

Chapter 24

Contract Terminations for Convenience



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CHAPTER 24

CONTRACT TERMINATIONS FOR CONVENIENCE

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CHAPTER 24

CONTRACT TERMINATIONS FOR CONVENIENCE

I. INTRODUCTION

A. References and Definition

1. FAR Part 49
2. Clauses: FAR 52.249-1 through 52.249-7
3. Definition: “‘Termination for convenience’ means the exercise of the Government's right to completely or partially terminate performance of work under a contract when it is in the Government's interest.” FAR 2.101.

B. Historical Development

See Krygoski Constr. Co., Inc. v. United States, 94 F.3d 1537 (Fed. Cir. 1996) (court traces history of government's right to terminate contracts for convenience).

1. Inherent Authority. The government has always possessed the inherent authority to suspend contracts. United States v. Corliss Steam Engine Co., 91 U.S. 321 (1875) (finding the Navy Department had authority to suspend work under a contract and enter into a breach settlement for partial performance); Krygoski, 94 F.3d at 1540-41.
2. Terminations for the government’s convenience “developed as a tool to avoid enormous procurements upon completion of a war effort.” Krygoski, 94 F.3d at 1540. Because public policy counseled against continuing wartime contracts after the end of hostilities, the government, under certain circumstances, terminated contracts and settled with the contractor for partial performance. Id.
3. Following WWI, large numbers of contracts were terminated by the government. The Dent Act provided new statutory authority for the settlement of claims from those terminations. See Dent Act, 40 Stat. 1272 (1919). Further statutory and regulatory provisions were provided at the onset of WWII. See Contract Settlement Act of 1944, 58 Stat. 649.
4. Historically, a contractor could recover breach of contract damages, which include anticipatory (lost) profits, as a result of a termination based on inherent authority. United States v. Speed, 75 U.S. 77 (1868). Currently,

convenience termination clauses preclude the contractor from recovering anticipatory or lost profits when the government, in good faith, terminates the contract for its convenience.

5. In 1964, the first edition of the Federal Procurement Regulation (FPR) included optional termination for convenience clauses. FPR 1-8.700-2. However, by 1967, the FPR required termination for convenience clauses in most contracts. 32 Fed. Reg. 9683 (1967). Accordingly, termination for convenience evolved into a principle of government contracting and the exigencies of war no longer limit the government's ability to terminate. Krygoski, 94 F.3d at 1541.

II. THE RIGHT TO TERMINATE FOR CONVENIENCE

- A. Termination is for the convenience of the government.

When a contractor is performing at a loss, termination may be beneficial to the contractor, but the government has no duty to the contractor to exercise the government's right to terminate for the contractor's benefit. Contact Int'l Corp., ASBCA No. 44636, 95-2 BCA ¶ 27,887; Rotair Indus., ASBCA No. 27571, 84-2 BCA ¶ 17,417; John Massman Contracting Co. v. United States, 23 Cl. Ct. 24 (1991) (no duty to terminate when it would be in the contractor's best interest).

- B. Termination for Convenience Clauses

1. The FAR provides various termination for convenience clauses. See FAR 52.249-1 through 52.249-7. The proper clause for a specific contract is dependent upon the type and dollar amount of the contract. See FAR Subpart 49.5.
 - a. Contracts for commercial items and simplified acquisitions for other than commercial items include unique convenience termination provisions that, for the most part, are not covered by Subpart 49.5. See 52.212-4 and 52.213-4.
 - b. "Short form" clauses govern fixed-price contracts not to exceed the Simplified Acquisition Threshold (SAT)(generally \$150,000). Settlement is governed by FAR Part 49. See Arrow, Inc., ASBCA No. 41330, 94-1 BCA ¶ 26,353 (board denied claim for useful value of special machinery and equipment because service contract properly contained short form termination clause, which limited settlement charges to services provided prior to termination).

- c. “Long form” clauses govern fixed-price contracts exceeding the SAT. These clauses specify contractor obligations and termination settlement provisions. See FAR 52.249-2.
 - d. Cost reimbursement contract clauses. These clauses cover both convenience and default terminations, and specify detailed termination settlement provisions. See FAR 52.249-6.
- 2. The clauses give the government a right to terminate a contract, in whole or in part, when in the government's interest.
 - 3. The clauses also provide the contractor with a monetary remedy.
 - a. The contractor is entitled to:
 - (1) the contract price for completed supplies or services accepted by the government;
 - (2) reasonable costs incurred in the performance of the work terminated,
 - (3) a fair and reasonable profit (**UNLESS** the contractor would have sustained a loss on the contract if the entire contract had been completed); and
 - (4) reasonable costs of settlement of the work terminated. See FAR 52.249-2(g).
 - b. Exclusive of settlement costs, the contractor's recovery may NOT exceed the total contract price.
 - c. The contractor cannot recover anticipated (lost) profits or consequential damages, which would be recoverable under common law breach of contract principles. FAR 49.202(a).
 - d. The cost principles of FAR Part 31 in effect on the date of the contract shall govern the claimed costs.

C. The “Christian Doctrine”

- 1. **Rule:** A mandatory contract clause that expresses a significant or deeply ingrained strand of public procurement policy is considered to be included in a contract by operation of law. G.L. Christian & Assoc. v. United States, 312 F.2d 418 (Ct. Cl. 1963) (termination for convenience clause read into the contract by operation of law).

