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TERMINATION FOR CONVENIENCE AS BREACH OF A GOVERNMENT CONTRACT

HENRY G. BEAUREGARD*

It has long been settled that, while the United States has an inherent and sovereign power to terminate a government contract, even though the contractor is not in default, such a termination must be considered a breach of contract, entitling the contractor to damages. These include loss of anticipated profits—at least in the absence of a statute, regulation or contract clause authorizing the termination.¹ This is true even though the motive of the Government's contracting officer is perfectly proper, such as the lack of further need by the Government for the supplies covered by the contract.²

The only substantial difference between what a contractor receives upon a contract termination constituting a breach on the one hand, and an authorized contract termination not constituting a breach on the other, is, normally, that in the event the termination is a breach of contract by the Government, the contractor recovers anticipated profits, consistent with the usual common law rule of damages for breach of contract; while in the case of an authorized termination, the contractor is held to a prescribed formula of compensation which usually excludes any recovery of anticipated profits.³ Current forms of "Termination for Convenience of the Government" clauses generally exclude recovery by a terminated contractor of anticipated profits, though permitting a measure of profit on the work performed prior to termination.⁴

A terminated contractor may have to follow differing procedures dependent upon whether or not the termination is a breach.⁵ If there

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¹ *United States v. Speed*, 75 U.S. (8 Wall.): 77 (1869); see *United States v. Penn Foundry & Mfg. Co.*, 337 U.S. 198, 208 (1949); *United States v. Behan*, 110 U.S. 338, 343 (1884).

² In *United States v. Behan*, *ibid.*, the Government's engineers had determined that the contract, if carried to completion, as a matter of engineering fact would not accomplish its objective.

³ *United States v. Penn Foundry & Mfg. Co.*, 337 U.S. 198 (1949).

⁴ Examples include the clauses found in the Armed Services Procurement Regulations (ASPR), 32 C.F.R. §§ 8.701, .702, .704, .705 (1965); Federal Procurement Regulations (FPR), 41 C.F.R. §§ 1-8.701-03, .704-1, .705-1, -2 (1965); and National Aeronautics and Space Administration Procurement Regulations (NASA PR), 41 C.F.R. §§ 18-8.701-05 (1965).

⁵ See Comment, *Claims Against the Government—Proposed Administrative Action to Prevent Dual Consideration*, CCH Gov't Cont. Rep. ¶ 80,421.

is a statute which authorizes a termination at the sole discretion of the Government, though the contractor is not in default, and sets a formula of compensation excluding anticipatory profits, then a termination under that statute is not a breach and the contractor cannot recover for the loss of anticipatory profits. Sometimes such a statute is Government-wide, such as the Contract Settlement Act of 1944⁶ which, during its effective period, made any termination of a "war contract," other than for default, subject to its terms and its formula for compensation, excluding anticipatory profits.⁷ Sometimes such a statute applies only to the contracts of a particular department for a particular time, such as the World War I statute which authorized unconditional cancellation of Navy contracts, even though not in default, and limited the terminated contractor to damages excluding anticipatory profits.⁸ The Post Office has a continuing statute⁹ which has been interpreted as giving the Postmaster General absolute discretion, with the contractor not being in default, to terminate a mail transportation contract and thereby hold the contractor to the formula stated in the contract which excludes anticipatory profits.¹⁰ It is interesting that the cases reaching this result have examined alternatively the conduct of the contracting officer and have found it to be prudent and in the best interests of the Government, in spite of the harsh economic results to the contractor.

Most government contracts, however, are governed only by the Armed Services Procurement Act¹¹ or the Federal Property and Administrative Services Acts of 1949 and 1954 (as amended),¹² neither of which have any such statutory provisions authorizing termination

⁶ 58 Stat. 649 (1944), 41 U.S.C. § 101 (1964).

⁷ *Monolith Portland Midwest Co. v. RFC*, 178 F.2d 854 (9th Cir. 1949), cert. denied, 339 U.S. 932, rehearing denied, 339 U.S. 954 (1950). The case had extensive travel in the federal courts. Following *Monolith's* exhaustion of administrative remedies, it brought a second action, basically like the first, resulting in a decision that it was entitled only to "fair compensation" under the War Mobilization and Reconversion Act. 95 F. Supp. 570 (S.D. Cal. 1951). This was followed by a finding that a plaintiff in *Monolith's* position was not entitled to a jury trial. 102 F. Supp. 951 (S.D. Cal. 1952). In a subsequent action on the merits, the RFC prevailed. 128 F. Supp. 824 (S.D. Cal. 1955), judgment vacated, 240 F.2d 444 (9th Cir.), cert. denied, 354 U.S. 921 (1957). This seemingly interminable action finally ended with the granting of a motion to dismiss by the Administrator of General Services, on grounds that the action abated for failure to substitute the proper party within twelve months of the "dissolution" of the RFC. 282 F.2d 439 (9th Cir.), cert. denied, 364 U.S. 926 (1960).

