

Part I Chapter 57
Contractor Performance and Legal Remedies
(Materials and Services)

- A. Contractor Performance.** When a contract or purchase order is issued, the contractor can respond in one of four ways:
- 1. Performance.** The contractor may satisfactorily perform its obligations under the contract or purchase order.
 - 2. Nonperforming Breach.** The contractor may fail or refuse to perform or make delivery.
 - 3. Partial Performance Breach.** The contractor may commence delivery or performance, but fail or refuse to complete delivery or performance.
 - 4. Nonconforming Breach.** The contractor may perform or make delivery, but still breach the contract, because:
 - a.** The delivery is improper (i.e., at the wrong place); or
 - b.** The material fails to conform to the specifications or is defective; or
 - c.** The work fails to conform to the specifications or is defective.
- B. Delivery (Materials Only).** Delivery is the transfer of possession of the material from the supplier to the Commonwealth in accordance with the terms of the contract or purchase order. It is a primary obligation of a supplier.
- 1.** In order to determine whether a nonconforming breach has occurred, three questions are fundamental:
 - a.** Where is delivery to be made?
 - b.** When is it to be accomplished?
 - c.** How is the delivery to be made?
 - 2. Where.** The contract and/or purchase order should clearly set forth the delivery location. If the supplier delivers the materials to a place other than the location specified, the supplier has made a nonconforming delivery. If a delivery location is not specified in the contract or purchase order, the place of delivery is the business address for the Commonwealth agency issuing the purchase order or entering into the contract. 13 Pa.C.S.A. Section 2308.
 - 3. When.**
 - a. Time Stated.** Where there is a time for delivery stated within the contract and/or purchase order, it is presumed to be reasonable and delivery must occur on or before that date. If the delivery is late, the delivery is nonconforming and the supplier has breached.

- (1) The delivery time can be stated as a specific date with delivery to be made on that date and no other date.
- (2) The delivery time can be stated as “no later than” a specific date.
- (3) The delivery time can be stated as within a specified number of days after the contract execution date or purchase order date or after receipt of the purchase order or executed contract or after another condition precedent to delivery (e.g. after acceptance of proofs).

b. No Delivery Time Stated. Absent a contrary provision in the contract and/or purchase order, the materials must be delivered within a *reasonable time* after the order is received (13 Pa.C.S.A. Section 2309(a)) and at a reasonable hour (13 Pa.C.S.A. Section 2503(a)(1)). The reasonableness of the time depends upon the circumstances of the individual case. It depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken.

4. How.

- a. General Rule.** The contractor must put and hold the materials at the disposition of the agency and give the agency any notification reasonably necessary to enable the agency to take delivery. 13 Pa.C.S.A. Section 2503.
- b. Delivery by Lots.** Where the contract does not provide whether the materials are to be delivered in one or a number of shipments, they are to be delivered in a single delivery, unless the circumstances give either party the right to make or demand delivery in lots. 13 Pa.C.S.A. Section 2307.
- c. Method of Transportation.** Unless otherwise specified, the means of transportation (truck, train, delivery service, etc.) is within the discretion of the supplier.
- d. Offloading.** Unless the contract or purchase order otherwise specifies, delivery is generally made when the carrier makes the materials available for offloading at the loading dock. The agency must furnish the facilities reasonably suited for receipt of the materials. (13 Pa.C.S.A. Section 2503(a)(2)).

5. Free On Board (“FOB”) Destination. FOB Destination is defined in 13 Pa.C.S.A. Section 2319(a)(2). The majority of the Commonwealth’s contracts are FOB Destination.

- a.** The supplier must bear the expense of delivery if the delivery is F.O.B. Destination.
- b.** The supplier is required to put and hold the materials at the Commonwealth’s disposition at the destination point and give the Commonwealth notice that they are ready for receipt. The delivery must

be at a reasonable hour and the materials must be kept available for a period reasonably necessary for the Commonwealth to receive them.

- c. The supplier also bears the risk of loss or damage to the materials in transit.
- d. The Commonwealth has the obligation of furnishing any facilities needed to receive the materials and for unloading the materials. Any storage charges incurred after arrival at the delivery location are also the Commonwealth's responsibility.

6. Free On Board ("FOB") Shipment. FOB Shipment is defined in 13 Pa.C.S.A. Section 2319(a)(1).

- a. If delivery is FOB Shipment, the supplier is only obligated to put the materials into the possession of the carrier.
- b. The supplier does not bear the cost of loading the materials on the carrier, the cost of transportation to the Commonwealth, or the risk of loss or damage to the materials in transit.

