantial inspection and warranty-related rights, and contractors should reacquaint themselves with the government's ability to demand performance under these concepts.

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Set forth below is a summary of the government's inspection-related rights (and contractors' obligations that flow from those rights) and a summary of the parties' rights and obligations under various warranty clauses. Interposed between those two concepts is also a discussion of acceptance and how the act of acceptance provides a limited check against the government's substantial inspection rights.

## The Government's Right to Inspect and Contractors' Obligations

The government's ability to inspect goods or services is perhaps its most powerful quality assurance tool. At base, the government's ability to inspect allows it to identify nonconformities in goods or services and demand corrective action to bring those goods or services up to the level specified by the government.<sup>1</sup> And as can be expected, the extent and scope of the government's ability to inspect comes largely from the numerous inspection clauses contained in the Federal Acquisition Regulation (FAR), with clauses tailored to the nature of the contract and the nature of the goods or services being procured.<sup>2</sup> For example, inspection clauses are available for fixed-price construction projects,<sup>3</sup> cost-reimbursement supply contracts,<sup>4</sup> and various other permutations of government contracts. Although the parties' rights and obligations vary greatly depending on the terms of the clause, most clauses share certain general principles.

In general, the government can inspect goods or services multiple times so long as the inspections are reasonable.<sup>5</sup> And absent contractually specified tests, the government can unilaterally determine the inspection or test methodology so long as that method is "accurate and reasonably calculated to determine compliance" with the contract specifications.<sup>6</sup> Indeed, when contractually specified tests or standards are ambiguous or provide a subjective

element, courts and boards have held that the government can use other inspection methods so long as the method does not require a higher level of performance.<sup>7</sup>

When the government inspects and finds a nonconformity, the government has substantial rights in connection with its ability to demand corrective action. These rights include its ability to reject or require corrections to nonconforming items.<sup>8</sup> Moreover, if the contractor fails to resolve the nonconformity, the government can correct the issue itself and charge the contractor for the cost of that work.<sup>9</sup> Further, in the event the contractor does not resolve identified nonconformities, the government can nevertheless accept those nonconforming goods or services and then reduce the contract price to reflect the value of the nonconforming supplies or services.<sup>10</sup> Termination for default, of course, remains as the most drastic government remedy in the event the contractor refuses to remediate the nonconformity.<sup>11</sup>

Finally, the government's right to reinspect goods or services (after it finds and the contractor resolves a nonconformity) provides the government with even further power in connection with certain inspection clauses. Under certain FAR clauses,<sup>12</sup> the government may assess the costs of such reinspections against the contractor.<sup>13</sup> While the government has had this right for quite some time, the government has only recently begun to assess such reinspection costs against contractors. Catching contractors by surprise, the government's recent assessments, at least under Department of Defense contracts, are in conflict with certain internal agency guidance that instructs contracting officers to only assess reinspection costs when the contractor's work requires "habitual" or frequent reinspections.<sup>14</sup> Contractors seeking to prevent the assessment of reinspection costs in the event of less than "habitual" or frequent reinspections, however, face an uphill battle, as the agency guidance referenced above is nonbinding<sup>15</sup> and the assessment of reinspection costs for even one reinspection has been embraced by at least one board of contract appeals.<sup>16</sup>

Therefore, as outlined above, the government has substantial power to inspect goods or services and to use its power in this regard to demand strict performance to contract terms. And although the government's approach to enforcing its rights has varied over time, recent court and board decisions reveal an increase in government assertions of its power. For example, in one recent decision, the government offset a contract's price by the amount of a claim under the contract's inspection clause for deficient work.<sup>17</sup> In that case, the government asserted a strict interpretation of contract requirements, resulting in the nonconformity that served as the basis for the government's claim.<sup>18</sup> In yet another recent decision, the government terminated a construction contractor for default in a road construction contract after inspections resulted in findings of nonconformities and after the contractor failed to remediate the nonconformities.<sup>19</sup> Again, the findings of nonconformities resulted from the government's strict

interpretation of the contract's terms.<sup>20</sup> Therefore, although these decisions pre-date sequestration, these decisions nevertheless reflect an increased willingness on the part of the government to assert and enforce its inspection-related rights.