⁸ See *College Point Boat Corp. v. United States*, 267 U.S. 12 (1925).

⁹ 74 Stat. 688 (1960), 39 U.S.C. § 6106 (1964).

¹⁰ *Miller v. United States*, 233 U.S. 1 (1914); *Slavens v. United States*, 196 U.S. 229 (1905); *Cornelius v. United States*, 348 F.2d 960 (Ct. Cl. 1965).

¹¹ 70A Stat. 127-33 (1956), 10 U.S.C. §§ 2301-14 (1964).

¹² 63 Stat. 378-93 (1949), as amended, 40 U.S.C. §§ 471-92 (1964); 63 Stat. 393-97 (1949), as amended, 41 U.S.C. §§ 251-60 (1964).

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solely at the Government's discretion, absent a default by the contractor.

If there is no applicable statute, the question arises whether a government agency may, by regulation, vest itself with the power to terminate at any time in its sole discretion, absent a default by the contractor, and to hold the contractor to a formula of compensation which excludes anticipatory profits. The answer to this question is possibly in the affirmative if such a regulation not only antedates the contract involved but possesses as well the respectability of age, such as the Post Office regulation to this effect.¹³ But the answer might possibly be in the negative if an agency attempted, without any prior history of such regulations to show the presumable blessing of a silent Congress, for the first time to endow itself with such power, particularly if the agency attempted to apply such a regulation to a contract in existence prior to its promulgation.

If a particular agency has a valid regulation authorizing termination for convenience, as distinguished from a default termination, at the absolute discretion of the Government and excluding recovery of anticipated profits, the Court of Claims might very well read it into a disputed contract to supplement the express language of the contract.¹⁴

Current regulations concerning the issuance of a termination for

¹³ See the Post Office cases cited note 10 supra. The qualification of "possibly" has been added to the affirmative answer because these cases also rested on the Post Office statute and a conclusion that each termination was justified on the facts involved.

¹⁴ *G. L. Christian & Associates v. United States*, 312 F.2d 418, motion for rehearing and reargument denied, 320 F.2d 345 (Ct. Cl. 1963), cert. denied, 376 U.S. 929, motion for leave to file second petition for rehearing denied, 377 U.S. 1010 (1964), cert. denied, Fed. Cont. Rep., Oct. 18, 1965, p. B-1, held that a termination for convenience of a military contract was valid, though the contract contained no termination for convenience clause, because the Armed Services Procurement Regulations in effect as of the time of execution, required a termination for convenience clause, and the court read in the ASPR clause, thereby excluding the recovery of anticipatory profits sought by the contractor. The *Christian* case does not dispose of the subject matter of this paper, however, because in *Christian*, the contractor claimed that any termination was a breach and did not reach the point that, assuming the termination for convenience clause prescribed by ASPR was in the contract, the particular termination was not authorized by such clause. A similar incorporation of a termination for convenience clause, required by a regulation antedating the date of the contract, was urged by the concurring minority of four in *United States v. Penn Foundry & Mfg. Co.*, supra note 3. The Federal Procurement Regulations (FPR), 41 C.F.R. § 1-8.201(b) (1965), applicable to most agencies (but excluding certain major agencies as Defense, NASA, and the AEC) state:

However, the power of a contracting activity to issue a termination notice does not depend on the existence of a termination for convenience clause in the contract. In the absence of a termination for convenience clause, however, such action normally constitutes a breach of contract. Such a breach of contract may subject the Government to liability for common-law damages, including anticipatory profit, unless the Government arrives at a voluntary settlement with the contractor.

convenience of the Government are a far cry from those authorizing terminations for convenience *at the absolute discretion* of the Government. The Department of Defense prescribes that its contracts shall be terminated for the convenience of the Government "only when such action is in the best interest of the Government, as determined in accordance with Departmental [*i.e.*, military department] procedures."¹⁵ The regulations of the Army, Defense Supply Agency, Air Force, and Navy add nothing of substance to the "best interest of the Government" test.¹⁶ The Federal Procurement Regulations only reiterate the test of "best interest of the Government"¹⁷ as does the National Aeronautics and Space Administration Regulation.¹⁸

