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¶ 66 POSTSCRIPT IV: TERMINATION FOR CONVENIENCE OF FAR PART 12 COMMERCIAL ITEM CONTRACTS

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In a recent decision, *Microtechnologies LLC dba Microtech* v. *Department of Justice*, CBCA 6772, 21-1 BCA ¶ 37,830, 2021 WL 1327479, involving the termination for convenience of a commercial item contract, the Civilian Board of Contract Appeals denied the contractor's motion for summary judgment seeking recovery of termination costs. The contractor appealed this decision to the U.S. Court of Appeals for the Federal Circuit on July 26, 2021, which docketed it as No. 21-2169.

Westlaw lists *Microtech* as the case most critical of *SWR, Inc.*, ASBCA 56708 15-1 BCA ¶ 35,832, 2014 WL 708493, the leading case on recovery under the commercial item clause. See Seidman, *Postscript III: Termination for Convenience of FAR Part 12 Commercial Item Contracts* 33 NCRNL ¶ 26. *Microtech*'s application is much broader than *SWR*'s. *Microtech* distinguishes cases relating to the termination for convenience of commercial item and traditional Government contracts because this termination resulted from a mistaken option exercise. *Microtech* also makes a questionable statement limiting the recovery of precontract costs where performance has not commenced.

As discussed in several prior *Guest Appearance* articles, the Federal Acquisition Regulation 52.212-4(l) commercial item termination for convenience clause entitles a terminated commercial item contractor to 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"). See Seidman, *Termination for Convenience of FAR Part 12 Commercial Item Contracts: Is Fair Compensation Required?*, 24 N&CR ¶ 37, and *Postscripts* at 25 N&CR ¶ 37, 29 NCRNL ¶ 21, and 33 NCRNL ¶ 26, for a discussion of rules applicable to FAR Part 12 commercial item contracts.

Microtech Facts

Microtech involved a delivery order for workstation perpetual software licenses and software maintenance. The resulting contract had one base year, from September 29, 2017, to September 28,

2018, and two option years. The contractor alleged (but according to the board provided no proof) that at the outset of base year performance it purchased software licenses for the base year and both option years.

On Sunday, September 30, 2018, at approximately, 2:30 p.m., two days after the base period expired, the contractor advised the agency it had not heard whether the option had been exercised. At approximately 6:30 p.m. the agency forwarded bilateral modification 2 exercising the option in the amount of $688,051.80 to the contractor for signature. The contractor signed modification 2 and returned it at approximately 9:10 p.m.

By email dated Monday, October 1, 2017, at 8:37 a.m., the agency advised the contractor that it had exercised the option in error. Attached proposed bilateral modification 3 stated: "The purpose of this modification is to terminate Option Year One. The option year was exercised in error."

The contractor did not sign the proposed modification. On October 2, 2018, the agency sent a unilateral modification terminating the contract for convenience.

Footnote 2 Exception To Termination for Convenience Recovery

Footnote 2 in the board's decision states:

> Appellant relies upon *Dream Management, Inc. v. Department of Homeland Security*, CBCA 5517, 17-1 BCA ¶ 36,716; *ACM Construction & Marine Group, Inc. v. Department of Transportation*, CBCA 2245, et al., 14-1 BCA ¶ 35,537; *Rex Systems, Inc.*, ASBCA 59624, 16-1 BCA ¶ 36,350; *SWR, Inc.*, ASBCA 56708, 15-1 BCA ¶ 35,832 (2014); and *Information Systems & Networks Corp.*, ASBCA 46119, 02-2 BCA ¶ 31,952. These decisions do not address the issue of entitlement to termination costs arising from a termination of an erroneously exercised option period.

The meaning of *Microtech* is hidden. One is unaware of its scope without perusing footnote 2 *and* the cited cases. *Microtech* is purely a commercial item case. However, *Rex Systems, Inc.*, ASBCA 59624, 16-1 BCA ¶ 36,350, 2016 WL 1715458, and *Information Systems & Network Corp.*, ASBCA 46119, 02-2 BCA ¶ 31,952, 2002 WL 1501660, cited by the board, concern traditional Government contracts.