In the context of sequestration and continuing budget issues, the government can be expected to continue to use these and other inspection-related rights to demand strict performance or, more likely, to use the inspection regime as a mechanism to assert ever expanding and aggressive interpretations of contract specifications. Accordingly, contractors should understand each party's inspection-related rights and obligations in order to meet the government's expected approach.

### **The Potentially Conclusive Effect of Acceptance**

Acceptance is the critical act where the government acknowledges that the contractor has performed completely, satisfying all of the contract's requirements.<sup>21</sup> Once the government accepts the contractor's work, the parties' rights and obligations change significantly: The contractor

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***The contractor must ensure that the individual accepting goods or services has the authority to bind the government; otherwise the contractor runs the risk that the "acceptance" will not be conclusive.***

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is entitled to payment, title (as well as risk of loss) transfers to the government, and the government's ability to revoke acceptance is limited.<sup>22</sup> Given this important shift in rights and obligations, understanding how acceptance occurs and how acceptance can be revoked are critical to understanding the effect of acceptance.

Acceptance, like most significant actions in federal government contracting, can be effected only by a government official with authority to act.<sup>23</sup> Despite this requirement, the government regularly delegates responsibility for the actual inspection or testing of goods or services to a subject matter expert who either also received authority to issue acceptance or is required to report back to a contracting officer who retained authority to issue acceptance.<sup>24</sup> In these situations, the contractor must ensure that the individual accepting goods or services has the authority to bind the government; otherwise the contractor runs the risk that the "acceptance" will not be conclusive.

Although contractors stand on the firmest ground when they receive a formal acceptance from the

government,<sup>25</sup> such formal acceptance is not necessary to invoke the protections afforded through acceptance.<sup>26</sup> Instead, acceptance may be implied in various circumstances. The two most common scenarios where acceptance is implied occur when the government unreasonably delays rejecting goods or services<sup>27</sup> or takes an action inconsistent with the contractor's ownership of the goods.<sup>28</sup> To prove that the government unreasonably delayed rejecting the goods or services, a contractor must show that it was prejudiced by the delay, for example, by proving that the government's delay denied the contractor an opportunity to cure the defect.<sup>29</sup> The second scenario, referenced above, typically occurs when the government retains and uses goods supplied by the contractor or alters the nature of such goods.<sup>30</sup> Further, in establishing implied acceptance, contractors often must point to more than just the government's payment for goods or services, as payment alone usually does not establish acceptance, particularly when those payments are merely progress payments.<sup>31</sup>

Finally, and yet another critical element to understanding the effect of acceptance, once the government has accepted a contractor's performance (either expressly or implicitly), the government can revoke that acceptance only when the government discovers a latent defect, in the

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event of fraud or a gross mistake amounting to fraud, or when there are other contract terms (such as a warranty clause) that proscribe revocation as a remedy.<sup>32</sup> In each of these scenarios, the government carries the burden of proof. In the most litigated revocation scenario, an alleged latent defect, the government must show that the defect was unknown to the government at the time it accepted performance, the defect was in existence at the time of acceptance, and the defect was not discoverable by a reasonable inspection.<sup>33</sup> When fraud is at issue, the government must show that (1) it was induced into accepting performance, (2) it relied on a misrepresentation of fact (actual or implied) or the concealment of a material fact, (3) the contractor made the misrepresentation with knowledge of its falsity or reckless disregard of the facts, (4) the contractor intended to mislead the government, and (5) the government suffered an injury as a result.<sup>34</sup> As referenced

