

FAR PT 12 Commercial Item Terminations for Convenience: IS FAIR COMPENSATION REQUIRED?

**AMERICAN BAR ASSOCIATION SECTION ON PUBLIC CONTRACT LAW
COMMITTEE ON COMMERCIAL ITEMS**

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• 1

BACKGROUND TRADITIONAL GOVERNMENT CONTRACTS

- **What is a Termination for Convenience ("T/C")?**
- **Purpose**
 - Need for flexibility
- **Effect**
 - No anticipatory profits on traditional government contracts
 - FAR PT 12 Commercial Item Contracts?
 - Comparison to private sector contracts
- **Contractor need to know**

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• 2

TRADITIONAL GOVERNMENT CONTRACTS FORMULA FOR RECOVERY

- **Basic Formula**

- Completed Deliverables at Contract Price
- + FAR 31.205-42 Termination Costs
- + Profit on Costs Other than Settlement Expense
- = Recovery

Subject to

- o Fair Compensation Principle, FAR 49.201
- o Loss Adjustment, FAR 49.203



FAR PT 12 COMMERCIAL ITEMS CONTRACTS - Formula for Recovery

- **Basic Formula**

- % of contract price reflecting % of completion
- + reasonable charges resulting from termination
- = Recovery

- **No Mention of :**

- o "Fair Compensation"
- o Loss Adjustment

- **Role of FAR PT 49 (Traditional Government Contracts)**

- o May use as guidance if not inconsistent with CI rules and clause. FAR 12.403(a).



FAR PT 12 COMMERCIAL ITEMS CONTRACTS – ISSUES

1. **WHAT IS THE % CONTRACT PRICE REFLECTING THE % COMPLETION?**
 - o % physical completion? % effort required?
2. **WHAT ARE REASONABLE *CHARGES* RESULTING FROM THE TERMINATION?**
 - o DOES “*CHARGES*” MEAN COSTS?
 - o ARE *CHARGES* RECOVERABLE IN TRADITIONAL CONTRACTS ALLOWABLE?
 - o ARE *CHARGES* NOT ALLOWABLE IN TRADITIONAL CONTRACTS ALLOWABLE?
3. **ARE THE “FAIR COMPENSATION” PRINCIPLE AND OTHER PRINCIPLES IN FAR PT 49 APPLICABLE?**



COMMERCIAL ITEM PRONG 1 – WHAT IS % CONTRACT PRICE REFLECTING THE % COMPLETION?

- I. **MEANS PAYMENT FOR COMPLETED ITEMS AT CONTRACT PRICE**
 - NOT % EFFORT REQUIRED FOR COMPLETION
 - SUPPORTING AUTHORITY
 - o *Red River Holdings, LLC*, ASBCA 56316, 09-2 BCA ¶134304
 - o *Corners & Edges, Inc. v. HHS*, cbca 762, 08-2 BCA ¶133961
 - o FAR 52.212-4, Alt. I (Oct 2008) for T & M/LH Contracts
- II. **SUBSTANTIALLY IDENTICAL TO TRADITIONAL GOVERNMENT CONTRACTS**
 - CONTRACTOR PAID FOR COMPLETED DELIVERABLES AT CONTRACT PRICE



**COMMERCIAL ITEM PT 2- WHAT ARE REASONABLE CHARGES
RESULTING FROM THE TERMINATION?**

- COMPARISON TO TRADITIONAL CONTRACTS

- **TRADITIONAL – “Termination Costs” , FAR 31.205-42**
 - Costs continuing after termination **CBCA - probably, DMD - maybe, ASBCA - no**
 - Unamortized Initial Costs **CBCA & DMD - yes, ASBCA - no**
 - Loss of Useful Value **CBCA - probably, DMD - maybe, ASBCA - no**
 - Rental Costs Under Unexpired Leases **CBCA & DMD - yes, ASBCA - no**
 - Unamortized Alterations of Leased Property **CBCA & DMD - yes, ASBCA - no**
- **FAR PT 12 Commercial Item**

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•7

**COMMERCIAL ITEM PT 2- WHAT ARE REASONABLE CHARGES
RESULTING FROM THE TERMINATION?**

- COMPARISON TO TRADITIONAL CONTRACTS

- **TRADITIONAL – “Termination Costs” , FAR 31.205-42 (continued)**
 - Subcontract Costs FAR 31.205-42(h)
 - Settlement Expense FAR 31.205-32(g) **CBCA, DMD AND ASBCA - YES**
- **FAR PT 12 Commercial Item (continued)**
- **TRADITIONAL – “Profit” , FAR 49.202**
 - Reasonable Profit on Costs Other Than Settlement Expense **DMD - No Profit on Prong 2**
 - No Anticipatory Profit **CBCA&GFC-no anticipatory profit, ASBCA ?**