2. The Christian doctrine does not turn “on whether clause was intentionally or inadvertently omitted, but on whether procurement policies are being ‘avoided or evaded (deliberately or negligently) by lesser officials.’” S.J. Amoroso Constr. Co. v. United States, 12 F.3d 1072, 1075 (Fed. Cir. 1993) (Buy American Act (BAA) clause for construction contract read into contract after it had been stricken and erroneously replaced by the BAA supply clause).
3. The doctrine, however, does not permit the automatic incorporation of every required contract clause. General Engineering & Mach. Works v. O’Keefe, 991 F.2d 775, 779 (Fed. Cir. 1993). Rather, it must be determined whether there is any significant or deeply ingrained public procurement policy supporting incorporation of the clause. Lambrecht & Sons, Inc., ASBCA No. 49515, 97-2 BCA ¶ 20,105.
4. The Christian doctrine applies only to mandatory clauses reflecting significant public procurement policies. Michael Grinberg, DOT BCA No. 1543, 87-1 BCA ¶ 19,573 (board refused to incorporate by operation of law a discretionary T4C clause).
5. It has also been applied to incorporate less fundamental or significant mandatory clauses if they were not written to benefit or protect the party seeking the incorporation. General Engineering & Mach. Works v. O’Keefe, 991 F.2d 775, 780 (Fed. Cir. 1993) (citing Chris Berg, Inc. v. United States, 426 F.2d 314, 317 (Ct. Cl. 1970)).
6. The Christian doctrine does not apply when the contract includes an authorized deviation from the standard termination for convenience clause. Montana Refining Co., ASBCA No. 44250, 94-2 BCA ¶ 26,656 (ID/IQ contract with a stated minimum quantity included deviation in T4C clause that agency would not be liable for unordered quantities of fuel “unless otherwise stated in the contract”).
7. When a contract lacks a termination clause, an agency can’t limit termination settlement costs by arguing that the Short Form termination clause applies. Empres de Viacao Terceireense, ASBCA No. 49827, 00-1 BCA ¶ 30,796 (ASBCA noted that use of the Short Form clause was predicated on a contracting officer’s determination and exercise of discretion, which was lacking in this case).
8. Impact of other termination clauses: Existence of “Termination on Notice” clause in contract modification, did not render T4C clause meaningless. Dart Advantage Warehousing, Inc. v. United States, 52 Fed. Cl. 694 (2002) (clause with such ancient lineage, reflecting deeply ingrained public procurement policy, and applied to contracts with the

force and effect of law even when omitted, should not be materially modified or summarily rendered meaningless without good cause).

D. Convenience Terminations Imposed by Law

1. Termination by Conversion

- a. The termination for default clauses provide that an erroneous default termination converts to a termination for convenience. FAR 52.249-8(g); FAR 52.249-10(c); ALKAI Consultants, LLC, ASBCA 56792, 10-2 BCA ¶ 34,493 (converted T4D to T4C based on unanticipated conditions and government failure to cooperate).
- b. However, if the government acted in bad faith while terminating a contract for default, courts and boards will award common law breach damages rather than the usual termination for convenience costs. See Apex Int'l Mgmt. Servs., Inc., ASBCA No. 38087, 94-2 BCA ¶ 26,842 (finding 20 breaches, ASBCA holds Navy liable for breach damages); Sigal Constr. Corp., CBCA No. 508, 10-1 BCA ¶ 34,442 (finding T4C to be in bad faith where GSA deleted work from a construction contract to have that work performed by another contractor at a lower price).

2. Constructive Termination for Convenience

- a. A government directive to end performance of work will not be considered a breach but rather a convenience termination if the action could lawfully fall under that clause, even if the government mistakenly thinks a contract invalid, erroneously thinks the contract can be terminated on other grounds, or wrongly calls a directive to stop work a "cancellation." G.C. Casebolt Co. v. United States, 421 F.2d 710 (Ct. Cl. 1970); John Reiner & Co. v. United States, 325 F.2d 438 (Ct. Cl. 1963).
- b. The constructive termination for convenience doctrine is based on the concept that a contracting party who is sued for breach may ordinarily defend on the ground that there existed at the time of the breach a legal excuse for nonperformance, although that party was then ignorant of the fact. College Point Boat Corp. v. United States, 267 U.S. 12 (1925).
- c. However, the government cannot use the constructive termination for convenience theory to retroactively terminate a fully performed contract in an effort to limit its liability for failing to order the contract's minimum amount of goods or services. Ace-Federal Reporting, Inc., v. Barram, 226 F.3d 1329 (Fed. Cir. 2000);

Maxima Corp. v. United States, 847 F.2d 1549 (Fed. Cir. 1988);
PHP Healthcare Corp., ASBCA No. 39207, 91-1 BCA ¶ 23,647.

d. Further, the government may not require bidders to agree in advance that the government's failure to order the contract's minimum quantity will be treated as a termination for convenience. Southwest Lab. of Okla., Inc., B-251778, May 5, 1993, 93-1 CPD ¶ 368.

3. Deductive Change v. Partial Termination for Convenience

a. The contracting officer must determine whether deleted work is a deductive change **or** a partial termination for convenience.

b. This distinction is important because it determines whether the measure of the contractor's recovery is under the contract's changes clause or the termination for convenience clause.

c. Generally, the courts and boards will not overturn the contracting officer's determination that the deleted work is a deductive change if the parties consistently treated the deletion as such. Dollar Roofing, ASBCA No. 36461, 92-1 BCA ¶ 24,695. But see Griffin Servs., Inc., GSBCA No. 11022, 92-3 BCA ¶ 25,181 (board characterized deleted work as a partial termination for convenience, but ordered recovery based on the changes clause).

d. If the contractor disputes the contracting officer's treatment of the deletion, courts and boards will examine the relative significance of the deleted work.

