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GUEST APPEARANCE

¶ 21 POSTSCRIPT II: TERMINATION FOR CONVENIENCE OF FAR PART 12 COMMERCIAL ITEM CONTRACTS

A special column by Paul J. Seidman, Seidman & Associates, P.C., Washington, D.C.

Two recent decisions of the Armed Services Board of Contract Appeals take another look at the commercial item termination for convenience provision in paragraph (l) of the "Contract Terms and Conditions—Commercial Items" clause in Federal Acquisition Regulation 52.212-4 and FAR 12.403(d). The first, *SWR, Inc.*, ASBCA 56708, 15-1 BCA ¶ 35832, 2014 WL 7084933, concerns the applicability of the ASBCA decision *Red River Holdings*, LLC, ASBCA 56316, 09-2 BCA ¶ 34304, 2009 WL 3838891, *rev'd on other grounds and remanded, Red River Holdings, LLC, v. U.S.*, 802 F. Supp. 2d 648 (D.MD 2011), in a subsequent nonmaritime ASBCA appeal despite having been overturned by the U.S. District Court for Maryland in a maritime case. The *Red River* ASBCA decision held that unamortized initial costs were not recoverable under prong 2 of the commercial item formula for recovery as reasonable charges resulting from termination because such charges were incurred before termination. The second recent decision, *TriRad Technologies, Inc.*, ASBCA 58855, 2015 WL 1009677 (Feb. 23, 2015), concerns recovery for work in process in a manufacturing contract under prong 1 as reasonable charges resulting from termination.

The *Red River* ASBCA decision was discussed in my *Guest Appearance, Termination for Convenience of FAR Part 12 Contracts: Is Fair Compensation Required?*, 24 N&CR ¶ 37. The U.S. District Court decision reversing the ASBCA was discussed by Ralph in a *Postscript* at 25 N&CR ¶ 37, as well as in my *Addendum* to his article.

Applicable FAR Provisions

The FAR 52.212-4(l) clause states:

> (l) *Termination for the Government's convenience*. The Government reserves the right to terminate this contract, or any part hereof, for its sole convenience. In the event of such termination, the Contractor shall immediately stop all work hereunder and shall immediately cause any and all of its suppliers and subcontractors to cease work. Subject to the terms of this contract, 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. The Contractor shall not be required to comply with the cost accounting standards or contract cost principles for this purpose. This paragraph does not give the Government any right to audit the Contractor's records. The Contractor shall not be paid for any work performed or costs incurred which reasonably could have been avoided.

Thus, the measure of contractor recovery for convenience terminations in commercial item contracts under this clause is the sum of (1) "a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination" and (2) "reasonable charges the Contractor can demonstrate to the satisfaction of the Government using its standard record keeping system, have resulted from the termination." The clause provides for proof of costs using a contractor's standard accounting system. It prohibits the Government from requiring a contractor to comply with the Cost Accounting Standards or Government contract cost principles and states it does not give the Government the right to audit the contractor's records. Under the FAR 52.212–4(l) Alternate I clause for time-and-materials and labor-hour contracts (1) is direct labor hours prior to

termination multiplied by the pertinent contract hourly rate(s) instead of the percentage of the contract price reflecting the percentage of completion.

As discussed in 24 N&CR ¶ 37, the measure of recovery under the second prong is stated differently in FAR 12.403(d):

(d) Termination for the Government's convenience.

(1) When the contracting officer terminates a contract for commercial items for the Government's convenience, the contractor shall be paid—

(i)(A) The percentage of the contract price reflecting the percentage of the work performed prior to the notice of the termination for fixed-price or fixed-price with economic price adjustment contracts; or

(B) An amount for direct labor hours (as defined in the Schedule of the contract) determined by multiplying the number of direct labor hours expended before the effective date of termination by the hourly rate(s) in the Schedule; and

(ii) Any charges the contractor can demonstrate directly resulted from the termination. The contractor may demonstrate such charges using its standard record keeping system and is not required to comply with the cost accounting standards or the contract cost principles in part 31. The Government does not have any right to audit the contractor's records solely because of the termination for convenience.

(2) Generally, the parties should mutually agree upon the requirements of the termination proposal. The parties must balance the Government's need to obtain sufficient documentation to support payment to the contractor against the goal of having a simple and expeditious settlement.