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•8

ANTICIPATORY PROFIT AND POST TERMINATION UNABSORBED OVERHEAD

I. TRADITIONAL GOVERNMENT CONTRACTS

- ANTICIPATORY PROFIT AND POST T/C UNABSORBED OH UNALLOWABLE

II. COMMERCIAL ITEM CASELAW

- NO PROFIT ALLOWABLE ON PRONG 2
 - *Red River Holdings v. US*, 2011 WL 2160887 (DMD May 31, 2011) (“safety valve” rationale)
- NO ANTICIPATORY PROFIT
 - *Corners & Edges*, CBCA 762 08-2 BCA ¶ 33961
 - *Praecomm v. US*, 78 F. Cl. 5 (Fed. Cl 2007)(dictum)



ANTICIPATORY PROFIT AND POST TERMINATION UNABSORBED OVERHEAD (continued)

- ARGUMENT FOR ALLOWABILITY
 - Case Law Support for No Allowability Questionable
 - *Red River “Safety Valve”* Analysis by MD US District Court Irrational
 - *Corners & Edges* and *Praecomm* rely on *International Data Products v. US*, 492 F.3d 1317 (Fed. Cir. 2007) which is not a commercial item case
 - Inconsistent with Plain Meaning of CI Clause
 - Inconsistent With FASA Mandate to Adopt Standard Commercial Practices
 - FASA 8002(b)
 - Inconsistent With Standard Commercial Practice
 - UCC 2-708(2)



CASELAW

CBCA

Corners & Edges, Inc., CBCA 762, 08-2 BCA ¶ 33961

I. No Anticipatory Profits

II. Prong 1

% contract price reflecting % completion means payment for completed work at contract price.

III. Prong 2

- o Contractor entitled to reasonable charges resulting from T/C under prong 2
 - Cites cases from predecessor BCAs stating unamortized initial costs recoverable under prong 2
 - o *Divecom Services, LLP*, GSBCA 15996-COM, 04-2 BCA ¶ 32656
 - o *Jon Winter*, AGBCA 2005-129-2, 2005 WL 1423636 (June 30, 2005)



CASELAW

ASBCA

Red River, LLC, ASBCA 56316, 09-2 BCA ¶ 34304

I. FAR 49.201 "Fair Compensation" Principle Inapplicable to Commercial Item Terminations

II. Prong 1

% contract price reflecting % completion means payment for completed work at contract price.

III. Prong 2

- A. Confuses *costs* with charges
- B. Only settlement expense

IV. Reversed by US District Court for MD

- *Red River Holdings, LLC v. US*, 2011 WL 2160887 (May 31, 2011)



CASELAW
US DISTRICT COURT FOR MD

Red River, Holdings, LLC v, U.S., Civil No. PJM10-534, 2011 WL 2160887 (May 31, 2011)

- **Procedural Note**
 - US District Court Heard Appeal From ASBCA Because a Maritime Case
- **Holding**
 - **FAR 49.201 “Fair Compensation” Principle Applies**
 - **Prong 1**
 - % contract price reflecting % completion means payment for completed work at contract price.
 - **Prong 2**
 - Unamortized Initial Costs Allowable
 - Costs Continuing After Termination? (not at issue)
 - Profit
 - not allowable – prong 2 a “safety valve”
- **Reverses and Remands to ASBCA**



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• 13

CASELAW
US COURT OF FEDERAL CLAIMS

Praecom v U.S., 78 Fed. Cl. 5 (Fed. Cl. 2005)

- **COFC**
 - states in dictum:
“Under the termination-for-convenience clause anticipatory profits and consequential damages are not recoverable.”
 - Cites *International Data Products*, 492 F.3d 1317 (Fed. Cir. 2007)
- **Of Limited Precedential Value**
 - Dictum
 - *International Data Products* Not a Commercial Items Decision
 - Not Binding on Other COFC Judges



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• 14

STRATEGY

- CLAIM ANTICIPATORY PROFIT AND POST TERMINATION UNABSORBED OVERHEAD
- SAME STRATEGIES FOR MAXIMIZING RECOVERY AS TRADITIONAL GOVERNMENT CONTRACTS
 - charge indirect costs directly, utilize "fair compensation" principle, etc.
- CHOICE OF FORUM BASED ON PRESENT CASE LAW
 - AVOID ASBCA
 - DOD CONTRACT > COFC
 - CIVILIAN AGENCY > CBCA



ARTICLES

- P. Seidman, "Termination for Convenience of FAR PT 12 Commercial Item Contracts", 24 Nash & Cibinic Report ¶ 37 (August 2010)
- R. Nash and P. Seidman, "Postscript: Termination for Convenience of FAR PT 12 Commercial Item Contracts", 25 Nash & Cibinic Report ¶ 37 (August 2011) (Authors Express Differing Views)
- P. Seidman & D. Seidman, *Maximizing Termination for Convenience Settlements/Edition II-Part I*, BRIEFING PAPERS No. 08-3 (Feb. 2008)
- P. Seidman & D. Seidman, *Maximizing Termination for Convenience Settlements/Edition II-Part II*, BRIEFING PAPERS No. 08-5 (Apr. 2008)



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