For the past 20 years the Federal government – in particular the Department of Defense – has focused on buying as many "commercial items" as possible. The focus has been driven both by statute and by regulation. As the DoD's Commercial Item Handbook (Version 2.0) states—

Title VIII of the Federal Acquisition Streamlining Act (Public Law 103-355) established the statutory requirements for acquiring commercial items. Section 8104 of the Act specifies a preference for commercial item acquisitions. Section 8105 specifies that certain provisions of law do not apply to acquisitions of items that meet the definition of a commercial item when acquired by the Government. Further, Section 8002 limits the types of clauses that may be included in a contract for an item meeting the statutory commercial item definition and acquired under 48 CFR, Chapter 1, Part 12 (Federal Acquisition Regulation (FAR) part 12). FAR implementation of the Act provided acquisition officials with wide latitude to use judgment in deciding whether a Government need can be met by an item that meets the commercial item definition. However, neither the Act itself nor the FAR implementation specifies how this decision is to be made or at what level within an organization it is to be made. These are established in the Defense Federal Acquisition Regulation Supplement (DFARS) and the DFARS Procedures, Guidance and Information (PGI). Consistency in the use of established approaches to acquire commercial supplies and services should exist across the Department.

Thus, for the past 20 years Federal buyers have been seeking commercial items to acquire, albeit with mixed success. While the Federal government spends literally billions of dollars each year on "commercial items," most of those items are of the paper clip and pencil variety. In other words, several commenters have asserted that there has not been enough effort made to qualify contractor-provided goods as "commercial items" – especially within the DoD. They have asserted that Contracting Officers are too slow in making their commerciality determinations, that they are too quick to reject items as being non-qualifying, and that both DCMA and DCAA have a propensity to second-guess prime contractors' commerciality determinations with respect to their lower-tier suppliers, leading to questioned and disallowed costs.

Recently, the DoD has moved to centralize commerciality determinations and has established a goal of making those determinations in 10 days or less. That plan has not gone over well with contractors, according to **this story** at GovExec.com. The story quoted from a letter sent by the Professional Services Council (PSC) to Rep. Mac Thornberry, the sponsor of acquisition reform legislation. The letter said—

There are thousands of commercial items determinations made each year and requiring that they all be conducted by one office, disconnected from the customer base and the acquisition offices, will almost certainly result in procurement delays … Since commercial items determinations are among the core responsibilities of a contracting officer, rather than negat[ing] that training and removing that authority from contracting officers, we would recommend that the training continue and Congress direct an assessment of such efforts to see if the training has been effective and where additional focus may be necessary.

As a matter of fact, there is a solid basis for Contracting Officers to be skeptical – or even suspicious – of contractors' claims of commerciality. Most of us should remember the Boeing tanker **fiasco** , which at one point involved the claim of commerciality for "green" aircraft that were significantly modified to meet military requirements, such that there was little likelihood they could be sold to the general public. (Unless the general public suddenly found a need to refuel the jet fighters parked in their garages.) Given the history (and political finger-pointing) associated with problematic claims of commerciality, it's rational for Contracting Officers (and auditors) to take a second look at such claims to ensure there is a valid basis for them. But the difference between a second look and an automatic rejection is huge, and there is no legitimate statutory, regulatory, or policy basis for failing to support an otherwise valid commerciality claim.

Notwithstanding the problems associated with commerciality determinations, the Federal government and the Department of Defense manage to award quite a few of commercial item contracts, using the procedures found at FAR Part 12.

Some of those commercial contracts will be terminated for convenience.

How does that work?

The first thing to know is that the "normal" termination protocols of FAR Part 49 and the Cost Principle at FAR 31.205-42 don't operate for terminations for convenience (T4Cs) associated with commercial item contracts awarded under FAR Part 12 procedures. Instead, the requirements of the contract clause 52.212-4 ("Contract Terms and Conditions – Commercial Items", May 2015) establish termination procedures for commercial item contracts. That being said, Contracting Officers may use the Part 49 T4C procedures as "guidance" to the extent there is no conflict with the termination procedures established by 52.212-4.

According to the termination procedures of 52.212-4, in a T4C the contractor will be paid as follows:

- The percentage of the contract price reflecting the percentage of the work performed prior to the notice of the termination, plus

- Any charges the contractor can demonstrate directly resulted from the termination.

With respect to the termination charges, the standard clause language provides that those charges must be "reasonable" in amount and must be demonstrated "to the satisfaction of the Government" using the contractor's "standard record keeping system." The clause expressly states that "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." However, "The Contractor shall not be paid for any work performed or costs incurred which reasonably could have been avoided."

Seems clear enough.

But appearances can be deceiving.

Recently, the ASBCA heard **an appeal** from Dellew Corporation in which Dellew sought to recover $279,558 in "unrecovered amounts and settlement and proposal preparation costs" following the T4C of its firm, fixed-priced FAR Part 12 commercial item contract. The kicker here is that the government, in its wisdom, decided to incrementally fund the commercial item contract. The contract was modified to incorporate the DFARS contract clause 252.232-7007 ("Limitation of Government's Obligation," May 2006) which established a notification requirement: the contractor was required to notify the Contracting Officer is writing "at least ninety days prior to the date when … the work will reach a point in which the total amount payable by the Government, including any cost for termination for convenience, will approximate 85 percent of the total amount then allotted to the contract…."

Which is ridiculous on its face and possibly tantamount to a violation of the implied duty of good faith and fair dealing.