As can be seen, while the FAR 52.212-4(l) clause requires that a contractor demonstrate charges resulted from the termination "to the satisfaction of the Government," FAR 12.403(d)(1)(ii) requires proof that costs "directly" resulted from the termination. It does not require that proof be to the Government's satisfaction.

In addition, FAR 12.403 permits a Contracting Officer to use the provisions applicable to the termination of traditional Government contracts in FAR Part 49 as "guidance" to the extent such provisions do not conflict with FAR Part 12 or the commercial items clause. Such provisions include the FAR 49.201 guarantee that a terminated contractor will be fairly compensated. This guarantee has been held to override any other provision that would deprive a terminated contractor of fair compensation. See *Codex v. U.S.*, 226 Ct. Cl. 693, 23 GC ¶ 239 (1981); *Kasler Electric Co.*, DOTCAB 1425, 84-2 BCA ¶ 17374, 1984 WL 13424, 26 GC ¶ 326.

Judicial Interpretation And *Red River* ASBCA Decision

In my *Guest Appearance* at 24 N&CR ¶ 37, I analyzed the language and judicial interpretation of these provisions. The Civilian Board of Contract Appeals and the ASBCA interpreted the first prong—"a percentage of contract price reflecting the work performed"—as requiring payment for completed deliverables or services at the contract price. *Corners & Edges, Inc. v. Department of Health & Human Services*, CBCA 762, 08-2 BCA ¶ 33961, 2008 WL 4359431; *Red River Holdings*, LLC, ASBCA 56316, 09-2 BCA ¶ 34304, 2009 WL 3838891, *rev'd on other grounds and remanded, Red River Holdings, LLC, v. U.S.*, 802 F. Supp. 2d 648 (D. Md. 2011). The boards were split on the meaning of the second prong providing for recovery of reasonable charges resulting from termination.

The CBCA in *Corners & Edges* held that unamortized initial costs are recoverable under the second prong as reasonable charges resulting from termination, while the ASBCA in *Red River Holdings, LLC* held they are not. The ASBCA reasoned that since initial costs were incurred prior to termination, they did not result from the termination and are not recoverable under the second prong as a charge resulting from termination. The ASBCA rejected the contractor's contention that payment of unamortized initial costs was necessary for fair compensation as required by FAR 49.201 in traditional Government contracts.

My *Guest Appearance* at 24 N&CR ¶ 37 argues that *Red River* was wrongly decided by the ASBCA. The FAR 52.212-4(l) clause provides for recovery of *charges* rather than *costs* resulting from termination. Although initial *costs* did not result from a termination, it is reasonable to *charge* for such costs if unamortized after the termination. The board's interpretation is also contrary to the regulatory history of the provision at issue and the "fair compensation principle" requiring the Government to fairly compensate a terminated contractor.

Red River—U.S. District Court

Since *Red River* was a maritime case, it was appealed to the U.S. District Court in Maryland rather than to the U.S. Court of Appeals for the Federal Circuit. In *Red River Holdings, LLC, v. U.S.*, 802 F. Supp. 2d 648 (D. Md. 2011), the district court took a step in the right direction by reversing the ASBCA decision and holding (1) initial cost are recoverable under prong 2 as reasonable charges resulting from termination, and (2) the "fair compensation" principle applies to FAR Part 12 commercial item contracts.

In his *Postscript* at 25 N&CR ¶ 37, Ralph describes the district court decision in *Red River* as "a very sound interpretation of this somewhat cryptic language." My *Addendum* to that article states that although the decision is "a step in the right direction", '' 'unfair compensation' may result from (a) unnecessary language (*dictum*) indicating recovery for reasonable charges resulting from the termination under the second prong is limited to unamortized initial costs and (b) by [the court's] holding that profit is not allowable under prong two," which the court erroneously characterizes as a "safety valve."

SWR, Inc.

In *SWR, Inc.*, the Army, using FAR Part 12 procedures for the acquisition of commercial items, awarded SWR a fixed-price requirements contract for storing motor vehicles. A competitor filed a Government Accountability Office protest staying performance and the Army took corrective action by terminating the contract for convenience. Prior to termination, the contractor incurred site preparation, personnel, travel, and other costs in preparation for performance. Relying upon the ASBCA's opinion in *Red River*, the Army denied virtually all costs using a "heads I win, tails you lose" approach. According to the Army, such costs were not allowable under prong 1 based on physical completion because termination occurred prior to performance or under prong 2 as resulting from termination because the costs were incurred prior to termination.