The language of these regulations, applicable to most government contracts, does no more in fact than repeat the language of the usual clause, entitled "Termination for Convenience of the Government," which authorizes termination only when the contracting officer determines that such termination is in "the best interest of the Government."¹⁹ This language does not on its face permit the contracting officer to terminate a contract at any time with or without justification, thereby distinguishing the case presented by this termination clause from those cases in which, under the language of different clauses, the Government had an absolute and unconditional right to terminate.²⁰

The "best interest of the Government" language in the standard termination clause permits an examination as to the motives of the Government, particularly its good faith in issuing a termination for convenience.²¹

¹⁵ ASPR, 32 C.F.R. § 8.201 (1965).

¹⁶ 32 C.F.R. § 597.201 (Supp. 1965) (Army); 32 C.F.R. § 1008.201 (1965) (Air Force); 32 C.F.R. § 1208.201 (1965) (Defense Supply Agency). Navy Regulations are silent as to this specific point.

¹⁷ FPR, 41 C.F.R. § 1-8.201(a) (1965).

¹⁸ NASA PR, 41 C.F.R. § 18-8.201 (1965).

¹⁹ See clauses cited note 4 *supra*.

²⁰ RFC v. Sherwood Distilling Co., 200 F.2d 672 (4th Cir. 1952) (lease terminable by either party on fifteen days' notice); Phillips Petroleum Co. v. Johnson, 71 F. Supp. 791 (D.D.C. 1947); Maco Warehouse Co. California v. United States, 169 F. Supp. 494 (Ct. Cl. 1959) (lease revocable at will of Secretary of the Army); McNaught v. United States, 117 F. Supp. 420 (Ct. Cl. 1954) (lease cancellable any March 1 by thirty days' notice from the Government); Jardine Mining Co. v. United States, 88 F. Supp. 265 (Ct. Cl. 1950) (absolute right in the Government to cancel without payment of damages); Bailes & Bailes Barber Shop, 65-2 B.C.A. ¶ 5118 (ASBCA, Sept. 30, 1965) (concession contract, containing thirty day termination notice provision, can be terminated by giving of a thirty day notice without necessity of passing on the reason).

²¹ Jacobs v. United States, 239 F.2d 459 (4th Cir. 1956), cert. denied, 353 U.S. 904, petition for rehearing denied, 353 U.S. 652 (1957) (termination for convenience found issued in good faith and for proper reasons); Librach & Cutler v. United States, 147 Ct. Cl. 605 (1959) (Army mistakenly but in good faith believed contract was in excess of requirements and termination for convenience upheld); see United States v. Golgra, 312 U.S. 203 (1941) (contract subject to lawful cancellation whenever

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The "best interest of the Government" cannot be served by a purported termination for convenience when the Government has a need for the supplies already ordered by the contract. The most recent case (excluding the 1961-1965 Court of Claims cases to be discussed)²² in support of this conclusion is *Ready-Mix Concrete Co. v. United States*.²³ In that case, a unanimous Court of Claims rode rough-shod over the Armed Services Board of Contract Appeals. It determined that a contract provided for binding orders to be issued by a contracting officer to meet certain needs, construed a telephone conversation by a government project engineer as a binding order from the contracting officer to meet the needs, treated a subsequent telephone conversation by the project engineer as an attempted but futile termination, and ordered the Government to take and pay the contract prices for all the supplies prepared by the contractor in reliance on the first telephone conversation (less certain amounts by which the contractor had mitigated damages). While this decision held that the oral termination was valid as to supplies not produced by the contractor, on this point it is distinguishable from a case in which the Government had continuing needs for which the contractor had produced the supplies in whole or in part. The court felt that a binding obligation under the contract involved in *Ready-Mix* was created only when there was both (i) "need," and (ii) an "order" (which did not have to be issued), while in the ordinary government supply contract, the condition for the issuance of an order is not stated.

There have been a series of recent Court of Claims cases which support the conclusion that when the Government has a continuing need for the supplies involved, any purported exercise of the termination for convenience clause would be a breach of contract. Thus, recently the Court of Claims has repeatedly held that there can be no termination for convenience when the Government has already breached the contract by a termination for default, in spite of the language in the "Default" clause.²⁴

The reasoning in *Klein v. United States*²⁵ is especially useful in considering this point. The court held that there could be no termination for convenience because the "best interest of the Government"

chief of engineers, rightly or wrongly, but in good faith, determined contractor was violating its provisions). The Armed Services Board of Contract Appeals has, however, recently decided it has no jurisdiction to determine whether a termination for convenience was arbitrary, capricious and not in good faith. *Topeka Janitor Service*, 65-2 B.C.A. ¶ 4911.

