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Terminations for Convenience

View From Crowell & Moring: Commercial Item Terminations for Convenience—Navigating to an Equitable Conclusion

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The political fire storms over sequestration, shutdowns, and debt ceilings have diminished this season, and it is perhaps easy for some to forget that federal agencies are struggling to work through substantial budget cuts and programmatic challenges. But we see stark reminders of these struggles every day, as agencies continue to scale back or entirely terminate even high performing contracts and programs.

Federal contracts include provisions allowing the government to terminate for convenience, and this is true even for contracts procuring ''commercial items.'' But the language of the standard commercial item termination provision has generated confusion about how contractors are to be compensated in commercial item terminations. That confusion has been extended, rather than resolved, by the relatively limited number of decisions from the boards of contract appeals and the courts that address the issue.

In our experience, federal agencies and contractors most often are able to negotiate terminations of commercial item contracts successfully, keeping their focus on achieving a fair and equitable resolution. But that will not always be the case. In this article, we briefly highlight some of the most common points of confusion surrounding the commercial item termination provision, differing approaches that the courts and boards have used, and considerations that contractors should take into account – not only after a termination occurs, but even before performance begins.

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The Standard Commercial Item Termination for Convenience Clause. The standard commercial item termination for convenience provision is included in the clause entitled ''Contract Terms and Conditions – Commercial Items'' at FAR 52.212-4. The clause states in part that, when there is a termination for convenience:

> the Contractor shall be paid a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination, plus reasonable charges the Contractor can demonstrate to the satisfaction of the Government using its standard record keeping system, have resulted from the termination.[1]

The clause also states that the contractor ''shall not be required to comply with the cost accounting standards or contract cost principles for this purpose'' and that this ''does not give the Government any right to audit the Contractor's records.''[2] The confusion about these provisions has been mainly in two areas: (1) how to determine ''the percentage of work performed'' prior to the termination; and (2) how to define ''charges'' that ''have resulted from the termination.''

Practice Tips

- Focus on achieving a fair and equitable resolution when negotiating a termination.
- Where terminations cannot be resolved through negotiations, carefully consider choice of forum in any appeal.

In addition, FAR 12.403(a) advises that, while the FAR Part 49 regulations do not strictly apply when terminating contracts for commercial items,

[1] FAR 52.212-4(l).
[2] *Id.*

''[c]ontracting officers may continue to use Part 49 as guidance to the extent that Part 49 does not conflict with [FAR 12.403] and the language of the termination paragraphs in 52.212-4.''[3] Courts and boards have referred to and relied on these standards, to varying degrees, when addressing commercial item terminations for convenience.

The percentage of work performed

In determining the ''percentage of work performed,'' we have seen a range of approaches by contracting parties as they successfully negotiate commercial item terminations for convenience. Often these approaches are driven by the particular facts surrounding the procurement, the nature of the items being procured, the various types of deliverables involved, and the methods reasonably available to the parties without resort to extensive audits or cost principles. These approaches reflect the practical reality that all ''commercial item'' contracts are not alike. Both in practice and by regulation, the umbrella of ''commercial item'' procurements is much broader than simple deliveries of off-the-shelf items.[4] In part, these successful approaches might also be viewed as an application of the principle of ''fairness'' in determining how, under a particular contract, ''the percentage of work performed'' should be measured.[5]

The courts and boards of contract appeals have also touched on this issue, using various approaches but also leaving some uncertainty about extent to which those approaches will have broader application.

For example, in *Red RiverHoldings*, the Armed Services Board of Contract Appeals (ASBCA) addressed a contract with daily hire rates for a ship to carry DoD cargo, and determined that the ''percentage of work performed'' should be measured by length of performance as compared to the original contract term.[6] That decision was later reversed on other grounds by the District Court of Maryland (discussed below), exercising its jurisdiction over appeals involving maritime contracts.[7]

In a different circumstance, the Civilian Board of Contract Appeals (CBCA) rejected arguments that the ''percentage of work performed'' should be calculated based solely on the length of performance. In *Dreamscapes, LLC*, the CBCA addressed the termination of a commercial services contract to thin trees on 98 acres of land, with a 90-day period of performance. The board specifically declined to calculate the percentage of work performed based on the number of days worked and, instead, based its determination on the number of acres completed.

The Court of Federal Claims has indicated still another approach. For example, in *United Partition*, the court examined a commercial item contract for delivery and demolition of prefabricated modular units.[8] At the time of the termination, the contractor had completed all work except the demolition of two buildings.[9] The court held that the termination entitled the contractor to payment for the work performed plus a reasonable profit.[10] To determine the amount owed, the court started with the full contract price, removed the anticipated price of the terminated work,[11] and deducted the unit price of work that did not conform to contract requirements.[12]

Charges that have resulted from the termination

Decisions addressing ''charges'' that ''have resulted from the termination'' also have been diverse. The Court of Federal Claims does not appear to have directly addressed this issue, and there are two very different histories before the ASBCA and the CBCA.