● *Red River ASBCA Decision Not Binding Precedent*. The Army argued that the ASBCA was bound by its *Red River* decision despite the district court's reversal. According to the Army, the district court's opinion in *Red River* is not precedent because it was issued in a maritime case. The Army contended that for other than maritime cases, the ASBCA is bound by its own decisions and those of the U.S. Court of Appeals for the Federal Circuit. Judge Hartman, writing for the majority, rejected this argument, stating:

> Neither our decision in *Red River* initially construing FAR 52.212-4(1), the convenience termination clause for commercial item contracts, nor the decision on appeal in *Red River* of the district court which sets forth a differing interpretation of that clause, constitutes precedent that is "binding" in this appeal. The relevant part of our *Red River* decision was reversed during appellate review and thereby effectively vacated. *Red River*, 802 F. Supp. 2d at 648. . . . [W]hile the district court's decision in *Red River* was binding on this Board under the law of the case doctrine for further proceedings in the *Red River* appeal, it does not constitute legal precedent "binding" on the panel in this appeal.

● *Red River ASBCA Decision Wrongly Decided*. In his opinion, Judge Hartman traced the history of terminations for convenience of the Government back to the Civil War and provided a history of Government acquisition of commercial items and the rulemaking effort resulting in the commercial items termination for convenience clause at issue. Based on this history, the board decision states that the purpose of a termination for convenience clause is to enable the Government to cancel performance without incurring liability for anticipatory profits and "to fairly compensate the contractor and to make the contractor whole for the costs incurred in connection with the terminated work." The board interpreted the commercial items formula for recovery in a manner intended to achieve these purposes stating:

> The first prong of the sentence providing for payment to the contractor of "a percentage of the contract price reflecting the percentage of work performed" prior to the termination notice, by its plain language, specifies a means for compensating the contractor for the work it has done before termination. The second prong of the sentence providing for payment to the contractor of "reasonable charges" the contractor can "demonstrate" "have resulted from the termination," when read in conjunction with the first prong of the sentence relating to recovery for work completed, refers to the recovery of those charges incurred that "do not relate to work completed" but should be reimbursed to fairly compensate the contractor whose contract has been terminated.
>
> This interpretation of the second prong. . . is supported by the language of related termination for convenience clauses. See *Vazquez-Claudio* [*v. Shinseki*], 713 F.3d [112] at 115 [(Fed. Cir. 2013)] (regulation language must be read in the context of related regulatory

sections). FAR 52.212-4(1) has been referred to by some commentators as a "short form" termination clause because it sets forth a concise process or means by which a contractor whose contract has been terminated receives compensation. *See, e.g.*, Ralph C. Nash & Paul J. Seidman, *Postscript: Termination for Convenience of FAR Part 12 Commercial Item Contracts*, Vol. 25, No. 8, NASH & CIBINIC REPORT 37 (2011). The FAR instruction (FAR 49.502(c)) for another termination clause commonly referred to as "short form" (FAR 52.249-4) also uses the term "charges" with no definition of that word. This Board, and others, have construed the word "charges" with respect to that short form convenience termination clause as referring to: start-up costs; unrecovered running expense; preventive maintenance; settlement charges; and other charges that are normally paid pursuant to a long form termination for convenience clause to fairly compensate a contractor. *Carrier Corp.*, [GSBCA 8516,] 90-1 BCA ¶ 22,409 at 112,557; *Am. Maint. and Mgmt. Servs.*, [ASBCA 19556,] 76-2 BCA ¶ 11,960 at 57,341; *Trans-Student Lines*, [ASBCA 20230,] 75-1 BCA ¶ 11,343, at 54,027; *American Packers*, [ASBCA 14275,] 71-1 BCA ¶ 8846 at 41,128. Both the Court of Claims and Federal Circuit have held that a reasonable and consistent government interpretation is to be given great weight. *Santa Fe Engineers, Inc. v. United States*, 801 F.2d 379, 381 (Fed. Cir. 1986); *Honeywell, Inc. v. United States*, 661 F.2d 182, 186 (Ct. Cl. 1981).