²² See pp. 263-65, *infra*.

²³ 158 F. Supp. 571 (Ct. Cl. 1959).

²⁴ *Dale Constr. Co. v. United States*, No. 134-57, Ct. Cl. Dec. 11, 1964; *Goldwasser v. United States*, 325 F.2d 722 (Ct. Cl. 1963); *Klein v. United States*, 285 F.2d 788 (Ct. Cl. 1961).

²⁵ *Ibid*.

would not thereby be served. Its rationale was based on the fact that deliveries under the repurchase contracts would have been almost a year later than deliveries under the contract involved, and that the Government never presented any valid reason for a termination for convenience.

The reasoning in *Klein* pertinent to the question under consideration here remains unshaken despite several influences which operate to weaken the decision. The first such influence is found in *Klein* itself, in which there is a dissent from the position that the Government's purported termination for convenience could not cure a breach for which the contractor was entitled to damages, including loss of anticipatory profits. Then, too, some of *Klein's* language was criticized in general terms in *John Reiner & Co. v. United States*,²⁶ in which the cancellation of an award which was found to be invalid by a ruling of the Government Accounting Office was held to be a termination for convenience, rather than a breach of contract. Further, *Reiner* was followed in a similar case decided on the same day, *Brown & Son Elec. Co. v. United States*.²⁷

However, there are several reasons for considering *Klein* to be solid precedent. Among them are:

(1) On the same day as the decisions in *Reiner* and *Brown*, *Klein* was specifically followed by *Goldwasser v. United States*.²⁸ It has been followed even more recently by *Dale Constr. Co. v. United States*.²⁹

(2) While *Klein*, *Reiner*, *Brown* and *Goldwasser* were decided by divided courts, there were no dissents in *Litchfield Mfg. Co. v. United States*³⁰ and *Dale Constr. Co.* In *Litchfield*, a contractor was held entitled to damages for breach, rather than being subject to compensation limitations under a termination for convenience clause, when his default was caused by the Government.

(3) *Carrier Corp. v. United States*³¹ held that the cancellation of a contract for fraud, after the contractor had purged itself of the fraud, constituted a breach for which the Government was liable in damages. This result was consistent with *Klein*. The case had two dissents, one of which was based on the theory that the damages were incurred prior to the purging and the other on the theory that the fraud had not been purged.

(4) In *Reiner* itself, the majority opinion very carefully tested the validity of a termination for convenience and concluded that it

²⁶ 325 F.2d 438 (Ct. Cl. 1963).

²⁷ 325 F.2d 446 (Ct. Cl. 1963).

²⁸ Supra note 24.

²⁹ Supra note 24.

³⁰ 338 F.2d 94 (Ct. Cl. 1964).

³¹ 325 F.2d 328 (Ct. Cl. 1964).

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would be in the "best interest of the Government" because it would minimize a conflict with another arm of the Government, the Government Accounting Office. The court observed that the "best interest of the Government" is a broad phrase, not necessarily tied to a decrease in the need for the supplies involved, and also that the contracting officer's decision to terminate for convenience is conclusive only "in the absence of bad faith or clear abuse of discretion."

Consequently, on the cases as they stand, a purported exercise of the termination clause may well be a breach of contract as long as the Government has need for the products or supplies covered by the contract.³²

The above analysis of the cases is consistent with an interpretation giving full effect to the termination for convenience clause. It sometimes happens that the Schedule of a government contract (*i.e.*, the particular "tailor-made" provisions, as distinguished from the standard "boiler-plate") has language which commits the Government to taking a definite or minimum quantity of the supplies covered by the contract, though the "boiler-plate" contains the usual termination for convenience clause. It may be argued that the presence in the Schedule of provisions committing the Government to a definite or minimum quantity is so inconsistent with the usual termination for convenience clause that the latter must be disregarded. This interpretation finds support in a recent Court of Claims case³³ in which the court, overruling the Armed Services Board of Contract Appeals, held that a clause requiring the Government to order only \$100 worth of work was so inconsistent with the rest of the contract, calling for the repair of 183 machines, that it must be disregarded.