(1) If MAJOR portions of the work are deleted and no additional work is substituted in its place, the termination for convenience clause must be used. Nager Elec. Co. v. United States, 442 F.2d 936 (Ct. Cl. 1971).

(2) Courts and boards will treat the deletion of relatively MINOR and segregable items of work as a deductive change. Lionsgate Corp., ENG BCA No. 5425, 90-2 BCA ¶ 22,730.

III. THE DECISION TO TERMINATE FOR CONVENIENCE

A. Regulatory Guidance

1. The FAR clauses give the government the right to terminate a contract in whole, or in part, if the contracting officer determines that termination is

in the government's interest. See John Massman Contracting Co. v. United States, 23 Cl. Ct. 24 (1991) (no duty to terminate when it would be in the contractor's best interest).

2. The FAR provides **no guidance** on factors that the contracting officer should consider when determining whether termination is “in the government's interest.” FAR 49.101(b) and the convenience termination clauses merely provide that contracting officers shall terminate contracts only when it is in the government's interest to do so.
 - a. The right to terminate “comprehends termination in a host of variable and unspecified situations” and is not limited to situations where there is a “decrease in the need for the item purchased.” John Reiner & Co. v. United States, 325 F.2d 438 (Ct. Cl. 1963), cert. denied, 377 U.S. 931 (1964).
 - b. A “cardinal change” in the government's requirements is not a prerequisite to a termination for convenience. T&M Distributors, Inc. v. United States, 185 F.3d 1279 (Fed. Cir. 1999).
3. The FAR does provide guidance concerning circumstances in which contracting officers normally **cannot or should not** use a convenience termination.
 - a. A negotiated **no-cost settlement** is appropriate instead of a termination for convenience or default when: (1) the contractor will accept it; (2) government property was not furnished; and (3) there are no outstanding payments due to the contractor, debts due by the contractor to the government, or other contractor obligations. FAR 49.101(b).
 - b. The government normally should not terminate a contract, but should allow it to run to completion, when the price of the undelivered balance of the **contract is less than \$5,000**. FAR 49.101(c).
 - c. **CAUTION**—Termination simply to get the item at a **lower price** may amount to **bad faith**. Sigal Constr. Co., CBCA No. 508, 10-1 BCA ¶ 34,442 (quoting Krygoski Constr. Co., 94 F.3d 1537 (Fed. Cir. 1996) (“A contracting officer may not terminate for convenience in bad faith, for example, simply to acquire a better bargain from another source.”))
4. There is no requirement to give the contractor a hearing before the termination decision. Melvin R. Kessler, PSBCA No. 2820, 92-2 BCA ¶ 24,857.

5. Notice of termination

- a. When terminating a contract for convenience, the contracting officer **must provide notice** to the contractor, the contract administration office, and any known assignee, guarantor, or surety of the contractor. Notice shall be made by certified mail or hand delivery. FAR 49.102. After the contracting officer issues the notice of termination, a termination contracting officer (TCO) is responsible for negotiating any settlement with the contractor. FAR 49.101(d). In practice, the administering contracting officer (ACO) and the TCO are one and the same.
- b. For DoD components, **congressional notification** is required for any termination involving a reduction in employment of 100 or more contractor employees. DFARS 249.7001. The agency liaison offices will coordinate timing of the congressional notification and public release of the information with release of the termination notice to the contractor. DFARS PGI 249.7001. Similar reports are required by some DOD agencies for terminations with high-level agency interest or litigation potential. See e.g., AFFARS MP5349.

6. Contractor duties after receipt of notice of termination. FAR 49.104. The contractor is required generally to:

- a. Stop work immediately and stop placing subcontracts;
- b. Terminate all subcontracts;
- c. Immediately advise the TCO of any special circumstances precluding work stoppage;
- d. Perform any continued portion of the contract and submit promptly any request for equitable adjustment to the price;
- e. Protect and preserve property in the contractor's possession, and dispose of termination inventory as directed or authorized by TCO.
- f. Notify TCO in writing concerning any legal proceedings growing out of any subcontract or other commitment related to the terminated portion of the contract;
- g. Settle subcontract proposals;
- h. Promptly submit own termination settlement proposal; and

- i. Dispose of termination inventory as authorized by TCO.
7. Duties of TCO after notice of termination. FAR 49.105.
- a. Direct the action required of the prime contractor;
 - b. Examine the contractor's settlement proposal (and when appropriate, the settlement proposals of subcontractors); and
 - c. Promptly negotiate settlement agreement (or settle by determination for the elements that cannot be agreed upon, if unable to negotiate a complete settlement).

B. Standard of Review

1. The courts and boards recognize the government's broad right to terminate a contract for convenience. It is not the province of the courts to decide de novo whether termination of the contract was the best course of action. Salsbury Indus. v. United States, 905 F.2d 1518 (Fed. Cir. 1990).
2. The "Kalvar" test. To find that a termination for convenience in legal effect is a breach of contract, a contractor must prove **bad faith** or **clear abuse of discretion**. This is sometimes referred to as the "Kalvar" test. Kalvar Corp., Inc., v. United States, 543 F.2d 1298 (Ct. Cl. 1976); Salsbury Indus. v. United States, 905 F.2d 1518 (Fed. Cir. 1990).
 - a. Bad Faith
 - (1) Proof of bad faith requires proof tantamount to some **specific intent to injure** the plaintiff, malice, or "designedly oppressive conduct." Kalvar Corp., Inc., v. United States, 543 F.2d 1298, 1302 (Ct. Cl. 1976).
 - (2) Courts and boards presume that contracting officers act conscientiously in the discharge of their duties. Krygoski Constr. Co., Inc. v. United States, 94 F.3d 1537, 1541 (Fed. Cir. 1996).
 - (3) Overcoming this strong presumption requires "clear and convincing evidence." Am-Pro Protective Services, Inc. v. United States, 281 F.3d 1234, 1241 (Fed. Cir. 2002). This "clear and convincing evidence" standard is an articulation of a long-standing precedent holding that to overcome the presumption of good faith, contractors alleging bad faith on