Based on these principles the ASBCA concluded that the *Red River* ASBCA decision was wrongly decided. Under the correct interpretation, a contractor is entitled to "fair compensation," which includes the recovery of unamortized initial costs under prong 2. As stated by the board:

> Relying on our decision in *Red River*, 09-2 BCA ¶ 34,304, which was reversed, the Army maintains that. . . SWR cannot recover the charges because they arose "in advance of the termination date" and, as a matter of law, "cannot be said to logically result" from the "later" contract termination. As discussed at length above, after extensive review of FAR 52.212-4(1), the case law concerning convenience terminations, and the statutory and regulatory framework for such terminations, we have concluded that our initial interpretation of the second prong of the third sentence of FAR 52.212-4(1) set forth in the *Red River* decision, which was effectively vacated by the district court's reversal and is not now binding on us, was incorrect. We construe the third sentence of FAR 52.212-4(1) as simply setting forth a more simple, straightforward method or process for ascertaining fair compensation for a commercial items contract terminated for the government's convenience. Nothing in the language of FAR 52.212-4(1), or its authorizing statute, [the Federal Acquisition Streamlining Act], directs or suggests any deviation from the long-established rule of providing just or fair compensation to contractors who have had their contracts curtailed by the government under a convenience termination provision. The second prong of the third sentence, when read in the context of related clauses, refers to the recovery of unavoidable, reasonable charges incurred other than those relating to contract work completed (which was addressed under the first prong) that should be paid to fairly or justly compensate a contractor whose contract has been terminated.
>
> When the drafters of procurement regulations desire to limit or restrict recovery in a convenience termination, they know how to do so. A "short form" termination for convenience clause (for inclusion in service contracts) provides for no recovery other than for services rendered. . . . The second prong of the third sentence of FAR 52.212-4(1) contains no language limiting or restricting compensation where a contract has been terminated to payment essentially for services rendered. We decline to read such language into the clause where it now does not exist. [Citations omitted.]

My *Addendum* to the initial *Postscript*, 25 N&CR ¶ 37, criticizes the U.S. District Court for Maryland for characterizing prong 2 in *Red River* as a mere "safety valve." The board in *SWR* recognizes prong 2 is more than a "safety valve" in this case, stating:

> In sum, this is one of those unique cases commentators have postulated in support of their criticism of the *Red River* district court's characterization of the second prong of FAR 52.212-4(1) as simply a "safety valve." *See* Nash & Seidman,*Postscript: Termination for Convenience of FAR Part 12 Commercial Item Contracts*, Vol. 25, No.8, NASH & CIBINIC REPORT ¶ 37 (unfair compensation may result from unnecessary language indicating recovery for reasonable charges resulting from termination under second prong is limited and not subject to an award of profit), (citing *Red River*, 802 F. Supp. 2d at 662, n.18). In the appeal before us, there can be no recovery under the first prong of FAR 52.212-4(1) because the Army terminated the contract for convenience before work was performed under that contract. The contractor therefore is limited by the plain language of the convenience termination clause to recovery under the second prong of the third sentence of FAR 52.212-4(1), which here will be the basis for the just or fair compensation that the contractor is entitled to receive.

● *G&A Expense*. The Army contended that general and administrative expense is not allowable following the termination for convenience of a FAR Part 12 commercial items contract because a contractor is not required to comply with cost principles and is not subject to audit. The board rejected the Army's argument holding G&A expense recoverable on direct costs other than settlement expense and profit proven using the contractor's standard recordkeeping system. The board stated:

> The second prong, when read in conjunction with the first prong. . . relating to recovery for work completed, refers to the recovery of those charges incurred that "do not relate to work completed" but to work terminated and not performed that should be reimbursed to

> fairly compensate the commercial items contractor whose contract has been terminated. Indirect costs of G&A or home office overhead can be such a charge.

The board found that SWR proved an 11.8% G&A rate using QuickBooks, its standard recordkeeping system and was entitled to recover G&A expense on all costs "except with respect to settlement charges and profit." SWR did not claim G&A expense on either settlement expense or profit. The board's statement that G&A expense is not allowable on settlement expense and profit is *dictum*.

