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¶ 26 POSTSCRIPT III: TERMINATION FOR CONVENIENCE OF FAR PART 12 COMMERCIAL ITEM CONTRACTS

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The Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, and Federal Acquisition Reform Act of 1996, Pub. L. No. 104-106, mandated a preference for the purchase of commercial items using simplified procedures more akin to those in the commercial marketplace. To implement this congressional mandate rulemakers promulgated Federal Acquisition Regulation Part 12 for "Acquisition of Commercial Items" and the FAR 52.212-4 "Contract Terms and Conditions—Commercial Items" clause.

Terminations for convenience of traditional Government contracts are governed by required forms, arcane inventory procedures, the Truth in Negotiations Act, Cost Accounting Standards, and Government contracts cost principles. See Seidman and Seidman, *Maximizing Termination for Convenience Settlements/Edition II/Part I* and *Part II*, 08-3 BRIEFING PAPERS 1 (Feb. 2008), and 08-5 BRIEFING PAPERS 1 (Apr. 2008); Seidman and Banfield, *Preparing Termination Settlement Proposals for Fixed-Price Contracts*, 97-11 BRIEFING PAPERS 1 (Oct. 1997). The Government scrapped this approach for new FAR Part 12 rules for commercial item contracts. In its place is the "Termination for Convenience" clause for Government purchases of commercial items that appears as paragraph (l) of the FAR 52.212-4 "Terms and Conditions—Commercial Items" clause and FAR 12.403 entitled "Termination." The FAR 52.212-4, paragraph (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.

This *Guest Appearance* (1) provides a history of the case law interpreting the FAR 52.212-4(l) clause, (2) analyzes the Armed Services Board of Contract Appeals' recent decision in *Green Bay Logistic Services Co.*, ASBCA 61063, 18-1 BCA ¶ 37031, 2018 WL 1964934, (3) compares recovery under traditional Government contracts, (4) provides practice pointers, and (5) notes that in some cases this "simplified" provision has added complexity to the termination process.

Case Law Interpretation Of The FAR 52.212-4(l) Commercial Item Formula For Recovery

When a commercial item contractor is terminated for convenience it is entitled to recover the percentage of contract price reflecting the percentage of completion, commonly referred to as prong 1, plus reasonable charges resulting from termination, commonly referred to as prong 2. The purpose of this provision was to simplify the termination for convenience process. Nevertheless, it took 20 years after the promulgation of this FAR provision in 1995 for a judicial consensus concerning the meaning of this "simplified" provision.

In *Red River Holdings, LLC*. ASBCA 56316, 09-2 BCA ¶ 34,304, 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), and *Corners & Edges, Inc. v, Department of Health &*

Human Services, CBCA 762, 08-2 BCA ¶ 33,961, 2008 WL 4359431, the ASBCA and the Civilian Board of Contract Appeals agreed prong one meant the percentage of physical completion at termination multiplied by the contract price but disagreed on the meaning of prong 2. The CBCA in *Corners & Edges* and its predecessor boards held unamortized initial costs are recoverable under prong 2 as reasonable charges resulting from termination, *Corners & Edges; Divecon Services, L.P. v. Department of Commerce*, GSBCA 15997-COM, 04-2 BCA ¶ 32,656, 2004 WL 1405648; *Jon Winter & Associates*, AGBCA 2005-129-2, 2005 WL 1423636 (June 20, 2005).

The ASBCA in *Red River* held that unamortized initial costs were unallowable under prong 2. The ASBCA reasoned that such costs could not have resulted from the termination because they were incurred prior to the termination. This deprived contractors of fair compensation. It also made little sense. The commercial item clause speaks of reasonable *charges* resulting from termination rather than reasonable *costs* resulting from termination. Although unamortized initial costs are not the result of termination it is reasonable to charge for such costs to fairly compensate the contractor. This is evident from the allowability of unamortized initial costs under FAR 31.205-42 in traditional Government contracts because terminations "generally give rise to...the need for special treatment of costs that would not have arisen had the contract not been terminated."