the part of the government needed “well-nigh irrefragable proof.”¹

- (4) TLT Constr. Corp., ASBCA No. 40501, 93-3 BCA ¶ 25,978 (inept government actions do not constitute bad faith).
- (5) McHugh v. DLT Solutions, Inc., 618 F.3d 1375 (Fed. Cir. 2010) (government may T4C even where it contemplated at time of award that it might T4C the contract in the future); Caldwell & Santmyer, Inc., v. Glickman, 55 F.3d 1578, 1582 (Fed. Cir. 1995) (refusing to disallow a termination for convenience in a “situation in which the government contracts in good faith but, at the same time, has knowledge of facts supposedly putting it on notice that, at some future date, it may be appropriate to terminate the contract for convenience”).
- (6) Oregon Woods, Inc. v. United States, 355 Fed. Appx. 403 (Fed. Cir. 2009) (unpublished) (no bad faith where government terminated due to inadequate specifications even though government engineers modified the specs twice before contract award).
- (7) BioFuction, LLC v. United States, 92 Fed. Cl. 167 (2010) (no bad faith where government terminated the contract for convenience after inducing contractor to perform on a related unfunded pilot program because government employee did not have authority to enter into contract).
- (8) Evidence that government acted with malice or with specific intent to injure is not necessary to establish breach of the duty of good faith and fair dealing. Teresa A. McVicker, P.C., ASBCA 57487, 57653, 2012-2 BCA ¶ 35,127 (bad faith found in “bait and switch” situation where government contracts for PA services specifying contractor must hire two current contract employees; at

¹ The United States Court of Appeals for the Federal Circuit held in Am-Pro Protective Agency, Inc., v. United States, “In fact, for almost 50 years this court and its predecessor have repeated that we are ‘loath to find to the contrary [of good faith], and it takes, and should take, well-nigh irrefragable proof to induce us to do so.’” 281 F.3d 1234, 1239 (quoting Schaefer v. United States, 224 Ct. Cl. 541, 633 F.2d 945, 948-49 (Ct. Cl. 1980)) (also citing Grover v. United States, 200 Ct. Cl. 337, 344 (1973); Kalvar Corp. Inc., v. United States, 543 F.2d 1298, 1302, 211 Ct. Cl. 192 (1976); Torncello v. United States, 231 Ct. Cl. 20, 681 F.2d 756, 770 (Ct. Cl. 1982); T&M Distribs., Inc. v. United States, 185 F.3d 1279, 1285 (Fed. Cir. 1999)).

same time government works to hire same individuals as federal employees).

b. Abuse of Discretion

- (1) A contracting officer's decision to terminate for convenience cannot be arbitrary or capricious.
- (2) The Court of Claims (predecessor to the Court of Appeals for the Federal Circuit) cited four factors to apply in determining whether a contracting officer's discretionary decision is arbitrary or capricious. Keco Indus. v. United States, 492 F.2d 1200, 1203-04 (Ct. Cl. 1974). These factors are:
 - (a) Evidence of subjective bad faith on the part of the government official;
 - (b) Lack of a reasonable basis for the decision;
 - (c) The degree of proof to recover is related to the amount of discretion given to the government official; *i.e.*, the greater the discretion granted, the more difficult it is to prove that the decision was arbitrary and capricious; and,
 - (d) A proven violation of an applicable statute or regulation (this factor alone may be enough to show that the conduct was arbitrary and capricious).

3. The Torncello "change in circumstances" test

a. Background.

- (1) In 1982, a plurality of the Court of Claims (predecessor to the Federal Circuit) articulated a different test for the sufficiency of a convenience termination.
- (2) The test was known as the "change in circumstances" test. Torncello v. United States, 681 F.2d 756 (Ct. Cl. 1982) (T4C clause could not be used to avoid paying anticipated profits unless there was some change in circumstances between time of award and termination).
- (3) Critics of the "change in circumstances" test charged that the court should have applied the "Kalvar" test. See e.g.,

Krygoski Constr. Co., Inc. v. United States, 94 F.3d 1537, 1543-1544 (Fed. Cir. 1996).

- (4) The Court of Appeals for the Federal Circuit subsequently characterized Torncello as a “bad faith” case. Salsbury Indus. v. United States, 905 F.2d. 1518 (Fed. Cir. 1990) (The Torncello decision “stands for the unremarkable proposition that when the government contracts with a party knowing full well that it will not honor the contract, it cannot avoid a breach claim by advertng to the convenience termination clause.”) This rationale had been applied by the ASBCA prior to the Federal Circuit's decision. See Dr. Richard L. Simmons, ASBCA No. 34049, 87-3 BCA ¶ 19,984; Tamp Corp., ASBCA No. 25692, 84-2 BCA ¶ 17,460.

b. Today.

- (1) Contractors occasionally still argue the change in circumstances test, though unsuccessfully. See T&M Distributors, Inc. v. United States, 185 F.3d 1279 (Fed. Cir. 1999); Charles Mullens, ASBCA No. 56927, 12-2 BCA ¶ 35163.
- (2) The court has since refused to extend Torncello to situations in which the government contracts in good faith while having knowledge of facts putting it on notice that termination may be appropriate in the future. See Krygoski Construction Company, Inc. v. United States, 94 F.3d 1537 (Fed. Cir. 1996).