C. Time to Perform (Services).

- 1. Completion Date.** The contract or purchase order should include a completion date. The completion date should be a specific calendar date or fixed in terms of the number of days after execution date, effective date, commencement date, receipt of order or completion date of a previous task.
- 2. Milestone or Deliverable Dates.** For those contracts for which contractor performance will extend over a lengthy time period, the contract should contain milestone or deliverable dates which require the contractor to complete identified tasks on or before those dates. Progress payment can be tied to those dates.
- 3. Repetitive Periodic Performance.** For those contracts for which the contractor will perform repetitive tasks (cleaning or preventative maintenance, for example) the contract should define the time requirements for the periodic performance (e.g. monthly, quarterly, annual).
- 4. No Performance Period Stated.** Where there is no completion date in the contract or purchase order, performance must be completed within a reasonable time after the execution of the contract or reasonable time periods throughout the contract term. The reasonableness of the time depends upon the circumstances surrounding performance of the contract as well as industry standards.

D. Monitoring Supplier Performance. A precursor to monitoring supplier performance is to ensure all procurement documents must be established with clear specifications that are comprehensive, measurable, and enforceable. Both the receiver/project manager and the purchaser have roles in monitoring supplier performance and communicating/escalating issues to their internal management team. Monitoring is needed to ensure that the supplier is meeting the terms and conditions of the contract. Monitoring will include, but not limited to, items such as on-time delivery,

responsiveness, completion of all requirements, and quality of supply or service provided.

E. No Delivery or Performance. When no delivery or performance is made by the date and time stated or, if no time is stated, within a reasonable time, the agency should immediately contact the contractor in an effort to discover why there was no timely delivery or performance.

1. Excusable Delay. The agency may discover that the delay in the delivery or performance must be excused because the delay was caused by an event outside the control of the contractor such as weather conditions, strike, natural disaster, etc. The contractor should provide justification and a new projected date of delivery or performance. The agency must decide whether to cancel the contract or purchase order or give the contractor reasonable time to deliver or perform. In this case, it is unlikely that the agency can collect damages for breach. If the contract contains a Force Majeure clause, the contractor should follow the process outlined in the language in the contract. Force Majeure events do not justify an increase in price and no price increases may be granted other than routine price escalations that are already part of the contract.

2. Inability to Deliver or Perform. The agency may discover that the contractor will not be able to deliver or perform at all because of an unforeseeable event that makes it impossible to perform such as a fire or natural disaster or death of key personnel or insolvency of the contractor. In these cases, the contract or purchase order should be immediately cancelled. NOTE: Bankruptcy under Chapter 11 (Reorganization) is not grounds, in and of itself, for cancellation of the contract or purchase order.

3. More Time Needed. The agency may discover that the contractor would like additional time to deliver or perform. The agency may decide not to cancel the purchase order or contract, but rather to give the contractor additional time to deliver or perform. The agency can still seek to collect monetary damages (or liquidated damages) that it incurred for the untimely delivery or performance. Any Commonwealth-granted extension should be established in writing.

4. Mistake. The agency may discover that the contractor has no intention of delivering or performing because it made a mistake. The agency should discuss with agency legal counsel whether the contractor has grounds to rescind the contract due to mistake.

F. Remedies for Failure to make Delivery or Failure to Perform. When the contractor fails or refuses to perform or make any delivery at all, the Commonwealth basically has the following remedies:

1. Termination. The Commonwealth may terminate the contract and/or purchase order. If this is done, the Commonwealth may retain the right to recover damages. Cancellation means that the Commonwealth no longer has a duty to accept delivery or performance or the duty to make payment. The Commonwealth may also be able to recover any payments made to the contractor.

a. A formal termination letter must be drafted by the agency Contracting Officer and approved by the Office of Chief Counsel prior to issuance. If

the termination of a purchase order involves a Department of General Services (DGS) contract, the appropriate Commodity Specialist must be informed of the problem prior to termination. In the later case, DGS and the respective agency legal counsel must approve termination and be copied on the letter.

- b.** The approved termination letter may be emailed (with a receipt confirmation requested), mailed with a delivery receipt, or faxed to the supplier. Copies of the confirmation documents must be retained as part of the purchasing record.
- c.** If several instances with this same supplier have occurred or if any one event is significant enough by itself, the Contracting officer should give consideration to suspension or debarment of the supplier.