The *Red River* and *Corners & Edges* board cases are discussed in detail in *Termination for Convenience of FAR Part 12 Commercial Item Contracts: Is Fair Compensation Required?*, 24 N&CR ¶ 37. A *Postscript*, 25 N&CR ¶ 37, discusses the reversal of the ASBCA decision in *Red River* by the U.S. District Court in Maryland in *Red River Holdings, LLC v. U.S.*, 802 F. Supp. 2d 648 (D. Md. 2011). The *Red River* appeal from the ASBCA was decided by the U.S. District Court in Maryland rather than the U.S. Court of Appeals for the Federal Circuit because it is a maritime case.

SWR, Inc, ASBCA 56708, 15-1 BCA ¶ 35832, 2014 WL 7084933, is the most significant commercial item termination for convenience case to date. In *SWR*, the ASBCA held that its decision in *Red River* was in error and that unamortized initial costs are recoverable following a commercial item termination for convenience. The board explained the relationship of prong 1 and prong 2 as follows:

> 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.

The board also held that a commercial item contractor was entitled to recover general and administrative expense and a reasonable profit. The board stated in *dictum* that anticipatory profit was not recoverable. The board denied compensation of $6 million in material costs based solely on the testimony of SWR's president stating: "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."

In *TriRAD Technologies*, ASBCA 58855, 15-1 BCA ¶ 35,898, 2015 WL 1009677, the board held that the percentage of completion under prong 1 includes, "all work performed including partially completed items on the production line at the time of termination." Under prior cases the percentage of completion was interpreted as requiring payment for completed deliverables at the contract price. The Air Force contended TriRAD was not entitled to recover certain costs under prong 2 because it had not proven them to the Contracting Officer's satisfaction. The board allowed the claimed costs in part 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.

SWR and *TriRAD* are discussed in detail in *Postscript II*, 29 NCRNL ¶ 21.

Green Bay

Unlike almost all prior cases, *Green Bay Logistic Services Co.*, ASBCA 61063, 18-1 BCA ¶ 37,031, 2018 WL 1964934, focuses primarily on prong 1 recovery based on percentage of completion rather than reasonable charges resulting from

termination recoverable under prong 2. The case concerns a June 1, 2016 contract for a lease awarded to Green Bay for two flatbed or stakebed diesel trucks. The contract required trucks "less than three (3) years old (based on vehicle model year)." This required that trucks be no older than model year 2014. Green Bay tendered two model year 2000 Mercedes trucks. The Government rejected the trucks as noncompliant. Instead of providing newer trucks as required by the contract, Green Bay tendered even older trucks—a 1989 Mercedes Truck and a 1996 Mercedes truck. Green Bay invoiced one month's rent in the amount of $3,740. The Government paid the invoice despite the fact the trucks were nonconforming and never delivered. The CO terminated the contract for convenience. Green Bay submitted a termination settlement proposal for the rent it had paid for use of the noncompliant trucks and cost of modifications required to meet Government specifications. The Termination Contracting Officer issued a decision allowing Green Bay to keep the $3,740 paid for one month's rent but no additional compensation because its "percent of completion for this contract is 0%." The ASBCA denied Green Bay's appeal stating:

> The government properly declined acceptance of both attempts to deliver non-compliant vehicles. Green Bay never attempted to deliver compliant vehicles. The government's determination that Green Bay completed zero percent of the contract was accurate. Thus, Green Bay is not entitled to recovery under the first prong of the analysis.
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> For the second prong of the analysis, Green Bay did not present any "reasonable charges the Contractor can demonstrate to the satisfaction of the Government using its standard record keeping system, have resulted from the termination." We have previously held that this second prong "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." *SWR*, 15-1 BCA ¶ 35,832 at 175,223 (original quotations omitted). Green Bay solely provided costs for leasing the vehicles it intended to use to perform the contract. Because Green Bay did not submit any amounts not related to the work completed, it cannot recover any charges under the second prong.
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> Had Green Bay submitted an opening brief, it might have argued that the payments it made for the various leased vehicles should be analyzed under the second prong of the analysis. Even if we review the claimed amount under the second prong, we cannot agree that entering multiple non-reimbursable lease agreements for non-compliant vehicles were reasonable charges that imposed upon the government a requirement to pay. As stated above, Green Bay presented invoices to the government that demonstrated payment for two separate non-reimbursable leases, arguing that because it made payments for the leases that it was entitled to recover those amounts. Even if Green Bay paid for the two separate non-reimbursable leases, the vehicles never complied with the contract and, therefore, are not reasonable charges. Indeed, the leases that Green Bay provided to the TCO demonstrate that the vehicles did not comply with the contract because the vehicles were more than three years old. Thus, Green Bay still cannot recover under the second prong.