The ability to track spending and project spending against incremental funds is not an attribute of the average commercial "standard record keeping system." Instead, that is an attribute of a sophisticated accounting system, one used by experienced contractors to account for project costs charged to cost-reimbursement and other complex contracts awarded pursuant to FAR Part 15 procedures. It is an attribute of an "adequate accounting system" and is a requirement found in the Standard Form 1408, which is used to evaluate the adequacy of a contractor's accounting system prior to award of a FAR Part 15 contract. There is no way poor Dellew was ever going to be able to comply with the onerous requirements associated with that DFARS contract clause.

Moreover, the clause requires the contractor to track a termination liability, since the T4C costs must be included in the required cost projections. It's doubtful that any commercial business even knows what a termination liability is, let alone knows how to account for it and project it in calculations of future project costs.

In sum, we assert (as non-lawyers) that there is a decent argument here that Dellew was induced into a commercial item contract, a contract into which the Government insidiously inserted, after award and with no prior notice, non-commercial item requirements, requirements with which it knew (or should have known) that Dellew could never comply. But so what? Dellew signed the bilateral contract modification, very likely without much in the way of thought or trepidation. We're guessing Dellew never knew what it was signing. As we've **opined** before, contractors need to be careful what they sign—and Dellew learned its lesson the hard way.

And then the government terminated Dellew's contract for convenience.

The other kicker here is the government, in its wisdom, did not terminate the contract effective on the day of the T4C notice. Nope. Instead, it submitted the T4C notice on April 2, 2012, to be effective October 1, 2012, almost exactly six months in the future. And the government expected Dellew to know how to handle that strange situation, which would flummox many sophisticated defense contractors.

The actual termination language in the standard 52.212-4 clause is quite clear. It says –

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.

Nothing in that language hints at a government right to terminate at a future date. Indeed, how would a commercial contractor "immediately stop all work hereunder" and "immediately cause any and all of its suppliers and subcontractors to cease work" when the termination date is in the future? How would that work and we assert that not even the best contract minds at Lockheed Martin could figure that out with certitude, let alone the contract minds at Dellew. Again, to our ill-educated minds, such actions hint at a violation of the implied duty of good faith and fair dealing at best, or to an inducement at worst. Yet Dellow persevered and attempted to perform its contract to the best of its ability.

A month after receiving its T4C notice, Dellew submitted its required 85% notification letter. In that letter, Dellew stated it would hit its funding limit on July 31, 2012. It stated it needed an additional increment of funds ("$250,000 to $300,000") in order to perform through September 30, 2012, In addition, Dellew stated that it needed an additional $250,000 to $300,000 for "settlement expenses and termination costs," including "overhead costs continuing after the termination … employee paid time off and vacation pay accumulated at the date of termination, settlement expenses and proposal preparation costs, and profit on those costs consistent with the margin on the terminated contract."

The Contracting Officer did not respond to that notification. However, on June 28, 2012, the contract was terminated for convenience via contract modification.

Note that, consistent with our inducement theory, the contract was not terminated on the date stated in the April 2, 2012, T4C notification letter. Instead, the contract was terminated three months earlier than the date the contractor was led to expect. None of the requested additional funds had been provided. Instead, the government paid Dellew $1,119,096.72—which was the amount of funds that had been incrementally provided.

Thus, should we be surprised that when Dellew submitted a Termination Settlement Proposal (TSP) in the amount of $279,641 it was rejected by the Contracting Officer? Instead, the CO offered Dellew $26,011, which was the amount of Dellew's "settlement expenses" plus G&A (without any fee). Dellew submitted a properly certified claim for the full amount it believe it was entitled to receive. The CO granted the $26,011 and denied the remainder of the claim. Dellew appealed to the ASBCA.

Dellew argued that the inclusion of DFARS 252.232-7007 changed the deal. Instead of following the standard termination language in the 52.212-4 clause, both clauses had to be read together in harmony. Administrative Judge Page rejected that theory. Writing for the Board, she stated—

None of the language in DFARS 252.232-7007 indicates that it is a remedy granting clause of the contract that would entitle a contractor to recovery of particular items in the event of a convenience termination. Ultimately, any entitlement to termination settlement expenses due appellant must be established through the process prescribed by FAR 52.212-4(1).

Judge Page then proceeded to analyze the three prongs of contractor recovery established by 52.212-4. In her analysis, the three prongs are:

1. The price of work performed under the contract prior to the termination

2. Settlement expenses

3. Costs resulting from the termination

Judge Page confirmed what we noted above, which is that the price of work performed prior to termination is determined via a calculation based on the percentage of work completed times the contract price. (We note she did not address the unique facts of this case, where Dellew's contract was incrementally funded at at amount less than the full FFP contract price awarded.)

With respect to Item 2, settlement expenses, Judge Page wrote—

Settlement expenses include those expenses incurred by the contractor for the preparation and presentation of settlement claims to the CO. … It is well established that settlement expenses, including legal expenses, are generally allowable. … However, a contractor is only entitled to those settlement expenses that are reasonably necessary for the preparation and presentation of the termination settlement proposal.

Judge Page also wrote that the third item is for costs incurred by the contractor that were incurred only because the contract had been terminated. These costs "do not relate to work completed" but, instead, are reimbursed "to fairly compensate the contractor whose contract has been terminated." She referenced FAR 31.205-42(b) for a list of examples of such costs. That's an interesting approach to take, given that the 52.212-4 clause language (which we quoted earlier in this article) expressly states that the Cost Principles do not apply to commercial item terminations for convenience.

While Judge Page's analysis provides good information for contractors with Part 12 commercial item contracts that get terminated for convenience, her analysis was of little help to Dellew. Judge Page rejected both Dellew's and the Government's Motions for Summary Judgment, and we expect the parties will either settle their dispute or proceed to trial. Should there be a trial, we look forward to hearing the Government's explanation for its seemingly abnormal treatment of this contractor.