above, if the government's evidence falls short of actual fraud, it may still be able to revoke its acceptance on the basis of a gross mistake amounting to fraud if it can show all the elements of fraud other than the intent to deceive.<sup>35</sup> This means that although the government does not have to prove that the contractor intended to deceive the government, it still must prove that the contractor knew of the falsity or recklessly disregarded the facts.<sup>36</sup> And, ultimately, the government may revoke its acceptance by invoking a warranty right.<sup>37</sup> As some recent cases show, even though the government's right to revoke its acceptance may be narrow, the consequences are significant because when the government revokes its acceptance, it typically terminates the contract for default.<sup>38</sup>

Therefore, with the exception of the government's ability to revoke acceptance under these limited circumstances, acceptance provides contractors with an effective check against the government's substantial inspection-related rights. In the context of the government's attempts to stretch its budget in response to funding limitations, as addressed above, acceptance is a critically important tool to limiting contractor's liability, and contractors are well-advised to constantly push the government to formally accept goods and services and not let the issue of acceptance linger.

### **The Government's Right to Assert Warranty Claims**

Warranties, when used, provide the government with post-acceptance rights.<sup>39</sup> Although warranties in government contracts are not mandatory and there is no FAR provision that requires agencies to obtain warranties,<sup>40</sup> warranties are common in a variety of contracts. The FAR provides a number of warranty clauses for inclusion in various contracts,<sup>41</sup> and, similar to its inspection-related clauses, each of these warranty clauses is tailored to the type and nature of the contract at issue.<sup>42</sup>

When the government includes warranties in a contract, the government is again afforded substantial rights in connection with its ability to require the contractor to repair or replace defective goods or services.<sup>43</sup> In this respect, there are many remedies that the government can pursue, but the government typically pursues one of three remedies. First, the government may direct the contractor to either repair, replace, correct, or re-perform the work at the contractor's expense.<sup>44</sup> Second, the government may choose to cure the defect itself or hire another contractor to do so and then charge the initial contractor the costs of the work.<sup>45</sup> Third, instead of curing the defect, the government may accept the performance as-is and seek a reduction in price.<sup>46</sup> In addition to these three more commonly used remedies, the government can seek a refund of the purchase price.<sup>47</sup>

Therefore, just as the government has substantial rights in connection with its ability to inspect goods or services, so does the government in connection with its rights under warranty clauses. Given the government's power under warranty clauses, contractors should expect the government to assert its warranty rights more aggressively as

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agencies continue to cope with shrinking budgets. Accordingly, contractors should understand the government's right to assert warranty claims and consider the government's ability to assert such claims when proposing and executing federal government contracts.

### Conclusion

As addressed above, the government's ability to inspect goods or services (and to demand corrective action when such inspections reveal nonconformities) provides the government with a powerful quality assurance tool—a tool that can easily be misused to stretch government budgets during times of funding limitations. Further, under available warranty clauses, the government is in a position to attempt to exert significant pressure on contractors long after those contractors believe their work is done. As explained above, however, contractors are afforded at least some protection through the act of acceptance, and contractors are well-advised to familiarize themselves with all

of these concepts as the government continues to operate under ever-tightening budgets. [PL](#)

### Endnotes

1. See, e.g., FAR 52.246-12 (stating the government's ability to inspect construction services and requiring the contractor to repair or replace any defective work).

2. See FAR 52.246-1 (Contractor Inspection Requirements); FAR 52.246-2 (Inspection of Supplies—Fixed-Price); FAR 52.246-3 (Inspection of Supplies—Cost-Reimbursement); FAR 52.246-4 (Inspection of Services—Fixed Price); FAR 52.246-5 (Inspection of Services—Cost Reimbursement); FAR 52.246-6 (Inspection—Time-and-Material and Labor-Hour); FAR 52.246-7 (Inspection of Research and Development—Fixed Price); FAR 52.246-8 (Inspection of Research and Development—Cost-Reimbursement); FAR 52.246-9 (Inspection of Research and Development (Short Form)); FAR 52.246-12 (Inspection of Construction); FAR 52.246-13 (Inspection—Dismantling, Demolition, or Removal of Improvements); FAR 52.246-14 (Inspection of Transportation); FAR 52.212-4 (Contract Terms and Conditions—Commercial Items); FAR 52.213-4 (Terms and Conditions—Simplified Acquisitions (Other than Commercial Items)).