Green Bay holds that percentage of completion under prong 1 is based on the percentage of conforming completion performed prior to termination. There was no conforming completion because the tendered trucks were older than permitted by specification. The contractor did not claim any cost as reasonable charges resulting from termination under prong 2. The board states that it would have disallowed costs as unreasonable because Green Bay incurred the costs to acquire and modify noncompliant trucks.

Compare the ASBCA's award of all claimed prong 1 costs in *TriRAD*, which concerned an Air Force contract for 10 flight simulators. The CO initially terminated the contract for cause because simulator one failed acceptance testing, but converted it to a termination for convenience after an appeal to the ASBCA. In contesting the termination for convenience, the Air Force argued the contractor was not entitled to recover for simulator one under prong 1 based on percentage of completion because simulator one was noncompliant. The ASBCA rejected this position stating: "The Air Force abandoned any argument that TriRAD was not entitled to be paid pursuant to [FAR] 52.212-4(1) for work it performed when it converted the termination from one for cause to one for the convenience of the Air Force." (Footnote omitted.) See discussion of *TriRAD* in *Postscript II*, 29 NCRNL ¶ 21.

The Board's hypothetical disallowance of costs recoverable under prong 2 in *Green Bay* is consistent with traditional Government contracts where recovery for defective or nonconforming work is allowed if the defect did not result from willful misconduct or gross negligence. *Morton-Thiokol, Inc.*, ASBCA 32629, 90-3 BCA ¶ 23,207, 32 GC ¶ 254. See the discussion of recovery for defective or nonconforming work in 08-5 Briefing Papers 1, at 3–4. Green Bay's incurrence of costs for trucks older than permitted by the contract is clearly willful misconduct or gross negligence. The contractor's second tender of too old trucks borders on the bizarre. Instead of correcting the deficiency resulting in the initial rejection Green Bay provided even older trucks in its second tender.

Termination Recovery Under FAR Part 12 Commercial Item And Traditional Government Contracts Compared

The two-prong recovery in a commercial item contract is a rough equivalent of contractor recovery following the termination for convenience of a traditional Government contract.

First, under a traditional Government contract the contractor receives payment for completed deliverables at the contract price. The result is the same under prong 1 of the commercial item formula providing for payment of the percentage of contract price reflecting the percentage of completion at termination, *SWR* and *Corners & Edges*. However only commercial item contracts provide for recovery for partially completed deliverables based on percentage of completion instead of costs incurred, *TriRAD*.

Second, FAR 31.205-42 provides for the recovery of unamortized performance costs and costs unavoidably continuing after termination. *Corners & Edges* and *SWR* held that prong 2 of the commercial item formula for reasonable charges resulting from termination includes unamortized performance costs. Based on the rationale in these cases, the formula would also appear to include costs unavoidably continuing after termination. The ASBCA allowed recovery for costs unavoidably continuing after termination in *TriRAD*.

The commercial item standard of reasonable charges resulting from a termination is broader than the particular continuing costs allowable under the FAR 31.205-42 cost principle for traditional Government contracts. FAR 31.205-42 provides for the recovery of particular costs resulting from a termination, while the commercial items provision allows the recovery of all reasonable charges resulting from the termination.

The Government often relies on FAR Part 49 rules to deny recovery of post-termination unabsorbed overhead and anticipatory profit. See *Defense Contract Audit Agency Contract Audit Manual* ¶ 12-305.7b concerning post-termination unabsorbed overhead and ¶ 12-307a concerning anticipatory profit. However, it appears reasonable to charge post-termination unabsorbed overhead and profit resulting from a termination for convenience of a commercial item contract. This is evident from Uniform Commercial Code § 2-708(2), applicable to private sector contracts, which defines "damages" as including "the profit (including reasonable overhead) that the seller would have made from full performance by the buyer."