2. Cover Damages. The Commonwealth generally obtains the materials or service from another contractor and seeks monetary damages from the defaulting contractor for cover. "Cover" is the difference between what the Commonwealth pays and the new contract price (13 Pa.C.S.A. Sections 2711(a), 2712). That becomes the measure of damages. This is more popularly known as a "surcharge."

- a.** The repurchase must be made in good faith and without unreasonable delay or upon reasonable terms.
- b.** The Commonwealth should re-award the contract and/or purchase order to the next lowest responsible bidder or the lowest responsible bidder under a rebid.

3. Market Damages. If the Commonwealth does not obtain the materials or service from another contractor, the Commonwealth is still entitled to seek damages for loss of the benefit of the bargain (13 Pa.C.S.A. Sections 2711(a), 2713). Damages are measured as the difference between the market price and the contract price.

4. Delay Damages. If the Commonwealth suffered monetary damages as a result of the delinquent delivery or delinquent performance of the contractor (whether it is the contractor or another contractor that ultimately delivers/performs), the Commonwealth make seek restitution in damages that were caused by the delay.

5. Liquidated Damages. Contract clauses can fix damages at a certain amount.

- a.** A "Liquidated Damages" clause is valid if:
 - (1)** The amount stated as damages bears a reasonable relationship to either the amount of actual damages incurred or an amount which could have been anticipated by the parties when they entered into the contract.
 - (2)** The monetary damages that would be caused by the breach are incapable or very difficult to determine.

- b. **Use.** A liquidated damages clause can be used to ensure timely delivery or performance. If delivery is not made by the date specified, the amount to be paid by the Commonwealth will be reduced by the agreed upon amount for each day of delay in delivery or performance.
- c. **Penalty.** Penalties are not enforceable in Pennsylvania. A penalty is a fixed amount of payment for a breach which is not a pre-estimate of probable actual damages, but rather as a punishment in which the threat is designed to prevent the breach. If the dollar amount of the liquidated damages is set at an unreasonably high amount, it may be treated as a penalty and, therefore, unenforceable.
- d. **Burden of Unanticipated Event.** Unless otherwise indicated in the contract or purchase order, the contractor is presumed to undertake the burden of an unanticipated event unless the event rises to the level of an act of God or the event was caused or created by the Commonwealth or is excused by law. *Commonwealth, Department of Transportation, v, Interstate Contractors Supply Company*, 568 A.2d 294 (Pa. Cmwlth. 1990).

6. **Specific Performance.** The Commonwealth can *attempt* to force the contractor to perform by seeking a decree of specific performance (13 Pa.C.S.A. Sections 2711(b)(2), 2716). The situations in which this remedy may be obtained are extremely limited.

- a. The form of the remedy would be an injunction prohibiting the breach.
- b. Specific performance may be decreed only where the materials or work performance are unique or in other proper circumstances.
- c. A decree for specific performance may also give complete relief by including whatever terms and conditions regarding payment of the price, damages, or otherwise as the court may deem just.

7. **Replevin.** The Commonwealth can recover materials from the contractor in cases in which the contractor becomes insolvent 10 days after the first installment payment (13 Pa.C.S.A. Section 2711(b)(1)).

8. **Incidental and Consequential Damages.** See 13 Pa.C.S.A. Section 2715.

G. **Inspection.**

1. **Right to Inspect: Duty to Accept or Reject.** Where the contractor has delivered or performed, the Commonwealth has certain duties, rights, and responsibilities upon delivery, upon completion of the work, and/or upon completion of identified segments of the work.

- a. The Commonwealth always has the right of inspection before it accepts.
- b. The Commonwealth's duty to accept or reject materials or the work is influenced by its right to inspect the materials or work.