The ASBCA decision in *Red River* took a somewhat narrow approach.[13] In that case, the contractor sought to be paid not only the contract's monthly payments for the lease of its ship (up to the time of the termination for convenience), but also its unrecovered costs of acquiring and modifying the vessel for the contract.[14] The contractor argued that these were reasonable charges resulting from the termination.[15] But the board construed the FAR provision to include ''charges in the nature of settlement expenses'' and held that ''[i]ncurrence of costs solely for the purpose of contract performance, or incurrence of costs in anticipation of such performance, are not criteria under the FAR 52.212-4(l) 'reasonable charges' provision . . . .''[16]

As noted above, however, the District Court of Maryland reversed the board's decision on this point, reasoning in part that it was inconsistent with the ''longstanding principle that a contractor is not supposed to suffer as the result of a termination for convenience of the Government, nor to underwrite the Government's decision to terminate.''[17] The court held that costs incurred in anticipation of contact performance were recoverable, provided that such costs were neither avoidable nor adequately reflected as a percentage of the work performed.[18] The court then remanded the case to the ASBCA for reevaluation in light of the court's holding.

The CBCA has focused particularly on the principle, as set out in FAR 49, that ''[a] settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit.''[19] Accordingly, much like non-commercial contracts with the standard FAR Part 49 termination for convenience

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[3] FAR 12.403(a).

[4] *See* FAR 2.101 definition of ''commercial item''; *see also Precision Lift, Inc. v. United States*, 83 Fed. Cl. 661, 666 (2008) (noting that what constitutes a commercial item is ''broad, unclear, and will be interpreted as setting the 'commercial item' standard very low'').

[5] FAR 49.201(a) (''A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit.'').

[6] *Red River Holdings, LLC*, ASBCA No. 56316, 09-2 BCA ¶ 34,304 at 169,456-57.

[7] *Red River Holdings, LLC. v. United States*, 802 F. Supp. 2d 648, 660-63 (D. Md. 2011).

[8] *United Partition Sys. v United States,* 90 Fed. Cl. 74, 88-89, 91-93 (2009).

[9] *Id.* at 91-92.

[10] *Id.* at 91.

[11] *Id.* at 92.

[12] *Id.* at 93-94.

[13] *Red River Holdings, LLC*, ASBCA No. 56316, 09-2 BCA ¶ 34,304 at 169,456-57.

[14] *See id.*

[15] *See id.*

[16] *Id.* at 169,457.

[17] *Red River Holdings, LLC. v. United States*, 802 F. Supp. 2d 648, 660 (D. Md. 2011).

[18] *Id.* at 662.

[19] *Russell Sand & Gravel Co. v. Int'l Boundary & Water Comm'n*, CBCA No. 2235, 13-1 BCA ¶ 35,455 at 173,868 (*quoting* 49.201(a)).

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provisions, the CBCA has stated that a termination for convenience ''essentially acts to convert a fixed-price contract into a cost reimbursement contract.''[20] The board also noted that ''the use of business judgment, as distinguished from strict accounting principles, is the heart of a [termination] settlement'' and ''[c]ost accounting data may provide guides, but are not rigid measures, for ascertaining fair compensation.''[21] Following this approach, the CBCA has stated that entitlement to ''reasonable charges'' is governed by the rule of reasonableness.[22] And the CBCA and its predecessor boards have, for example, construed ''reasonable charges'' to include costs incurred ''in anticipation of performing the entire contract'' but that ''may not be fully reflected as a percentage of the work performed.''[23]

Conclusion. We have seen that federal agencies and contractors most often are able to negotiate terminations of commercial item contracts successfully by keeping their focus on achieving a fair and equitable resolution. But where terminations cannot be resolved through negotiations, the developing nature of this area of law means that there may be uncertainty about the standards that will ultimately apply. Contractors will need to carefully consider their choice of forum in any appeal. When it is particularly important to eliminate risks and uncertainties associated with a termination for convenience, the parties might also consider tailoring their contract's termination for convenience clause. Instead of using the language of FAR 52.212-4(l), the parties could modify the FAR 52.212-4(l) clause to reflect the language of the standard non-commercial termination for convenience clause of FAR 52.249-2, for which the law is more consistently applied.

[20] *Id*.

[21] *Id*. at 173,869.

[22] *Dreamscapes, LLC v. Dept. of Interior*, CBCA No. 1331, 09-1 BCA ¶ 34,032 at 168,334-35.

[23] *Jon Winter & Assocs*., AGBCA No. 2005-129-2, 2005 WL 1423636 at *5 (June 20, 2005); *see Russell Sand & Gravel Co. v. Int'l Boundary & Water Comm'n*, CBCA No. 2235, 13-1 BCA ¶ 35,455 at 173,868.