There is no basis for not allowing a contractor to recover G&A expense on settlement expense. Indirect costs on settlement expense are allowable under traditional Government contract under FAR 31.205-42(g)(iii) with a reduced indirect rate for normally indirect personnel charged directly. Not allowing a contractor to recover G&A expense on settlement expense deprives a contractor of fair compensation for the reasons stated by the board in rejecting the Army's contention that G&A expenses are not allowable on FAR Part 12 contracts for the acquisition of commercial items.

It does not make sense to allow G&A expense on profit. G&A is applied to costs. Profit is a fee rather than a cost.

● *Normally indirect costs charged directly*. The Army argued that the contractor was attempting to recover costs twice by removing them from G&A expense and charging them directly. The board held that there was no double recovery because the costs charged directly were removed from the G&A expense pool reducing the G&A rate.

After a termination for convenience a contractor is often left in a position where normal treatment of its indirect costs will not result in fair compensation. Under such circumstances, indirect costs may be charged as direct costs under the "fair compensation" principle. *Agrinautics*, ASBCA 21512, 79-2 BCA ¶ 14149, 1980 WL 120474, 22 GC ¶ 200. When charging what would otherwise be indirect costs as direct costs a contractor must avoid double counting by removing the costs from indirect cost pools. See generally Seidman & Seidman, *Maximizing Termination for Convenience Settlements/Edition II—Part I*, Briefing Papers No. 08-03, at 7 (Feb. 2008), as well as Seidman & Seidman, *Maximizing Termination for Convenience Settlements/Edition II—Part II*, Briefing Papers No. 08-5 (Apr. 2008).

SWR can be used to rebut auditor contentions that when a cost is removed from an indirect cost pool and charged directly, similar costs must also be removed in calculating the applicable indirect rate. *SWR* firmly establishes that only the costs removed from indirect cost pools and charged directly need be removed from the indirect cost pool.

● *Profit*. The opinion concludes with the following "SUMMARY":

> We reaffirm the well-established principle that, when the government elects to terminate for its convenience one of its contracts subject to a convenience termination clause, the contractor whose contract has been terminated is entitled to receive fair and just compensation from the government in the form of a termination settlement, *which does not include anticipated but unearned profits*. Commercial item statutes and their implementing FAR provisions contain no language indicating that their drafters had any intent to alter this principle, which has existed for approximately a century. [Emphasis added.]

SWR did not claim anticipatory profits. Nevertheless the board in *dictum* stated that anticipatory profits are unallowable in commercial item terminations. The board reasoned that this is the longstanding rule in traditional Government contracts and there is no indication that Congress or FAR drafters intended a change. Although this rationale supports the board's holding on the legal issues presented by the facts of the case, it does not support the board's gratuitous statement concerning anticipatory profits. The clear intent of commercial item legislation and implementing FAR provisions is to replace longstanding Government-unique rules with commercial practices. As stated in my *Addendum* to the initial Postscript, 25 N&CR ¶ 37:

> FASA [Pub. L. No. 103-355] § 8002(b)(1) directs that the FAR include, to the maximum extent practicable, only clauses—"(A) that are required to implement provisions of law or executive orders applicable to acquisitions of commercial items or commercial components, as the case may be; or (B) that are determined to be consistent with standard commercial practice." A termination for convenience clause is not required to implement a statute or executive order. FASA therefore requires that the termination for convenience clause be "consistent with standard commercial practice."
>
> "Standard commercial practice" is set forth in the [Uniform Commercial Code], which has been adopted in 49 states. UCC § 2-708(2) states that "the measure of damages [for cancellation by the buyer includes]. . . the profit (including reasonable overhead) which the seller

would have made from full performance by the buyer." Both costs unavoidably continuing after termination and profit on all costs incurred are recoverable under UCC § 2-708(2).

Standard commercial practice as reflected in UCC § 2-708(2) is for payment of anticipatory profit—the profit (including reasonable overhead) *which the seller would have made from full performance by the buyer*." (Emphasis added.) A terminated contractor is not entitled to anticipatory profit under a traditional Government contract, FAR 49.202.

* * *

In *Commercial Item Terms and Conditions: Neither Fish Nor Fowl*, 10 N&CR ¶ 61, Professor Cibinic criticized the inclusion of a termination for convenience clause in FAR Part 12 commercial item contracts as inconsistent with standard commercial practice. However, if anticipatory profits are recoverable under the commercial items formula, there would be no inconsistency.