4. Effect of Improper Termination

- a. The general rule is to place the injured party in as good a position as the one he would have been in had the breaching party fully performed.
- b. By terminating in bad faith or arbitrarily and capriciously, the government breaches the contract, permitting the contractor to recover **breach of contract damages**, including anticipatory (lost) profits. See Operational Serv. Corp., ASBCA No. 37059, 93-3 BCA ¶ 26,190 (government breached contract by exercising option year of contract while knowing that it would T4C the current contract once it had awarded a commercial activities contract or decided to perform the work in house).

- c. Remote and consequential damages are not recoverable. San Carlos Irr. & Drainage Dist. v. United States, 111 F.3d 1557, 1563 (Fed. Cir. 1997). But see Energy Capital Corp. v. United States, 47 Fed. Cl. 382 (2000) (awarding \$8.78 million in lost profits to new venture).

C. Revocation of a Termination for Convenience

- 1. Reinstatement of the contract. FAR 49.102(d).
 - a. A terminated portion of a contract may be reinstated in whole, or in part, if the contracting officer determines in writing that there is a requirement for the terminated items and that the reinstatement is advantageous to the government. To the Administrator, Gen. Servs. Admin., 34 Comp. Gen. 343 (1955).
 - b. The contracting officer may not reinstate a contract unilaterally. The written consent of the contractor is required. B3h Corp., GSBICA No. 12813-P-REM, 96-2 BCA ¶ 28360 (May 3, 1996).
- 2. A termination for default cannot be substituted for a termination for convenience. Roged, Inc., ASBCA No. 20702, 76-2 BCA ¶ 12,018; but see Amwest Surety Ins. Co., ENG BCA No. 6036, 94-2 BCA ¶ 26,648 (substitution allowed where government issued “conditional” termination for convenience while negotiating following a termination for default).

IV. CONVENIENCE TERMINATION SETTLEMENTS

A. Procedures. FAR Part 49.

- 1. After termination for convenience, the parties must:
 - a. Stop the work;
 - b. Dispose of termination inventory; and
 - c. Adjust the contract price.
- 2. Timing of the Termination Settlement Proposal
 - a. The contractor must submit its termination proposal within **one year** of notice of the termination for convenience. FAR 49.206-1; Do-Well Mach. Shop, Inc. v. United States, 870 F.2d 637 (Fed. Cir. 1989) (“we cannot hold that Congress wanted to prevent parties from agreeing to terms that would further expedite the claim resolution process.”).

- b. Timely submittal is defined as mailing the proposal within one year after receipt of the termination notice. Voices R Us, Inc., ASBCA No. 51565, 99-1 BCA ¶ 30,213 (denying government's summary judgment motion for failure to provide evidence that fax notice of termination was sent to and received by contractor); Jo-Bar Mfg. Corp., ASBCA No. 39572, 93-2 BCA ¶ 25,756 (finding timely mailing despite lack of government receipt).
- c. If a contractor fails to submit its termination settlement proposal within the required time period, or any extension granted by the contracting officer, the contracting officer may then unilaterally determine the amount due the contractor. FAR 49.109-7. Industrial Data Link Corp., ASBCA No. 49348, 98-1 BCA ¶ 29,634, aff'd 194 F.3d 1337 (Fed. Cir., 1999) (granting summary judgment in favor of government because termination settlement proposal was untimely submitted); Harris Corp., ASBCA No. 37940, 90-3 BCA ¶ 23,257 (termination settlement proposal found untimely where contractor notified of defects in proposal and fails to correct within extension granted by TCO).
- d. A contracting officer's refusal to grant an extension of time to submit a settlement proposal is a decision that can be appealed but requires the contractor to submit a proposal for jurisdiction under the Contract Disputes Act. Cedar Constr., ASBCA No. 42178, 92-2 BCA ¶ 24,896. But, failure of the contracting officer to act on a timely request for an extension cannot deny the contractor the right to appeal. The Swanson Group, ASBCA No. 52109, 01-1 BCA ¶ 31,164.

B. Methods and Basis for Settlement

- 1. Methods of settlement. FAR 49.103.
 - a. Bilateral negotiations between the contractor and the government.
 - b. Unilateral determination of the government. FAR 49.109-7. This method is appropriate only when the contractor fails to submit a proposal or a settlement cannot be reached by agreement.
- 2. Bases of settlement. The two basis for settlement proposals are the inventory basis (the preferred method), and the total cost basis. FAR 49.206-2.
 - a. Inventory basis. FAR 49.206-2(a).

- (1) This is the preferred method. Propellex Corp. v. Brownlee, 342 F.3d 1335, 1338 (Fed. Cir. 2003) (the preferred way for a contractor to prove increased costs is by submitting actual cost data).
- (2) Settlement proposal must itemize separately:
 - (a) Metals, raw materials, purchased parts, work in process, finished parts, components, dies, jigs, fixtures, and tooling, at purchase or manufacturing cost;
 - (b) Charges such as engineering costs, initial costs, and general administrative costs;
 - (c) Costs of settlements with subcontractors;
 - (d) Settlement expenses; and
 - (e) Other proper charges;
 - (f) An allowance for profit or adjustment for loss must be made to complete the gross settlement proposal. All unliquidated advance and progress payments and all disposal and other credits known when the proposal is submitted are then deducted.

b. Total cost basis. FAR 49.206-2(b).