Neither the FAR 52.212-4(l) termination for convenience clause for commercial item contracts, nor the FAR 52.249-2 termination for convenience clause for traditional fixed-price contracts, nor any other termination for convenience clause limits recovery based on the reason a contract is terminated for convenience. A contractor that has been terminated for convenience therefore is entitled to termination costs even if the contract was a commercial item contract that could have been terminated for cause or a traditional Government contract that could have been terminated for default. See *TriRad Technologies, Inc,* ASBCA 58855, 15-1 BCA ¶ 35,898, 2015 WL 1009677 (commercial item contract), discussed in *Postscript II*, 29 NCRNL ¶ 21, and *Postscript III*, 33 NCRNL ¶ 26; and *Phoenix Data Solutions LLC f/k/a Aetna Government Health Plans,* ASBCA 60207, 18-1 BCA ¶ 37,164, 2018 WL 529997, 60 GC ¶ 360 (traditional Government contract).

Cross Motions For Summary Judgment

In *Microtech*, the parties filed cross motions for summary judgment. Mere allegations are insufficient to prevail on or defeat a motion for summary judgment. Proof of the facts alleged is required. See generally Federal Rule of Civil Procedure 56 and *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S. Ct. 2548 (1986).

The contractor lost because the board determined that it had failed to prove essential elements of its case. The board found that the contractor did not prove, among other things, that it had purchased the software maintenance nor provided it to the Government for the option year.

Precontract Costs

The board's finding that the contractor did not provide software maintenance during the option year would have been relevant had the contractor claimed recovery under prong 1 based on percentage of completion. However, it is irrelevant to the contractor's claim for reasonable charges resulting from termination under prong 2. It is also inconsistent with cost principles for traditional fixed-price Government contracts.

The FAR 52.212-4(l) commercial item termination for convenience clause provides for prong 2 recovery of reasonable charges resulting from termination. It is reasonable to charge for a cost under prong 2 if it would be allowable under Government contract cost principles.

The commercial item standard of reasonable charges resulting from a termination is broader than the particular costs allowable under the general cost principles in FAR Part 31 and FAR 31.205-42 cost principle for traditional Government contracts. Such cost principles provide for the recovery of particular costs resulting from a termination, while the commercial items provision provides for recovery of all reasonable charges resulting from the termination. See Seidman & Seidman, *Maximizing Termination for Convenience Settlements/Edition II—Part I*, 08-3 Briefing Papers 1 (Feb. 2008), and Seidman & Seidman, *Maximizing Termination for Convenience Settlements/Edition II—Part II*, 08-5 Briefing Papers 1 (Apr. 2008), for a discussion of the rules applicable to the termination for convenience of a traditional Government contract.

Such position is consistent with the FAR 52.212-4(l) clause. Although the clause prohibits requiring contractors to use cost principles to prove prong 2 costs it does not preclude their use for this purpose.

It is also consistent with FAR 12.403(a), stating: "Contracting officers may continue to use [FAR] part 49 [Termination of Contracts] as guidance to the extent that part 49 does not conflict with this section and the language of the termination paragraphs in [FAR] 52.212-4."

There are three cost principles applicable to the recovery of precontract costs in traditional Government contracts: (1) FAR 31.205-32, the general cost principle for precontract costs, (2) FAR 31.205-42(c), the termination cost principle for initial costs, and (3) FAR 49.201(a), the fair compensation guarantee for terminated contracts. The application of these principles to the facts *Microtech* is set forth below.

The FAR 31.205-32 cost principle for precontract costs for traditional Government contracts provides for recovery if, among other things, "incurrence is necessary to comply with the proposed delivery schedule." The "necessary to comply with the proposed delivery schedule" requirement is not literally interpreted. All that is required is that the contractor believed the precontract work was necessary and undertook it in good faith. *Phoenix Data Solutions*.

The facts in *Microtech* do not appear to support recovery under the FAR 31.205-32 precontract costs principle for traditional Government contracts. Any argument that it was reasonable for the contractor to believe that payment for software licenses at the outset of the base year was necessary to meet the option year 1 delivery schedule appears to be a hard sell.

Nevertheless, it would appear that the contractor could recover precontract costs under prong 2 because they would be recoverable under the FAR 31.205-42(c) termination cost principle for initial costs and/or the FAR 49.201(a) fair compensation guarantee.

Initial costs, including starting load and preparatory costs are recoverable under the FAR 31.205-42(c) "Termination costs" principle in a traditional Government contract. "Starting load costs" are defined by FAR 31.205-42(c)(1) as nonrecurring costs not fully absorbed because of termination such as labor, material, and related overhead costs incurred in the early part of production. FAR 31.205-42(c)(2) states: "Preparatory costs incurred in preparing to perform the terminated contract include such costs as those incurred for initial plant rearrangement and alterations, management and personnel organization, and production planning."