The majority opinion in *SWR* held that profit should be paid under the second prong for reasonable charges resulting from termination. Judge Melnick's opinion concurring in part and dissenting in part states that it should not. This is the same position taken by the U.S. District Court for Maryland in its opinion in *Red River* reversing the ASBCA. The majority is correct and Judge Melnick's dissenting view is flawed for the reasons stated in my *Addendum*:

The court concludes that a contractor is not entitled to profit under the second prong because it may be able to recover some profit under the first prong. The first prong entitles a contractor to the percentage of contract price reflecting the percentage of completion.

The court justifies its position based on its characterization of the second prong as a "safety valve." This is the court's characterization. It has no basis in statute, legislative history, regulation, rulemaking history, or logic.

Prong two is not a mere "safety valve." Rather, it is the primary source of the net recovery to a terminated contractor. All that prong one does is restate the right to be paid for completed work at the contract price. It is irrelevant to the termination because the contractor is entitled to such amount under the paragraph (i) "Payment" term of the FAR 52.212-4 "Terms and Conditions—Commercial Items" clause irrespective of whether the contract is terminated for convenience.

● *Proof of Costs*. The second prong for recovery in the FAR 52.212-4(l) provides for recovery of "reasonable charges the Contractor can demonstrate to the satisfaction of the Government *using its standard record keeping system*, have resulted from the termination" (emphasis added). FAR 12.403(d) does not require that proof be to the Government's satisfaction or that a contractor prove its costs using its standard recordkeeping system.

Judge Hartman, writing for the majority, denied SWR's claimed cost of $6 million for storage tents stating:

Accordingly, to recover fabric structure cost here, SWR must at a minimum show "using its standard record keeping system" that it actually incurred such cost. We agree with the Army that SWR has not made that showing here.

* * *

While SWR appears to suggest we are free to accept the testimony of [SWR's vice president] that a $6 million purchase of fabric structures occurred here between SWR and [a subcontractor] and simply make such a finding, SWR's suggestion contravenes the express language of the convenience termination clause of its contract. Under the clause, a contractor is entitled to payment of charges it can "demonstrate to the satisfaction of the Government using its standard record keeping system," not any charges asserted under oath by a company official.

The majority opinion states that even if the board could consider SWR's vice president's testimony as proof it would come to the same result because his testimony was not credible.

Judge Melnick's opinion concurring in part and dissenting in part criticizes the majority opinion for limiting proof of costs by a contractor's standard recordkeeping system. Judge Melnick stated such a limitation on proof is unfair and an improper interpretation when the FAR 52.212-4 clause is read in the context of FAR 12.403(d).

The repartee between the majority and the dissent appears to be "Much Ado About Nothing." Judge Melnick agreed that SWR is not owed the $6 million but arrived at this conclusion based on a different rationale—SWR's failure to mitigate costs The majority in footnote 9 appears to retreat from limiting proof of costs to a contractor's standard recordkeeping system, stating:

Finally, the dissent suggests we impose a "special evidentiary burden" on commercial item contractors barring them "as a matter of law" from demonstrating their convenience termination claims with any evidence other than a "contractor record." Once again, we do no such

> thing here. In resolving this appeal, we examine and rely on, among other things, emails sent by the government, invoices generated by lessors, and bills of lading obtained by [a subcontractor], none of which constitutes a "contractor record." As best we can ascertain, the dissent's true disagreement with our decision is that we abide by well-established legal precedent requiring a contractor to prove costs it incurred *(Lisbon Contractors,* [*Inc. v. U.S.*], 828 F.2d [759] at 767 [(Fed. Cir. 1987)]; *Dehdari Gen. Trading*, [ASBCA 53987,] 03-1 BCA ¶ 32,249 at 159,450

● *A Well-Reasoned Opinion With Questionable Dictum*. The *SWR* majority opinion by Judge Hartman is an excellent primer on the evolution of terminations for convenience and the acquisition of commercial items under FAR Part 12. It is well reasoned. I agree with its conclusions with the exception of its gratuitous statements that G&A expense is not allowable on settlement expense and anticipatory profits are not recoverable. Such statements on matters not at issue in the case are *dictum* that is not binding precedent. It is unclear what effect the ASBCA and other tribunals will give to these gratuitous statements in future cases.