- 2. Time for Inspection.** In the absence of a contrary provision in the contract, the Commonwealth may inspect the materials or work at any reasonable time and place and in any reasonable manner (13 Pa.C.S.A. Section 2513).
 - a.** Inspection of materials will generally be made when materials are delivered or shortly thereafter. It may, however, be made before shipment, or it may be postponed until a reasonable time after the materials have been received. The reasonableness of the time will be determined by trade usage, past practices between the parties, and the circumstances of each case.
 - b.** To the extent that work is done at a Commonwealth-owned or leased location, inspection of the work should be ongoing.
 - c.** To the extent that work is completed offsite, inspection should be made upon delivery of the product.
 - 3. Cost of Inspection.** The Commonwealth must pay the costs of inspection but those costs may be recovered from the contractor if the materials are rightfully rejected for nonconformity(13 Pa.C.S.A. Section 2513(b)).
 - 4. Testing.** The Commonwealth may test the materials prior to acceptance even though the tests involve the destruction of a small portion of them.
 - 5. Proofs.** The Commonwealth may require the contractor to deliver proofs for inspection prior to delivery of the materials or product.
 - 6. Waiver of Right of Inspection.** The Commonwealth may waive the right to inspect or reject nonconforming materials by failing to inspect within a reasonable time period.
- H. Rights of Commonwealth Upon Improper Delivery.** If the delivery or the materials or service fail in any respect to conform to the contractual requirements, the agency may (13 Pa.C.S.A. Section 2601):
- 1.** Reject the whole shipment or the complete work.
 - 2.** Accept the whole shipment of the complete work.
 - 3.** Accept any commercial unit(s) or portions of the work and reject the rest.
- I. Rejection.** . In order for rejection to be effective, the agency must (13 Pa.C.S.A. Section 2602):
- 1.** Notify the contractor in writing that the delivery, materials or work have been rejected. Rejection is ineffective unless the Commonwealth reasonably notifies the contractor. Therefore, where a delivery of materials is made by the contractor or substantial completion of the work has been accomplished or identifiable portions of the work have been completed, positive action is required by the Commonwealth in order to avoid acceptance. An agency, which is not specific in its objection in connection with rejection, may lose its right to rely on "the unstated defect" to justify the rejection. Rejection or revocation

should be in writing and should be carefully drafted. Those who depend upon nonwritten notice will not fare well.

2. Be timely in its notification of rejection. Timely rejection of materials or work must be within a reasonable time after their delivery or tender. This reasonable period for rejection overlaps the reasonable opportunity for inspection. Thus, if the inspection discloses a defect, there remains the obligation to reject within a reasonable time.
3. Not exercise any ownership with respect to the rejected material or work.
4. Hold the materials or work with reasonable care at the disposition of the contractor for a time sufficient to permit the contractor to remove them. If the contractor gives no instructions within a reasonable time after notification of rejection, the agency may store the rejected materials or work for the account of the contractor; ship them to the contractor C.O.D.; or resell them for the account of the contractor with reimbursement for reasonable expenses for caring and selling the materials or work plus a commission not to exceed 10% of the gross proceeds. 13 Pa.C.S.A. Sections 2604, 2603. According to the DGS invitation for bids, the contractor has the duty to remove rejected items from the premises without expense to the Commonwealth within 15 days after notification of rejection. Rejected items left longer than 15 days will be regarded as abandoned and the Commonwealth shall have the right to dispose of them as its own property and shall retain that portion of the proceeds of any sale which represents the Commonwealth's costs and expenses in regard to the storage and sale of the items.

J. Revocation. Revocation of acceptance is similar to rejection except that it occurs after acceptance. Since revocation of acceptance always occurs after acceptance and may occur long after the contractor regarded the transaction as closed, the Commonwealth which might have rejected with ease must meet several additional conditions in order to revoke acceptance (13 Pa.C.S.A. Section 2608).

1. First, in order to revoke acceptance, the nonconformity must substantially impair the value of the lot or commercial unit or project.
2. Second, the Commonwealth must have accepted either:
 - a. With the discovery of the defect, on the reasonable assumption that the nonconformity would be cured.
 - b. Without discovery and acceptance was reasonably induced by the difficulty of the discovery before acceptance or by the contractor's assurances.
3. Third, revocation must occur within a reasonable time after the nonconformity was discovered or should have been discovered.
4. Finally, revocation must occur before a substantial change takes place in the condition of the materials not caused by its own defects.
5. **Reasonable Time for Revocation.** What is a reasonable time for taking any action depends upon the nature, purpose, and circumstances of such action.

There are four circumstances which will always have relevance to the determination of whether a reasonable time has passed before the Commonwealth took action to reject or revoke:

- a. Difficulty of Discovery of the Defect.** That is, if the defect was difficult to discover, the reasonable time would not commence to run until a later time that it would have commenced with a defect that was easy to find. The agency's skill will also be a factor in determining the difficulty of discovery of a defect.
- b. Contract Itself.** If the contract provides that the Commonwealth must inspect and report all complaints within a specified period of time, the courts will give effect to such a provision, provided the time set is not unreasonable.
- c. Perishability of the materials.** If the materials are perishable in nature (food items, livestock, etc.), the Commonwealth had better take immediate action if it wishes to reject or revoke acceptance.
- d. Course of Performance Between the Parties After the Sale but Before Formal Rejection.** If the principal policy of the rejection notice requirement is to give the contractor an opportunity to cure and to permit it to assist in minimizing the Commonwealth losses, that policy is met if there has been a continuing series of complaints, negotiations, and attempted repairs prior to formal rejection.