- (1) This approach to calculating damages is disfavored. Tecom, Inc. v. United States, 86 Fed. Cl. 437, 455 (2009) (citing Serrvidone Constr. Corp. v. United States, 931 F.2d 860, 861-62 (Fed. Cir. 1991) (describing method as “a last result” that may be used “in those extraordinary circumstances where no other way to compute damages was feasible”); WRB Corp. v. United States, 183 Ct. Cl. 409, 426 (1968) (explaining this method “has been tolerated only when no other mode was available”)).
- (2) Used only when approved in advance by the TCO and when use of inventory basis is impracticable or will unduly delay settlement, as when production has not commenced and accumulated costs represent planning and preproduction expenses. FAR 49.206-2(b)(1)

- (3) ALKAI Consultants, LLC, ASBCA 56792, 10-2 BCA ¶ 34,493 (where costs of additional work could not readily be separated from the cost of the basic contract work, a cost-based approach would be an appropriate measure of the percentage of work performed).

C. Amount of Settlement.

1. Convenience termination settlements are based on:
 - a. Costs incurred in the performance of terminated work, plus
 - b. A fair and reasonable profit on the incurred costs, plus
 - c. Settlement expenses.
 - d. See FAR 31.205-42; Teems, Inc. v. General Services Administration, GSBCA No. 14090, 98-1 BCA ¶ 29,357.
2. The contractor has the burden of establishing its proposed settlement amount. FAR 49.109-7(c); American Geometrics Constr. Co., ASBCA No. 37734, 92-1 BCA ¶ 24,545.
3. As a general rule, a termination for convenience converts the terminated portion of a fixed-price contract to a cost-reimbursement type of contract, so costs on the settlement proposal are determined under FAR Part 31 Cost Principles and Procedures. See FAR 31.205-42 – Termination Costs (these principles to be used in conjunction with other cost principles in Subpart 31.2), which lists the following categories of costs:
 - a. Common items;
 - b. Costs continuing after termination;
 - c. Initial costs;
 - d. Loss of useful value of special tooling and machinery;
 - e. Rental under unexpired leases;
 - f. Alteration of leased property;
 - g. Settlement expenses; and
 - h. Subcontractor claims.

4. The cost principles must be applied subject to the fairness principle set forth at FAR 49.201(a), which states:
 - 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. See Ralcon, Inc., ASBCA No. 43176, 94-2 BCA ¶ 26,935; Red River Holdings, LLC v. United States, 802 F.Supp.2d 648 (D. Md., 2011) (rejecting narrow interpretation of fairness principles).
 - b. Fair compensation is a matter of judgment and cannot be measured exactly. In a given case, various methods may be equally appropriate for arriving at fair compensation.
 - c. The use of business judgment, as distinguished from strict accounting principles, is the heart of a settlement. See Codex Corp. v. United States, 226 Ct. Cl. 693 (1981) (board decision disallowing pre-contract costs based on strict application of cost principles was remanded for further consideration by the board based on the court's determination that cost principles must be applied "subject to" the fairness concept in FAR 49.201); see also J.W. Cook & Sons, ASBCA No. 39691, 92-3 BCA ¶ 25,053 (board definition of "fairness").
5. Cost of Termination Inventory. Except for normal spoilage and except to the extent that the government assumed the risk of loss, the contracting officer shall exclude from the amounts due the contractor the fair value of property that is destroyed, lost, stolen, or damaged so as to become undeliverable to the government. FAR 52.249-2(h); see Lisbon Contractors, Inc. v. United States, 828 F.2d 759 (Fed. Cir. 1987) (contractor cannot recover "simply by pleading ignorance" of fate of materials); Industrial Tectonics Bearings Corp. v. United States, 44 Fed. Cl. 115 (1999) ("fair value" means "fair market value" and not the amount sought by the contractor).
6. Common Items
 - a. FAR 31.205-42(a) provides that "[t]he costs of items reasonably usable on the contractor's other work shall not be allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss."
 - b. Courts and boards have applied this provision to more than just materiel costs. Dairy Sales Corp. v. United States, 593 F.2d 1002 (Ct. Cl. 1979) (cost of butter wrapping machine not allowed in a

partial termination of a butter packing contract); Hugo Auchter GmbH, ASBCA No. 39642, 91-1 BCA ¶ 23,645 (only depreciation, not costs for general purpose off-the-shelf computer equipment allowed).

7. Subcontract Settlements. FAR 49.108.

- a. Upon termination of a prime contract, the prime and each subcontractor are responsible for prompt settlement of the settlement proposals of their immediate subcontractors. FAR 49.108-1.
- b. Such subcontractor recovery amounts are allowable as part of the prime's termination for convenience settlement with the government. FAR 31.205-42(h); see Fluor Intercontinental, Inc. v. IAO Worldwide Serv., Inc., 2010 WL 3610449 (N.D. Fla. Sept. 13, 2010) (prime contractor liable to subcontractor for breach although prime contractor's government contract was T4C'd).
- c. The TCO shall examine each subcontract settlement to determine that it was arrived at in good faith, is reasonable in amount, and is allocable to the terminated portion of the contract. FAR 49.108-3(c). A contractor's settlement with a subcontractor must be done at "arm's-length", or it may be disallowed. Bos'n Towing & Salvage Co., ASBCA No. 41357, 92-2 BCA ¶ 24,864 (denying claim for costs of terminating charter of tug boats).
- d. The contractor has a duty to determine the allowability and reimbursability of the costs submitted by the subcontractor as part of the settlement. Parsons Global Serv. Inc., ASBCA 56731, 11-1 BCA ¶ 34,643 (dismissing contractor claims for reimbursement of sub's costs as premature when prime had not evaluated costs).