Initial costs are allowable termination costs under a traditional Government contract even if the requirements for recovery of precontract costs under FAR 31.205-32 are not met. As stated in Manos, 1 Government Contracts Costs & Pricing § 49:5 (June 2021 Update);

> Initial costs are reimbursable when a contract is terminated for convenience of the Government even if the same costs would not have been allowable as precontract costs under FAR 31.205-32 (discussed in §§ 39:1 et seq.). For example, the [board] in *RHC Construction* [IBCA 2083, 88-3 BCA ¶ 20,991 at 106,061] upheld the allowability of "planning and organizational" costs incurred before notice of award of the contract without analyzing whether the costs satisfied the requirements of FAR 31.205-32. The board stated:
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> > We hold that when a construction contractor undertakes a course of action to assure compliance with a contract completion period by engaging in planning and organizational activities in advance of the actual performance period, the settlement process, pursuant to a subsequent termination for the convenience of the Government, requires reimbursement of the reasonable costs incurred by such contractor for such advance planning and preparation, as well as reimbursement of the reasonable costs he incurred in preparing and supporting his settlement proposal. The contrary result would penalize the conscientious contractor and be out of harmony with the purpose and intent of the contract clauses and regulations pertaining to terminations for the convenience of the Government. [Footnotes omitted.]

The contractor in *Microtech* should also be entitled to recover under the FAR 49.201(a) fair compensation principle for traditional fixed-price Government contracts. FAR 49.201(a) states: "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." FAR 49.201(a) has been held to apply to the termination for convenience of commercial item contracts. *SWR*; *Dream Management, Inc. v. Department of Homeland Security*, CBCA 5517, 17-1 BCA ¶ 36,716, 2017 WL 1424217, and *ACM Construction & Marine Group, Inc. v. Department of Transportation*, CBCA 2245, 14-1 BCA ¶ 35,537, 2014 WL 2478112.

SWR included the fair compensation guarantee as part of prong 2 recovery for reasonable charges resulting from termination. The Armed Services Board of Contract Appeals stated that prong 2 provides for "recovery of those charges incurred that 'do not relate to work completed' [percentage of completion] but should be reimbursed to fairly compensate the contractor whose contract has been terminated."

As a result of the FAR 49.201(a) fair compensation guarantee, "[t]here is considerably more leeway permitted in the recovery of precontract costs in firm-fixed-price contracts terminated for the convenience of the Government" than under the FAR 31.205-32 rules for recovery of precontract costs. See *Precontract Costs: A Risky Business*, 1 N&CR ¶ 29. In *Codex v. United States*, 226 Ct. Cl. 693 (1981), the contractor developed a mobile communications system for purposes of obtaining a

traditional Government contract. The Air Force awarded the contract on March 25, 1971, with an effective date of April 2, 1971. On April 15, 1971, the Air Force terminated the contract for convenience before any deliveries were made. The ASBCA held precontract costs to be unallowable because they were not necessary to meet the delivery schedule. The ASBCA relied upon Armed Services Procurement Regulation 15.205-30, a predecessor of the FAR 31.205-32 general cost principle on precontract costs. The Court of Claims held the disallowance to be improper if it deprived the contractor of fair compensation and remanded to the board to make the necessary factual determination. The court relied on ASPR 8.301, a predecessor of the FAR 49.201(a) fair compensation guarantee for terminated contractors.

Codex was decided by the U.S. Court of Claims, the predecessor of the U.S. Court of Appeals for the Federal Circuit. Its decisions have the same weight as a decision of the Federal Circuit. The Federal Circuit extended the FAR 49.201(a) fair compensation guarantee to traditional cost reimbursement contracts in *Jacobs Engineering Group, Inc. v. United States,* 434 F.3d 1378 (Fed. Cir. 2006), 48 GC ¶ 49. The Federal Circuit should take the next logical step in *Microtech* and follow the board decisions applying FAR 49.201(a) to FAR Part 12 commercial item contracts.

In both *Microtech* and *Codex*, the contractors spent money for purposes of obtaining a Government contract. The commercial item contract in *Microtech* is not subject to the precontract cost principle for traditional Government contracts advocated by the Government to avoid liability in *Codex*. The contractor in *Microtech* should therefore not fare worse than the contractor in *Codex*.

In both *Dream Management* and *ACM*, the CBCA referenced the FAR 49.201(a) fair compensation guarantee as a principle applicable to commercial item terminations for convenience. In *SWR*, the ASBCA applied the FAR 49.201(a) fair compensation guarantee to a commercial item contract. As a result of *SWR* and aforementioned CBCA cases recovery for a commercial item termination appears essentially the same as that for traditional Government contracts. The Federal Circuit will hopefully maintain the *status quo* when deciding *Microtech* on appeal. *Paul J. Seidman*