K. Acceptance.

- 1.** Acceptance may occur in three ways (13 Pa.C.S.A. Section 2606):
 - a.** If the Commonwealth, after a reasonable opportunity to inspect, signifies either that the materials or work are conforming or that it will retain them in spite of their nonconformity. In some instances, "acceptance" is easy to identify. Certainly when an agency inspects materials which it has received and then states orally or in writing to the contractor that it will take them, there is an acceptance.
 - b.** If the Commonwealth fails to make an effective rejection.
 - c.** The Commonwealth does not act inconsistently with the contractor's ownership of the materials.
 - (1) Example:** Assume, for example, that an agency purchases two sections of 10 feet of cast iron pipe. On the day after the purchase, it discovers that the sections of pipe are 10-1/2 feet in length. Rather than reject, however, the agency attempts to use the 10-1/2 foot lengths by cutting them down to size. If the pipe is mistakenly cut too short, the agency cannot thereafter reject the pipe. The attempts to use the pipe at a time when the agency was aware of the alleged defect in the materials should be regarded as an act inconsistent with the contractor's ownership and will constitute acceptance.

- (2) Acts done in ignorance of the defects which an agency could not have discovered should not be considered acceptance. If an agency purchases a dump truck, no one would regard the use of that truck on the day after purchase as an acceptance, despite the fact that a defect was later discovered and the use is theoretically inconsistent with the contractor's ownership.
- (3) Any agency which, after discovery of a defect, goes more than a very small step beyond the acts it is obligated and permitted to take, takes a grave risk that it will have accepted the materials. There are, however, cases where continued use is inevitable (for instance, a carpet nailed to the floor) and in such cases, use should not be regarded as inconsistent with contractor's ownership.
- (4) The most difficult cases are those where an agency continues to use a complex piece of equipment with knowledge that it is defective but the agency and the contractor are attempting to fix the equipment. In such circumstances, courts will be hesitant to find that the acts are "inconsistent with the contractor's ownership." The parties should be encouraged to engage in this kind of bargaining and adjustment and the agency should not be made to engage in it at its peril.
- (5) Payment is another circumstance tending to signify acceptance but it is not conclusive.

2. The legal consequences of acceptance are (13 Pa.C.S.A. Section 2607):
 - a. The Commonwealth must pay the contract price for the materials or services accepted.
 - b. The Commonwealth loses its right to reject the materials or services.
 - c. Time starts to run within which the Commonwealth must complain of a breach or be barred from any remedy.
 - d. The burden shifts to the Agency to establish a breach.
3. **Acceptance and Breach of Warranty.** Acceptance does not foreclose Commonwealth action for breach of warranty. The typical purchaser who accepts and then sues for breach of warranty will recover only for the injury resulting from the defects in the materials at the time of sale (i.e., a purchased auto had a cracked piston that cost \$300 to repair and the value of the car is diminished by \$300, the buyer will receive \$300). If they reject the car, the purchaser will recover damages resulting from the seller's failure to perform.

L. Remedies Following Delivery or Completion of Performance.

1. **Damages and Cover.** Upon rejection or revocation, the Commonwealth still has the same remedies as though no delivery or performance was made at all. It may seek damages equal to the market price minus the contract price, or it

may cover and recover damages (surcharge action) or in some instances, it may seek specific performance or replevin. However, the contractor has to be given the right to cure the defect before the Commonwealth proceeds to seek to cover and/or recover damages.

- 2. Breach of Warranty.** Where the materials are nonconforming, this amounts to a breach of warranty by the contractor. The Commonwealth may accept delivery of the nonconforming materials or services and recover damages. The measure of damages in such cases is the difference between the value the materials or services would have had if they had been as warranted and their actual value with the defect.
- 3. Breach of Tender Obligations.** Where the materials or services are nonconforming results from late delivery or untimely performance, the agency may recover all damages that results from the breach. The agency can still recover liquidated damages, if included in the contract, as a result of late delivery.
- 4. Recovery of Payments Made.** If the Commonwealth has revoked its acceptance but has already made payment towards the purchase of the materials, it can recover those payments. If rejected materials or work remain on the Commonwealth premises, it can look to the materials and their proceeds for satisfaction of its expenses and damages.