D. Settlement Expenses. FAR 31.205-42(g).

1. Accounting, legal, clerical, and similar costs reasonably necessary for: (a) the preparation and presentation, including supporting data, of settlement claims to the contracting officer; and (b) the termination and settlement of subcontracts.
2. Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.
3. Indirect costs related to salary and wages incurred as settlement expenses in 1. and 2. above; normally limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.

E. Limitations on Termination for Convenience Settlements

1. A contractor is not entitled to anticipatory profits or consequential damages. FAR 49.202; Dairy Sales Corp. v. United States, 593 F.2d 1002 (Ct. Cl. 1979); Centennial Leasing Corp., ASBCA No. 49217, 96-2 BCA ¶ 28,571
2. **Loss Contracts**
 - a. A contracting officer may **not allow profit** in settling a termination claim if it appears that the contractor would have incurred a loss had the entire contract been completed. FAR 49.203.
 - b. If the contractor would have suffered a loss on the contract in the absence of the termination, the contractor may recover only the same **percentage of costs** incurred as would have been recovered had the contract gone to completion. The rate of loss is applied to costs incurred to determine the cost recovery. FAR 49.203.
 - c. The government has the burden of proving that the contractor would have incurred a loss at contract completion. Balimoy Mfg. Co. of Venice, ASBCA Nos. 47140 and 48165, 98-2 BCA ¶ 30,017, aff'd, 2000 U.S. App. LEXIS 26702 (Fed. Cir. 2000).
 - d. The target price of the fixed items, rather than the ceiling price, is used to compute the loss adjustment ratio for a convenience termination of a contract with both firm fixed price items and fixed price incentive fee line items. Boeing Defense & Space Group, ASBCA No. 51773, 98-2 BCA ¶ 30,069.
3. Overall contract price for fixed-price contracts:
 - a. The total settlement **may not exceed the contract price** (less payments made or to be made under the contract) - plus the amount of the settlement expenses. FAR 49.207. See also, Tom Shaw, Inc., ENG BCA No. 5540, 93-2 BCA ¶ 25,742; Alta Constr. Co., PSBCA No. 1463, 92-2 BCA ¶ 24,824.
 - b. Compare Okaw Indus., ASBCA No. 17863, 77-2 BCA ¶12,793 (the contract price of items terminated on an indefinite quantity contract is the price of the ordered quantity, not of the estimated quantity, where the government has ordered the minimum quantity) with Aviation Specialists, Inc., DOT BCA No. 1967, 91-1 BCA ¶ 23,534 (the only reasonable measure of the maximum recovery under a requirements contract is the government estimate).

4. Pending claims. Add the cost of valid pending claims for government delay, defective specifications, etc., to the original contract price to establish the “ceiling” of convenience termination recovery. See, e.g., Wolfe Constr. Co., ENG BCA No. 5309, 88-3 BCA ¶ 21,122.

F. Special Considerations

1. Offsets. The government may withhold a portion of the termination settlement as an offset against other claims. See Applied Companies v. United States, 37 Fed. Cl. 749 (1997) (Army properly withheld \$1.9 million from termination settlement due to overpayments on another contract).
2. Merger. Claims against the government arising out of contract performance are generally merged with the termination for convenience settlement proposal; therefore, it is not necessary to distinguish equitable adjustment costs from normal performance costs unless the contract is in a loss status. Worsham Constr. Co., ASBCA No. 25907, 85-2 BCA ¶ 18,016; Symbion Ozdil Joint Venture, ASBCA 56713, 10-1 BCA ¶ 34,367.
3. Equitable adjustments. In cases of partial terminations a contractor may request an equitable adjustment for the continued portion of the contract. See FAR 52.249-2(l) (requiring proposal to be submitted within 90 days of effective date of termination unless extended in writing by KO); Varo Inc., ASBCA Nos. 47945, 47946, 98-1 BCA ¶ 29,484 (affirmative defense of untimeliness waived where not raised until third day of hearing).
4. Mutual fault. If both the government and the contractor are responsible for the causes resulting in termination of a contract, contractors have been denied full recovery of termination costs.
 - a. In Dynalectron Corp. v. United States, 518 F.2d 594 (Ct. Cl. 1975), the court allowed the contractor only one-half of the allowable termination for convenience costs because the contractor was at fault in continuing to incur costs while trying to meet impossible government specifications without notifying the government of its efforts.
 - b. In Insul-Glass, Inc., GSBCA No. 8223, 89-1 BCA ¶ 21,361, the board denied termination for convenience recovery because of the contractor’s deficient administration of the contract. The board noted that under the default clause, if the default is determined to be improper, “the rights and obligations of the parties shall be the same as if a notice of termination for convenience of the

government had been issued.’ . . . We may exercise our equitable powers, however, to fashion, in circumstances where both parties share in the blame for the predicament which engenders an appeal, a remedy which apportions costs fairly.”

G. Commercial Items – Termination for Convenience

1. Background. The Federal Acquisition Streamlining Act of 1994, P.L. 103-355, 108 Stat. 3243 (Oct. 13, 1994), established special requirements for the acquisition of commercial items. Congress intended government acquisitions to more closely resemble those customarily used in the commercial market place. FAR 12.201.
2. FAR 12.403(a) states that the termination for convenience concepts for commercial items differ from those in FAR Part 49 for non-commercial items, and that the Part 49 principles do not apply to terminations for convenience of a commercial item, except as guidance to the extent they do not conflict with FAR 52.212-4.
3. Policy. The contracting officer should exercise the government’s right to terminate a contract for a commercial item only when such a termination would be in the best interests of the government. FAR 12.403(b).
4. When the contracting officer terminates for convenience a commercial item contract, the contractor shall be paid:
 - a. The percentage of the contract price reflecting the percentage of the work performed prior to the notice of the termination, and
 - b. Any charges the contractor can demonstrate directly resulted from the termination. FAR 12.403(d)(1).
5. 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. FAR 12.403(d)(1)(ii).
6. 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. FAR 12.403(d)(2).
7. Recovery on commercial item contracts.