In *Corners & Edges*, the CBCA held that anticipatory profits are not recoverable under the commercial item clause. The ASBCA stated the same in *dictum* in *SWR* and *Dellew Corp.*, ASBCA 58538, 15-1 BCA ¶ 35,975, 2015 WL 2256767. There is a cogent argument for the recovery of anticipatory profit. As stated in my *Addendum* to the initial *Postscript*, 25 N&CR ¶ 37, and quoted in *Postscript II*, 29 NCRNL ¶ 21:

> 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."
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> "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).
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> 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.
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> 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.

Third, the cost-based formula for a traditional Government contract provides for a downward loss adjustment if a contract would be completed at a loss. A similar downward adjustment results from prong 1 of the commercial item formula that provides for recovery of the percentage of contract price reflecting the percentage of completion at termination. Irrespective of costs prong 1 recovery cannot exceed the contract price.

The burden of proof for a loss adjustment differs. In a traditional Government contract the Government must prove (1) the contractor operated at a loss and (2) the amount of such loss. *Maitland Bros.Co.*, ASBCA 43088, 93-3 BCA ¶ 26,007, 1993 WL 145464, *aff'd on recons.*, 94-1 ¶ 26,285, 1993 WL 325114. The Government often has difficulty meeting this burden of proof absent an admission from the contractor. The DCAA *Contract Audit Manual* requires auditors to ask contractors for an estimate to complete but recognizes that there is no contractual requirement for a contractor to provide it. CAM ¶ 12-307a.(2) (2018); see discussion on avoiding loss adjustments in 08-5 Briefing Papers 1, at 7–8. In a commercial item Government contract, the burden of proving the percentage of contract price reflecting the percentage of completion is on the contractor.

Strategy

In *Green Bay*, the ASBCA noted that the contractor did not contend that it was entitled to any recovery under prong 2 as a reasonable charge resulting from termination. Contractors should consider whether they are entitled to claim costs under prong 2 as reasonable charges resulting from termination. Costs not recoverable under prong 1 "that 'do not relate to work completed' but should be reimbursed to fairly compensate the commercial items contractor whose contract has been terminated" are recoverable under prong 2, *SWR*. Such costs include unamortized initial costs. *SWR* and *Corners & Edges*. As stated by the ASBCA in *TriRAD*:

> TriRAD is also entitled to reimbursement of its uncompensated start-up costs. We have held that the percentage of completion amounts included a percentage of start-up costs. Start-up costs would have been allocated to all of the simulators and since the total percent of completion is 56.14% there remain 43.86% of start-up costs that are not compensated in the percent completion amount.

Green Bay holds that nonconforming work does not count towards the percentage of completion under prong 1. Consideration should be given to claiming costs in the alternative under prong 1 and prong 2 where the Government contends work is noncompliant.

Consideration should also be given to claiming anticipatory profit. As previously stated there is a cogent argument for the recovery of anticipatory profit based on FASA rules governing commercial item procurement. The Federal Circuit has not yet spoken on the issue. In *Palantir v. U.S.*, 904 F.3d 980 (Fed. Cir. 2018), 60 GC ¶ 287, the Federal Circuit has shown that it will enforce statutory requirements relating to the acquisition of commercial items given short shrift by contracting personnel and rejected by the Government Accountability Office in *Palantir USG, Inc.*, Comp Gen. Dec. B-412746, 2016 CPD ¶ 138. See *Commercial Products and Services: Raising the Market Research Bar or Much Ado About Nothing?*, 32 NCRNL ¶ 52.

Commercial Item Formula More Complex In Some Cases

In a traditional Government contract a termination for convenience converts what was a fixed-price contract to a cost-reimbursement contract. All that a contractor need prove to recover costs up to the contract price is incurrence. *Durette, GmbH*, ASBCA 34072, 91-2 BCA ¶ 23,756, 1991 WL 17898. To recover based on percentage of completion under prong 1, *Green Bay* requires that a contractor prove its percentage of compliant completion. One wonders if this is the sort of simplification intended when the commercial item provisions were added to the FAR.

Fortunately, in most cases partially completed deliverables and percentage of completion are not at issue. The Government routinely pays for completed deliverables at the contract price without submission of a termination settlement proposal. This leaves only prong 2 reasonable charges resulting from termination at issue in the termination settlement proposal. *Paul J. Seidman*