TriRad Technologies

TriRad concerned an Air Force contract for commercial flight simulators. The contractor delivered one flight simulator that the Air Force rejected. The Air Force terminated the contract for cause based on two failed inspections but subsequently converted the termination for cause to a termination for convenience. TriRad submitted a termination settlement proposal claiming partially completed simulators as initial costs under prong 1 based on percentage of completion. TriRad claimed storage costs and settlement expense under prong 2 as reasonable charges resulting from termination.

● *Percentage of Contract Price Reflecting the Percentage of Completion*. The Air Force contended that TriRad could not recover under prong 1 because no deliverables were accepted. It further contended that if recovery were allowed under prong 1 for partially completed items, TriRad must provide cost records to prove percentage of completion. The board rejected both arguments, stating:

> We conclude that the only reasonable interpretation of "a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination" is that it applies to all work performed including partially completed items on the production line at the time of termination. This interpretation establishes a simple mathematical calculation to arrive at compensation that does not require cost data required by Part 49. This is consistent with the language of FAR 52.212-4(1) and the stated intent behind Part 12. . . .
>
> The methodology for calculating the percentage of the contract price due the contractor is straightforward, for each unit: (1) determine the percentage of completion at termination, and (2) multiply the percentage of completion times the contract price for that unit. Cost and payroll data is not required to prove percentage of completion as [Contracting Officer] Pritchett demanded. . . . The resulting amount will increase the percentage of the price that represents profit, G&A and start-up costs relating to the work performed.

The board determined physical completion based on expert testimony at trial but excluded startup costs claimed by TriRad under prong 1 from its calculation.

● *Proof of Reasonable Charges Resulting From Termination*. The Air Force contended that TriRad could not recover costs claimed under prong 2 as reasonable charges resulting from termination because it did not prove such costs "to the government's satisfaction" as required for recovery. TriRad claimed storage costs and settlement expense under prong 2. The board disallowed some storage costs because TriRad did not mitigate expenses but allowed the recovery of all claimed settlement expense. The board allowed TriRad to recover under prong 2 the startup costs held not recoverable based on physical completion under prong 1.

In arriving at this determination, the board looked beyond TriRad's standard recordkeeping system, stating: "We do not interpret the language 'using its standard record keeping system' so narrowly as to preclude recovery if a contractor's 'standard record keeping system' is lacking sophistication. Indeed, in *SWR* we relied upon 'records other than the contractor's own standard record keeping system, e.g., contemporaneous Army and SWR emails discussing the Pineridge Farms site lease' when we allowed SWR to recover a $15,000 payment to end a lease."

Under prior cases, the percentage of completion was interpreted as requiring payment for completed deliverables at the contract price. These cases are unlike *TriRad* because there were no partially completed deliverables. As I discussed in 24

N&CR ¶ 37, recovery based on such an interpretation under a commercial item contract is a rough equivalent of that for a traditional Government contract. In each case, the contractor receives payment for completed work at the contract price plus costs resulting from termination.

TriRad departs from this approach. Part of a contractor's price is profit. Recovery of the percentage of contract price for partially complete items will in some cases result in recovery of what would be anticipatory profit if the cost of performance were claimed under prong 2.

Strategy

First, my recommendation that contractors avoid the ASBCA in cases concerning commercial item terminations for convenience in my original article at 24 N&CR ¶ 37 and *Addendum* at 25 N&CR ¶ 37 is withdrawn. It is no longer necessary after SWR in which the board has disavowed its decision in *Red River*. Under *SWR*, a terminated commercial item contractor is entitled to fair compensation which includes recovery of its unamortized initial costs at the ASBCA. Second, the board's gratuitous statements (dictum) in *SWR* concerning G&A expense on settlement expense and anticipatory profit are precedent. Nevertheless, *dictum* is not binding on the ASBCA in a future case. Third, the Government will likely contest contractor claims to anticipatory profit. Work is often more difficult and involves greater risk early in performance. A terminated contractor can often increase profit without claiming anticipatory profit by using a structured approach such as Defense FAR Supplement 215.404-71 weighted guidelines to frontload the profit. Finally, percentage of completion accounting is used for financial reporting on long-term contracts. Although not required the supporting records could be used to prove percentage of completion under prong 1. *Paul J. Seidman*