- a. In Red River Holdings, LLC, ASBCA 56316, 09-2 BCA ¶ 34,304, a charter of a vessel to the government included the commercial item termination for convenience clause. The contractor was not entitled to recover for a termination for convenience under FAR Part 49 cost principles. The phrase in the termination for convenience clause “reasonable charges the Contractor can demonstrate . . . have resulted from the termination” is read to mean settlement expenses, and not items such as preparatory costs.
- b. For a good analysis of Red River and how the commercial item principles have been applied in other cases, see Seidman, Termination for Convenience of FAR Par 12 Commercial Contracts, Nash & Cibinic Report August 2010 at 117.

V. DISPUTES REGARDING TERMINATION SETTLEMENTS

- A. When does a T4C proposal become a claim? Once the parties reach an “impasse” in settlement negotiations, a request that the contracting officer render a final decision is implicit in the contractor’s settlement proposal.
- B. Once the parties reach an impasse, the proposal becomes a claim under the Contract Disputes Act. James M. Ellet Constr. Co. v. United States, 93 F.3d 1537 (Fed. Cir. 1996); Rex Systems, Inc. v. Cohen, 224 F.3d 1367 (Fed. Cir. 2000) (no impasse entitling contractor to interest despite taking 2 ½ years to settle the termination); MediAx Interactive Technologies, Inc., ASBCA No. 43961, 99-2 BCA ¶ 30,318.
- C. If an Agency fails to respond to a contractor’s settlement proposal, the contractor can file an appeal with the appropriate Board. ePlus Tech., Inc. v. FCC., CBCA 2573, 2012-2 BCA ¶ 25,114 (Board found jurisdiction over appeal when Agency failed to respond for six months to termination settlement proposal that was certified as a claim).
- D. A claim based upon the termination of a contract is typically pursued under the Contract Disputes Act, 41 U.S.C. §§ 7101-09. QAO Corp. v. Johnson, 49 F.3d 721, 724-25 (Fed. Cir. 1995); Data Monitor Sys., Inc. v. United States, 74 Fed. Cl. 66, 71 (2006). Be aware, however, the Court of Federal Claims has reviewed some terminations for convenience pursuant to its bid protest jurisdiction when the termination is in conjunction with corrective action. Wildflower Int’l, Inc. v. United States, 105 Fed. Cl. 362 (2012).

VI. FISCAL CONSIDERATIONS

- A. An agency must analyze each contract that it plans to terminate for convenience to determine whether termination for convenience or completion of the contract is less costly or otherwise in the best interests of the government.
- B. An agency must determine whether the convenience termination settlement would be governed by standard FAR convenience termination clause provisions, or by contract specific terms, such as termination ceilings, multi-year contract termination costs, or other specific contractual terms.
- C. **General Rule:** A prior year's funding obligation is extinguished upon termination of a contract, and those funds will **not remain available** to fund a **replacement contract** in a subsequent year where a contracting officer terminates a contract for the convenience of the government. The contracting officer must deobligate all funds in excess of the estimated termination settlement costs. FAR 49.101(f); DOD Financial Management Regulation 7000.14-R, vol. 3, ch. 8, para. 080512.
- D. **Two Exceptions:**
 - 1. In response to judicial order.
 - a. Funds originally obligated in one fiscal year for a contract that is later terminated for convenience in response to a **court order** or to a determination by the Government Accountability Office or other competent authority that the award was improper, can remain available in a subsequent fiscal year to fund a replacement contract. Funding of Replacement Contracts, B-232616, 68 Comp. Gen. 158 (1988).
 - b. Funds available for obligation for a contract at the time of a GAO protest, agency protest, or court action filed in connection with a solicitation for, proposed award of, or award of such contract, remain available for obligation for 100 days after the date on which the final ruling is made on the protest or other action. A ruling is considered "final" on the date on which the time allowed for filing an appeal or request for reconsideration has expired, or the date on which a decision is rendered on such an appeal or request, whichever is later. 31 U.S.C. § 1558; DFAS-IN 37-1, para. 080606. See also OFFICE OF THE GENERAL COUNSEL, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, Principles of Federal Appropriations Law, Vol I, 5-89 (3d ed. 2004).

2. Clearly erroneous award. Funds originally obligated in one FY for a contract that is later terminated for convenience as a result of the contracting officer's determination that award was clearly erroneous, can remain available in a subsequent FY to fund a replacement contract. Navy, Replacement Contract, B-238548, 70 Comp. Gen. 230 (1991).
3. The two exceptions above apply subject to the following conditions:
 - a. The original award was made in good faith;
 - b. The agency has a continuing bona fide need for the goods or services involved;
 - c. The replacement contract is of the same size and scope as the original contract;
 - d. The replacement contract is executed without undue delay after the original contract is terminated for convenience; and
 - e. If the termination for convenience is issued by the contracting officer, the contracting officer's determination that the award was improper is supported by findings of fact and law. Funding of Replacement Contracts, B-232616, 68 Comp. Gen. 158 (1988); Navy, Replacement Contract, B-238548, 70 Comp. Gen. 230 (1991).

VII. CONCLUSION