June 4, 1998

Ms. Beverly D. Fayson 
FAR Secretariat 
Room 4035 
1800 F Street N.W. 
Washington, D.C. 20405 

Re: Proposed Revisions to FAR Termination Provisions 

Dear Ms. Fayson: 

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting proposed FAR revisions on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section's governing Council and substantive committees contain members representing these three segments, to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services, and public works. 

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association. 

Proposed Revision 

The Section adopted at a recent quarterly meeting the proposed FAR revisions relating to the authority of the government to terminate its contracts. The language is attached. The basic concept is that, when exercising its contractual termination authority, the government should be held to the same duties as are other parties in the marketplace. This proposed revision is entirely consistent with current administration
and congressional initiatives to conform federal contracting to commercial contracting, while fully preserving the government's legitimate needs for termination authority. The principal concerns that motivated this proposed revision are described further below, followed by an overview of the proposed revision itself.

**Principal Concerns**

The Federal Circuit's decision in *Krygoski Construction Co. v. United States*, 94 F.3d 1537 (Fed. Cir. 1996), *cert. denied*, 117 S. Ct. 1691 (1997), has sparked reinvigorated discussion within the government contracting community as to the appropriate use of the termination for convenience clause and the limits, if any, to the government's exercise of its discretion under the standard clause. See, e.g., Petrillo & Conner, *Convenience Terminations After Krygoski*, 67 Fed. Contracts Rep. (BNA) 447 (Apr. 14, 1997). In *Krygoski*, the Federal Circuit has apparently held that the government abuses its discretion to terminate only when it "enters a contract with no intention of fulfilling its promises" or otherwise acts in malicious (i.e., subjective) bad faith. 94 F.3d at 1545.

The Section does not wish to enter the debate of whether *Krygoski* properly construed prior precedent, most notably *Torncello v. United States*, 681 F.2d 756 (Ct. Cl. 1982) (en banc). However, it does share the concerns expressed by some in the industry that, if the government is free to terminate its contracts for any or no reason after contract award, irrespective of the justified expectations of the parties or the opportunities foreclosed when they entered the deal, the contracts are illusory and lack mutuality of obligation and effective consideration.

Some have argued that, in that event, the contractor is just as free to terminate the agreement as is the government, as there are no binding obligations except to the extent of performance. This puts the government at risk that a contractor can walk away from a disadvantageous contract without fear of default. See *Willard, Sutherland & Co. v. United States*, 262 U.S. 489 (1923).

Obviously, such uncertainty benefits neither the government nor contractors. Although impossible to quantify with precision, the Section believes the government pays a real price for an almost unlimited right to terminate. The substantial risk to the contractor results in higher bid prices by those companies who do participate in the federal acquisition process and reduced overall competition because of the refusal of some companies to do business with the government due at least in part to termination risk and uncertainty.

Just as fundamentally, the Section has been guided by the principle, recently reaffirmed by the Supreme Court in *United States v. Winstar Corp.*, 116 S. Ct. 2432 (1996), that government contracts are controlled by "ordinary principles of contract construction and breach that would be applicable to any contract action between private parties." *Id.* at 2453 (plurality opinion). This principle is equitable and of long standing. See, e.g., *United States v. Mississippi Valley Gen. Co.*, 364 U.S. 520, 565-66 (1961) ("Of course, the Government could not avoid the contract merely because it turned out to be a bad bargain."). It is also consistent with recent Congressional and regulatory initiatives to align government contracting more closely to commercial practices. Its application in this area would assure the maximum possible competition and lowest prices consistent with the government's legitimate needs for a unilateral right to terminate. As Justice Souter articulated in *Winstar*, placing the government in a privileged contractual position when its sovereignty does not require it would be "at odds with the Government's own long-run interest as a reliable contracting partner in the myriad workaday transaction[s] of its agencies" and would have "the untoward result of compromising the government's practical ability to make contracts, . . . with the certain result of undermining the Government's credibility at the bargaining table and increasing the cost of its engagements." 116 S. Ct. at 2459.

Judge Souter articulates not just judicial policy and common sense; he echoes established executive and legislative policy as well. A major initiative for defense procurement reform of the Reagan, Bush, and Clinton administrations and the Congress has been to incorporate commercial practices and standards in order to make government contracts more attractive to all companies, but especially innovative and dynamic ones. In 1993, President Clinton noted that the existing procurement situation perpetuated a division of industry in the United States and the defense and non-defense sectors [which] results in higher prices to the government, less purchasing flexibility to the armed services, and too
often actually denies our military state of the art technologies found in the commercial marketplace.

To underscore his point, the President noted that five of the top 10 semiconductor companies in the United States still refused to do business with the Department of Defense because of the burdens and special requirements the Government imposes. "Announcement by President Clinton of Federal Procurement Changes," October 26, 1993, Federal News Service.

Suggested FAR Revision

The Section believes that FAR 49.101, dealing with termination authority and responsibilities, should be amended to make explicit the guiding principle articulated in Winstar and prior Supreme Court precedent: "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between individuals." Lynch v. United States, 292 U.S. 571, 579 (1934); see Winstar 116 S. Ct. at 2964-65 (citing as "general principle"). The Section in the suggested FAR language applies that principle as follows: "An assertion by the contractor that the government when terminating for convenience or default has acted in bad faith shall be assessed objectively based upon standards applicable to private parties in commercial contracts."

In further defining those duties in the suggested FAR language, the Section relied on the discussion of the common law by Professors Steven Burton and Eric Andersen in their recent treatise, Contractual Good Faith (1995). See also Claybrook, Good Faith in the Termination and Formation of Federal Contracts, 56 U. Md. L. Rev. 555 (1997). In short, the suggested FAR language adopts the generally held common law rule that a party must exercise its discretion under the contract consistently with the justified expectations of the parties at the time of contracting. As our proposed language puts it, the government "may not attempt to recapture an opportunity foreclosed at the time of contracting."