3. See FAR 52.246-12.
4. See FAR 52.246-3.
5. See, e.g., Jet Flight Transp., Inc., ASBCA No. 40020, July 31, 1992, 93-1 BCA ¶ 25,336 (finding “nothing impermissible” in the fact that the government conducted multiple inspections on certain dates). Further, to the extent the government makes multiple inspections, each of those inspections must be consistent with each other. W.F. Kilbride Constr., Inc., ASBCA No. 19484, Jan. 29, 1976, 76-1 BCA ¶ 11,726.
6. See, e.g., Nash Metalware Co., Inc., GSBCA No. 11951, March 15, 1994, 94-2 BCA ¶ 26,780.
7. See, e.g., Circle Constr. Grp., ASBCA No. 38844, May 29, 1990, 90-3 BCA ¶ 22,999.
8. See e.g., FAR 52.246-2(f) (explaining that “[t]he Government has the right either to reject or to require correction of non-conforming supplies”).
9. See, e.g., FAR 52.246-2(h).
10. *Id.*
11. See F Tawazuh Commercial and Constr. Co. Ltd., ASBCA No. 55656, June 13, 2011, 11-2 BCA ¶ 34,781.
12. See FAR 52.246-2(e); FAR 52.246-12(e).
13. See, e.g., FAR 52.246-2(e)(2) (“The Contracting Office may also charge the Contractor for any additional cost of inspection or test when prior rejection makes reinspection or retest necessary.”).
14. See Defense Contract Management Agency Instruction, Corrective Action Process, December 4, 2012, at 5.2.1 (“Per FAR 52.246-2 . . . recoupment of reinspection costs should be considered if there are habitual rejections of supplies that require retesting, or supplies are consistently not ready for the functional specialist’s inspection when inspection is requested.”).
15. See *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) (viewing agency policies as “a body of experience . . . [with] power to persuade, if lacking power to control”).
16. See Coastal Structures, Inc., DOTCAB No. 1787, July 25, 1988, 88-3 BCA ¶ 21,016 (interpreting FAR 52.246-12(e), providing that “[t]he Government may charge to the Contractor any additional cost of inspection or test . . . when prior rejection makes reinspection or retest necessary”)(ellipsis in original)).
17. See M.L. Engergia, Inc., ASBCA No. 55947, July 24, 2012, 12-2 BCA ¶ 35,110.
18. See *id.*
19. See F Tawazuh Commercial and Constr. Co. Ltd., 11-2 BCA ¶ 34,781.
20. See *id.*
21. See FAR 46.101.
22. See FAR 46.505(a)-(b).
23. See FAR 46.101; *Winter v. Cath-dr/Balti Joint Venture*, 497 F.3d 1339, 1344 (Fed. Cir. 2007) (noting that a change under the Changes Clause, FAR 52.243-4, must be ordered by a government representative that has authority to bind the government).
24. See, e.g., Nu-Way Concrete Co. Inc., CBCA No. 1411, Dec. 16, 2010, 11-1 BCA ¶ 34,636 (explaining that “[e]ven if . . . inspectors had ordered it to perform extra work . . . [the contract must] show that these inspectors had authority to modify the contract to require such work”).
25. See FAR 46.501 (stating that “[a]cceptance shall ordinarily be evidenced by execution of an acceptance certificate. . .”).
26. See, e.g., *John C. Kohler Co. v. United States*, 498 F.2d 1360, 1367 (Ct. Cl. 1974).
27. See *Snowbird Indus., Inc.*, ASBCA No. 31368, Feb. 18, 1988, 88-2 BCA ¶ 20,618.
28. See *John C. Kohler Co.*, 498 F.2d at 1367.