An interesting example of a situation in which the exercise of the usual termination for convenience clause could be a breach of contract is the case in which the contractor executes the contract with the Government after giving notice to the contracting officer that he will incur additional financing in reliance upon the contract. If this understanding is stated in the Schedule of the contract, it might well be a helpful factor in reinforcing an interpretation that the termination for convenience clause may not be used arbitrarily, capriciously or

³² While a conclusion that a termination for convenience may be a breach may have the appearance of novelty, it is, as shown by the analysis of the cases herein, considerably more conservative than *Eastern Service Management Co. v. United States*, 11 CCF ¶ 80,057 (E.D.S.C. 1965), CCH Gov't Cont. Rep., Report Letter No. 1, Oct. 15, 1965. In that case the court held that the refusal of the contracting officer to grant an adjustment under the "Changes" clause of a cleaning services contract, to compensate the contractor for cleaning square footage in excess of the amount stated in the contract, was a breach. It is believed that the Court of Claims would consider such a refusal to be, not a breach, but cause for equitable adjustment, enforced by the court, in the contract price under the "Changes" clause.

³³ *E. H. Sales, Inc. v. United States*, 340 F.2d 358 (Ct. Cl. 1965).

without good faith, and might also reinforce the interpretation that, until the additional financing has been repaid or otherwise amortized, the termination for convenience clause would be inconsistent with the Schedule. Another recent Court of Claims case³⁴ held that the fact that a contractor had advised an unidentified official of the Post Office Department that, in order to accept a contract for mail transportation service, he would have to acquire a new vehicle to perform the work under the contract, did not prevent the exercise of the termination for convenience clause. This case is probably distinguishable from the hypothetical case previously stated because the Post Office official remained unidentified. There was no delineation of the scope of his authority in contract matters.³⁵

While there is an oft-repeated maxim that administrative officers of the Government cannot settle claims for unliquidated damages, including loss of anticipatory profits, and while there is a serious question whether administrative Contract Appeals Boards will entertain jurisdiction of a claim for damages for breach of a contract by termination, both the Supreme Court and the Comptroller General have sustained the authority of the contracting officer as such to negotiate a settlement which constitutes a breach.³⁶

While, as has been shown above, there is a very respectable argument to the effect that the exercise by the Government of the termination for convenience clause may in certain circumstances be a

³⁴ *Cornelius v. United States*, supra note 10.

³⁵ The case is also distinguishable because of its express reliance upon the long-standing Post Office statute and regulation discussed, supra notes 9-10 and accompanying text.

³⁶ In *United States v. Corliss Steam-Engine Co.*, 91 U.S. 321 (1876), a leading case on the law of terminations in government contracts, the Court sustained a negotiated settlement of termination of a contract, absent a termination clause, which constituted a breach of the contract. The report of the case below shows that the Court of Claims gave judgment for the contractor, enforcing the negotiated settlement, in spite of a series of prohibitory riders in appropriation acts passed after the execution of the negotiated settlement, and in spite of the findings of the Government Board (convened after the execution of the negotiated settlement in the amount of \$295,068.40) that the contractor would have suffered a loss of \$31,713.44 if the contract had been completed and that deduction of the cost to complete would result in a settlement of approximately \$147,000. 10 Ct. Cl. 494 (1875). While it is impossible to establish definitely from the reports of this case in the Court of Claims and the Supreme Court, it appears likely that the negotiated settlement included loss of anticipatory profits. The Comptroller General recently relied solely on *Corliss Engine* in authorizing the Post Office Department to settle administratively a termination for convenience of a contract which contained no termination clause. Comp. Gen. Op. No. B-155936 (1965), 10 CCF ¶ 72,916.

Notwithstanding this, the Armed Services Board of Contract Appeals has held that it has no jurisdiction in a case in which the contract did not contain a termination clause but was nevertheless terminated by the Government. *World Electrical Specialties Corp.*, 65-1 BCA ¶ 4679. *World Electrical Specialties* was preceded by *Industrial Precision Products Co.*, ASBCA No. 3171 (1956) which held that the Board had no jurisdiction over a termination which was a breach of contract.

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breach of contract, the exceptions to the general rule permitting the Government to terminate practically at will are narrow and the Government contractor is ordinarily left in a vulnerable position with respect to expenditures incurred. This is particularly true of expenditures for additional financing in the nature of interest on borrowings or the cost of a secondary underwriting. Thus a more careful "termination for convenience" clause should be drawn, one which delineates much more precisely the circumstances in which the Government can terminate for convenience, and which permits optional variations in the "termination for convenience" clause. This could well be the subject of a "case" for consideration by such administrative agencies as the Defense Industrial Advisory Committee or the Armed Forces Procurement Regulation Committee, both of which customarily have on their agenda "cases" with respect to improving the government procurement process.