This approach rejects the view that the government only abuses its contractual discretion to terminate when it acts in subjective bad faith, i.e., with malicious intent to injure the contractor. An objective, rather than a subjective, test is applied, as with other allegations of breach. Thus, an inappropriate exercise of discretion is not excused either because it was innocently done or because it was unpremeditated prior to award. Application of this common law rule protects the contract from assertions that it is illusory or that it lacks mutuality or consideration. See, e.g., Martin v. Prier Brass Mfg. Co., 710 S.W.2d 466, 473 (Mo. App. 1986) (an ultimate power of interpretation given in the contract to one party did not render it illusory because that power had to be exercised in good faith so as not "to evade the spirit of the transaction or . . . deny the other party of the expected benefits of the contract"); cf. Aviation Contractor Employees, Inc v. United States, 945 F.2d 1568, 1572 (Fed. Cir. 1991) (common law good faith duties save government contract from indefiniteness).

While application of this standard is fact intensive, the Section thought it advisable to give several common examples of appropriate and inappropriate uses of authority to terminate.

(i) It is generally appropriate to terminate an unlawful contract. No party can have a justified expectation that he will receive a contract unlawfully awarded, and other actual or potential bidders or offerors have a justified expectation that the agency will act consistently with applicable law and regulations. These expectations are reflected in both bidding laws and regulations and solicitation documents.

(ii) It is generally appropriate to terminate due to the elimination of actual needs. The parties have the expectation at the time of contracting, based on the language of the termination for convenience clause, that the elimination of actual requirements will allow the government to alter the contractual arrangement through that clause.

(iii) It is generally inappropriate to terminate to get a better price. This is an attempt to recapture an opportunity foreclosed at the time of contracting and is inconsistent with the justified expectations of the parties at the time of contracting. If one party is free to walk away simply to get a better deal, the contract is illusory and lacks mutuality and consideration.
Proposed Revisions to FAR Termination Provisions


(iv) It is generally inappropriate to terminate to avoid making what would be a valid change within the general scope of the contract (i.e., not a "cardinal change"). The parties, from the terms of the contract itself, have the expectation that the Changes clause (or other appropriate clauses) will be used for changes, rather than the termination clause, where applicable in the circumstances. This adopts the Krygoski ruling (but not all of the decision's language).

(v) In the final example, we have eliminated the possibility that, to achieve what would otherwise be an improper termination for convenience, the government could unjustifiably default the contractor and achieve an automatically appropriate convenience termination.

The Section also has proposed minor conforming amendments to the standard FAR termination and default clauses to cross reference the provisions on the government's termination authority and responsibilities under FAR 49.101. While even without an express cross-reference the applicability of FAR 49.101 should be implied, all potential ambiguity would be eliminated by an explicit reference in the standard clauses themselves. Similar language should be included in all current and future standard termination clauses.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Marcia G. Madsen
Chair
Section of Public Contract Law

cc: David A. Churchill
    Rand L. Allen
    Gregory A. Smith
    Patricia A. Meagher
    Marshall J. Doke, Jr.
    John T. Kuelbs
    Frank H. Menaker, Jr.
    Michael K. Love
    Council Members
    Alan W. H. Gourley
    Richard P. Rector
    Alexander J. Brittin

Proposed FAR Termination Language

Proposed amendment to FAR 49.101: "Authorities and responsibilities."

After the first full sentence of subsection (b), add the following:

An assertion by the contractor that the government when terminating for convenience or default has acted in bad faith shall be assessed objectively based upon standards applicable to private parties in commercial contracts. Among other things, this means that the government, whether knowingly or not, may not attempt to recapture an opportunity foreclosed at the time of contracting.

(c) Examples of appropriate and inappropriate uses of authority to terminate under the clauses of Part 52.249 are as follows:

   (i) Timely termination for convenience of a voidable, unlawfully awarded contract is appropriate.
(ii) Termination for convenience, in whole or in part, to reflect the elimination of all, or any further, actual needs of the government is appropriate.

(iii) Termination for convenience, in whole or in part, to obtain a more advantageous price, whether initially known to the agency before or after award, is inappropriate.

(iv) Termination for convenience to reflect changes in, but not elimination of, the actual needs of the government is appropriate, unless the change arises under and can be addressed by one of the remedy-granting clauses of the contract.

(v) Termination for convenience as a result of an improper termination for default would be inappropriate if, at the time of the termination for default, termination for convenience would have been inconsistent with the government's duties under paragraph (b) above.

The second sentence of present subsection (b) becomes subsection (d); present subsection (c) becomes subsection (e); present subsection (d) becomes subsection (f); present subsection (e) becomes subsection (g); and present subsection (f) becomes subsection (h).

Proposed amendment to FAR 52.249: "Termination of Contracts, Provisions and Clauses for FAR Part 49"

The following conforming amendments to the clauses found under FAR 52.249 are made:

(a) To the Termination for Convenience, Termination, and Termination of Work clauses found at 52.249-1, 52.249-2, 52.249-3, 52.249-4, 52.249-5, 52.249-6, 52.249-11, and 52.249-12, at the beginning of the clause add Consistent with FAR 49.101,.

(b) To the Default clauses found at 52.249-8 and 52.249-9, in paragraph (g), at the end of the clause substitute a comma for the period and add when consistent with FAR 49.101.

(c) To the Default clause found at 52.249-10, in paragraph (c), at the end of the clause substitute a comma for the period and add when consistent with FAR 49.101.

Return to Regulatory Coordinating Committee Home Page