29. See, e.g., *Snowbird Indus., Inc.*, 88-2 BCA ¶ 20,618.
30. See, e.g., *John C. Kohler Co.*, 498 F.2d at 1367.
31. See, e.g., *Indus. Data Link Corp.*, ASBCA No. 31570, Sept. 11, 1990, 91-1 BCA ¶ 23,382 (finding that the government did not accept the contractor’s performance even though the government paid the contractor).
32. See, e.g., FAR 52.246-2 (Inspection of Supplies—Fixed Price).
33. See, e.g., FAR 2.101 (defining the term “latent defect”).
34. See, e.g., *Bender GmbH*, ASBCA No. 52266, Nov. 20, 2003, 04-1 BCA ¶ 32,474.
35. See, e.g., *Am. Renovation & Constr. Co.*, ASBCA No. 53723, June 30, 2009, 09-2 BCA ¶ 34,199.
36. See *Am. Renovation & Constr. Co.*, ASBCA No. 53723, June 16, 2010, 10-2 BCA ¶ 34,487.
37. E.g., FAR 52.246-17(b)(1) (noting that the warranty provisions apply “[n]otwithstanding inspection and acceptance by the Government”).
38. See, e.g., *Kaman Precision Prods., Inc.*, ASBCA No. 56305, Aug. 4, 2010, 10-2 BCA ¶ 34,529 (denying motion for summary judgment on termination for default claim where contractor alleged that government wrongfully revoked its acceptance of patently defective goods); *Am. Renovation & Constr. Co.*, ASBCA No. 53723, June 16, 2010, 10-2 BCA ¶ 34,487 (upholding, upon motion for reconsideration, termination for default after finding, among other things, gross mistakes amounting to fraud).
39. See, e.g., FAR 52.246-17.
40. See FAR 46.710 (stating that the warranty clauses “may be used in solicitations and contracts in which inclusion of a warranty is appropriate”).
41. See FAR 52.246-17 (Warranty of Supplies of a Noncomplex Nature); FAR 52.246-18 (Warranty of Supplies of a Complex Nature); FAR 52.246-19 (Warranty of Systems and Equipment under Performance Specifications or Design Criteria); FAR 52.246-20 (Warranty of Services); FAR 52.246-21 (Warranty of Construction). Note that, in addition to warranties provided through explicit FAR clause, warranties may also be implied in contracts. *Gen. Elec. Co., IBCA No. 451-8-64*, Apr. 13, 1966, 66-1 BCA ¶ 5,507 (noting “that an implied warranty arises under certain circumstances by operation of law irrespective of any intention on the seller’s part to create it”).
42. See e.g., FAR 52.246-21 (providing warranty clause for fixed-price construction contracts).
43. See FAR 46.706(b)(2)(i) (“Normally, a warranty shall provide as a minimum that the Government may (A) [o]btain an equitable adjustment of the contract, or (B) [d]irect the contractor to repair or replace the defective items at the contractor’s expense.”).
44. See *id.*
45. See FAR 46.706(b)(2)(ii)(B).
46. See FAR 46.706(b)(2)(ii)(A).
47. FAR 52.246-17(c)(2)(ii). When the contract specifies the remedies available and those remedies apply to the type of defect involved, the government is limited to those remedies. See *Kordick & Son, Inc. v. United States*, 12 Cl. Ct. 662, 668 (1987) (holding, “[i]n accordance with the tendency to construe warranty clauses strictly and literally, the government is limited to the remedies enumerated in the clause itself”) (citing *O.F. Paulson Constr. Co., VACAB No. 1214*, Dec. 28, 1978, 79-1 BCA ¶ 13, 623)).